IASB/FASB Meeting 1st-2nd March 2011

IASB Agenda reference: **1 App C**

FASB Agenda reference: **87 App C**

Staff Paper

Project	**Financial Statement Presentation**
Topic	**Appendix C – Analyses of Changes in Asset and Liability Line Items**

INTRODUCTION

1. This appendix will detail what the staff learned in its outreach concerning the analyses of changes of statement of financial position (SFP) line items as well as present alternatives for the guidance presented in the Staff Draft.

STAFF DRAFT PROPOSAL

2. The Staff Draft proposes that an entity disclose analyses of changes of SFP line items in the notes to the financial statements. According to the Staff Draft, analyses of changes are to be disclosed for all asset and liability line items (or group of line items) that management regards as important for understanding the current period change in the entity's financial position. The Staff Draft contains guidance on how to determine the importance of an asset or liability line item.

3. The Staff Draft proposes that the following changes should be presented in the analyses (if applicable):

   (a) Changes resulting from cash inflows and cash outflows

   (b) Changes resulting from noncash transactions that are recurring and routine (for example, credit sales and interest expense)

   (c) Changes resulting from noncash transactions that are neither recurring nor routine (for example, a business combination)

   (d) Changes resulting from accounting allocations (for example, depreciation expense)

   (e) Changes resulting from accounting allowances (for example, bad debt expense)

(f) Other changes resulting from remeasurements (for example, fair value changes, foreign currency translations, and impairment losses).

WHAT WE HEARD DURING OUTREACH ACTIVITIES

Field Visit Input

4. Companies we met with during our field visits stated that the costs to compile the information required in the analyses of changes note disclosure would be very high. They explained that they would not be comfortable disclosing this information if it was not generated in a systematic way because:

   (a) The short reporting periods necessitate a systematic solution to the disclosure.

   (b) System generated information is more consistent with the controls environment that the certifying officers view as compliant with internal controls standards set forth by Section 404 of the Sarbanes-Oxley Act.

   (c) System generated information will provide answers to questions users may have about the information disclosed.

   (d) Foreign exchange and multiple reporting entities necessitate an approach that involves consolidating information from multiple entities and systems that currently is not gathered in any of the systems that are in place today.

5. Most companies were supportive of the objective of the analyses of changes disclosures, but believe that a modified approach that focuses on disclosing more limited types of changes would be more appropriate.

6. The following issues were raised during the field visits:

   (a) Companies said that to determine which line items are important in understanding the current period change in the entity's financial position, they would need to prepare an analysis for each asset and liability line item on the SFP.

   (b) Most companies indicated that the guidance in the Staff Draft for selecting which line items to analyze would result in them determining that an analysis of changes should be disclosed for every asset and liability line item on the SFP.

(c) Companies indicated that major system changes would be required to track and compile each major type of movement within the line items being analyzed. (They expressed similar concerns regarding a direct method statement of cash flows.)

(d) Companies questioned the benefit of disclosing all of the types of changes required by the Staff Draft relative to the expected cost. The greatest concern relates to the Staff Draft proposal to present changes resulting from cash inflows and outflows, and from noncash transactions that are recurring and routine.

(e) Many companies noted redundancies between the amounts presented within the analyses of changes and those presented in the remeasurements note, the direct method cash flow statement, and in the statement of comprehensive income as unusual or infrequently occurring transactions.

7. Some companies noted that a trend has developed in recent years within U.S. GAAP whereby many new and proposed standards require account rollforwards. These companies indicated that generally they are able to prepare rollforwards without significant difficulty or cost for accounts currently required to be disclosed (for example, goodwill, accrued warranty, and accrued restructuring) and many prepare rollforwards of other accounts for internal purposes only. However, these rollforwards are not being prepared in the same level of detail proposed in the Staff Draft.

Views of Financial Statement Users

8. The analyses of changes are viewed by users of financial statements as one of the most useful aspects of the Staff Draft. Most analysts felt the information would reduce the amount of "digging and plugging" they currently do to complete their models.

9. Some of the users we spoke to indicated that the analyses of changes will provide information that is very useful in understanding the changes in the SFP which currently is not available. Of particular interest is that the analyses would

differentiate nonrecurring changes from recurring changes, and operating changes from nonoperating changes.

