Joint International Group and Financial Institution Advisory Group

Agenda reference 2

Staff Paper

Date Feb. 12, 2010

Project	**Financial Statement Presentation**
Topic	**Disaggregation principle**

Introduction

1. At the working group meeting, we would like to discuss a number of questions related to the boards' tentative decisions regarding:

   (a) Disaggregation of income and expense items in the financial statements

   (b) An overall disaggregation principle and application of that principle to the statement of financial position (SFP).

The discussion paper proposal

2. The discussion paper, *Preliminary Views on Financial Statement Presentation*, proposes that within each category, an entity should disaggregate its items of income and expense by **function**. *Function* refers to the primary activities in which an entity is engaged, such as selling goods, providing services, manufacturing, advertising, marketing, business development or administration.

3. Each of those functions is further disaggregated by **nature** to the extent that information enhances the usefulness of the statement of comprehensive income (SCI) in predicting the entity's future cash flows. If that presentation is impractical on the face of the SCI, the entity presents the information in the notes to financial statements. *Nature* refers to the economic characteristics or attributes that distinguish assets, liabilities, and income and expense items that respond differently to similar economic events. Examples of disaggregation by nature include disaggregating total revenues into wholesale revenues and retail revenues or disaggregating total cost of sales into materials, labour, transport and energy costs.

4. If, in the opinion of management, presenting disaggregated information by function would not provide relevant information (because, for example, the entity does not engage in a variety of functions, that is, it provides mainly services), an entity could disaggregate its items of comprehensive income by their nature within the operating, investing and financing categories.

Tentative decisions

5. In October 2009, the boards affirmed most of what was proposed in the discussion paper for disaggregation on the SCI. The boards also tentatively agreed with the staff's recommended overall disaggregation principle that provides the objective or goal of disaggregation. That principle is as follows:

> An entity should disaggregate information and provide line item descriptions in its financial statements in a manner that provides transparency to that entity's *business model(s)*. (Emphasis added) An entity should consider and apply the disaggregation attributes of function, nature and measurement bases both individually and in concert with each other to provide the best representation of how the entity uses its resources to generate income and cash flows. An entity should present the disaggregated information so that:
>
> (a) the activities the entity performs to conduct its business and generate income are clear;
>
> (b) the relationship between *significant* (emphasis added) or material assets, liabilities, income, expenses, gains, losses and cash are faithfully represented; and
>
> (c) the *significant (emphasis added)* or material cash flows of the entity from its business and financing activities are apparent.

Disaggregation by function and by nature

6. Application of that principle led the boards to tentatively decide that an entity that has more than one reportable segment should present its by-nature information in its segment note. By-function information would be presented in the segment note as well to maintain an organizing context for the by-nature information. The boards also tentatively decided that an entity with only one reportable segment could similarly present its by-function and by-nature information either in the SCI or in the notes to financial statements (in a separate new note).

7. Because by-nature information will be presented in the segment note, the boards agreed to make the following amendments to IFRS 8, *Segment Reporting*, and FASB ASC Topic 280, *Segment Reporting*, to ensure alignment between the SCI and the notes:

    (a) Require an entity that presents by-nature income and expense information in its segment note to classify items consistently between the SCI and the segment note

    (b) Require an entity to reconcile the operating profit (loss) of its reportable segments to its consolidated operating profit presented on the SCI.

8. The staff recommended that the boards also modify existing segment requirements to include the following; however, the boards did not agree.

    (a) Require an entity to attribute assets, liabilities and related depreciation, amortization, and depletion to its individual reportable segments where such attribution is reasonable

    (b) Require an entity to attribute income and expenses to its individual reportable segments where such attribution is reasonable.

9. The FASB did agree to require disclosure of a measure of operating assets, liabilities, and cash flows by reportable segment. The FASB considered this a key improvement to the segment note disclosure. The IASB did not agree with requiring a measure of operating cash flow by reportable segment (IAS 7 encourages but does not require disclosure of cash flows arising from operating, investing and financing activities of each reportable segment). Because the IASB did not want to make any additional amendments to IFRS 8, they were not asked about disclosure of operating assets and liabilities for each reportable segment.

10. The staff think that the decision usefulness of by-nature income and expense information for each reportable segment is not complete without information about the related operating assets, operating liabilities and operating cash flow by segment. Therefore, if both boards do not agree to include that information in the segment notes, the staff will suggest that by-nature income and expense information be presented in a new separate note, not in the segment note. This has the benefit of all entities presenting by-nature information in a new note.

