Topic **Financial statement presentation – Update**

Introduction

1. This summary reflects the cumulative and tentative decisions made to date jointly by the IASB and FASB. Those tentative decisions have been reported in the newsletter IASB *Update*. Financial statement presentation is an ongoing project and, like in any project, tentative decisions sometimes, and often do, change.

Why are the IASB and FASB working on a financial statement presentation project?

2. How an entity presents information in its financial statements is vitally important because financial statements are a central feature of financial reporting—a principal means of communicating financial information to those outside the entity.

3. The International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board (FASB) initiated the joint project on financial statement presentation to address users' concerns that existing requirements permit too many alternative types of presentation and that information in financial statements is highly aggregated and inconsistently presented, making it difficult to understand fully the relationship between an entity's financial statements and its financial results.

4. The objective of the financial statement presentation project is to establish a global standard that will guide the organisation and presentation of information in the financial statements. The proposals in this project would directly affect how the management of an entity communicates financial statement information to the users of its financial statements, such as existing and potential equity

This paper has been prepared for discussion at a public meeting of the IFRS Advisory Council of the IASB.

The views expressed in this paper are those of the authors.

Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRS Interpretations Committee or the IASB can make such a determination.

The tentative decisions made by the IASB at its public meetings are reported in IASB *Update*. Official pronouncements of the IASB, including Discussion Papers, Exposure Drafts, IFRSs and Interpretations are published only after it has completed its full due process, including appropriate public consultation and formal voting procedures.

investors, lenders and other creditors. The boards' goal is to improve the usefulness of the information provided in an entity's financial statements to help those users in their decision-making.

Information is not presented consistently in financial statements

5. Transactions or events recognised in financial statements today are not described or classified in the same way in each of the statements. That makes it difficult for users to understand how the information in one statement relates to information in the other statements. For example, the boards' standards on the statement of cash flows require a section for operating activities, but International Financial Reporting Standards (IFRSs) and US generally accepted accounting principles (GAAP) do not provide a section for operating activities in the statement of comprehensive income or the statement of financial position. That makes it difficult, for example, for users who want to compare operating income with operating cash flows—a comparison often made in assessing the degree to which an entity's earnings are likely to recur and to reflect the underlying cash flows. Even though users can sometimes understand the relationship between items of information in the financial statements (eg the statement of cash flows is intended to explain the change in the cash account), users have asked for improved linkage among the different statements.

6. Both IFRSs and US GAAP permit alternatives for how an entity presents information in its financial statements. Permitted alternatives include (a) direct and indirect methods of presenting operating cash flows and (b) presentation of all items of income and expense in an overall statement of comprehensive income or in two statements. US GAAP permits a third alternative—presentation of other comprehensive income items in the statement of changes in equity rather than in a performance statement. Alternative presentations make it difficult for users to compare financial information across entities.

7. IAS 1 *Presentation of Financial Statements* includes minimum presentation requirements for an entity applying IFRSs. Although US GAAP includes some requirements that focus on presentation of information in the financial

statements (for example, how information is to be classified in the statement of cash flows), those requirements were developed on statement-by-statement basis and are not as comprehensive as IAS 1. In addition, the US Securities and Exchange Commission (SEC) requires particular presentation and disclosures for entities that file financial statements in accordance with Regulation S-X.[1] Thus, the existing presentation requirements in IFRSs and US GAAP provide opportunities for a wide spectrum of presentation formats that comply with the requirements but vary in detail and comparability. This is counter to the needs of users. Increased globalisation of capital markets and investment opportunities have led to a need for a common set of principles for presenting information in financial statements used by capital providers around the world. Even if entities' financial statements use the same underlying recognition and measurement principles, different presentations of the resulting information make it difficult for users to compare the financial results of those entities.

Information is not sufficiently disaggregated in financial statements

8. Even though IAS 1 and Regulation S-X address presentation issues, IFRSs and US GAAP provide little specific guidance on the presentation of line items in financial statements, such as the level of detail or number of line items that should be presented. The resulting variation and inconsistency in the amount of aggregation create difficulties for users who want to understand and analyse an entity's activities. For example, some entities may disaggregate direct product costs (eg materials and labour) as well as general and administrative costs (eg rent and utilities) in their statements of comprehensive income. However, other entities may present both product costs and general and administrative costs in the aggregate. Such aggregation makes it difficult for users to study the relationship between revenue and costs for an entity's principal activities as well as to perform a benchmark analysis of those activities across an industry.

[1] Regulation S-X sets out the form and content of and requirements for financial statements that are required to be filed by the Securities Act of 1933, the Securities Exchange Act of 1934, and the Investment Company Act of 1940.

