Project	**Financial Statement Presentation**
Topic	**Appendix G – Field test activities**

INTRODUCTION

1. The purpose of this appendix is to provide the boards with information about the field test activities related to the Staff Draft on Financial Statement Presentation (FSP)

2. The field test focused on the following four distinct participant groups:

   a. Preparers that participated in the field test of the October 2008 Discussion Paper (DP)
   b. Private company preparers
   c. Lenders affiliated with the RMA trade association[1]
   d. Banking preparers

3. Field test activities took place from July 2010 until December 2010. These activities included weekly Webex conference call sessions, surveys, other correspondence and analysis of and follow-up on input received.

FIELD TEST RESULTS

Discussion Paper Follow-Up Group

4. Thirty preparers that participated in the field test of the DP were asked to participate in a follow-up survey related to the June 2010 Staff Draft. Thirteen completed the survey. One provided their feedback in the form of written commentary rather than completing the survey. Feedback from the written commentary incorporated in the summary of participant responses where possible.

[1] The Risk Management Association (RMA), a member-driven professional association, helps banking and nonbanking institutions identify and manage the impacts of credit risk, operational risk, and market risk on their businesses and customers.

5. The composition of the respondents in the DP follow-up field test group are as follows:

Number of Participants	Geographic Location
6	Asia
3	Europe
4	North America

6. The survey focused on areas that changed between the Discussion Paper and the Staff Draft. Some of those changes were based in part on the feedback received from this former field test group. Participants read the Staff Draft and revised their financial statements from the initial recasting exercise for the DP. Due to issues with market listing rules (i.e. Regulation FD) participants did not submit those recast statements to the project team as part of the follow-up field test.

7. The purpose of the follow-up survey was to determine:
    a. Whether the participants thought the changes made to the DP and reflected in the Staff Draft were responsive to the concerns they raised during the DP field test
    b. Whether the amended presentation model was more operational and less costly than the model proposed in the DP.

8. Overall, the respondents in the follow-up group did not view the proposals in the Staff Draft as addressing the concerns they raised about the DP. Additionally, the respondents are of the opinion that the cost and time necessary to implement the proposals in the Staff Draft will cost the same as or more than the proposals in the DP. Many expressed concerns that the Staff Draft proposals would require substantial process and control changes, increase the level of manual intervention in the reporting process and increase time needed to report results.

Statement of Cash Flows

9. Respondents in this field test group were most vocal about the continued focus on the direct method SCF. The respondents did not believe that the revised direct-method SCF

Disaggregation

10. Participants believed that applying the guidance proposed in the Staff Draft would still result in too much disaggregation in the primary financial statements and/or in the notes overall. Nearly all respondents do not think that using the "economic characteristics or attributes" as a basis for disaggregation is operational. Two-thirds of the respondents agreed that requiring functional amounts to be further disaggregated into relevant components (rather than by function further disaggregated by nature) would be sufficient. The term "relevant components" was not defined in the questionnaire. Three-fourths of the respondents also agreed that the requirement to disaggregate by-function income and expenses further by nature is redundant given the overall disaggregation principle proposed in the Staff Draft. The staff interprets these results as an indication that respondents are not necessarily opposed to additional disaggregation in the financial statements, but our current proposal of secondary disaggregation by nature as currently defined in the Staff Draft is not operational.

11. When asked whether the segment note provides the appropriate context for an additional level of disaggregation about 40% of the participants agreed. However, most participants were not in favor of requiring all entities to further disaggregate income and expenses in a single note. Most of the participants agreed that the relationship between additional disaggregation of income and expenses was more important to segment activity than functional activities. The staff interprets these responses to indicate that the preparers are more open to by-nature disaggregation presented in context of their business units

12. One participant commented “We expect users, in particular financial analysts, to be strongly focused on the segment reporting information and in this regard this presentation needs to be most transparent and decision-useful for the user.” Additionally, this participant also commented “To the extent the segment reporting would not be overloaded and if based on management’s assessment for some preparers further disaggregation by-nature could possibly allow an entity to better depict economic characteristics and attributes that are specific to the various segments and, therefore, such information could be relevant and decision-useful for the user.” This participant advocated providing preparers with an option to present disaggregated information by-nature either in a single note or in the segment disclosure.