11. Appendix A to this paper contains sample notes that illustrate possible ways to present disaggregated by-nature information. The sample notes are based on the facts provided in the brief company profile found in the appendix. The samples illustrate the following:

    (a) **Sample Note A**: by-nature information is presented in a matrix format as new single note disclosure based on the overall disaggregation principle (paragraph 7)

    (b) **Sample Note B**: by nature information is presented in a non-matrix format as a new single note disclosure based on the overall disaggregation principle (paragraph 7)

    (c) **Sample Note C**: by-nature information is presented in a non-matrix format as a new single note disclosure based on the disaggregation guidance in the DP (no concept of business model or significance)

    (d) **Sample Note D**: the entity's segment note prepared in accordance with current segment guidance

    (e) **Sample Note E**: the entity's segment note prepared in accordance with the boards' tentative decisions for presentation of by-nature information in the segment note.

12. Discussion questions 1-8 are based on the company profile and sample notes provided in Appendix A.

Discussion questions—disaggregation of income and expenses
1. What qualitative characteristics make by-nature information decision useful? Are there examples of useful or not useful by-nature information that you can point to in the sample notes provided?
2. The overall disaggregation principle in paragraph 7 includes an idea of "business model" and "significance". Do the sample notes illustrating these concepts (Sample Notes A, B and E) provide more useful or meaningful information? If so, how?
3. Which of the sample by-nature notes provided the most decision useful information to you? Why?

4. How does the boards' decision to not require reasonable attribution of assets, liabilities, income, expenses, gains and losses affect your opinion of the usefulness of presenting by-nature information in an entity's segment note? (Sample notes C and D)

5. Should an entity be allowed to present more than one measure of segment profit or loss?

6. Given the boards' decisions to date, is presentation of by-nature information in the segment note more useful than presentation of by-nature information in a new separate note?

7. If the concept of business models is retained, what level should the entity look to when describing it's business models? Is it more useful to look at types of revenue streams as in the sample notes or is a more general type of business view (i.e. manufacturing, retail, financial services) more useful?

Disaggregation on the SFP

13. The boards affirmed the discussion paper proposal that, if assets and liabilities are of the same nature and are measured differently, measurement basis should be used for further disaggregation on the SFP. The IASB agreed that the exposure draft should include the minimum line item requirements for the SFP that are in IAS 1. The FASB was not interested in including minimum line item requirements for the SFP.

14. IASB members that support the inclusion of minimum requirements do so for the following reasons:

    (a) They are concerned that, without minimum line item requirements, information that is currently separately presented will no longer be separately presented

    (b) They consider minimum line item requirements to be a good starting point for an entity to think about how it should put the financial statement presentation principles into practice.

15. The counter argument to including minimum line item requirements in the exposure draft is that entities should look to their respective regulator for minimum line item requirements, rather than the accounting standards-setter. For example, the US Securities and Exchange Commission (SEC) already provides detailed minimum line item requirements for registrants as part of Regulation S-X. This was one of the reasons the FASB decided not to require minimum line items. FASB members also noted that the disaggregation principle should be sufficient for a principles-based standard.

Discussion question—disaggregation on SFP
8. Given the proposed principles of cohesiveness and disaggregation in this project, will including minimum line items in the standard be useful? Why, or why not?

Appendix A—Disaggregation of by-nature information in a stand-alone note

COMPANY PROFILE

Example:
The reporting entity is a spirits and wine company that owns several retail food chains. The company's spirits and wine groups and its retail food chains consist of premium and non-premium branded goods as well as non-branded bulk goods. The company manufactures and sells its own brands. Additionally, the company sells several other significant brands in selected markets under distribution agreements with non-related brand owners. The company also generates significant revenue through multi-year wholesaler consolidation agreements which are payments to secure the right to carry the company's complete portfolio of spirits and wines in a particular market.

The retail food chains consist of a combination of franchise arrangements and company owned stores. The company also has significant royalty income from various brand licensing arrangements for both the spirits portfolio and the retail food chains.

The company sold its vineyards and has several long term contracts in-place for the purchase of grapes.

Potential Business Models at play

- Manufacture and sale of premium and ultra premium spirit and wine brands
- Manufacture and sale of non-premium spirit and wine brands
- Distribution of non-owned spirits and wine brands
- Franchising
- Brand licensing
- Sale of bulk spirits

The company decides that it has three business models that it manages to:

1. The manufacture and sale of premium spirit and wine brands
2. The sale of non-premium spirit and wined brands
3. The franchising of fast food restaurants

Reportable Segments

The company determines that it has two reportable segments: (1) Spirits and Wines and (2) Fast Food Restaurants

The CODM assesses segment performance and allocates resources based on the sales amounts in the segments.

All corporate expenses are allocated proportionately to the segments based on the segments percent of total sales. (i.e. Spirits and Wines generate 95% of total sales; then 95% of corporate overheads are allocated to that segment.)

The spirits and wine Inventory is reported at LIFO since that is the measure used by the CODM.

The segments share many co-located facilities. The leases are nearly all executed with the spirits and wine legal entity. The costs of these leases are treated as expenses of the spirits and wine segment for reporting purposes.

