



LETTER OF COMMENT NO. 21



CAMBRIDGE  
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22 March 2009

## Comments in Response to FASB/IASB Preliminary Views on Financial Statement Presentation

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### *Chapter 2: Objectives and Principles of Financial Statement Presentation*

*1. Would the **objectives of financial statement presentation** proposed in paragraphs 2.5–2.13 improve the usefulness of the information provided in an entity's financial statements and help users make better decisions in their capacity as capital providers? Why or why not? Should the Boards consider any other objectives of financial statement presentation in addition to or instead of the objectives proposed in this Discussion Paper? If so, please describe and explain.*

The objectives are useful, and they serve as a clear guide for much of the analysis in the Preliminary Views.

However, I wonder whether there are actually two objectives and not three, because the liquidity and financial flexibility objective appears to be a subset of the disaggregation

objective: if there is sufficient disaggregation to assess the amount, timing and uncertainty of future cash flows, then what additional information is required to assess liquidity and financial flexibility?

Moreover, the definitions of liquidity and financial flexibility are unclear. For example: the ability to raise capital is not a resource; liquidity as defined is probably closer to the concept of solvency, and it would be helpful to define both concepts; ‘including commitments related to operations and financing’ does not add anything explanatory; the capacity to ‘earn returns on investments’ has implications for financial flexibility but is primarily an issue of profitability; it is unclear how financial statement presentation can provide more than a limited subset of information about an entity’s capacity ‘to take effective action to alter the amount and timing of cash flows.’

I would suggest dropping the liquidity and financial flexibility objective.

Other issues in Chapters 1 and 2:

- 1.6 (and elsewhere): why is the term ‘capital providers’ used rather than simply ‘users’? ‘Capital providers’ is not synonymous with ‘investors, lenders and other creditors’ (and is ‘capital’ defined anyway?).
- 1.19: this scope clarification is very helpful.
- 1.21e: the issue of earnings per share is brushed aside too lightly. For many stakeholders, the definition of earnings is the burning issue in this project, with obvious implications for earnings per share. The Boards may not agree with stakeholders on the importance of this issue but it should at least be acknowledged and discussed rather than ruled out of scope without explanation.
- 1.22: while it is true that the project does not address recognition or measurement for individual assets or liabilities, and neither is it proposed to change the measurement of net income, there are nevertheless significant proposed changes to reported subtotals, and many stakeholders will interpret these as significant measurement changes. To avoid confusion and unhelpful debate, it is worth stating these issues more explicitly. Also, the paragraph is not correct as stated:

the definition of net income and the application of recycling are independent of the measurement of individual assets, liabilities or transactions, and it is not a necessary consequence of not changing individual measurement that there is no change to net income or to the application of recycling.

- 2.4: it is asserted that ‘the proposed presentation model should help to achieve the stewardship objective of financial reporting.’ I do not know whether this is true or not, but it is not self-evident. Either the implications for the stewardship objective should be explained and discussed, or it should be clarified that the stewardship objective has not formed part of the Boards’ deliberations.
- I am not sure how much it matters, but several of the bold-type principles are not really principles at all. For example, ‘an entity should present information about its discontinued operations separately from its continuing business and financing activities’ (2.20) is a requirement, that is presumably derived from a principle but it is not in itself a principle. (In this example, the underlying principle is presumably related to sustainability and therefore to information-usefulness.)

*2. Would the **separation of business activities from financing activities** provide information that is more decision useful than that provided in the financial statement formats used today (see paragraph 2.19)? Why or why not?*

With good reason, there is strong market demand for the separation of business activities from financing activities.

*3. Should **equity** be presented as a section separate from the financing section or should it be included as a category in the financing section (see paragraphs 2.19(b), 2.36, and 2.52–2.55)? Why or why not?*

Yes, equity should be separate. This distinction is fundamental to the Framework, it is the conceptual basis of the bottom line in the Statement of Comprehensive Income, and it is a permanent source of difference between the Statement of Comprehensive Income and the Statement of Cash Flows.

I do not understand (2.48) why dividend payments should be classified outside equity. This seems to be entirely inconsistent with the cohesion principle.