10. All analysts we spoke with were satisfied with the analyses of changes being performed for significant accounts only.

11. Many analysts felt strongly that this information must be provided quarterly in order to be useful. However, some analysts felt this information was sufficient in annual filings only.

12. Some of the users we spoke to recommended modifications to the guidance as follows:

(a) Gross balances should be disaggregated when an account is reported net of an allowance/reserve so that the flows of each portion of the balance could be analyzed (for example, Accounts Receivable and the Allowance for Doubtful Accounts disclosed in separate columns).

(b) An individual SFP line item that has separate components should be analyzed in several columns (for example, Accrued Expenses).

Other Input Received During Outreach Activities

Auditors

13. During our meetings held with the Big 4 public accounting firms, the firms were supportive of the objective of the analyses of changes, but also felt that a modified approach that focused on significant unusual activity would provide more benefits at a substantially lower cost. The issues are summarized as follows:

(a) Considerable judgment would be necessary in assessing whether their clients have selected the appropriate accounts to include in the analyses of changes.

(b) There is a potential lack of precision regarding unexplained variances and “other” changes in the analyses.

(c) Substantially all multinational and multi-subsidiary clients would have to implement a considerable number of controls at each business unit where account reconciliations are performed.

(d) Additional audit costs could be significant based on the size and complexity of the company. This is because of the need to test new internal controls, the new figures to be disclosed within all of the analyses of changes, and the IT system upgrade and conversion costs at the time of adoption.

(e) Several of their clients indicated that difficulties will arise in preparing the analyses of changes due to foreign transaction gains and losses, and post-closing adjustments that are booked centrally.

Field Test Results and/or Feedback

14. Field test findings were consistent with the observations from the field visits described above.

Financial Service Entity Issues

15. All financial services entity analysts agreed that the analyses of changes will be very helpful to their analysis. There was consensus that information about loans and securities (trading, available-for-sale and held to maturity) is most important, by class (commercial mortgage, residential mortgage). Some of this information will be provided as part of the guidance recently issued by the FASB on credit quality disclosures.

16. Financial services entity analysts did not think that the analysis of changes should be expanded to include all asset and liability line items on the SFP.

17. An insurance analyst noted that deferred acquisition costs, securities, and commercial mortgages are already rolled forward but that an analysis of changes of insurance liability reserves would be useful.

STAFF ANALYSIS AND POSSIBLE MODIFICATIONS

18. Substantially all participants in our outreach activities indicated their support for disclosing additional information that will assist a user in better understanding significant, unusual, and nonrecurring changes and reclassifications in asset and liability line items.

19. However, many preparer participants suggested that the disclosure requirement in the Staff Draft is too costly and that the disclosure requirement should be modified.

20. During our outreach activities, both preparers and users of financial statements indicated that information about the following types of changes would be most useful and generally is currently available:

    (a) Foreign exchange translation adjustment

    (b) Changes in balances due to acquisitions and dispositions

    (c) Reclassifications

    (d) Unusual or infrequently occurring events such as impairments and settlements.

21. Preparers said that requiring the analyses to contain information about recurring cash and noncash transactions (such as sales, material purchases, payments against accrued expenses, depreciation expense and interest expense) would provide information about recurring operations that is less useful, and in many cases will be very costly to prepare.

22. Thus, the staff may ask the boards to modify the guidance in the Staff Draft to include amounts contained in the Analyses of Changes notes that users have indicated are useful and that preparers have indicated would not be as costly to provide, and remove requirements to present information that has been indicated to be most costly and less useful.

23. The staff may ask the boards to consider requiring a disclosure containing a prescribed list of items that affect SFP balances. Those items may be:

(a) Foreign exchange translation adjustments

(b) Remeasurements (including impairments and write-downs)

(c) Reclassifications

(d) Changes in balances from acquisition and disposition transactions

(e) Other items that management believes are important in understanding the changes in SFP line items.

24. Another alternative the staff may ask the boards to consider would be to develop a principle to capture changes in SFP line items that are not “routine” transactions that flow through those accounts. The principle would be intended to capture the items listed in letters a-e in the previous paragraph while not providing a prescribed list.

25. The staff thinks considering these modifications would be responsive to the cost concerns raised during the outreach period while still retaining many of the beneficial aspects of the analyses of changes disclosures.