9. Insufficient disaggregation also makes it more difficult for users to understand how a line item in one financial statement relates to other information presented in the other financial statements.

10. It is also common practice for users to analyse an entity's financial performance independently of its capital structure. However, users say that this analysis is difficult because financial statements do not usually distinguish an entity's financing activities (how it obtains capital) from its business activities (how it uses that capital to generate income).

11. Users of financial statements often analyse the change in an asset or liability caused by changes in market prices or rates (ie gains attributable to remeasurement of an asset) differently from other changes in an entity's net assets. That is because those changes do not usually have the same implications for future cash flows as other amounts recognised in comprehensive income. However, amounts that are likely to have different implications for future cash flows are often aggregated in the statement of comprehensive income.

Who would be affected?

12. The proposals in this project would affect all business entities that prepare financial statements in accordance with IFRSs or US GAAP except a benefit plan within the scope of IAS 26 *Accounting and Reporting by Retirement Benefit Plans* or within the scope of FASB Accounting Standards Codification™ Topics 960, *Plan Accounting–Defined Benefit Pension Plans*; 962, *Plan Accounting–Defined Contribution Pension Plans;* and 965, *Plan Accounting–Health and Welfare Benefit Plans.*

What are the main proposals and how would they differ from current IFRSs and US GAAP?

Core principles

13. The proposals in this project contain two core financial statement presentation principles—cohesiveness and disaggregation. Cohesiveness means that the relationship between items in the financial statements is clear and that an entity's financial statements complement each other as much as possible. Disaggregation means separating resources by the activity in which they are used and by their economic characteristics. Together, the disaggregation and cohesiveness principles enhance the understandability of an entity's financial statement information.

Classification and format

14. The proposals in this project would establish a common structure for the statements of financial position, comprehensive income and cash flows in the form of required sections, categories and subcategory and related subtotals. The financial statements would display related information in the same sections, categories and subcategory in each statement so that the information is more easily associated.

15. Separate presentation of business and financing activities allows for better communication of an entity's financial position and financial performance.

16. The business section would include items that are part of an entity's day-to-day and other income-generating activities and segregate them into operating and investing categories. Select liabilities directly related to operating activities, which some users view as an alternative source of financing (eg a pension obligation), would be classified in a subcategory within the operating category.

17. The financing section would include items that are part of an entity's activities to obtain (or repay) capital and segregate them into debt and equity categories.

18. Discontinued operations and income taxes would be presented in their own separate sections.

19. The statement of changes in equity would not include the sections and categories used in the other statements because that statement presents information solely about changes in items classified in the equity category in the statement of financial position.

20. The following table illustrates the sections, categories and subcategory in each financial statement:

Statement of financial position	Statement of comprehensive income	Statement of cash flows
Business section	**Business section**	**Business section**
Operating category	Operating category	Operating category
Operating finance subcategory	Operating finance subcategory	
Investing category	Investing category	Investing category
Financing section	**Financing section**	**Financing section**
Debt category	Debt category	
Equity category		
	Multi-category transaction section	**Multi-category transaction section**
Income tax section	**Income tax section**	**Income tax section**
Discontinued operation section	**Discontinued operation section**, net of tax	**Discontinued operation section**
	Other comprehensive income, net of tax	

Statement of financial position

21. In the statement of financial position, an entity would classify its assets and liabilities on the basis of how those items relate to its major activities or functions (operating, investing and financing), not grouped by assets, liabilities and equity. Thus, unlike current practice, assets would not be presented separately from liabilities.

22. Within each section, category and subcategory, an entity would choose one of the following formats: its short-term assets and liabilities presented separately from its long-term assets and liabilities or its assets and liabilities presented in order of liquidity. An entity would use the format that provides the most relevant information. The entity would present totals for assets and liabilities and subtotals for short-term and long-term assets and liabilities in the statement of financial position.

23. The classification of assets and liabilities into the required sections, categories and subcategory is a means of disaggregating assets and liabilities by function. Assets and liabilities also would be disaggregated in the statement of financial position by measurement basis and/or nature. Nature refers to the economic characteristics or attributes that distinguish assets and liabilities that do not respond similarly to similar events.

Statement of comprehensive income

24. In the statement of comprehensive income, an entity would disaggregate its income and expense amounts by function (ie the primary activities in which the entity is engaged, such as selling goods, providing services, manufacturing, advertising, marketing, business development or administration). An entity would not disaggregate its income and expense amounts by function if that disaggregation is not useful in understanding the entity's activities and the amounts, timing, and uncertainty of future cash flows.

