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Presentation of financial statements

In October 2008, the International Accounting Standards Board (IASB) published for public comment a Discussion Paper (DP) entitled **Preliminary Views on Financial Statement Presentation**. The DP represents the first step in the development of a Standard on this subject jointly with the US Financial Accounting Standards Board (FASB).

The IASB has requested comments on the DP by 14 April 2009.

Key proposals

This project deals with how information is presented in financial statements, and does not address how the components of financial statements are recognised and measured. Key proposals include:

- the structure of the statements of financial position, comprehensive income and cash flows would be such that a cohesive relationship would be evident across the various statements (i.e. the line items presented, descriptions used and order of presentation would be aligned);
- the format for the financial statements would be such that:
 - information about how an entity creates value (its 'business' activities) would be presented separately from information about the way it funds those activities (its 'financing' activities);
 - within business activities, 'operating' activities would be segregated from 'investing' activities; and
 - information regarding discontinued operations and income taxes would be separately presented;
- the classification of items would be based on a 'management approach', so as to reflect how assets and liabilities are used within an entity; and
- more detailed analyses would appear on the face of the financial statements.

These proposals would result in fundamental changes in the appearance of the financial statements, both as regards the structure of the statements (e.g. the segregation of assets and liabilities would mean that the statement of financial position would not necessarily present 'total assets' or 'total liabilities') and the level of detail presented.

The proposed classification scheme for financial statements is set out in Table 1 overleaf, and the following pages review the most significant proposals made in the DP.

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Table 1. Proposed classification scheme for financial statements

Statement of financial position	Statement of comprehensive income	Statement of cash flows
Business	Business	Business
<ul style="list-style-type: none"> • Operating assets and liabilities • Investing assets and liabilities 	<ul style="list-style-type: none"> • Operating income and expenses • Investment income and expenses 	<ul style="list-style-type: none"> • Operating cash flows • Investing cash flows
Financing	Financing	Financing
<ul style="list-style-type: none"> • Financing assets • Financing liabilities 	<ul style="list-style-type: none"> • Financing asset income • Financing liability expenses 	<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

Notes

- Section names are in **bold type**.
- Required categories within sections are indicated by bullet points.
- Entities would be permitted to present the sections and categories within a section in a different order as long as the order is the same in each statement.
- Each section and category within a section would have a subtotal.
- The statement of comprehensive income would also include a subtotal for profit or loss or net income and a total for comprehensive income.

History of the project

The DP relates to Phase B of a three-step joint project between the IASB and the FASB:

- Phase A resulted in the revised IAS 1 Presentation of Financial Statements issued in 2007. The key issues addressed in that revision were the titles of the financial statements, the periods for which they are required to be presented, and the two options for the presentation of the statement of comprehensive income;
- Phase B (i.e. this DP) is much more extensive in its scope and ambition. Overall, it aims to make an entity's financial statements more useful by requiring entities to provide detailed information organised in a manner that clearly communicates an integrated (cohesive) financial picture of the entity. As a result, the DP addresses numerous issues relating to the presentation and display of information in financial statements; and
- Phase C will address interim financial statements.

Objectives of the proposed presentation model

The objectives for financial statement presentation underlying the proposed presentation model (as set out in the DP) are that information should be presented in the financial statements in a manner 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;
- disaggregates information so that it is useful in predicting an entity's future cash flows; and
- helps users assess an entity's liquidity and financial flexibility.

To present a cohesive set of financial statements, entities would be required to align the line items, their descriptions and the order of presentation of information in the statements of financial position, comprehensive income and cash flows. To the extent practical, entities would disaggregate, label and total individual items similarly in each statement.

Consistent disaggregation based on ‘management approach’

The first step in the disaggregation process would be the classification of assets and liabilities in the statement of financial position as set out in Table 1. That classification would determine the classification in the statements of comprehensive income and cash flows. For example, if an asset (e.g. plant and equipment) is determined to be an operating asset, then any expense and cash flows related to that asset would also be classified as operating in the statements of comprehensive income and cash flows.

