



Project	Financial Statement Presentation
Topic	New categories for “financing arising from operating activities” and for “assets and liabilities arising from equity”

Introduction

1. At the December 2009 joint board meeting, the boards tentatively decided to add a new category to the business section in the statement of financial position (SFP) and the statement of comprehensive income (SCI) labelled *financing arising from operating activities*. The boards indicated that the new category should include long-term liabilities tied to operating activities such as a net pension liability (or asset) and an asset retirement obligation (ARO). An entity should present cash flows related to items in that new category in a category on the statement of cash flows (SCF) labelled *operating activities and financing arising from operating activities*.
2. We had small group meetings in January 2010 to discuss the definition of the *financing arising from operating activities* category and how to display that new category. At those small group meetings, board members also discussed adding a category to the financing section for assets and liabilities related to equity financing.

This paper has been prepared by the technical staff of the FASB and the IASB for discussion at a public meeting of the FASB or the IASB.

The views expressed in this paper are those of the staff preparing the paper. They do not purport to represent the views of any individual members of the FASB or the IASB.

Comments made in relation to the application of IFRSs or U.S. GAAP do not purport to be acceptable or unacceptable application of IFRSs or U.S. GAAP.

The tentative decisions made by the FASB or the IASB at public meetings are reported in FASB *Action Alert* or in IASB *Update*. Official pronouncements of the FASB or the IASB are published only after each board has completed its full due process, including appropriate public consultation and formal voting procedures.

3. Board members generally supported the staff recommendation on those two issues. At the February joint meeting, we will ask the boards to formally vote on those issues, which are described briefly in this paper.

Issue 1: Financing arising from operating activities

Display

4. The boards agreed at the December 2009 joint meeting that operating cash flows and cash flows from items in the *financing arising from operating activities* category will be presented together on the SCF (in an *operating plus financing arising from operating activities* category). The indirect reconciliation will reconcile the combination of operating income and financing arising from operating activities expense with the cash flows from the ‘operating plus financing arising from operating activities’ category.
5. The operating category and the financing arising from operating activities category need to be combined on the SCF because, as discussed at the December 2009 joint meeting, the cash flows related to pension plans include both operating and financing components that are not separable. The staff note that cash flows related to other items in the financing arising from operating activities category do not share this “problem” (because, for example, one can attribute the cash paid on a lease to the principle and interest component of that lease). However, even though the other cash flows would be separable, there is still debate on whether the flow is the cash realization of the expense (in operating) or the settlement of the liability (in the new category).
6. As discussed in December 2009 and at the January 2010 small group meetings, the statements will not be cohesive because the SCF will not have a separate operating category or a separate financing arising from operating activities category like the SFP and SCI will.
7. As discussed at the small group meetings, the staff recommend that financing arising from operating activities should be presented in a subcategory of the

FASB/IASB Staff paper

operating category on the SFP and the SCI instead of being a separate category in the business section. In that alternative display, the SCF would not include the new subcategory; there would be only an operating category. The staff suggest that a subtotal on the SFP and the SCI for the operating category should be placed before the subcategory and after the subcategory. The resulting statements would be cohesive at the category level. See below for a summary of the financial statement structure and Appendix B for an example of financial statements with the *financing arising from operating* subcategory.

SFP	SCI	SCF
Business	Business	Business
Operating	Operating	Operating
Financing arising from operating	Financing arising from operating	
Investing	Investing	
Financing	Financing	Financing
Debt + other	Debt + other	Debt + other
Equity		Equity
	Effect of multicategory trans	Effect of multicategory trans
Income taxes	Income taxes	Income taxes
Discontinued ops	Discontinued ops	Discontinued ops
	OCI	

Definition

8. The financing arising from operating activities (sub)category should include all liabilities (and assets bound to the related obligation for the purpose of settling the liability):
 - (a) that do not meet the definition of *financing* (Appendix A includes the working definitions),
 - (b) that are initially long term and
 - (c) that have a time value of money component that is evidenced by either interest or an accretion of the liability due to the passage of time.

9. The *financing arising from operating activities* (sub)category will include the following on the SFP:
 - (a) A net pension obligation (or asset)
 - (b) Lease obligations
 - (c) Asset retirement obligations
 - (d) Vendor financing (that is, a long-term payable that relates to a supplier providing a specific good used in production or providing a specific service)
 - (e) Deferred compensation arrangements other than share-based payments (and any associated asset), such as a bonus earned that is to be paid at a later date.
 - (f) Structured settlements (for example a worker's compensation claim that has been settled and will be paid out over a period of time).
 - (g) Contingencies that are discounted pursuant to IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*. (Paragraphs 45 and 46 of IAS 37 say that where the effect of the time value of money is material, the provision should be discounted to present value. US GAAP does not have a similar requirement.)