13. Discussions during field testing indicate that some participants have an understanding of why the segment disclosure provides context for further disaggregation for complex entities. However, most perceive a disconnect between the current objectives of the segment disclosure and the objectives of the FSP project. There is much concern that the segment note is based on management’s views of the business and the FSP requirements would force more GAAP measures into the segment note and take away from the segment information management is trying to convey. Many participants indicated that they do not currently capture the additional information necessary to comply with the requirements of the Staff Draft and most of the by-nature information would be subjective allocations which could be misleading to the users.

Categorization

14. Four-fifths of the respondents thought the operating category and the debt category were appropriately defined in the Staff Draft. Two-thirds thought the investing category was appropriately defined. Although the respondents thought the operating, debt and investing category were appropriately defined, most (about 60%) thought the application of the definitions would not enhance comparability. However, in reviewing the

15. Examples of aspects of the Staff Draft that influenced the participants views on comparability are:

    a. Some participants interpreted the guidance (and illustrations) related to investments in associates to mean that all equity investments in associates were to be classified in the investing category. This misinterpretation lead some participants to comment that investments in associates related to the operations of the company should be classified in operating, and the classifying all of these types of investments in the investing category would affect comparability between entities.
    b. The elimination of the cash equivalent term and classifying and disaggregating items formerly in this line item was seen by some participants as negatively affecting comparability. Many respondents commented that they view these items as cash, and the cash and items in the current cash equivalents line item should be classified in the same category.
    c. At least two participants expressed concern that the additional disaggregation requirements will negatively affect comparability between entities. One participant explained that requirements in the Staff Draft will lead to highly disaggregated financial statements with line items being influenced more by the form of transaction rather than its substance. Examples given included "the disclosure of cash payments for a commercial entity that purchases finished goods from a contract manufacturer would be significantly different from a vertically integrated entity in the same industry that manufactures the same type of goods. One of these entities would provide much greater disaggregation of their cash flows despite the fact that they are in the same line of business…. Similar concerns could be raised across a variety of transaction classes, such as employment arrangements, transportation and logistics costs, advertising and marketing expenses, and payments to outsourced providers."

16. The majority (about 60%) of participants did not think the Operating Finance Sub-Category was appropriately defined. There was no consensus as to whether they thought it was too loosely defined or too strictly defined. One participant stated they did not think this sub-category was particularly useful or helpful in reflecting economic reality. A few of the participants expressed concern that this sub-category could be misleading to investors.

17. One participant stated that "reporting the interest cost and/or the actuarial amortization components of a defined benefit plan expense in a different location than expenses related to a defined contribution plan will reduce comparability among companies and does not align with management's view of the financial performance of the Company."

Analyses of Changes

18. About 60% of the respondents do not think the analysis of changes disclosure is an improvement over the reconciliation schedule proposed in the Discussion Paper. In addition, about three-fourths do not think the factors to determine whether to provide an analysis of changes for an asset or liability line item as proposed in the Staff Draft are operational. While the participants agreed with the removal of the reconciliation schedule from the Staff Draft, several participants commented during the field test that in order to get the information to prepare the analysis of changes, they would have to capture information at the transaction level, specifically to identify the cash activity, much like they would have to do for the reconciliation schedule.

Remeasurements

19. Three-fourths of the participants indicated that the definition of remeasurements in the Staff Draft is not operational. Nearly all of the participants believed the proposed note disclosing remeasurement information is redundant with existing required fair value disclosures. None of the participants believed the additional disclosure will provide information that is useful in understanding their financial results.