Some further sub-classifications would be required, for example:

- assets and liabilities analysed as short-term and long-term;
- assets and liabilities analysed by measurement bases; and
- income, expenses and cash flows analysed by function and nature.

The DP provides broad principles and definitions for the identification of operating, investing and financing activities. However, classification of items would be determined in the context of the way in which the entity uses the relevant asset or liability, and the way in which it views its activities, (the ‘management approach’ to classification).

An entity’s policy for classifying the components in its financial statements would be an accounting policy choice to be decided by management and would be described in the notes to the financial statements. Any change in an entity’s classification policy would be implemented through retrospective application of the new classification policy to prior periods. The IASB has not yet considered how a change in the use of an asset or liability should be presented in the financial statements, nor has it considered how an entity should allocate an asset or a liability that is used for more than one purpose (e.g. an entity’s headquarters building).

Statement of financial position

Disaggregation of assets and liabilities by nature of activities

A fundamental shift as regards the statement of financial position would be that the statement would no longer be separated primarily between assets, liabilities and equity. The proposals suggest that the statement (and, therefore, the assets and liabilities) would be presented in separate sections:

- ‘business’ (further analysed between ‘operating’ and ‘investing’);
- ‘financing’ (with separate presentation of financing assets and financing liabilities);
- income taxes;
- discontinued operations; and
- equity.

Further disaggregation into short- and long-term

Assets and liabilities presented within each section would be further analysed as short-term and long-term, unless presenting assets and liabilities in order of liquidity would provide more relevant information. The distinction between short- and long-term would be based on the shorter of (a) contractual maturity and (b) expected realisation (for an asset) or settlement (for a liability). This would replace the current segregation between current and non-current based on the entity’s operating cycle.

Further disaggregation by different measurement bases

In addition, the DP proposes that an entity should disaggregate similar assets and similar liabilities that are measured on different bases and present them as separate line items in the statement of financial position.

Total assets and total liabilities

Entities would be required to disclose total assets and total liabilities either in the statement of financial position or in the notes to financial statements. An entity that presented its assets and liabilities in short-term and long-term subcategories would also be required to disclose subtotals for short-term assets, short-term liabilities, long-term assets and long-term liabilities either in the statement of financial position or in the notes.

Statement of comprehensive income

Single statement

The DP proposes that all entities should be required to present one single statement of comprehensive income. The existing option to present the components of profit or loss in a separate income statement would be eliminated. In the statement of comprehensive income, a sub-total for 'profit or loss' or 'net income' would continue to be presented, which would be the sum of the business, financing and discontinued operations sections and related income tax amounts.

Items of 'other comprehensive income' would be presented separately in the statement. For each item in the other comprehensive income section (except a foreign currency translation adjustment relating to a consolidated subsidiary or a proportionately consolidated jointly controlled entity), entities would be required to identify and indicate in the statement of comprehensive income whether the item relates to (or will relate to) an operating activity, investing activity, financing asset or financing liability. Foreign currency translation adjustments relating to a consolidated subsidiary or a proportionately consolidated jointly controlled entity would not need to be identified with a section or category in the statement of financial position because the translation adjustment may relate to more than one category of assets and liabilities in the statement of financial position.

Disaggregation by activities, function and nature

The statement of comprehensive income would be presented in separate sections:

- 'business' (further analysed between 'operating income and expenses' and 'investing income and expenses');
- 'financing' (with separate presentation of financing asset income and financing liability expenses);
- income taxes on continuing operations;
- discontinued operations (net of tax); and
- equity.

The items of income and expenses allocated to activities (i.e. not related to discontinued operations or taxes) would be further disaggregated to the extent that this would assist users in predicting the entity's future cash flows:

- first, by function (e.g. cost of sales, selling expenses); and
- second, within the above disaggregation, by nature (e.g. materials, labour).

