FINANCIAL ACCOUNTING STANDARDS BOARD

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Project	**CF: Conceptual Framework**
Topic	**Presentation—Tentative Decisions to Date**

Introduction

1. *Presentation* refers to display of line items, totals, and subtotals on the faces of the statements of financial position, financial performance, cash flows, and equity. The line items[1] displayed on the face of those statements represent recognized assets, liabilities, income, expense, gains, losses, equity items, and investments by and distributions to equity holders.

2. Concepts Statement 5 addresses financial statements that should be presented and how those statements contribute to the objective of financial reporting. However, the Board has decided there are two questions not addressed in Concepts Statement 5 that should be addressed in a Concepts Statement:

   (a) In which line item (or line items) should individual recognized items be included?

   (b) How should line items be ordered or grouped?

3. This paper describes two very broad concepts that the Board has decided to develop in addressing the questions above. For the purpose of this paper, the term *financial statements* does not include the notes.

[1] In this paper, the term *items* refers to individual transactions or balances, and the term *line items* refers to groups of items that appear as individual amounts on the face of financial statements.

Developing the Concepts

4. The underlying concepts described in this paper were developed from two basic facts. First, the information in the financial statements is fundamental to a resource provider's decision making, but the information that can be provided in that form is inherently limited. In concept, any individual recognized item could be a separate line item on a financial statement. However, all but the very smallest possible reporting entities have more balances and transactions than can be displayed individually on the faces of financial statements without making them unreasonably long and difficult to understand. Therefore, decisions must be made about how to group items. The first part of this paper discusses grouping.

5. Second, financial statements reflect different aspects of the same transactions, conditions, and circumstances affecting the entity. Many aspects of financial analysis depend on the relationships between components of different financial statements. That requires a link of some sort between changes in assets and liabilities (revenue, expense, gains, and losses) and assets and liabilities that changed. Additionally, assets and liabilities change for various reasons that need to be distinguished, including cash or noncash consequences. The second part of this paper addresses the complementary nature of financial statements.

Why is Grouping Necessary?

6. Financial statements communicate to investors, lenders, and other creditors. Financial statements provide financial information about an entity's resources, claims against the entity, and the effects of transactions and other events and circumstances that result in changes to those resources and claims. Financial statements are derived from large amounts of data in an entity's accounting records. If it is to be understandable, that information needs to be aggregated in financial statements. Oftentimes, the focus of discussion is on totals and subtotals; however, line items also are important to those who make investment, credit, and similar decisions and is the first level of aggregation.

7. Groupings in financial statements should make it easier for existing and potential resource providers to assimilate the information they need to make the assessments on which they will base their decisions. Financial analysis aimed at assessing the amount, timing, and uncertainty of (the prospects for) future net cash flows to the entity requires financial information to be grouped into reasonably homogeneous groups. In other words, line items or subtotals that consist of items that have similar characteristics in more than one respect are likely to provide more information about prospects for future cash flows than if their characteristics are dissimilar.

Concept #1—Information should be combined into reasonably homogeneous groups. Line items or subtotals that include items that are similar in more than one respect are likely to provide more information about prospects for future cash flows than if their characteristics are dissimilar.

8. The concept described above is not new. It is currently described in paragraph 20 of Concepts Statement 5. The Board has decided that the concept described above is enough to help them make decisions about how recognized items should be presented in financial statements. A list of factors, or possible groupings, to consider would be useful in a Concepts Statement.

How Should Items Be Grouped?

9. Logically, line items and subtotals should be determined based on similarities and differences in the cash inflows and outflows of each individual item. Perhaps the most obvious way to group recognized items is by the element definitions in Concepts Statement 6. However, a balance sheet with three line items—total assets, total liabilities, and total equity—is not particularly helpful in assessing the prospects for net cash flows. Similarly, an income statement with four lines—total revenue, total expenses, total gains, and total losses—is not particularly helpful. Therefore, further groupings within each of the elements must be considered.

