Project **Financial Statement Presentation**

Topic **Costs and benefits**

Introduction

1. The purpose of this paper is to:

   (a) summarize the information received about the costs and benefits of the presentation model proposed in the October 2008 discussion paper, *Preliminary Views on Financial Statement Presentation* (DP)

   (b) describe the changes made to the DP proposals, which address the cost and benefit issues raised by constituents.

2. At the January 2010 joint meeting, the boards will be asked if there is any specific cost-benefit information we should obtain before issuing the exposure draft. During a closed administrative session at the January 2010 joint meeting, the boards will be asked to provide their preliminary views on whether we should conduct a field test after the exposure draft is published and, if so, how we should design that test and what data we should use (see IASB paper 7D/FASB memorandum 73D).

Overall costs of the proposed presentation model

3. During deliberations we have discussed the feedback received by respondents to the DP and participants in the field test about the perceived costs, benefits, and effects of specific aspects of the proposed presentation model, particularly a direct method statement of cash flows (SCF), disaggregation by function and nature, and the reconciliation schedule. Paragraphs 7–27 summarize the input received on the *overall* costs of that model.

4. The input we received provides us with a wide range of estimated costs. The range in estimates is attributable to a number of reasons including the different approaches an entity could use to implement the proposed model, the entity's current reporting system, the size of the entity, and the country or countries in which the entity operates.

5. The information we received is of limited use in a cost-benefit analysis for the following reasons:

   (a) The information is from a very limited number of companies that cannot be considered a representative sample from which we could extrapolate cost estimates.

   (b) The information is anecdotal and difficult to verify because there are multiple implementation decisions and alternatives available. Therefore, we are unable to identify the cost and benefits for each of the viable alternatives.

   (c) We have focused mainly on input from preparers of large multinational companies and select analysts, and have not considered all of the groups that would be affected by the proposed changes.

   (d) We are unable to identify an appropriate time period over which costs and benefits will be realized.

6. However, the staff think that the overall cost information we received (see paragraphs 7−27) provides useful information regarding the potential effects of the proposed presentation model that should be considered in subsequent cost benefit discussions before finalizing a standard on financial statement presentation.

System changes

7. One of the most significant costs that an entity would incur to implement the proposed presentation model relates to the restructuring of accounting information systems.

8. To collect the appropriate data required to implement the proposals, an entity may be required to invest in information technology (IT) system upgrades, redesigns, or possibly a completely new accounting system. For example, upgrades or redesigns would likely be required for general ledgers and sub-ledger systems that feed into an enterprise resource planning system. There would have to be modifications of both the transaction systems and the reporting and consolidation systems. In addition to software changes, hardware changes may have to be made because of higher data processing volume per transaction.

9. One respondent (a Global 500 company with annual revenue between $35-40 billion) estimates that implementation costs would be in excess of $6 million and expects to incur at least another $2 million a year on an ongoing basis.

10. Another respondent (a Global 500 company with annual revenue between $90-105 billion) stated that, after an extensive analysis of the necessary system changes, development and deployment costs would be between $75 million and $100 million. This preparer operates in 170 companies but noted that the cost estimate is mitigated by the fact that it currently operates a globally integrated enterprise system. Global companies that utilize a decentralized system may have to develop a more centralized accounting and reporting systems and, therefore, might incur significantly higher costs. Also, this preparer observed that its estimated costs are relatively low since it would be able to perform a lot of the IT work internally.

11. One respondent (a Global 500 company with annual revenue between $60-$70 billion) estimated that its cost to implement the proposed presentation model would be over $0.5 billion and possibly as high as $1 billion.

12. One field test participant (a Global 500 company with annual revenue between $30-$40 billion) described three different possible approaches to implement the proposals and estimated the costs for each approach:

    (a) manual business process changes with minimal enterprise system impacts (implementation costs of at least $4 million and recurring costs of at least $2 million per year)

(b) manual business process and system process changes (implementation costs of at least $5 million and recurring costs of at least $2 million per year)

(c) increased automation for the statement of cash flows utilizing a cash flow ledger functionality within its enterprise system (implementation costs of at least $6 million and recurring costs of at least $1.5 million per year).

13. Other field test participants provided the following estimated information:

(a) A Global 500 company with annual revenue between $20-$25 billion: The one-off costs would amount to $200,000–500,000 and implementation would take less than 1 year. Recurring costs could be as high as $100,000 per year

(b) A Global 500 company with annual revenue between $20-$30 billion: A rough estimate of the cost to implement the proposals is around $2 million.

(c) A Global 500 company with annual revenue between $40-$50 billion: The necessary changes would take about 5 years and would have an initial cost around $50 million and ongoing costs of about $10-20 million a year. However, it estimated costs could be as high as $0.5 billion.

(d) A Global 500 company with annual revenue between $50-$60 billion: Initial costs of at least $30 million and recurring costs of $5 million. This entity currently utilizes over 100 different general ledger systems and over 1,000 different sub-ledger systems. It would have to make significant changes to its standard worldwide reporting procedures to implement the proposed changes to financial statement presentation.

(e) A Global 500 company with annual revenue between $75-$85 billion: Implementation costs are estimated to be over $100 million with ongoing costs of $4 million per year.

(f) The time and cost to implement the proposed model would be equal to the costs to convert to IFRS.