Income taxes

The rules for allocating and presenting income taxes in the statement of comprehensive income would remain unchanged. This could result in an entity presenting income tax expense or benefit in the discontinued operations and other comprehensive income sections in addition to the income tax section. Note, however, that income taxes would never be allocated to the business or financing sections, nor to categories within those sections.

Foreign exchange differences

The DP further proposes that an entity should present gains and losses on foreign currency transactions in the same section and category as the assets and liabilities that give rise to those differences. This includes foreign exchange differences that arise on remeasuring the entity's financial statements into its functional currency.

Statement of cash flows

Focus on movements in 'cash'

For the purposes of the statement of financial position, the DP proposes that the 'cash' line item should not include any 'cash equivalents'. For consistency, the DP would also require that an entity's statement of cash flows should reconcile the beginning and ending amounts of cash (rather than cash and cash equivalents as is currently required).

Direct method

Under the proposals, entities would no longer be permitted to use the indirect method for presenting operating cash flows. The DP would require that cash flows from all activities (including operating activities) should be presented using the direct method.

Disaggregation by activities, function and nature

As for the other financial statements, the statement of cash flows would first be disaggregated by activities, discontinued operations, taxes and equity. The proposed classification by activities would be likely to result in different classifications to those currently presented under IAS 7 **Statement of Cash Flows**, because the classification of cash flows would be based on the classification of the relevant asset or liability in the statement of financial position. For example, cash outflows relating to the acquisition of property, plant and equipment are classified as investing cash flows under IAS 7 whereas, under the proposals, if property, plant and equipment were classified as operating assets in the statement of financial position, then cash flows related to those assets would be classified as operating cash flows in the statement of cash flows.

Within each activity, the cash flows would then be further disaggregated on the same basis as in the statement of comprehensive income (i.e. first by function and then by nature) if this would help users to understand how those cash flows relate to information presented in the statements of comprehensive income and financial position.

Statement of changes in equity

The requirements for the statement of changes in equity would be largely unchanged. In particular, the principle of classification by activity would not flow through into the statement of changes in equity.

Notes to financial statements

Reconciliation schedule

The DP proposes to require (for the first time) presentation in the notes to the financial statements of a schedule that would reconcile two statements: the statement of cash flows (starting point) and the statement of comprehensive income (ending point). The components of the reconciliation (i.e. reconciling items) would be:

- cash received or paid other than in transactions with owners;
- accruals other than remeasurements (this includes depreciation and amortisation);
- recurring remeasurements for fair value changes and revaluation adjustments; and
- non-recurring remeasurements (i.e. only after a triggering event) for fair value changes and revaluation adjustments.

A detailed consideration of the format of this reconciliation is set out in Appendix B to the DP.

Accounting policies

Entities would be required to disclose the bases used for classifying assets and liabilities in the operating, investing and financing categories, and any change in those bases. This disclosure should include a description of the entity's activities and should provide users with the necessary information to understand management's approach to the business.

Contractual maturity schedules

If the entity decides to present its assets and liabilities in order of their liquidity in its statement of financial position, it would also present information about the maturities of its short-term contractual assets and liabilities in the notes to the financial statements.

All entities would also present information about the maturities of their long-term contractual assets and liabilities on an undiscounted basis.

These short-term and long-term maturity schedules would be based on contractual maturity dates, with an explanation if the expected realisation or settlement dates are significantly different.

Operating cycle

To enable users to assess liquidity and evaluate an entity's ability to meet its commitments as they fall due, the DP proposes that if an entity has an operating cycle of more than one year, the length of that cycle should be explained in the notes to the financial statements.

Illustrative examples

As will be clear from the discussion above, the proposals set out in the DP would have a fundamental impact on the appearance of financial statements. Appendix B to the DP sets out extracts from financial statements for a manufacturing entity (ToolCo) and a financial services entity (Bank Corp), which are intended to illustrate the proposed financial statement formats and proposed changes from traditional financial statement formats.

Next steps

Comments on the DP are due by 14 April 2009. During the comment period, the IASB and the FASB 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 DP, with a view to publishing an Exposure Draft in 2010.

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