All royalty income that arises from licensing arrangements for non-produced goods (ie something other than a bottled spirit or wine or food item of the fast food restaurant) is considered corporate income. These contracts are managed on a global basis.

SAMPLE NOTE A

New By-Nature Note that incorporates Business Model and significance
To be used in conjunction with sample segment note D.

	Premium	Non-Premium	Retail	Corporate
Turnover	3850	2800	50	
New Product Load-In	1000	200		
Franchise Fees			300	
Royalties	100		100	
Other	50			
	5000	3000	450	
Cost of Goods Sold				
Materials-consumables	450	450		
Materials-grapes	100			
Labor-temporary	75	25		
Labor-permanent	80	120		
Transportation	80	120		
Depreciation	30	70		
	815	785		
Marketing				
Advertising-trade	130	20		
Advertising -consumer	220	80	200	
Other Marketing Expenses	30	20	20	
Selling Expenses				
Commissions	20			
promotions-discounts&rebates	80	20		
promotions-other	150	30	20	
other selling expenses	20	10		
General & Administrative Expenses	All S&W			
labor	100		50	200
rent	50		20	80
other G&A	200		100	300
Investing				
fixed rate interest income			20	60
variable rate interest income			30	70
Debt				
fixed rate interest expense				60
variable rate interest expense				200

SAMPLE NOTE B

New By -Nature Note in Non-matrix format that incorporates business model and significance concepts. To be used with sample segment note D.

Revenues	
Turnover-premium brands	3850
Turnover-non-premium brands	2800
Franchise Fees	300
Royalties -Retail	100
Cost of Goods Sold	
Materials Consumables	900
Materials-Grapes	100
Labor-Temp	100
Labor-Permanent	200
Transportation	200
Depreciation	100
Marketing	
Advertising-Trade	150
Advertising-Consumer	300
Selling Expenses	
Commissions	20
Promotions-Discounts/Rebates	100
Promotions-other	180
G&A	
Labor-S&W	100
Labor-Retail	50
Rent S&W	50
Investing	
fixed rate interest income	80
variable rate interest income	100
Debt	
fixed rate interest expense	60
variable rate interest expense	200

SAMPLE NOTE C

New By Nature Note as presented in Discussion Paper(no business model or significance concept). To be used with sample segment note D.

Revenues	3500
Turnover-wholesale	4200
Turnover-retail	300
Franchise Fees	200
Royalties	
Cost of Goods Sold	900
Materials Consumables	100
Materials-Grapes	100
Labor-Temp	200
Labor-Permanent	200
Transportation	100
Depreciation	
Marketing	150
Advertising-Trade	300
Advertising-Consumer	
Selling Expenses	20
Commissions	100
Promotions-Discounts/Rebates	180
Promotions-other	
G&A	350
Labor	150
Rent	
Investing	80
fixed rate interest income	100
variable rate interest income	
Debt	60
fixed rate interest expense	200
variable rate interest expense	

SAMPLE NOTE D

Current Segment Note-No by nat	Spirits&Wine	Retail	All other	Total
Turnover	8000	450		8450
Operating Costs	(1,600)	(10)		(1,610)
Trading Profit	6400	440		6840
Assets	2600	200	100	2900

SAMPLE NOTE E

Segment Note with by- nature (FASB tentative decisions)

		Spirits&Wine	Retail	Corporate	Total
	Turnover	6650	50		6700
	New Product Load-In	1200			1200
	Franchise Fees		300		300
	Royalties		200	50	250
	Other			50	50
	Total Turnover	7850	550		8400
	Cost of Goods Sold				
	Materials-consumables	750	10		760
	Materials-grapes	80			80
	Labor-temp	100			100
	Labor permanent	200			200
	Transportation	200			200
	Depreciation	100			100
	Other	20	5		25
		1,450	15		1,465
	Marketing				
	Advertising-trade	150	20		
	Advertising-consumer	220	80		
	Other	30	20	10	
	Total Marketing	400	120	10	530
	Selling				
	Commissions	20			
	Promotions-Discounts & Rebates	80	20		
	Promotions-other	150	30		
	Other selling expenses	20	10		
	Total Selling	270	60		330
	General & Administrative				
	Labor	300	50		
	Rent	95	5	12	
	Other	300	100	100	
	Total G&A	695	155	112	962
	Operating Profit by Segment	5,035	200	(122)	5,113
	Investing				
	Interest Income -fixed			80	80
	Interest Income -variable			100	100
	Financing				
	Interest expense-fixed			60	60
	Interest expense-variable			200	200
FASB only	*operating assets by segment*	*5500*	*45*	*30*	*5575*
FASB only	*operating liabilities by segment*	*1200*	*3*	*2500*	*3703*
FASB only	*operating cash flow by segment*	*5000*	*60*	*(790)*	*4270*