10. The *financing arising from operating activities* (sub)category will include the following expenses:
 - (a) Periodic pension cost and return on plan assets (except service cost and any amount required to be presented in other comprehensive income)
 - (b) Interest expense related to a capital lease obligation
 - (c) Accretion expense related to the ARO (and return on any trust fund assets bound to the liability)
 - (d) Interest expense related to vendor financing
 - (e) Accretion expense related to deferred compensation
 - (f) Interest on a structured settlement
 - (g) Accretion expense related to contingencies that are discounted.

11. At one small group meeting, it was suggested that only the total of financing expenses arising from operating activities needs to be presented on the SCI, while the details could be presented in the notes. The staff think that is consistent with presenting by-function information on the SCI and by-nature information in the notes. See the illustrative statement of comprehensive income in Appendix B.

Other aspects of the new (sub)category

12. Under this definition, the new (sub)category will not include any type of treasury asset. The only assets it will include are those that are bound or tied to the obligation for purposes of paying off that obligation – such as pension plan assets and an ARO trust fund. As with all other sections and categories, hedges and derivatives that have been designated against an asset or liability within the financing arising from operating activities (sub)category will be presented in that new (sub)category.
13. The exposure draft would clarify that the resulting asset that is obtained or service that is procured would be included within the operating category on the SFP or SCI (such as the inventory obtained or the compensation cost), whereas the resulting costs associated with the financial characteristics of the liabilities (as well as the return on the assets bound to the obligations) would be classified in the new (sub)category on the SCI (such as interest charged by the vendor for the financing arrangement or the accretion of deferred compensation liabilities).

Staff recommendation

14. The staff recommend that a subcategory for financing arising from operating activities be included in the operating category of the SFP and the SCI for all liabilities (and assets bound to the related obligation for the purpose of settling the liability)
 - (a) that do not meet the definition of *financing*,
 - (b) that are initially long term and
 - (c) that have a time value of money component evidenced by either interest or an accretion of the liability due to the passage of time.

Question 1

The staff recommend that financing arising from operating activities (as defined in paragraph 14) be included in a new subcategory in the operating category of the SFP and the SCI for financing items. **Do the boards agree with this recommendation?**

Issue 2: Redefining the debt category in the financing section

15. The question has come up as to what to do with dividends payable or instruments entered into as part of an entity's capital raising activities that do not meet the definition of equity. Examples include a written put option on an entity's own stock or a prepaid forward purchase contract for an entity's own stock. These items do not meet the definition of debt as presented in Appendix A (paragraph A10). These items exist because an entity utilizes equity as part of its capital structure.
16. The staff think these items and their related flows clearly meet the definition of financing (see paragraph A8 in Appendix A). Initially, the staff thought adding a category within the financing section called *assets and liabilities arising from equity* would be the best way to present these items.
17. At the small group meetings, board members seemed reluctant to create another category and favored expanding the debt category to include those non-equity items. If we were to redefine the debt category to include these items, the last part of the definition might read as follows:

The debt category should also include assets and liabilities that arise from transactions involving an entity's own equity such as a dividend payable, a written put option on an entity's own shares or a prepaid forward purchase contract for an entity's own shares. Assets and liabilities that arise from transactions involving an entity's own equity are presented separately from borrowing arrangements within the debt category.
18. However, at the last small group meeting board members noted that if assets and liabilities that arise from transactions involving an entity's own equity are combined in the debt category there would be no subtotal for debt on the SFP or for the related expenses on the SCI. Without those totals, users of financial statements would not be able to readily calculate common ratios such as cost of debt.

FASB/IASB Staff paper

19. The following illustrates what the financing section might look like if we included assets and liabilities that arise from transactions involving an entity’s own equity in the debt category and what it would look like if we included those items in a separate category in the financing section.

