

Sir David Tweedie
Chairman
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH



14 April 2009

LETTER OF COMMENT NO. 108

Dear Sir David,

Preliminary Views on Financial Statement Presentation

This is the British Bankers' Association's response to the above discussion paper. We welcome the opportunity to comment.

At the outset we must make clear that we believe that the users of financial institutions' financial statements have very different information needs to those of corporates. Viewing the proposals through this lens, we are unsure of the relevance of much of what is proposed to financial institutions and of whether the specific information needs of banking analysts have been given sufficient consideration. We therefore encourage the Boards to discuss the proposals thoroughly with the users of banks' financial statements – as well as with banks themselves – to ascertain the usefulness of the information that would be provided if the proposals were to be adopted.

Whilst we generally agree with the objectives of the project, and fully agree that a certain degree of cohesiveness in the presentation of different entities' financial statements is desirable, this must be carefully balanced with the need to permit an entity's management to present the information in a manner which it believes most faithfully reflects the entity's business model. A rigid classification or common level of disaggregation might aid comparability but it will hinder users' understanding as it is unlikely that such a classification will reflect the way the business is managed. A careful balance therefore needs to be struck. Throughout the discussion paper, however, we believe that there are too many instances where this balance is wrong. Too many of the proposals are restrictive, detailed and prescriptive. Mandatory headings, subtotals and reconciliations also call into the question whether the proposals can be applied across different industries without reducing the decision-usefulness of the information that would be presented as a result.

This is particularly so in the case of the proposed direct cash flow method. Whilst we can see this might have relevance for corporates we do not believe it is relevant for the banking industry. Financial institutions' cash flow statements provide information which is of little value in forecasting future cash flows and which gives little indication of the liquidity risks the entity faces or information on how it manages its liquid resources. Furthermore, we believe that the costs of adopting the direct cash flow method will be very high and that this expense will not result in the provision of more consistent or meaningful information. If it is the case that users groups have indicated that the direct cash flow method will help them analyse financial institutions, we would welcome an explanation of how they would plan to use the information.

Finally, we believe that comprehensive income and net income should continue to be disclosed separately. We believe that presenting the components of comprehensive income under a single statement will lead to confusion as the reader might believe the comprehensive income to represent

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the value created during the reporting period. We propose that entities should continue to be permitted to present the statement of comprehensive income under one or two headings.

In conclusion, we welcome the project but encourage the Boards to consider the specific information needs of the users of banks' financial statements and to recognise the limited relevance of the direct cash flow method for financial institutions when redeliberating the proposals.

We offer our comments on the questions posed in the discussion paper in the attached annex.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Adam Cull', with a stylized, cursive script.

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ANNEX

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.**

In our view, the key function of general purpose financial statements is to provide a framework through which the management of entities can communicate information to stakeholders in order to allow them to make economic decisions, assess the performance of management and enable them to evaluate its ability to generate future cash flows. To achieve this, information must be relevant, reliable, understandable and comparable.

Cohesiveness

We agree that it is desirable for primary financial statements to exhibit cohesiveness and that ensuring the relationship between items across financial statements is clear will improve the usefulness of the information to users but caution that the rigid application of a standard form so that all lines are presented in the same order and all items disaggregated to the same extent will not serve to improve financial reporting. In our view, the cohesiveness objective should be regarded as being of lesser importance than the need to provide decision-useful information.

Disaggregation

Whilst we fully agree that entities should disaggregate information in a manner that is useful to users we do not believe that presenting it on the face of the primary financial statements in preference to the notes is beneficial to adding users' understanding. Rather, disaggregating information into too many lines on the primary financial statement may inadvertently reduce the usefulness of the information presented. Further, we do not agree that the focus of the disaggregation objective should be limited to information that is useful in assessing future cash flows. In our view, financial statements have a broader purpose than this and suggest that paragraph 2.7 should be reworded to make clear that information should be disaggregated in a manner that makes it decision-useful to users.

Liquidity and financial flexibility

Whilst we broadly agree with the objective, in that an entity should present information in a manner that enables users to assess its ability to meet its financial commitments as they fall due and accept the reasoning behind the 'financial flexibility' concept, we note that whilst financial flexibility is defined within the FASB framework but not in the defined in the IASB Framework. We believe it should be. As with the disaggregation objective, we do not believe the liquidity and flexibility objectives should focus exclusively on future cash flows as implied by paragraph 2.13(b). We would suggest therefore that the words 'to alter amounts and timing of cash flows' be deleted from paragraph 2.13(b).

- 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?**

Commenting as we do from the perspective of financial institutions, we do not believe that the separation of business activities from financing activities will provide users with information that is more decision-useful than the current presentation method for the statement of financial position used by the majority of financial institutions. The nature of the banking industry would lead, in our

opinion, to the vast majority of activities being presented within the business activities (operating category).