Private Company Field Test Group

20. Twelve private companies agreed to recast two consecutive years of financial statements in accordance with the Staff Draft. These companies were U.S. based and not complex in nature. Most of the companies did not provide segment disclosures. Ten companies completed the field test recasting work and submitted financial statements to the staff. Eight of the participants completed the post completion survey. The recasting work and survey was completed by the company's accountant or auditor who is affiliated with the AICPA Technical Issues Committee (Private Company Practice Section). Financial statements were received from companies in the following industries:

    a. Hedge fund
    b. Regulated gas utility
    c. Software
    d. Energy
    e. Office furniture manufacturing
    f. Retail
    g. Construction
    h. Banking
    i. Insurance
    j. Supply chain management (service).

21. The non-recast and recast financial statements and notes were reviewed and assessed by commercial credit lenders using the Risk Management Association's (RMA) standardized credit risk-rating system and a standardized worksheet for recording the borrower grade and components. RMA's credit risk-rating system used a uniform framework and common language for assessing the credit risk of the participating private companies. RMA managed the lender review process for the field test.

Preparer Group-Private Company Recasting Exercise

Categorization

22. The private company preparers responded similarly to the DP follow-up preparers with regard to classification as proposed in the Staff Draft; the majority agreed that the sections and categories were appropriately defined. However, in a difference from the DP follow-up group, they did believe the classifications would enhance the comparability of financial statement information between similar entities. Many of the participants in this group did not agree with the separation of cash and cash equivalents into different categories. In addition, many participants interpreted from the definition and the illustrations in the Staff Draft, that all equity method investments were to be categorized in the investing category.

23. All of the private company participants indicated that they experienced issues in classifying their company's assets and liabilities and those issues were moderately difficult to difficult to resolve. Most did not have difficulties in classifying income, expenses, gains, losses or cash flows.

Disaggregation

24. Most of the private company preparers indicated they did not have any difficulty disaggregating by function, nature, or measurement bases. Nearly all indicated that the application of the disaggregation guidance in the Staff Draft either had no effect or detracted from their ability to communicate their company's financial results from their recast financial statements and notes. Half of this group thought the disaggregation guidance resulted in too much disaggregation overall. Most agreed that the general disaggregation principle is useful in establishing a mindset in which to approach presentation of financial information in the financial statements. Overall, this group indicated that the specific disaggregation guidance provided for each financial statement would not result in an appropriate amount of disaggregation in those statements.

25. Field test results regarding outsourced activities, cohesiveness, and remeasurements were inconclusive because only one participant responded to questions on those topics.

Cash Flow Statement

26. The majority of respondents in this group thought the recast statements communicate the cash flows of their company “the same as” or “worse than” the non- recast statements.

Remeasurements

27. Five out of 8 participants responded in the survey that they thought the proposed definition of remeasurements is operational. Seven out of 8 thought the factors to determine whether to provide an analysis of changes for an asset or liability line item are also operational. However, most (5 out of 8) did not think that the proposed note disclosing information on remeasurements will provide information that is useful in understanding their company’s financial results.

User Group- Private Company Financial Statements

28. RMA selected banks associated with the trade association to review the recast and non-recast financial statements of the private company participants. The banks were instructed by RMA to perform a credit risk analysis and develop a borrower grade of the company like they would for any prospective or existing commercial client. Each reviewer either saw the non-recast or recast financial statements of a particular company, but not both.

29. To ensure consistency among the different banks, RMA’s 10 Point Risk Rating System was provided to and used by the participating banks during the exercise. This Risk Rating System included an overall credit rating that was based on the following seven areas of consideration:
    a. Industry/Industry Segment
    b. Position within Industry
    c. Earnings and Operating Cash Flow
    d. Asset and Liability Structure/Values

e. Debt Capacity/Financial Flexibility
f. Management and Controls
g. Quality of Financial Reporting

30. Five of the seven areas of consideration for the risk rating could potentially be affected by the reporting model proposed in the Staff Draft. Two areas of consideration, the "management and controls" section which is an assessment of the management team and internal controls and the "quality of financial reporting" assessment which considers the type of audit report the entity received from its external audit firm, would not be directly affected by the proposals in the Staff Draft.