SFP if we redefine Debt		SFP if we create new category	
FINANCING		FINANCING	
Debt		Debt	
Interest Payable	(50,000)	Interest Payable	(50,000)
Long-Term Debt	(1,000,000)	Long-Term Debt	<u>(1,000,000)</u>
Dividend Payable	(75,000)	Total Debt	<u>(1,050,000)</u>
Written Put Option	<u>(15,000)</u>		
Total Debt	<u>(1,140,000)</u>	Assets and Liabilities Related to Equity	
		Dividend Payable	(75,000)
Equity		Written Put Option	<u>(15,000)</u>
Common Stock	(100)	Total Assets and Liabilities Related to Equity	<u>(90,000)</u>
Additional Paid In Capital	(2,000,000)		
Retained Earnings	(550,000)	Equity	
Other Accumulated Comprehensive Income	<u>25,000</u>	Common Stock	(100)
Total Equity	<u>(2,525,100)</u>	Additional Paid In Capital	(2,000,000)
TOTAL FINANCING	<u>(3,665,100)</u>	Retained Earnings	(550,000)
		Other Accumulated Comprehensive Income	<u>25,000</u>
		Total Equity	<u>(2,525,100)</u>
		TOTAL FINANCING	<u>(2,615,100)</u>
SCI if we redefine Debt		SCI if we create new category	
FINANCING		FINANCING	
Debt		Debt	
Interest Cost	(75,000)	Interest cost	(75,000)
Gain from Equity Related Derivative	<u>2,500</u>	Assets and Liabilities Related to Equity	
Total Debt Cost	<u>(72,500)</u>	Gain from Equity Related Derivative Instruments	<u>2,500</u>
		TOTAL FINANCING COST	(72,500)
TOTAL FINANCING COST	(72,500)		

20. To present a cohesive picture, the financing section on the SCF should not have any categories. The reason for this is similar to the reason for not differentiating the cash flows for “financing arising from operating activities” from the operating activity cash flows. There will be cash flows that settle liabilities in the “assets and liabilities related to equity” category (or in the redefined debt category) that have everything to do with equity such as dividends paid. Furthermore, a user of the financial statements should be able to easily distinguish the cash paid/received for these items in the financing section even if that section does not have categories.

Staff recommendation

21. The staff recommend that the definition of debt be revised as noted in paragraph 17 and items that meet the financing section definition that are not equity be presented in the debt category. The staff think that this presents the information on the types of financing an entity engages in while not creating excess disaggregation. The staff note that the financing section in the SCF will not be cohesive with the SFP at the category level as the SCF will not have categories.

Question 2

The staff recommend that the debt definition be revised to include the following:

The debt category should also include assets and liabilities that arise from transactions involving an entity's own equity such as a dividend payable, a written put option on an entity's own shares or a prepaid forward purchase contract for an entity's own shares. Assets and liabilities that arise from transactions involving an entity's own equity are presented separately from borrowing arrangements within the debt category.

Do the boards agree with this recommendation?

Appendix A: Working definitions

- A1. The following paragraphs reflect the boards' tentative decisions made at the October 2009 joint meeting on the section and category definitions.

The business section

- A2. The **business** section shall include items that are part of a reporting entity's ongoing, value-creating activities. The business section shall include the effects of transactions related to the production of goods or provision of services that are associated with the revenue-generating activities of the entity. The business section shall report the effects of transactions with customers, suppliers and employees (in their capacities as such) because such transactions usually relate directly to a reporting entity's value-creating activities.

Operating

- A3. Assets and liabilities used in business activities shall be presented together in a separate category titled **operating** if the business activity:
- (a) is part of a reporting entity's day-to-day business activities; and
 - (b) the business activity generates revenue through a process that requires the interrelated use of the resources of the reporting entity. That process also includes the application of employee and management expertise.
- A4. Operating liabilities arising from business activities are likely to be replaced by similar obligations within a reporting entity's operating cycle.
- A5. Any derivative that arises from or is linked to part of a reporting entity's operating business activities shall be presented in the operating category. For example, a derivative held to offset currency or commodity price risk in a reporting entity's business activities would be reported within the operating category, regardless of whether that derivative is an asset or a liability at the reporting date.

Investing

- A6. Assets and liabilities used in business activities shall be presented together in a separate category titled **investing** if the business activity generates income not related to sales of products or services and if no significant synergies are created from combining "investing" assets.

- A7. Items related directly to assets and liabilities classified in the investing category, such as interest income and dividend income, shall also be classified in that category. A derivative held as part of a reporting entity's investing activities, regardless of whether it is an asset or a liability at the reporting date, shall also be presented in the investing category.

