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FASB and IASB Issue Discussion Paper on Financial Statement Presentation

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Overview

In a first step toward the creation of a new standard, the FASB and IASB have issued a Discussion Paper¹ on financial statement presentation. The new standard would require an entity to present a single set of financial statements that more clearly and cohesively depicts its financial picture. The boards believe that a single financial statement presentation model would enhance the usefulness of financial information by increasing financial statement comparability and consistency within and across entities. Key proposals in the Discussion Paper are summarized below.

Statement of Financial Position

- The financial statement will no longer be grouped as it currently is, with all assets presented together, all liabilities presented together, and equity; rather, assets and liabilities will be presented according to major activity (operating, investing, and financing categories).
- Assets and liabilities will be further classified as short-term or long-term (subcategories) within each category or in order of liquidity (if more relevant).
- Totals for assets and liabilities and subtotals for short-term and long-term assets and liabilities will be required in the statement or in its notes.

Statement of Comprehensive Income

- Entities will be required to present a single statement of comprehensive income; items of other comprehensive income will be presented in a separate section of the statement.
- The statement will be grouped using the same categories as those in the statement of financial position.
- The statement will include a subtotal of "profit or loss" or "net income" and a total for "comprehensive income" for the period.
- Line items on the statement will be further disaggregated by function (i.e., cost of sales or administration) and nature (i.e., materials, labor and depreciation) when such presentation will enhance the usefulness of the information to financial statement users in predicting future cash flows.

¹ FASB Discussion Paper, *Preliminary Views on Financial Statement Presentation*; IASB Discussion Paper, *Preliminary Views on Financial Statement Presentation*.

In working to develop a single, comprehensive financial presentation standard that will provide a cohesive and integrated financial picture of an entity, the boards have outlined three financial statement presentation objectives.

Statement of Cash Flows

- Entities will separately present the main categories of their cash receipts and cash payments for operating activities (i.e., direct method) rather than reconciling net income to net operating cash flows (i.e., indirect method).

Notes to the Financial Statements

- Entities will be required to disclose in their accounting policy footnotes the rationale they used to classify their assets and liabilities into categories and sections in the statement of financial position.
- A new schedule that reconciles cash flows to comprehensive income and that disaggregates income into cash, accrual other than remeasurement, and remeasurement components will be required.

Affected Entities

All entities except for the following would be required to apply the proposed presentation model:

- Not-for-profit entities.
- Entities in the scope of the IASB's forthcoming standard on private entities.
- Nonpublic entities that use U.S. GAAP.²
- Benefit plans within the scope of IAS 26³ or Statement 35.⁴

The boards did not specifically discuss whether the proposals in the Discussion Paper would apply to nonpublic entities. The boards will address this after they have received comments on the Discussion Paper and they have determined, for example, whether the needs of users of nonpublic entity financial statements are different enough from those of users of public entity financial statements to warrant a different presentation.

Objectives of the Financial Statement Presentation Model

Because the guidance on financial statement presentation in U.S. GAAP and IFRSs is limited and allows entities to present financial information in various forms, inconsistencies have resulted within and among entities. In working to develop a single, comprehensive financial presentation standard that will provide a cohesive and integrated financial picture of an entity, the boards have outlined three financial statement presentation objectives. The Discussion Paper states that these objectives are that financial statement information should be presented in a way that:

- Portrays a cohesive financial picture of an entity's activities.** A cohesive financial picture means that the relationship between items across financial statements is clear and that an entity's financial statements complement each other as much as possible.

² Footnote 4 of the Discussion Paper states, "A nonpublic entity is any entity other than one (a) whose debt or equity securities trade in a public market either on a stock exchange (domestic or foreign) or in the over-the-counter market, including securities quoted only locally or regionally, (b) that is a conduit bond obligor for conduit debt securities that are traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local or regional markets), (c) that makes a filing with a regulatory agency in preparation for the sale of any class of debt or equity securities in a public market, or (d) that is controlled by an entity covered by (a), (b), or (c)."