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

We agree with the Boards' analysis that equity should be presented separately from the financing section. This is consistent with current practice under IFRS and is therefore familiar to users.

4. In the proposed presentation model, an entity would present its discontinued operations in a separate section (see paragraphs 2.20, 2.37 and 2.71-2.37). 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, financial assets and financing liabilities)? Why or why not?

We agree that the results of discontinued operations should be presented in a separate section. We believe that presenting this information separately is helpful to users and fits with the need for management to faithfully present its operations. It is also consistent with the objective of IFRS 5.

5. The proposed presentation model relies on a management approach to classifications 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?**

We do not believe the proposed presentation model is relevant to banks. That being said, if a breakdown were to be made, we believe that the management approach would provide the most decision-useful information to users as it enables management to show their intention in the primary financial statements.

Financial statements must reflect how assets and liabilities are used in an entity's business model. Whilst we support the production of information which is comparable, this cannot override this point. In our view, the management approach should be seen as a strategy decided and followed by management in a consistent and transparent way. We would add that we do not believe that the management approach will necessarily result in the level of comparability across financial statements being reduced.

6. Paragraphs 2.27 proposes that both assets and liabilities should be presented in the business section and in the financing section of the statement 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?

Again, from the perspective of the banking industry, we do not believe that separating information into sections and categories will provide decision-useful information for users. Indeed, we believe that a bank's activities would principally fall into one section as banks have little, if any, activities in the financing section.

- 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.**

We believe that assets and liabilities should be classified at the level of the entity and that segmental reporting should be outside the scope of this project since it is defined by another standard. The classification should be consistent with the management approach as assets and liabilities should be classified on the basis of the business model employed.

- 8. The proposed presentation model introduces sections and categories in the statements of financial position, comprehensive income and cash flows. As discussed in paragraphs 1.21(c), the boards will need to consider making consequential amendments to existing segments disclosure requirements as a result of the proposed classification scheme. For example, the boards may need to clarify which assets should be disclosed by segments: only total assets as required today or assets for each sections or category within a section, what, if any, changes in segment disclosures should the boards consider to make segments information more useless in light of the proposed presentation model? Please explain.**

In our view, segment reporting should remain at the disclosure level and not at the level of the primary financial statements, to which this project should be limited. We recommend that the Boards address the issue of segment reporting disclosures within the context of IFRS 8.

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

We welcome the fact that the definitions in paragraphs 2.31 to 2.33 are principles-based and permit management to determine what should be classified within each category in accordance with its assessment of the relevance to the central operations of the entity. We support the view expressed in paragraph 2.64 that the classification of assets and liabilities according to what management views as the central operations of the entity will provide more useful information than would a narrow or prescriptive definition of operating and investing.

- 10. Are the financing section and the financing assets and financing liabilities categories within that section defined appropriately (see paragraphs 2.43 and 2.56-2.62)? Should the financing section be restricted to *financial assets* and *financial liabilities* as defined in IFRSs and US GAAP as proposed? Why or why not?**

We do not agree that non-financial assets and liabilities should be excluded from the definition of financing assets and financing liabilities. As noted in paragraph 2.56, conceptually all liabilities are sources of finance for an entity's activities and it therefore follows that they should be labelled as such. We do not agree that 'objectivity' is enhanced if the classification process restricts certain items from a category (paragraph 2.62). It should be for management to determine which items should be included as part of the entity's financing activities and whether there are liabilities outside the scope of IAS 32 and IAS 39 which should be included in this category.

Chapter 3: Implications of the objectives and principles for each financial statement

11. Paragraphs 3.2 proposes that an entity should present a classified statement of financial positions (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 positions in order of liquidity? If so, what additional guidance is needed?**

We would not expect banks to present a classified statement of financial position. Arbitrary decisions would be required to distinguish liquidity risks into short and long term buckets and, coupled with the fact that the classifications would be very broad, would be unlikely to provide decision-useful information to users. We believe that in the case of banks, presentation in order of liquidity provides better information for users on liquidity risk.

We do not think there is a need for more guidance but do suggest that there should be a requirement for entities to explain why they have chosen the presentation approach they have and the basis used for the presentation in order of liquidity.

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?

We agree. Cash should be treated as a financial asset.

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 measure don different bases? Why or why not?

In principle, we agree that presenting similar assets and liabilities that are measured on different bases on separate lines would provide decision-useful information to users but believe that providing this information in the notes would be sufficient.

For financial institutions, we suggest that the more relevant disaggregation would involve classifying the balance sheet into financial instruments and non-financial instruments, further disaggregated according to their classification and by the type of instruments with regard to the entity's business model.

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?

No. We do not agree with the proposed single statement of comprehensive income and furthermore do not believe changes should be made to the division between the P&L and OCI without an extensive debate.