The financing section

- A8. The financing section shall include items that are part of a reporting entity's activities to obtain (or repay) capital. The financing section provides transparency about a reporting entity's capital structure and the financing activities the reporting entity engages in.
- A9. A reporting entity shall make transparent its capital structure by grouping its financing activities into categories that reveal how related resources and claims are used to provide capital to the reporting entity. That capital structure may consist of two categories of financing activities: debt and equity.

Debt

- A10. The debt category shall include liabilities where the nature of those liabilities is a borrowing arrangement entered into for the purpose of raising capital. That borrowing arrangement is usually transacted on an arm's-length basis on market terms.
- A11. A reporting entity may enter into a borrowing arrangement with its own suppliers or customers as a mutually beneficial arrangement. If such a borrowing arrangement is entered into primarily to facilitate a supplier arrangement for the provision of a specific good used in production or the provision of a specific service, that borrowing arrangement shall be classified in the operating category.
- A12. Items related directly to liabilities classified in the debt category, such as interest payable and fees, shall also be classified in that section. A derivative held as part of an entity's debt financing, regardless of whether it is an asset or a liability at the reporting date, shall also be presented in the debt category.

Equity

- A13. A reporting entity should refer to existing accounting standards when classifying items in the equity category.

Appendix B—Illustration of *new* sub-category

Chip Co with Sub Category in Operating

Statement of Comprehensive Income		
	2011	2010
BUSINESS		
Operating		
Sales	3,083,000	2,945,000
Cost of Goods Sold	(1,907,730)	(1,789,300)
<i>Gross Profit</i>	<u>1,175,270</u>	<u>1,155,700</u>
Selling expense	(204,900)	(199,330)
R&D expense	(232,200)	(183,180)
Administration expense	(312,400)	(298,800)
Impairment loss		(120,000)
Operating income before net financing expenses arising from operating activities	425,770	354,390
Costs of financing from operating obligations.	(21,050)	(20,000)
Total Operating Income	404,720	334,390
Investing		
Equity income	3,050	2,872
Total investing income	<u>3,050</u>	<u>2,872</u>
TOTAL BUSINESS INCOME	407,770	337,262
FINANCING		
Debt		
Interest expense	(93,450)	(93,450)
TOTAL FINANCING EXPENSE	<u>(93,450)</u>	<u>(93,450)</u>
Profit from Continuing Operations before taxes and OCI	<u>314,320</u>	<u>243,812</u>
INCOME TAXES		
Income tax expense	(129,350)	(198,719)
NET INCOME	184,970	45,093
OTHER COMPREHENSIVE INCOME, NET OF TAX		
Unrealized holding (loss) gain	(14,800)	2,000
Net actuarial pension loss	(1,650)	(4,200)
TOTAL OTHER COMPREHENSIVE INCOME, NET OF TAX	<u>(16,450)</u>	<u>(2,200)</u>
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	<u>168,520</u>	<u>42,893</u>
Net income attributable to:		
Owners of the parent	169,220	25,331
Noncontrolling interests	15,750	19,762
Total comprehensive income attributable to:		
Owners of the parent	152,970	23,131
Noncontrolling interests	15,550	19,762
Earnings per share (in currency units)		
Basic and diluted	0.10	0.02

FASB/IASB Staff paper

Chip Co Sub Category in Operating

Statement of Financial Position		
	For the years ended 31 December	
	2011	2010
BUSINESS		
Operating		
<i>Short Term</i>		
Cash	447,004	708,302
Accounts Receivable	1,677,000	1,017,500
Inventories	1,563,625	1,851,625
Other Short Term Assets	63,750	53,750
Total short term assets	3,751,379	3,631,177
Accounts Payable	(850,604)	(1,046,202)
Accrued Labor	(80,625)	(62,125)
Accrued Advertising	(46,300)	(76,600)
Deferred Income	(353,700)	(353,700)
Other Accruals	(96,981)	(95,350)
Total short term liabilities	(1,428,210)	(1,633,977)
<i>Long Term</i>		
Land	100,000	100,000
Plant	170,000	177,500
Equipment	99,740	173,740
Goodwill	1,076,600	1,076,600
Other Intangibles	425,900	175,900
Other Long Term Assets	64,125	64,125
Total long term assets	1,936,365	1,767,865
Net Operating Assets before Financing arising from Operating Activities	4,259,534	3,765,065
<i>Financing Arising from Operating Activities</i>		
Short Term Portion of Lease	(10,000)	(10,000)
Pension Obligation	(300,530)	(281,630)
Long Term Portion of Lease Obligation	(20,000)	(30,000)
Other Long Term Financing Liabilities related to operating	(63,450)	(63,450)
Total financing liabilities arising from operating activities	(393,980)	(385,080)
Net operating assets	3,865,554	3,379,985
Investing		
Short Term Investments	758,700	859,500
Investment in Common Stock	87,000	102,000
Total short term investing assets	845,700	961,500
Equity Investment	130,642	127,592
Total investing assets	976,342	1,089,092
NET BUSINESS ASSETS	4,841,896	4,469,077

