

INTERNATIONAL ACCOUNTING STANDARDS BOARD FINANCIAL ACCOUNTING STANDARDS BOARD

<u>DISCUSSION PAPER: PRELIMINARY VIEWS ON FINANCIAL STATEMENT PRESENTATION</u>

CBI RESPONSE

<u>April 2009</u>

INTRODUCTION AND SUMMARY OF CBI POSITION

- 1. The Confederation of British Industry ("CBI") is pleased to respond to the Joint Boards' consultation.
- 2. Achieving an appropriate outcome to this project in a way acceptable to business and preparers of accounts is very important to CBI members. A company's financial statements are crucial to providing relevant and useful information to shareholders, and a key communication tool in discussing and assessing the company's performance. All proposals should enhance and improve that communication process.
- 3. CBI members strongly support a key aspect of the paper the application of the management approach. Whilst there can be benefits from "cohesiveness" in format across the financial statements and from certain disaggregation, these approaches should be secondary to, and not conflict with, the management approach, nor reduce clarity.
- 4. It is also considered that stewardship should also be addressed. How directors and management have discharged their responsibilities including stewardship would mean that transactions and cash flows are not given less prominence than the balance sheet.
- 5. This in turn raises the concern that the objectives the boards have developed for financial statement presentation information should provide a cohesive financial picture, use of disaggregation in predicting future cash flows, information to help assess liquidity and financial flexibility do not have reporting the company's performance at their heart. Shareholders and investors focus on the income statement, then the cash flow statement. Therefore, for example, net income (profit or loss) should not be shown only as a sub-total within a "comprehensive income" statement, when it is generally the starting point for analysis by shareholders and users.

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- 6. The use of the balance sheet for initial categorisation under the cohesiveness principle should not cause a loss of clarity in the more important income and cash flow statements. For example, pensions may be reported in a single line in one category in the balance sheet, but this should not restrict its presentation in the income statement.
- 7. In addition, CBI members strongly oppose the proposal for the compulsory use of the direct cash flow method (and for the reconciliation that is predicated on the direct cash flow statement). This would require a high additional cost to implement and maintain, and not having the information readily available in itself demonstrates a conflict with the management approach. We do not believe that investors seek this information, and therefore such a requirement would not pass a cost/benefit analysis.
- 8. However, CBI members do support a more standardised approach to presenting the cash flow statement. We have been involved in discussions on a potential format within the Business Europe accounting group and further information is provided in the Business Europe comment letter. It is not clear of the extent to which the outcome of the Financial Statement Presentation project would replace existing requirements in other accounting standards such as IAS 7.
- 9. Our responses to the specific consultation questions are set out overleaf.

II RESPONSES TO CONSULTATION QUESTIONS

Question 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 DP? If so, please describe and explain.

As explained above, the objectives should be more focused on reporting performance and by reflecting the importance of stewardship. The reporting of transactions and flows should be given more prominence than the balance sheet and movements in the balance sheet.

For example, the reporting of pension costs should not be restricted to a single item in one category in the income statement.

Ouestion 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?

We can support this proposal, provided that its application does not conflict with the management approach.

Question 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?

It is important that transactions with owners and non-owners should be distinguished and shown separately, and we support presentation in a section separate from the financing section.

Question 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?

We support the Boards' proposal of presenting discontinued operations in a separate section, and assuming that the definition of a discontinued operation is that proposed in recent amendments to IFRS.

Information about the results and cash flow of discontinued operations are usually treated differently from the results of continuing operations, because they have different implications for the future cash flows of the business and provide useful information.

Ouestion 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?

As explained above, the management approach, coupled with the requirement for a company to explain its performance, will support good communication with shareholders and investors. This approach should not be compromised by restrictions that may result from applying the cohesiveness principle based on balance sheet categorisation, for example, in the reporting of pensions.

We also do not agree with the proposed treatment of dividends set out in paragraphs 2.48 and 2.55. Dividends are transactions with equity holders, and they should be reported in the statement of changes in equity, and within the equity section of the cash flow statement, regardless of whether there is a liability for dividends payable at the period end.

Question 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?

We would expect shareholders and users to gain benefits from these proposals.