In our view, the information reported in the statement of comprehensive income (net income or profit and loss) is different in nature to the components of other comprehensive income. Aggregating non-owner changes in equity and net income together in a single statement would be misleading as some of the OCI will never become part of the P&L and OCI shows a potential benefit or loss. We

fear that users may view this total to be meaningful whilst other non-owner components such as cash-flow hedges, have been specifically excluded from the income statement because they do not contribute to the measure of the entity's performance. In our view, it would not be helpful for banks' to present results which mix recurring and non-recurring items.

We are also concerned that the proposal effectively renders the available-for-sale category redundant. Moving to a single statement of comprehensive income will eliminate the distinction between fair value gains and losses on AFS assets due to market fluctuations (currently recognised directly in equity) and the results for the period.

15. Paragraphs 3.25 proposed that an entity should indicate the category which items of other comprehensive income related (except some foreign currency translation adjustments) (see paragraphs 3.37-3.41). Would that information be decision-useful to users in their capacity as capital providers? Why or why not?

We do not believe that further disaggregation of OCI by category would be useful.

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 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?

Whilst we support disaggregation, we caution that there is a fine balance to be struck between providing users with too much data but not enough information. We therefore welcome the fact that paragraph 3.42 explicitly states the disaggregation should be to the extent that it 'will enhance the usefulness of the information' and that paragraph 3.46 notes management can present the information in the notes if they feel the statement of comprehensive income is becoming too lengthy or detracts from the overall understandability of the information. We would add to this that any disaggregation should reflect the business model of the entity.

We welcome the recognition in paragraph 3.52 that banks 'currently disaggregate income and expense items by nature only' and that requiring expenses to be presented 'separately for different functions to satisfy a by-function presentation requirement might result in less relevant information' and that this would be inconsistent with the goal of 'providing information that will be useful'. We agree.

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.

We do not support the allocation of income taxes to sections and categories and believe that disaggregation will reduce the comparability and cohesiveness of financial statements. Whilst in theory we agree that providing more details about income taxes in the same category as the related transaction would help users to assess the effectiveness of managements' decisions, we believe that in reality the total tax charge would have to be arbitrarily allocated between individual items. This would inevitably generate more complexity in the figures and would not add to users' understanding. As the Board will be well aware, income tax is not merely the sum of all income taxes resulting from each transaction but is influenced by a variety of other factors. We would add that IAS 12 disclosures – especially the reconciliation between expected and actual tax – already provide users with considerable information on the discrepancies between theoretical and current tax expenses.

18. Paragraphs 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 re-measurement 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 decision-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?**

We question whether the proposal would provide decision-useful information as it is at odds with the way FX risk is managed by banks. For instance, we believe that presenting gains and losses on foreign currency transactions in different sections and categories could lead to natural hedges under IAS 39 being presented in separate sections or categories. This may lead to higher perceived volatility when in fact there is only a presentation mismatch. Furthermore, allocations would be arbitrary and costly to implement. In our view, the current disclosures provided in the notes to financial statements provide users with adequate information. We would add that we believe that this has the potential to increase the complexity of financial statements and reduce their understandability.

19. Paragraph 3.7 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?**

(a) In the case of banks specifically, we do not believe that a direct method of presenting operating cash flows provides information that is decision-useful, although we accept that it may have some relevance to corporates where it could be used to measure an entity's performance in and outflows of inventory. For banks, cash flow statements do not provide users with information on the ability to generate future cash flows or anticipate future liquidity risks. Rather they present a limited and arbitrary view of the way in which banks operate since the proportion of transactions settled by cash or via customers' current accounts changes between periods. We would add that we believe that IFRS 7 liquidity disclosures already provide users with a sufficient understanding of the cash flow and liquidity risks faced by banks. As cash flow statements are clearly of limited value to users when assessing banks, we suggest that this requirement be optional for financial institutions.

(b) As we have made clear elsewhere, we do not believe that the cohesiveness and disaggregation objectives should be pursued at the expense of permitting management to determine the appropriate presentation. We do not therefore agree that the direct method should necessarily be viewed as being more consistent with the proposed cohesiveness objective than the indirect method. That being said, we do acknowledge that the direct cash flow method has the advantage over the indirect method that cash flows generated within the entity are shown directly without any adjustment to the cash flow statement and therefore provides users with information on an entity's complete cash flows. However, it is not the case in our view that the direct cash flow presentation method will produce information which enables users to correctly interpret current cash flows and predict future cash flows in all circumstances. For example, in the case of a bank, the direct cash flow method would overstate cash flows as processing payments for customers does not trigger any increase in a

bank's own liquidity. The information presented would therefore not be decision-useful or be in-keeping with the principle of fair presentation.