Chip Co Sub Category in Operating

Statement of Financial Position (continued)		
	For the years ended 31 December	
	2011	2010
INCOME TAXES		
Net Short Term Tax Liability	(61,254)	(54,754)
Net Long Term Tax Liability	(254,400)	(254,400)
TOTAL INCOME TAXES	(315,654)	(309,154)
FINANCING		
Debt		
Short Term Portion of Long Term Debt	(150,000)	
Long Term Debt	(1,273,000)	(1,335,000)
Total debt (and other equity related assets and liabilities)	(1,423,000)	(1,335,000)
Net Assets	3,103,243	2,824,923
Equity		
Chip Co Shareholders' Equity		
Common Stock	(240,500)	(240,500)
Paid in Capital	(780,400)	(670,400)
AOCI	18,650	2,200
Retained Earnings	(1,983,653)	(1,814,433)
Total Chip Co Shareholders' Equity	(2,985,903)	(2,723,133)
Noncontrolling interests	(117,340)	(101,790)
Total Equity	(3,103,243)	(2,824,923)
TOTAL FINANCING	(4,526,243)	(4,159,923)
Total short-term assets	4,597,079	4,592,677
Total long term assets	2,067,007	1,895,457
Total assets	6,664,086	6,488,134
Total short term liabilities	(1,649,463)	(1,698,731)
Total long term liabilities	(1,911,380)	(1,964,480)
Total liabilities	(3,560,843)	(3,663,211)

FASB/IASB Staff paper

Chip Co

Statement of Cash Flow		
	2011	2010
BUSINESS		
Operating		
Cash from customers	2,473,500	2,373,600
Cash paid to suppliers	(1,457,598)	(926,598)
Cash paid for rent	(219,500)	(212,500)
Cash paid to employees	(445,500)	(409,500)
Cash paid for advertising	(112,200)	(106,800)
Cash paid for other expenses	(154,000)	(153,500)
Cash paid on lease	(10,500)	(10,500)
Cash contribution to pension	(20,000)	(10,000)
Cash provided by operating activities	54,202	544,202
Investing		
Net change in short term investments	100,800	(523,000)
Purchase of investment in common stock		(100,000)
Cash provided by (used in) investing activities	100,800	(623,000)
TOTAL CASH PROVIDED BY (USED IN) BUSINESS ACTIVITIES	155,002	(78,798)
EFFECTS OF MULTICATEGORY TRANSACTIONS		
Cash paid for acquisition	(200,000)	0
Total Effects of Multicategory transactions	(200,000)	0
FINANCING		
Cash paid for interest	(93,450)	(93,450)
<i>Dividends Paid</i>		
<i>Proceeds from written put options</i>		
TOTAL CASH USED IN FINANCING ACTIVITIES	(93,450)	(93,450)
Change in Cash from continuing operations before taxes	(138,448)	(172,248)
INCOME TAXES		
Cash paid for income taxes	(122,850)	(118,450)
CHANGE IN CASH	(261,298)	(290,698)
Beginning cash	708,302	999,000
ENDING CASH	447,004	708,302

Chip co

Notes to the financial statements

Supplemental Cash Disclosures

Increase in debt from acquisitions	88,000	
------------------------------------	--------	--

Indirect reconciliation of Operating Cash Flows

Operating income	404,720	334,390
------------------	---------	---------

Non-cash Operating Income Items

Depreciation expense	81,500	81,500
Stock compensation expense	110,000	110,000
Pension expenses	37,250	35,430
Impairment charge		120,000

Changes in Operating Assets and Liabilities

Change in accounts receivable	(609,500)	(571,400)
Change in inventory	288,000	(239,000)
Change in accounts payable	(217,598)	742,402
Change in accrued compensation	18,500	11,500
Change in accrued advertising	(30,300)	(24,900)
Change in pension obligation	(20,000)	(10,000)
Change in other accrued	1,630	(35,720)
Change in Lease Liability	(10,000)	(10,000)

Cash (used in) provided by operating activities	54,202	544,202
---	--------	---------