



Memo

To: International Accounting Standards Board

From: Accounting Standards Board – Canada, Staff

Date: April 14, 2009

Re: Financial Statement Presentation

The following comprises the response of the staff of the Canadian Accounting Standards Board (AcSB staff) to the IASB's Discussion Paper on Financial Statement Presentation, dated October, 2008.

AcSB staff discussed this Discussion Paper with the AcSB's Academic Advisory Council, the AcSB's International Financial Reporting Standards Advisory Committee, the AcSB's User Advisory Council and various Canadian auditors, preparers and regulators. The views expressed in this memo take into account certain comments and perspectives raised by these constituents, though they do not necessarily represent a common view of the Board, its Committees or staff. Views of the Board are developed only through extensive due process.

Overall, we support the proposals in the Discussion Paper and, in particular, agree that the proposed objectives of financial statement presentation will improve the usefulness of the information provided in financial statements, and should help users make better decisions.

We agree that the proposed classification of items, which separates business activities from financing activities, is an important distinction in the financial statements and provides more decision-useful information than the current format does for many entities. In particular, it is formatted in a way that allows users to analyze an entity's performance independently of its capital structure, an analysis that is quite common in practice. However, we are aware that this classification scheme does not work well for financial institutions since 'investing' is a core operating activity for these entities, and it is difficult to distinguish financing activities from operating and investing activities, since they are all interconnected. Therefore, we suggest that either a separate classification scheme be developed for financial institutions, or clear guidance for applying the proposed classification scheme to financial institutions be added to the current proposals.

The distinction between the operating and investing categories in the business section is unclear. Paragraphs 2.32 and 2.33 of the discussion paper refer to the 'central purpose(s) of an entity', while paragraph 2.64 refers to 'central operations' and also to "core" and "non-core" activities. It is confusing to have three sets of terms. Presumably they are intended to be consistent, but a 'purpose' may be different to an 'operation', which may be different to an 'activity', while 'core' and 'central' may not be identical. Furthermore, none of these terms is defined. We therefore suggest that a single term be used and that a definition and application guidance be provided. Although management is given discretion to classify items to reflect how they are used by an entity, management still needs sufficiently clear criteria to apply when choosing between the categories. The lack of clarity is not helped by use of the term 'investing', which has a generally understood meaning that appears to be different to that envisioned in this discussion paper. For instance, ordinarily the term investing is associated with items where the underlying assets are passively managed. However, in this proposal, items that are actively managed could be in investing, if they are not related to the central purpose of an entity. For example, the Discussion Paper on Leases states that a right of use asset related to a lease contract might be classified as operating or investing. However, leased assets are usually not passively managed. Therefore, we suggest that the term 'investing' should be replaced, since the ordinary connotation of the definition of investing creates confusion in these proposals.

We support the proposal that equity be presented as a separate section from the financing category and agree that it better meets the cohesiveness objective of the project. Users are often equity holders to whom the separation of owner from non-owner sources of financing is important when performing their analyses.

In the proposed presentation model, an entity would present its discontinued operations in a separate section. We agree with this proposal and also feel that it is important for discontinued operations to be split into operating, investing and financing categories. This separation will provide more detailed and, therefore, better information for users. This information could be either on the face of the statements or in the notes.

We agree with the management approach to classification, since it gives management the opportunity to present the financial results and financial position of the company in the most meaningful way, taking into account the specific facts and circumstances pertaining to the company. This is also consistent with IAS 1, which allows significant management choice when presenting information in the financial statements, which is necessary if the financial statements are to be meaningful. However, the discretion inherent in the management approach may result in some companies not presenting information in the most transparent manner. For example, certain items that consistently produce positive results might be classified in the operating category, while other items with less favourable results might be placed in the investing category. Therefore, the proposed requirements for an entity to describe its classification policy and any change in its bases for classification in its financial statement notes, and the requirement to apply changes in an entity's classification policy retrospectively to prior periods is critical. We note that the boards have yet to discuss how to reflect a change in classification when an asset's or liability's use changes over time. An important aspect of this will be disclosure of the change in classification and why it was made at that particular time.

In general, the users we communicated with supported the management approach, since it enables entities to present information in a useful way. However, they are concerned about the potential for reduced comparability between entities and, in particular, between industries. This could occur as a result of the same item being classified differently by different entities or by

different segments within an entity. Therefore, users stressed the importance of clear disclosures about how items are allocated in the financial statements since this will help to mitigate the risks associated with reduced comparability. We note that comparability has been included as an enhancing characteristic in the first Conceptual Framework Exposure Draft and suggest that it be clarified as to how the likely lack of comparability inherent in the management approach is consistent with that exposure draft.