*4. In the proposed presentation model, an entity would present its **discontinued operations** in a separate section (see paragraphs 2.20, 2.37, and 2.71–2.73). Does this presentation provide decision-useful information? Instead of presenting this information in a separate section, should an entity present information about its discontinued operations in the relevant categories (operating, investing, financing assets, and financing liabilities)? Why or why not?*

This is a question of whether the primary purpose is forward-looking or backward-looking. A simple, forward-looking perspective would support separate disclosure because the discontinued operations are not directly relevant to future cash flows. They are indirectly relevant, however, because forecasts are based upon historical performance, and an entity's past effectiveness in managing a business indicates their likely future effectiveness, even if the actual businesses under management change. There are also issues of potentially opportunistic reporting if discontinued operations are 'below-the-line' as well as the question of the extent to which the stewardship objective is important, and so of the priority placed on accountability for past performance. On balance, my preference would be for separate disclosure within the relevant categories.

*5. The proposed presentation model relies on a **management approach** to classification of assets and liabilities and the related changes in those items in the sections and categories in order to reflect the way an item is used within the entity or its reportable segment (see paragraphs 2.27, 2.34, and 2.39–2.41).*

*a. Would a management approach provide the most useful view of an entity to users of its financial statements?*

*b. Would the potential for reduced comparability of financial statements resulting from a management approach to classification outweigh the benefits of that approach? Why or why not?*

I view the management approach as the most useful. Moreover, I do not see a viable alternative.

*6. Paragraph 2.27 proposes that both assets and liabilities should be presented in the business section and in the financing section of the **statement of financial position**. Would this change in presentation coupled with the separation of business and financing activities in the statements of comprehensive income and cash flows make it easier for users to calculate some key financial ratios for an entity's business activities or its financing activities? Why or why not?*

While the separate categorization of assets, liabilities and equity is easier to understand, the separation of business from financing is more useful for the informed user, especially if the statements are cohesive.

*7. Paragraphs 2.27, 2.76, and 2.77 discuss classification of assets and liabilities by entities that have **more than one reportable segment** for segment reporting purposes. Should those entities classify assets and liabilities (and related changes) at the reportable segment level as proposed instead of at the entity level? Please explain.*

Yes, entities should classify at the reportable segment level. To do otherwise would be inconsistent with the management approach. If the segments are fundamentally different from one another, then entity-level accounts are of limited use, and the user will necessarily focus on each of the reportable segments, for which the classifications of the managers of those businesses are preferable.

*8. The proposed presentation model introduces sections and categories in the statements of financial position, comprehensive income, and cash flows. As discussed in paragraph 1.21(c), the Boards will need to consider making **consequential amendments to existing segment disclosure requirements** as a result of the proposed classification scheme. example, the Boards may need to clarify which assets should be disclosed by segment:*

*only total assets as required today or assets for each section or category within a section. What, if any, changes in segment disclosures should the Boards consider to make segment information more useful in light of the proposed presentation model? Please explain.*

It is probably too early to reach conclusions on this issue, and confirmation of the entity-level model should come first. There is a case requiring segment reporting of the business category that is closely aligned with entity-level reporting but, in line with a management approach and recognising that the group structure of financing and taxation varies by entity, segment reporting should probably not be a requirement beyond the business category.

*9. Are the **business section** and the **operating and investing categories** within that section defined appropriately (see paragraphs 2.31–2.33 and 2.63–2.67)? Why or why not?*

The operating and investing categories are actually defined in terms of being core and non-core, and so they should probably be described as such. While the term operating could be retained, with the investing category perhaps being described as non-operating, it is the use of the term investing that is potentially misleading. Investment brings to mind capital expenditures made to grow the business, and it is in this sense that investing is currently used in the cash flow statement and is commonly understood. It is counter-intuitive that such investing activity would be described as operating, while other activities that are not core to the business, and may not even involve capital expenditure, are described as investing.

As to whether the categories are appropriately defined, it is consistent with the management approach to allow the separation of core from non-core, while the subjective difficulties of a 'below-the-line' category are avoided because both core and non-core are reported within the business section.

There is a loss of information, however, by removing the operating-investing distinction in the Statement of Cash Flows. There is a conceptual difference between the Statement of Cash Flows and the Statement of Comprehensive Income, which is essentially that the latter measures changes in wealth (net assets) but the former does not. The current Statement of Cash Flows acknowledges this difference by separating operating ('wealth-changing') from investing ('non-wealth-changing'). This distinction is not perfect, and of course investing decisions have consequential effects on wealth-generation and so are related, but to ignore the distinction altogether, in pursuit of the objective of cohesion, results in a loss of information. It would be worth exploring a requirement for the proposed operating category of the Statement of Cash Flows to be subdivided between operating and investing.