³ IAS 26, *Accounting and Reporting by Retirement Benefit Plans*.

⁴ FASB Statement No. 35, *Accounting and Reporting by Defined Benefit Pension Plans*.

- b. **Disaggregates information so that it is useful in predicting an entity's future cash flows.** Financial statement analysis aimed at objectives such as assessing the amount, timing, and uncertainty of future cash flows requires financial information that is disaggregated into reasonably homogeneous groups of items. If items differ economically, users may wish to take that into account differently in predicting future cash flows.
- c. **Helps users assess an entity's liquidity and financial flexibility.** Information about an entity's liquidity helps users to assess an entity's ability to meet its financial commitments as they become due. Information about financial flexibility helps users to assess an entity's ability to invest in business opportunities and respond to unexpected needs.

Presentation Format

To achieve these objectives, the boards have proposed a presentation format that is based on a "management approach" to classification. The approach would require an entity's management to "classify its assets and liabilities into the sections and categories in the statement of financial position." According to the Discussion Paper, "that classification will determine the classification in the statements of comprehensive income and cash flows." The classification is based on how the entity uses its assets and liabilities and how it views its activities. Management will be required to disclose its rationale for the classification in the financial statement footnotes as an accounting policy decision.

According to paragraph S4 of the Discussion Paper:

- a. An entity should further separate information about its business activities by presenting information about its operating activities separately from information about its investing activities.
- b. An entity should present information about the financing of its business activities separately depending on the source of that financing. Specifically, information about nonowner sources of finance (and related changes) should be presented separately from owner sources of finance (and related changes).
- c. An entity should present information about its discontinued operations separately from its continuing business and financing activities.
- d. An entity should present information about its income taxes separately from all other information in the statements of financial position and cash flows. In its statement of comprehensive income, an entity should separately present information about its income tax expense (benefit) related to:
 - (1) Income from continuing operations (the total of its income or loss from business and financing activities)
 - (2) Discontinued operations
 - (3) Other comprehensive income items.

Management will be required to disclose its rationale for the classification in the financial statement footnotes as an accounting policy decision.

The table below is reprinted from the Discussion Paper and illustrates the proposed presentation format.

Statement of Financial Position ^[5]	Statement of Comprehensive Income ^[6]	Statement of Cash Flows
Business ^[7] <ul style="list-style-type: none"> Operating assets and liabilities Investing assets and liabilities 	Business <ul style="list-style-type: none"> Operating income and expenses Investing income and expenses 	Business <ul style="list-style-type: none"> Operating cash flows Investing cash flows
Financing <ul style="list-style-type: none"> Financing assets Financing liabilities 	Financing <ul style="list-style-type: none"> Financing asset income Financing liability expenses 	Financing <ul style="list-style-type: none"> Financing asset cash flows Financing liability cash flows
Income taxes	Income taxes on continuing operations (business and financing)	Income taxes
Discontinued operations	Discontinued operations , net of tax	Discontinued operations
	Other comprehensive income , net of tax	
Equity		Equity

Next Steps

Comments on the Discussion Paper are due by April 14, 2009. During the comment period, the boards will conduct a series of field tests to learn about the costs and benefits of the proposed presentation model. The boards will evaluate these findings, along with the comment letters received on the Discussion Paper, before the publication of an Exposure Draft of the proposed standard. The Discussion Paper is available on the FASB's and IASB's Web sites.

⁵ The Discussion Paper states that because one of boards' objectives is to present a cohesive financial picture, "an entity should align the line items, their descriptions, and the order of presentation of information in the statements of financial position, comprehensive income, and cash flows."

⁶ The statement of comprehensive income is required to include a subtotal for "profit or loss" or "net income" and a total for "comprehensive income."

⁷ Section names are in boldface and bulleted items are categories within sections. Entities are permitted to reorder the sections and categories as long as the order is consistent in each financial statement. Each section and category within a section must have a subtotal.

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