14. An additional cost would be incurred by any entity that decides to run a parallel system for a limited period to assist with the transition to a new reporting system. One field test preparer (a Global 500 company with annual revenue between $30-$40 billion) estimated a parallel reporting system would cost at least $225,000 per year.

15. One comment letter respondent said that a bank, as a user of financial statements, would need to modify its databases to accommodate different financial statement layouts. In addition, banks would have to re-engineer small business credit score models and replace all risk rating models and validate new models. Other users of financial statements would need to make similar changes to their models. Respondents did not provide any cost estimates for those kinds of system changes.

Business process changes

16. In addition to the system changes, an entity would most likely incur costs to modify its control procedures. During implementation, an entity would have to analyze and test internal controls over financial reporting and amend or add controls as needed. Preparers would have to define and implement a new classification policy and design new controls over the updated chart of accounts.

17. Preparers also may need to make changes to their comparative financial statement preparation process so that they could appropriately capture and report prior period information reported under the old presentation format.

18. An entity's coding process may need to be updated to collect the additional information, including the exact position on the SCF and the appropriate column in the reconciliation schedule. Changes would need to be made to an entity's chart of accounts, basic bookkeeping processes, and communication processes within the interfaces of selling and invoicing functions, treasury functions, and accounting functions. One respondent estimated it would take at least two years to make the necessary system, process, and control changes.

Personnel costs

19. To implement the necessary system and process changes, an entity may need to utilize significant personnel resources. For example, resources would have to be devoted to overall project management, changing business processes and systems, updating XBRL tags, and testing internal controls.

20. In addition, personnel would need to receive extensive training on new systems and processes, and all training materials would need to be updated. Banks, for example, would have to retrain their personnel in accounting and credit risk analysis as well as in financial statement analysis.

21. A Global 500 company with annual revenues between $30-40 billion estimated that initial implementation would consume over 70,000 man hours and that another 20,000 man hours would be expended annually on an ongoing basis.

Audit and education costs

22. Field test participants commented that because of the increased detail in the financial statements, they would expect to incur increased external and internal audit costs. One field test participant estimated an increase of $500,000 in audit and other compliance fees for the first year. We did not receive any estimated cost information from the audit community.

23. There also will be education costs associated with such significant changes to financial statement presentation. The proposed changes would affect educational institutions on all levels and would require updating textbooks, retraining courses for teachers, and reconstructing teaching materials. There also would be education costs for both preparers and users of financial statements.

Non-quantitative costs

24. In addition to the quantitative costs associated with the proposed changes to financial statement presentation, respondents to the DP mentioned the possibility of other costs to the overall financial reporting system. They include the following:

(a) Additional time to deliver financial statements because of the added complexity to prepare the statements

(b) A lack of comparability between entities in the same industry operating in substantially the same manner

(c) Initially, auditors and users may not be able to discern when an item is misclassified or misrepresented in the financial statements because the new and unfamiliar format relies on increased management discretion in classifying assets and liabilities.

IFRS and other projects

25. There also is concern about the additional costs that could arise because of the coinciding timeline of this project, other MOU projects, and the adoption of IFRS.

26. One respondent suggested that there should be a multi-year timeline for implementation of this project and all of the other projects expected to be completed in 2011. This would hopefully provide preparers enough time to plan and budget for the changes and allow companies to maximize the use of their staff and potentially reduce some costs. In addition to the time preparers would need to make adjustments, users may need a very long adaptation phase for the new presentation format. This could lead to short-term difficulties in generating external capital.

27. Many countries are in the process of re-establishing new accounting systems to prepare for IFRS adoption. The proposed presentation changes could result in an entity that operates in those countries having to significantly modify or create new accounting systems more than once in a short period of time.

Modifications to proposed presentation model to address cost concerns

28. The boards made the following tentative decisions that should reduce the costs of implementing the proposed presentation model and retain the expected benefits of the proposed model:

(a) An entity with more than one reportable segment should present its disaggregated income and expense items by both function and nature in the segment note rather than entirely on the statement of comprehensive income (SCI).

(b) An entity should apply the cohesiveness principle at the category level, not the line-item level. Therefore, the line items on the SCF do not have to align with the line items on the SCI. An entity should disaggregate its cash flow information so that significant or material cash flows are apparent to a user of its financial statements.

(c) An entity should present an analysis of changes in the balances of all significant asset and liability line items in the notes to financial statements rather than in the reconciliation schedule proposed in the DP.

29. The boards will consider the breadth of the changes necessary to implement the proposed presentation model when setting the effective date for the financial statement presentation standard.

Understanding the benefits of the proposed presentation model

30. Both the field test and the Financial Accounting Standards Research Initiative's (FASRI) experimental study helped the boards assess the benefits of the presentation model proposed in the DP. The staff also engaged in a number of outreach efforts to understand the benefits of a direct method SCF because that was repeatedly identified by field test participants and comment letter respondents as the most costly aspect of the DP.

31. As noted previously, the boards addressed both the costs and benefits of the individual aspects of the DP during deliberations. In addition, we have addressed how possible changes to the proposed presentation model would impact the expected costs and benefits with the boards' various advisory groups.

Question for the boards
Q1. The staff has done all it can to assess the costs and benefits of the proposals in the DP and possible changes to those proposals (except to conduct a field test on the current package of tentative decisions). **Is there any cost/benefit information board members would like to obtain before issuing the exposure draft? If so, please describe.**