We support the discussion paper proposal that presents cash equivalents in a manner similar to other short-term investments and not as part of cash, since the risk characteristics for cash equivalents are often different than for other types of cash.

We agree with the proposal in the discussion paper that presents comprehensive income and its components in a single statement of comprehensive income. We agree that this presentation will make it easier for users to analyze the information, since it will be in one location. However, not addressing the issues related to comprehensive income, which was originally an important part of the scope of the project, is a lost opportunity, and one that the IASB should reconsider.

The discussion paper proposes that an entity disaggregate income and expense items in the statement of comprehensive income by ‘function’, a term and a basis of reporting not commonly employed in some jurisdictions. Function is defined as the ‘primary activities’ in which an entity is engaged. The Discussion Paper also uses the term ‘core activities’, which usually means the same thing as ‘primary activities’. However, the Discussion Paper uses these terms to refer to different concepts. Therefore, since the terms ‘primary’ and ‘core’ could be misinterpreted as being interchangeable, either different terminology should be used, or the terms ‘primary activities’ and ‘core activities’ should each be defined.

We agree with the underlying principle of disaggregation, but are concerned that it is too open-ended and does not provide any limits to the extent of disaggregation required. Without some limiting factors, it can be argued that further disaggregation will always enhance the usefulness of information. This makes it difficult for management to assess what the appropriate level of disaggregation is so as to achieve compliance with the proposals. We suggest that application

guidance be added on the extent of disaggregation that is required. Amongst other factors, this could include materiality and cost/benefit considerations. Without such guidance, the disaggregation proposals may be inoperable.

We support the use of the direct method of presenting cash flows, since it generally provides more useful information than the indirect method, and is more consistent with the proposed cohesiveness and disaggregation objectives. The direct method provides more detailed information, which contributes to both a better understanding of financial performance and to any earnings management that has occurred. As well, the same information that is necessary to prepare a direct method cash flow statement is also needed to complete the proposed reconciliation schedule. We are aware, however, that since many preparers currently use the indirect method for preparing their cash flow statements, they could face significant challenges in adopting the direct method, since they may need to reconfigure their information systems.

Users have communicated to us that the indirect method provides important information that they would still require if the direct method is used. Since this information is included in the proposed reconciliation schedule, the reconciliation will be necessary if the direct method is required in the cash flow statement. For this and other reasons, we strongly support the proposed reconciliation schedule and agree that it will increase users' understanding of future cash flows, since it provides information that may not otherwise be available, and is consistent with the concepts of persistence and disaggregation, which are important factors in predicting future cash flows.

We understand that the Discussion Paper did not focus on the cost elements of the proposals, however, the cost/benefit consideration is critical for many of these proposals. For example, while the disaggregation of information in the statement of comprehensive income by function and by nature may provide information that is more useful, the cost of developing this breakdown may exceed its benefit. In addition, we are aware that many preparers are quite concerned about the costs of implementing the direct method of presenting cash flows and the reconciliation schedule. Therefore, we stress the importance of a full consideration of the costs

and, in particular, the cost-benefit relationship for the proposals before an Exposure Draft is developed.

Finally, we are concerned about the timing of these and other proposals that are likely to be finalized around the same time as the conversion to IFRSs for entities in Canada and a number of other countries. The proposals (especially the use of the direct method and the reconciliation) are likely to require significant process and systems changes for many entities which, if required at the same time as, or shortly after, the initial adoption of IFRSs, would place a huge burden on preparers. Users would also face a significant challenge in adjusting to the cumulative effect of these significant changes in a short period of time. Additionally, there are significant educational implications which, coupled with the educational requirements for converting to IFRSs, could make it extremely difficult for educators, practitioners, preparers and users. Their capacity to implement new standards correctly is important, which could be jeopardized by requiring entities to make too many major changes in too short a period of time. Therefore, we recommend that the IASB reassess its timelines in light of the implementation effort that these projects entail, to ensure that proposed new standards can be implemented in an effective and efficient manner.

We would be pleased to elaborate on this in more detail if you require. If so, please contact Peter Martin, Director Accounting Standards at +1 416 204-3276 (e-mail peter.martin@cica.ca), Mark Walsh, Principal Accounting Standards at +1 416 204-3453 (e-mail mark.walsh@cica.ca), or Grace Lang, Principal Accounting Standards at +1 416 204-3478 (e-mail grace.lang@cica.ca).