A problematic and contentious case is that of postemployment benefits. A first observation is that I don't see the cohesiveness principle as requiring the service cost to be classified along with the resulting liability and associated value changes and cash flows (2.46). The service cost is an operating expense that gives rise to a liability; it is not a value change on that liability. To illustrate using a comparable case, entering a finance lease gives rise to an operating asset and a financing liability, yet this is not contrary to cohesiveness (subsequent depreciation arising on the asset is, however, required by cohesiveness to be classified in the operating category). Meanwhile, the postemployment benefit liability (and of course also the assets) are decidedly non-operating in nature. There is no relationship between an entity's core business activities and gains or losses associated with postemployment benefits. Indeed, these gains and losses may well relate to business activities that no longer even exist. I suggest that, in contrast with the final sentence of 2.45, the likely categorisation identified should be operating (core) for service cost and investing (non-core) for all other components of postemployment benefits.

*10. Are the **financing section** and the **financing assets and financing liabilities categories** within that section defined appropriately (see paragraphs 2.34 and 2.56–*

*2.62)? Should the financing section be restricted to financial assets and financial liabilities as defined in IFRSs and U.S. GAAP as proposed? Why or why not?*

The proposed definitions of financing assets and financing liabilities are not very clear. Indeed, it is arguably not possible to provide a definition when the underlying management approach allows choice and variation. What is missing is greater conceptual clarification of what is meant by financing, and what the practical implications are therefore likely to be. For example, 2.34 refers to ‘whether the item is interchangeable with other sources used to fund’ while 2.56 refers to two different ways to interpret the concept of financing, namely the purpose of the funding (‘trade accounts payable may be used to fund inventory purchases (an operating function)’) and the source of the liability (‘clearly stem directly from an entity's operations’). These interpretations of financing are similar but they are not the same. Meanwhile, 2.56 also states that ‘conceptually all liabilities are sources of financing’ which seems to imply that the proposed model is not conceptual.

I doubt that that the restriction to financial assets and financial liabilities has great practical consequence, and it could be viewed as inconsistent with a management approach, but it is perhaps a helpful and innocuous clarification.

**Chapter 3: Implications of the Objectives and Principles for Each Financial Statement**

11. Paragraph 3.2 proposes that an entity should present a **classified statement of financial position** (short-term and long-term subcategories for assets and liabilities) except when a presentation of assets and liabilities in order of liquidity provides information that is more relevant.

- a. What types of entities would you expect **not** to present a classified statement of financial position? Why?
- b. Should there be more guidance for distinguishing which entities should present a **statement of financial position in order of liquidity**? If so, what additional guidance is needed?

In line with the management approach, it seems appropriate to allow the choice between a classified statement and order of liquidity. The former would be the default choice, while the latter would most likely be applied by financial institutions and perhaps also by other entities where activities differ materially from a one-year operating cycle.

12. Paragraph 3.14 proposes that **cash equivalents** should be presented and classified in a manner similar to other short-term investments, not as part of cash. Do you agree? Why or why not?

I agree. The current three-month cut-off is no more or less arbitrary or helpful than restricting the definition to cash alone; there is no way to capture liquid assets in a single, universally standard definition.

13. Paragraph 3.19 proposes that an entity should present its similar **assets and liabilities that are measured on different bases** on separate lines in the statement of financial position. Would this disaggregation provide information that is more decision useful than a presentation that permits line items to include similar assets and liabilities measured on different bases? Why or why not?

I agree that this proposed presentation would be more useful, although presumably similar assets and liabilities are typically measured on the same basis anyway and therefore the practical effect of this requirement would be limited. (I am assuming the simplest interpretation of this requirement ... if, instead, a more complex requirement is intended, for example where assets impaired to recoverable amount are treated differently from those held at depreciated historical cost, then the requirement would probably be unhelpful.)

*14. Should an entity present comprehensive income and its components in a **single statement of comprehensive income** as proposed (see paragraphs 3.24–3.33)? Why or why not? If not, how should they be presented?*

Yes. All non-owner changes in net assets should be reported in the same statement. The differences among these components of comprehensive income can be resolved by means of presentation, and associated subtotals, within a single statement.

