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IFRS Project Insights

Financial Statement Presentation

1 March 2011

The IASB and FASB are undertaking a comprehensive project to establish a standard that will guide the organisation and presentation of financial statements. The aim of the project is to improve the usefulness of the information provided in financial statements to help users make decisions in their capacity as capital providers.

A staff draft of the exposure draft was published in July 2010, reflecting the cumulative tentative decisions reached to date on the presentation of information in financial statements. At the October 2010 joint meeting, the Boards decided to delay this project until after June 2011. The IASB and FASB staffs have performed additional outreach activities relating to the costs and benefits of the requirements in the staff draft and presented their findings to the Board at the 2 March 2011 meeting.

Summary of March 2011 Discussion

The staff discussed details of its outreach activities that consisted of preparer field visits, financial statement user meetings, field testing and other outreach with preparers, auditors, the working group, national standard setters and regulators, representative groups and users. The staff indicated that there is support for many elements of the proposals in the staff draft including the common structure, cohesiveness, increased disaggregation (though not necessarily as prescribed in the staff draft), increased information about changes in the statement of financial position line items and information about remeasurements. There was far less support for the direct method of cash flows (though many agreed the indirect method could be improved), "by nature" disaggregation within functional expense lines, cash and accrual components of the analyses of changes and a statement of financial position that does not present assets together and liabilities and equity together.

The Boards did not make any decisions but agreed that they would not be able to devote time to the project until the major projects are completed. The IASB also indicated that they will soon be seeking feedback on its future agenda.

Convergence

Although the IASB and FASB aim to establish a converged global standard that will guide the organisation and presentation of financial information, the IASB tentative decisions differ from that of the FASB in the following ways:

- The minimum line item requirements for the statement of financial position, similar to those in IAS 1, are retained;
- Information on the nature of income and expenses would be disclosed on an entity-basis rather than on a reportable segment-basis as required by the FASB; and
- Information about changes in asset and liability line items that normally constitute net debt should be disclosed as a single note, whereas the FASB does not propose similar disclosures.

Summary of proposals in the staff draft

Scope:

The principles and requirements underlying the presentation of financial statements would apply to all entities except:

- not-for-profit entities;

- entities within the scope of the IFRS for SMEs; and
- benefit plans within the scope of IAS 26 *Accounting and Reporting by Retirement Benefit Plans.*

Objectives and principles of financial statement presentation:

The core principles underlying the presentation of information in the financial statements would be articulated as:

- *Cohesiveness* – the relationship between items across financial statements should be apparent by aligning sections and categories across the statement of financial position, statement of comprehensive income and statement of cash flows in a manner that depicts the activities of the entity; and
- *Disaggregation* – information should be disaggregated in a way that is useful in predicting an entity's future cash flows. This would include information on liquidity and financial flexibility.

Separating information into sections and categories:

Information on business activities (activities that create value) would be presented separately from financing activities (activities that fund business activities).

Business activities would further be separated into operating activities, investing activities and financing arising from operating activities:

- the operating activities category would reflect the entity's day-to-day business activities that generate revenue through a process that requires the interrelated use of the net resources of the entity;
- the investing activities category would reflect the business activities that generate non-revenue income and create no significant symergies from combined assets;
- the financing arising from operating activities category would include all liabilities that are initially long-term with a time value of money component and that do not meet the definition of financing.

Financing activities would be separated based on the source of financing, i.e. owner-sources vs. non-owner sources. Equity would also be category within the financing section.

Classification of items in the financial statements would be determined by reference to the classification in the statement of financial position. Assets and liabilities would be classified in a manner that best reflects the way the asset or liability is used.

Information on discontinued operations would be presented separately from continuing business and financing activities.

Information on income taxes would be presented separately from all other information in the statement of financial position and statement of cash flows, whereas in the statement of comprehensive income, the income tax expense relating to continuing operations would be presented separately. The income tax expense related to discontinued operations and other comprehensive income items would be presented either in the statement of comprehensive income or the notes, however, any income tax expense that are required to be charged directly to equity (related to transactions with owners) would be presented in the statement of changes in equity.

Subtotals and related headings would be required for all sections, categories and subcategories.

Statement of financial position:

Assets and liabilities would be presented either into short-term and long-term subcategories or based on liquidity. Existing guidance on the classification of financial liabilities would be retained.

Cash would be classified only at the reporting entity level and overdrafts would be presented in the debt category of the financing section.

Statement of comprehensive income:

A separate exposure draft was issued in May 2010 requiring the presentation of a single statement of comprehensive income.

Income and expense items would be disaggregated by function in the statement of comprehensive income.

Foreign currency gains or losses would be presented in the same section and category as the assets and liabilities that gave rise to the gains or losses.

Statement of cash flows:

The statement of cash flows would be presented using the direct method.

The reconciliation of operating income to operating cash flows would be presented as part of the statement of cash flows.

Information on significant non-cash activities would be presented as part of the statement of cash flows.

Notes to the financial statements:

An analysis of the changes in balances of all significant asset and liability items would be presented, distinguishing between the following components:

- cash inflows and outflows;
- repetitive and routine non-cash transactions and those that are non-repetitive or non-routine;
- accounting allocations and provisions, e.g. depreciation, provision for obsolete inventory; and
- remeasurements.

Thinking ahead

- Careful consideration should be given to how assets and liabilities are used within the entity and how they are going to be allocated to the various sections, categories and subcategories across the financial statements.
- The proposals may represent a significant presentation change for investors and other stakeholders.
- Major system modifications may be required for tracking the classification of items and collating information to provide the required disclosures of changes in balances.
- Significant costs may have to be incurred for the redevelopment/redesign of templates for the publication of annual reports and financial statements.

Next steps

The Boards are not expected to make any decisions on this project until after June 2011.