31. The following criteria are from the remaining areas of consideration and provide an indication of the types of information the credit provider finds decision-useful:
    a. How vulnerable are the company's revenues and costs to industry cyclicality and sudden economic or technological change?
    b. Are the costs of operations dependent on the price level of a key commodity (ie energy, agricultural product, interest rates)?
    c. Are the revenues or costs dependent on access to a foreign country?
    d. How capital intensive is the business?
    e. What is is operating leverage?
    f. Is the company a pricing leader?
    g. Is the company a low-cost producer?
    h. How strong are the company's industry performance ratios?
    i. How strong is the company's earnings trend?
    j. What is the quality of earnings?
    k. Does the company have substantial excess cash flow?
    l. Does the company have substantial excess interest coverage?
    m. Are the company's assets of a high quality and fairly valued?
    n. How much of the company's assets are intangibles?
    o. How well does the company's liability structure fit its asset structure?
    p. What is the leverage of the company related to the rest of the industry?
    q. Does the company's long-term debt carry a favorable public rating?

r. What is the company’s debt capacity?

32. Forty two independent reviews were completed by the participating banks; 22 reviews of the non-recast financial statements and 20 reviews of the recast financial statements. There were no discernable differences in the borrower grades between the non-recast statements and recast statements. The average overall borrower grade for the non-recast and recast groups was “5” on the 10 point scale.

33. The credit scoring participants indicated that they found the format of the recast statements difficult to work with which is at least partially attributable to the unfamiliarity of the proposed format. As a result, many said they had to spend more time looking for the pieces of information they needed. However, these participants preferred the direct method cash flow presentation for their analysis as long as they understood what types of cash flows would be categorized into each section and category.

Results from Bank Preparers

34. Fifteen banks and credit unions (banks) agreed to recast their financial statements in accordance with the Staff Draft. The banking participants included U.S. credit unions, Australia/New Zealand commercial banks and a global US based commercial bank. Due to regulatory concerns, the banking participants were asked not to submit their recast statements to the staff. Five of the banks completed the post completion survey.

Categorization

35. Of the participants that completed the survey, most thought the sections and categories were well defined and that the application of those definitions would enhance the comparability of financial statement information between similar reporting entities. The survey results indicate that the issues encountered by the banks in classifying the company’s assets and liabilities were more difficult to resolve than as indicated by the other two test groups. This is consistent with questions and discussions that took place between the participants and the staff during the recasting exercise. Generally, the

36. Like the other field test groups, this group did not think the classification approach in the Staff Draft enhanced their ability to communicate their company's financial results---with the exception of the statement of comprehensive income. Four out of the five respondents indicated that they thought the classification of the statement of comprehensive income would enhance their communications. The other respondent indicated it would not affect their ability to communicate the company's financial results.

Disaggregation

37. This group of survey respondents did not indicate difficulties applying the disaggregation criteria and most indicated that they thought the implementation of the disaggregation guidance enhanced the communication of their company's financial results overall, except for the statement of financial position. Three out of the five thought the application of the disaggregation guidance resulted in an appropriate amount of disaggregation in the financial statements overall. Two of the five thought it resulted in too much disaggregation overall. However, open-ended comments indicated that some thought specific financial statements (statement of financial position, statement of cash flow) and some sections (tax) had too much disaggregation.

38. Four out of five respondents thought the general disaggregation principle is useful in establishing a mindset in which to approach the presentation of financial information in the financial statements. There was no agreement on the usefulness of the specific disaggregation guidance provided for each financial statement.

39. Three of the respondents indicated they preferred the format proposed in the Staff Draft (Bank Corp.) for the SFP over alternative SFP provided in the Staff Draft. Participants think the additional categories in the statement of financial position make the statement more visually complex with too many line items and subtotals which detract from the financial statements overall.