*15. Paragraph 3.25 proposes that an entity should indicate the category to which items of **other comprehensive income** relate (except some foreign currency translation adjustments) (see paragraphs 3.37–3.41). Would that information be decision useful? Why or why not?*

Yes, this would be helpful. The need for this disclosure highlights an arguable incongruity between the cohesion principle and the other comprehensive income category, yet this position is unavoidable if the current concept of net income is retained, and the proposed disclosure is therefore a reasonable compromise.

*16. Paragraphs 3.42–3.48 propose that an entity should further **disaggregate** within each section and category in the statement of comprehensive income its revenues, expenses, gains, and losses **by their function, by their nature, or both** if doing so will enhance the usefulness of the information in predicting the entity's future cash flows. Would this level*

*of disaggregation provide information that is decision useful to users in their capacity as capital providers? Why or why not?*

This proposal would be very much welcomed by users because it would, in principle, greatly enhance the availability of information directly relevant to forecasting business performance. Consistent with the management approach, it makes sense to give primacy to reporting by function, yet to also make available the additional information available through reporting by nature.

A potentially important qualification to the above is whether, in practice, there would be a significant change in the level of reported information. The requirement to disaggregate line items to the extent that this provides useful information is not so different, actually, to the current requirement in IAS 1, yet the detail and informativeness of current disclosures is remarkably thin. It would help greatly if the Boards could find a way to reduce the effective opt-out from this requirement.

A second potential weakness in the requirement is that entities would be allowed to opt out of reporting by function. I would suggest removing this option. At the least, it is worth exploring whether there actually exist any businesses that operate without functional organization and, if so, what makes them exceptions to the norm.

It would be helpful if the definitions of nature and function could be described and illustrated more clearly. Nature and function are commonly misunderstood, and there are also situations in which the distinction is genuinely difficult to apply (such as goodwill, pension obligations and disposal losses).

*17. Paragraph 3.55 proposes that an entity should allocate and present **income taxes** within the statement of comprehensive income in accordance with existing requirements (see paragraphs 3.56–3.62). To which sections and categories, if any, should an entity allocate income taxes in order to provide information that is decision useful to users? Please explain.*

There is a conflict between users' preferences for having tax allocated to the fullest extent and the arbitrary nature (and so low information-usefulness) that can be associated with such allocations. The answer rests upon whether the allocation is meaningful, which is probably best explored in field tests.

*18. Paragraph 3.63 proposes that an entity should present **foreign currency transaction gains and losses**, including the components of any net gain or loss arising on remeasurement into its functional currency, in the same section and category as the assets and liabilities that gave rise to the gains or losses.*

*a. Would this provide decisions-useful information to users in their capacity as capital providers? Please explain why or why not and discuss any alternative methods of presenting this information.*

*b. What costs should the Boards consider related to presenting the components of net foreign currency transaction gains or losses for presentation in different sections and categories?*

This approach seems sensible and, as above, is a candidate for field testing.

*19. Paragraph 3.75 proposes that an entity should use a **direct method of presenting cash flows** in the statement of cash flows.*

*a. Would a direct method of presenting operating cash flows provide information that is decision useful?*

*b. Is a direct method more consistent with the proposed cohesiveness and disaggregation objectives (see paragraphs 3.75–3.80) than an indirect method? Why or why not?*

*c. Would the information currently provided using an indirect method to present operating cash flows be provided in the proposed reconciliation schedule (see paragraphs 4.19 and 4.45)? Why or why not?*

The direct method does correspond better to the aim of cohesiveness and users would no doubt welcome the resulting greater insight into the relationships across the statements.

The proposed reconciliation schedule probably would not provide the current information on the indirect method but there could nevertheless be a footnote requirement to disclose this information. There may be practical constraints associated with the application of the direct method, however, and these need to be explored in field tests.

*20. What **costs** should the Boards consider related to using a direct method to present operating cash flows (see paragraphs 3.81–3.83)? Please distinguish between oneoff or one-time implementation costs and ongoing application costs. How might those costs be reduced without reducing the benefits of presenting operating cash receipts and payments?*

This is a question for field testing.

*21. On the basis of the discussion in paragraphs 3.88–3.95, should the **effects of basket transactions** be allocated to the related sections and categories in the statement of comprehensive income and the statement of cash flows to achieve cohesiveness? If not, in which section or category should those effects be presented?*

I would favour allocation.