10. The Board decided that recognized items may be grouped by the following factors:

(a) The activity from which, or within which, the item resulted
(b) The frequency with which similar items can be expected to arise in the future

(c) The origin of the item, that is, whether it is the result of a transaction, and event or a change in circumstances
(d) The types of changes in market factors, economic conditions, or other circumstances (and relative sensitivity to each one) that can affect the future cash flows related to an existing asset or liability or the frequency or amount of similar revenues, expenses, gains, or losses in the future
(e) The measurement method
(f) The contractual terms (if any) of the item
(g) The time until realization or settlement; for example, contractual maturities.

11. Although resource providers may analyze information differently, all analysis requires at least some level of aggregation of financial information. Many, if not most, financial analysis techniques involve trend analysis of transactions and events of types that tend to occur repeatedly. In fact, one may have to perform a brief trend analysis to determine whether the transactions and events occur repeatedly. Important factors in that sort of analysis are the anticipated frequency of the transactions and events.

12. Keeping items recognized as a result of transactions separate from those that result from other events, conditions, or circumstances and grouping transactions according to the frequency with which similar transactions occur is probably one of the most fundamental aspects of assessing the prospects for future cash inflows. Factors that affect that assessment include the nature of the activity from which the transaction or event occurs. Some activities are more important or more profitable to the entity than others. That characteristic has been described as central versus peripheral and/or frequent versus infrequent. Separating information as central versus peripheral and/or frequent versus infrequent is entity specific and relative to the activities of the entity. For example, entities that sell goods and services with relatively low prices would be expected to engage in transactions almost constantly. In contrast, entities that sell very expensive products or services (for example, ships or airplanes) may make relatively fewer sales as compared with high-volume retailers, even though selling activity is going on constantly. In both cases, sales are likely to be the most frequent type of transaction that results in significant cash inflows. Whether the activity is central or peripheral also is entity

specific. For example, two entities that produce similar products might have process-cost accounting systems that treat the same product differently. One might consider it a by-product.

13. Time until realization or settlement is another key piece of information that almost all resource providers focus on when assessing prospects for future cash flows. Changes in carrying amounts of recognized items also provide information to resource providers about future transactions and timing and uncertainty of (the prospects for) future net cash flows to the entity. Some common reasons for changes in carrying amounts include changes in market factors, economic conditions, or other circumstances and passages of time.

14. Putting items measured differently into the same line item will make it difficult for resource providers to assess the net cash flow prospects of an entity unless disaggregated information is provided in the notes.

15. In concept, any individual item could be a separate line item on a financial statement. However, all but the very smallest possible reporting entities have more balances and transactions that can be displayed individually on the faces of financial statements without making them unreasonably long and difficult to read. Not all of the potentially relevant information can be presented on the face of the financial statements—some must be provided in the notes. In some cases, there are choices about which information is to be provided in the financial statements and which is to be provided in the notes. Those decisions could be based on priority and prominence as well as the cost constraint, which may have to be standards-level considerations. Resource providers can always aggregate line items on financial statements or create their own subtotal, but they have no way to disaggregate information unless the information is in the notes.

16. Although line items are the primary focus in developing standards for presentation in financial statements, most financial statements include subtotals. In current practice, the activity from which (or within which) the recognized item resulted is the most common factor used to identify subtotals in comprehensive income.

Similarly, the timing of realization or settlement is the most common factor used to identify subtotals of assets and liabilities.

Complementary Nature of Financial Statements

17. The objective of financial reporting is to provide information to help investors, creditors, and other lenders assess the amount, timing, and uncertainty of (the prospects for) future net cash flows to the resource provider. Financial statements individually and collectively contribute to meeting the objective of financial reporting by providing information about the resources of the entity, claims against the entity, and changes in the resources and claims and how efficiently and effectively the entity's management has used the entity's resources.

Concept #2—The association between changes in assets, liabilities, and equity instruments and the assets, liabilities, and equity instruments that changed should be made apparent in the financial statements (or in the financial statements and notes).

18. Financial statements complement each other. There are probably a variety of ways in which this could be accomplished in a standards-level financial statement presentation project. The concepts project will address the complementary nature of financial statements and general ways to further that objective. We expect that changes may occur over time (evolution instead of revolution), and we will not attempt to envision an end state or even a series of interim steps.