(c) As we believe the direct cash flow statement should be optional for banks, it follows that we believe that the reconciliation schedule to comprehensive income should be also.

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

We welcome the recognition in paragraph 3.83 that many preparers are concerned about the costs the proposals in the discussion paper would entail in terms of obtaining information about operating cash receipts and payments. Although costs are difficult to predict, we would expect that the majority would be attributable to the one-off adoption of the direct cash flow statement and that they would be considerable. We would expect the most complex system change to relate to the allocation of income between realised and unrealised income and expense in order to identify unrealised income. The costs would relate to one-off IT changes, tagging all cash flow information and training costs.

21. On the basis on 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?

We agree with paragraph 3.92 that allocating basket transactions would be arbitrary and would be costly to implement. Furthermore, we think that allocation of basket transactions would be at odds with the management approach as acquisitions and transactions are rarely made with specific assets and liabilities in mind but rather on a portfolio basis at the higher level of synergies and corporate strategies. We also doubt whether there will be sufficient information in practice to allocate the effects of basket transactions into sections or categories.

Of the three options for presentation, B would be our preference – presenting in the category that reflects the activity that was the predominant source of those effects – as is most consistent with the management approach. Although, as noted above, we would expect in the case of banks that most assets and liabilities would be categorised in the operating section (more consistent with option A).

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?

We agree that the disclosure of information about the maturities of short-term contractual assets and liabilities might be decision-useful information in the case of some entities. However, in the case we believe this should be linked to the presentation of the assets and liabilities in order of liquidity of financial position but rather to liquidity risk management disclosures. We would highlight that it is already common practice for banks to present a breakdown of contractual maturity based on the maturities listed in the discussion paper and therefore find the proposed changes acceptable. We suggest that the presentation could be based on IFRS7.39 and IFRS 7.B11 which already require entities to provide a contractual maturity profile for financial liabilities when disclosing their liquidity risk.

23. Paragraphs 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) 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 components described in paragraph 4.19 please explain your answer rationale for any components you would either add or omit.**
- (c) Is the guidance provided in paragraphs 4.31, 4.41 and 4.44-4.46 clear sufficient to prepare the reconciliation schedule? If not, please explain how the guidance should be modified.**

As we do not support the direct cash flow method we do not see a need for a schedule in the notes reconciling cash flows to comprehensive income. We believe that the reconciliation of net income to operating cash flows achieved by the indirect method provides information on the differences between these two items that can be utilised by users to predict future cash flows. In addition, whilst further disaggregation as called for in the discussion paper is probably possible, we are not sure that it would provide users with decision-useful information.

- (a) We do not believe that the proposed schedule is needed. Rather than increasing users' understanding and providing useful information on which to assess future cash flows, we believe the schedule might actually reduce the understandability of the financial statements and make them less useful to the average reader. We believe that a more detailed statement of comprehensive income might give users a better understanding of the detail of income than the proposed schedule of reconciliation. We would add that we believe the cost of implementing the requirements would outweigh any potential benefits to users.**
- (b) One or other of changes in the comprehensive income or changes in assets and liabilities can be disaggregated but not both. We have real concerns about the practicality of applying the proposals to financial institutions which have significant trading portfolios and question how the provision of this information would help users to better understand financial statements. The cost of providing the same information twice is excessive and would, we believe, be confusing to users.**
- (c) We do believe it is necessary to produce a reconciliation schedule.**

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?

We do not see the need for a new project on the disaggregation of changes in fair value but suggest that any concerns could be addressed through the forthcoming reconsideration of IAS 39.

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 B10-B22? For example, should entities that primarily manage assets and liabilities rather than cash flows (for example, entities in the financial position reconciliation format rather than the proposed format that reconciles cash flows to comprehensive income? Why or why not?

As we believe that the direct cash flow method is not suitable for application to financial institutions we believe the proposed reconciliation to comprehensive income is unnecessary. However, we also disagree with the statement of financial position set out in paragraph B11. It is overly complex and it

constitutes reconciliation to the direct cash flow statement. The statement of comprehensive income matrix, though, could help users to assess the persistence and subjectivity of income and expense items, but we disagree with column C which requires an indication of cash flows, which we believe is problematic for the reasons already discussed.

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?**

We agree with the IASB's position. Details about how unusual events are presented should not be prescribed. IFRS already permits information to be presented in a narrative format and in our view it should be for management to determine the most appropriate form of communicating important information to users.

Questions specific to the FASB

27. As noted in paragraph 1.18(c), the FASB has not yet considered the application of the proposed presentation model to non-public entities. What issues should the FASB consider about the application of the proposed presentation model to non-public entities? If you are a user of financial statements for a non-public entity, please explain which aspects of the proposed presentation model would and would not be beneficial to you in making decisions in your capacity as a capital provider and why.

N/A