25. An entity that presents disaggregated information by function would disaggregate those functional amounts by nature in the notes to financial statements. Examples of disaggregation of income and expenses by nature include disaggregating revenues from selling goods into wholesale and retail components or disaggregating total cost of sales into materials, labour, transport, depreciation and energy costs.

26. In US GAAP, entities that are required to provide a segment note would disaggregate in that note income and expenses by their nature for each

reportable segment, with different by-nature disaggregation permitted for each reportable segment. Those entities also would disclose additional operating measures in the segment note. In IFRSs, all entities would disaggregate income and expenses by their nature on an entity basis (not by reportable segment) and present that information in the statement of comprehensive income or disclose that information in a separate note.

27. As proposed in a separate joint project on presentation of other comprehensive income, the statement of comprehensive income would be segregated into two parts: profit or loss (net income) and other comprehensive income. In IFRSs, items of other comprehensive income would be grouped into those that will be reclassified to profit or loss when specific conditions are met and those that will not be reclassified to profit or loss in subsequent periods. Income taxes would continue to be allocated to items in other comprehensive income.

28. In that separate joint project on presentation of other comprehensive income, the IASB decided to refer to the statement of comprehensive income as a 'statement of profit or loss and other comprehensive income.' However, an entity would not be required to use that title for the statement.

Statement of cash flows

29. In the statement of cash flows, an entity would use a direct method to present cash flows in each of the sections and categories. For example, an entity would present separately the classes of its cash receipts and payments for its operating activities, such as cash collected from customers and cash paid to suppliers to acquire inventory. The disaggregation of cash flows in the statement of cash flows would be more limited than in the statement of comprehensive income. This is a change from the proposal in the discussion paper the boards published on this project in October 2008.

30. An entity also would be required to reconcile operating income to operating cash flows as part of the statement of cash flows.

31. In current practice, most entities choose to present their operating cash flows indirectly in the statement of cash flows by reconciling profit or loss or net income to net operating cash flows rather than present those cash flows using a direct method. Existing IFRSs and US GAAP require all entities to use a direct method to present their investing and financing cash flows.

32. The definitions of operating, investing and financing cash flows are different from the definitions in IAS 7 *Statement of Cash Flows* and Topic 230 *Statement of Cash Flows*. For example, cash flows related to capital expenditures are currently presented in the investing category. An entity would most likely present those cash flows in the operating category using the proposed definitions. Aligning the definitions across statements and disaggregating operating cash flows would help users relate information about operating assets and liabilities and operating income and expenses to operating cash receipts and payments.

Notes to financial statements

33. The notes to financial statements would include new or additional disclosure requirements.

34. In the notes to financial statements, an entity would be required to provide an analysis of the changes between the opening balance and the closing balance of asset and liability line items that are important for understanding the current period change in the entity's financial position. As part of that analysis, an entity would present separately the change related to cash transactions, non-cash transactions (eg reclassifications), accounting allocations (eg depreciation), write-downs or impairment losses, acquisitions or dispositions, and other remeasurements (eg fair value changes).

35. [*IASB only*] As part of the analysis of changes in assets and liabilities, an entity would be required to present in a single note disclosure an analysis of changes in cash, short-term investments, finance leases, and all line items in the debt category.

36. The notes to financial statements also would include a note that discloses the remeasurement amounts recognised in the statement of comprehensive income and a narrative description as necessary to place the remeasurement information in context.

37. [*FASB only*] In addition to providing other information in its segment note, an entity would provide a measure of operating profit or loss, operating assets, operating liabilities and operating cash flows for each reportable segment. An entity would reconcile the totals of each of those operating measures to the corresponding consolidated totals for those items.

Questions for Council members
1. The **disaggregation principle** is based on three attributes (function, nature and measurement basis). Is this principle understandable and operational? Why or why not? Are there any **attributes** that should be either added or removed from the overall disaggregation principle? Should the IASB revisit **segment disclosures** as proposed by FASB? 2. Do you think the **proposed** financial statement structure with common section, categories and subcategory will improve communication of an entity's financial results to users of its financial statements? Why or why not? Should assets such as **cash and marketable securities** be included within the financing section as a move toward equating this section with a notion of **net debt**? Why or why not? 3. What would be the **minimum operating cash flow line** items you would like to see disaggregated in a statement of cash flows? Should the financial statements include a **reconciliation of profit or loss from operating activities to net cash flows from operating activities**? If so, should it be presented as part of the statement of cash flows or in the notes?