## **Chapter 4: Notes to Financial Statements**

22. *Should an entity that presents assets and liabilities in order of liquidity in its statement of financial position disclose information about the **maturities of its short-term contractual assets and liabilities** in the notes to financial statements as proposed in paragraph 4.7? Should all entities present this information? Why or why not?*

There is good reason to require this, and no obvious reason not to, yet the issue seems more appropriate for underlying standards dealing with specific assets and liabilities, rather than something for blanket coverage in a standard on presentation.

23. *Paragraph 4.19 proposes that an entity should present a schedule in the notes to financial statements that reconciles cash flows to comprehensive income and disaggregates comprehensive income into four components: (a) cash received or paid other than in transactions with owners, (b) accruals other than remeasurements, (c) remeasurements that are recurring fair value changes or valuation adjustments, and (d) remeasurements that are not recurring fair value changes or valuation adjustments.*

*a. Would the proposed **reconciliation schedule** increase users' understanding of the amount, timing, and uncertainty of an entity's future cash flows?*

*Why or why not? Please include a discussion of the costs and benefits of providing the reconciliation schedule.*

*b. Should changes in assets and liabilities be disaggregated into the components described in paragraph 4.19? Please explain your rationale for any component you would either add or omit.*

*c. Is the guidance provided in paragraphs 4.31, 4.41, and 4.44–4.46 clear and sufficient to prepare the reconciliation schedule? If not, please explain how the guidance should be modified.*

Yes, the reconciliation schedule would potentially help users greatly in understanding the amount, timing and uncertainty of future cash flows. It would no doubt take some time for users to become familiar with the information that the schedule provides, and to

develop analytical tools accordingly, but the significant increase in available information would surely be welcomed.

The reconciliation schedule as proposed makes strong implicit assumptions about an entity's ability to provide information. It is ultimately a question for field testing whether existing systems can meet the need or can reasonably be adapted.

The proposed components for the disaggregation are a good starting point for field testing. As is argued in the Preliminary Views, a case can be made for greater or fewer components, with trade-offs taking the form of greater information versus greater complexity and reduced practicality. Again, these are field testing issues; the current proposal provides a good base case for this testing.

*24. Should the Boards address further disaggregation of **changes in fair value** in a future project (see paragraphs 4.42 and 4.43)? Why or why not?*

This issue is reasonably beyond the scope of the current project but no doubt should be considered at a future date.

*25. Should the Boards consider other **alternative reconciliation formats** for disaggregating information in the financial statements, such as the statement of financial position reconciliation and the statement of comprehensive income matrix described in Appendix B, paragraphs B.10–B.22? For example, should entities that primarily manage assets and liabilities rather than cash flows (for example, entities in the financial services industries) be required to use the statement of financial position reconciliation format rather than the proposed format that reconciles cash flows to comprehensive income? Why or why not?*

This is substantially the same question as Q23 above, because each format is a variation on the theme of disaggregating rows in a columnar format.

The greatest focus for users and preparers alike is the statement of comprehensive income, and the most practical and readily understandable format in this context is the statement of comprehensive income matrix. One step up from this format in terms of information provision is the reconciliation schedule, but expanded information and increased reconciliation comes with greater complexity, in terms of user understanding and practicality of preparation. A further step up in both information and complexity is the statement of financial position reconciliation.

Field testing will be the most effective way to determine which of these three levels of information provision maximises the trade-offs between information usefulness and complexity.

*26. The FASB's preliminary view is that a memo column in the reconciliation schedule could provide a way for management to draw users' attention to **unusual or infrequent events or transactions** that are often presented as special items in earnings reports (see paragraphs 4.48–4.52). As noted in paragraph 4.53, the IASB is not supportive of including information in the reconciliation schedule about unusual or infrequent events or transactions.*

*a. Would this information be decision useful to users in their capacity as capital providers? Why or why not?*

*b. APB Opinion No. 30, Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions, contains definitions of unusual and infrequent (repeated in paragraph 4.51). Are those definitions too restrictive? If so, what type of restrictions, if any, should be placed on information presented in this column?*

*c. Should an entity have the option of presenting the information in narrative format only?*

There is no satisfactory way to define unusual or infrequent events or transactions. It is perfectly reasonable, indeed desirable, for companies to seek to explain such items and their impact on future reported performance. It is entirely undesirable, however, for such

disclosures to be formalised within the structure of the financial statements, and they should be presented separately.