Cohesiveness

40. No inferences can be made from the responses to the survey questions that specifically addressed regarding cohesiveness because only three respondents answered those questions. However, in a summary question in the survey, increased cohesiveness was ranked second most useful aspect of the proposed model (along with increased disaggregation). The separation of business and financing was ranked the most useful aspect of the proposed model in terms of communicating their company's financial results.

41. In an open-ended question, cohesiveness was identified by 4 out of 5 respondents as an aspect of the proposed model that they embraced as an improvement in financial statement presentation over what is done today. The aspect identified as not an improvement over what is done today was (too much) disaggregation.

Statement of Cash Flows

42. The banking test group thought the approach to classification and the implementation of the disaggregation guidance enhanced their ability to communicate their company's financial results. Three out of five respondents in this group also thought the reconciliation of income or loss from operating activities to net cash flows from operating activities is integral to understanding cash flow information about their company. However the direct method of presenting cash flows was ranked only the 4th most useful aspect (out of 5 choices provided) of the proposed presentation model.

Remeasurements

43. The banking test group survey results were divided on whether the proposed definition of remeasurments is operational. However, the survey results did indicate that these respondents thought the proposed note disclosing information on remeasurements was redundant with existing fair value disclosures and would not provide additional information that is useful in understanding their company's financial results.

Analyses of Changes

44. Most of the respondents thought the factors that an entity would use to determine whether to provide an analysis of changes for an asset or liability line item are operational. However, there was no clear consensus as to whether the analysis of changes disclosure is useful in communicating financial results.

Other

45. Many of the banking participants were credit unions that do not provide segment disclosures. Therefore, the survey questions about presenting by-nature information in the segment note were predominately answered as “not applicable”.

46. The banking participants indicated that the recast financial statements most clearly identified the results of their financing activities. The clarity of non-core operations ranked second while clarity of core operations results was ranked third. The clarity of the banks liquidity and financial flexibility was ranked last.

47. One banking participant identified three existing accounting issues specific to the financial services sector that are resolved by the proposed model, and in some cases exacerbate the current reporting issues. The issues identified are:
    a. Insurance: differentiating between activities attributable to policy holders and activities attributable to shareholders
    b. Banks: differentiating between liabilities arising from deposits, securitization and capital funding
    c. Differentiating between assets required for regulatory capital adequacy requirements and assets representing other shareholder funds.

48. The banking field test group indicated that they thought overall, the recast financial statements communicated their company’s results “the same as” or “better than” the non-recast statements—specifically the results of financing activities and the cash flows of their company. The survey results for the other two preparer test groups were skewed towards “the same” as or “worse than” the non-recast statements.

GENERAL SUMMARY

49. The alignment of financial information across the various statements were viewed as useful by the preparers, while the users that participated in the field test appeared be oriented to finding specific pieces of information within the statements.

50. All participants expressed concern that the disaggregation guidance currently in the Staff Draft would result in too much disaggregation and would detract from the understandability of the financial statements as a whole.

51. The DP follow-up participants and the banking preparers expressed concern that the proposed model would not promote comparability between like companies or like industries and that the form of individual arrangements and transactions rather than their substance, could influence the classification of items between companies. Users appear to require some uniformity as to where particular asset or liability information is located.

52. Preparer's that participated in the field test do not think the direct method cash flow presented in the Staff Draft represents an improvement over that presented in the Discussion Paper. Preparers indicated that they want as much of the financial reporting information to flow through controlled, documented systems and processes. Introducing manual intervention or manipulation increases the risk for errors and the additional processes required to reduce that risk negatively affect a company's reporting timeframes.

53. Participants understood the reasoning in the Staff Draft for presenting by-nature and other information in the segment disclosure. Regardless of that understanding, many thought any changes to the information in the disclosure should be addressed in a modification to the standards specific to segment disclosures.