Question 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 assume that if there is a segment mainly responsible for the financing of the business segments it would be classified as financing. On this basis, we expect it probable that the classification at the reportable segment level would not be different from that at the entity level.

Ouestion 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.

For 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.

Under IFRS 8, segment information must be presented in accordance with the management approach. We believe that the management approach should be applied when considering any changes to segment disclosures, and information should only be presented if already used by management.

Question 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?

Any definition for these categories should be based on the management approach.

We consider that including a separate category for items not integral (or "non-core") to the business may be unnecessary and cause additional complexity. Investments in financial assets simply to generate a return may well be allocated to financing, and "non-integral" assets and liabilities should by definition be the exception.

"Investment" is an important aspect of many companies' activities, especially companies with very long-term projects. We are concerned that confusion will arise from using the title "investing" for a category when its meaning in the paper is significantly different from "investing" as used in IAS 7 Statement of Cash Flows. If this category is retained, we suggest that an alternative title such as "Other" is used.

Regarding the cash flow statement, we have expressed our concerns about the direct method. By bringing the typical "investing" activities within "operating", the proposal in the Discussion Paper restricts the necessary discussion around the choice of method, because it is difficult to see how indirect cash flows and direct cash flows (the latter being currently used for cash flow from investing activities) can be presented together in any meaningful way within the same category.

Question 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?

We do not support any proposals that may compromise a management approach.

Restricting the financing section to only financial assets and financial liabilities (as those terms are defined in IFRS and US GAAP), seems to be inconsistent with the management approach to classification.

For example, we do not see the need to have any restrictions on using different categories for different elements of cash. It is unnecessarily complex to have a restriction with exceptions (Paras. 2.69 - 2.70). For some investors net debt is important information. We believe this should be net debt within financing, and thus exclude cash for operational requirements.

Ouestion 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?

Whilst additional guidance may not be necessary, it may be helpful to provide circumstances under which presentation based on liquidity would provide more relevant information, and perhaps examples of entities that may consider presenting on such a basis.

The Boards should also consider providing for this presentation based on the manner that best reflects the way the assets and liabilities are used within the entity (consistent with the management approach to classification).

In respect of deferred tax assets and liabilities, there should be no change to existing requirements in order that deferred tax assets and liabilities should be classified as short term or long term, based on the classification of the related items. Providing this information would cause additional cost and added complexity. There is also no apparent demand for such information from shareholders and users.

Question 12

Paragraph 3. J 4 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 support the Boards' proposal. We also assume that as a consequence cash equivalents will no longer be required to be shown as an item separate from short term investments.

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?

There are a multitude of ways in which assets and liabilities can be measured, not simply cost or fair value but also amortised cost, net realisable value, impaired cost etc, and the method applied for each item is already set out in an entity's accounting policies.

We believe that, because of the potential for significantly increasing the number of lines in the statement of financial position, the proposal will actually make the balance sheet more complex and less easy to understand, and add to the cost of preparation.

Question 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?

We do not agree with the statement in Para 3.29 that "including all income and expense items in a single statement ... will make it easier for users to understand ...".

We believe that net income (profit or loss) is the starting point for discussing an entity's performance and clarity will be lost if this is part of a single statement together with items of other comprehensive income such as currency translation effects.

We also consider that the income attributable to parent company shareholders is the most important number and should be shown on the face of the income statement.

Question 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?

We do not believe that this information will be decision-useful, and in many cases it may only be possible with rather arbitrary allocations.

Ouestion 16

Paragraphs 3.42-3.48 propose that an entity should farther 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?

What is key here is the proviso "if doing so will enhance the usefulness of the information in predicting the entity's future cash flow".

An unrestricted requirement to show all of this information would not be appropriate. It would increase companies' costs and in many cases be impractical.

We support the proposal to report any additional information in the notes, rather than on the face of the statement.

Ouestion 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 support the retention of the existing requirements.

It would be arbitrary and more complex to allocate tax between operating, investing and financing categories, and that would not be helpful to shareholders and users.

Ouestion 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 is also likely often to cause arbitrary allocations, and therefore be unhelpful to shareholders and users.

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

- a. Would a direct method of presenting operating cashflows 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 cashflows be provided in the proposed reconciliation schedule (see paragraphs 4.19 and 4.45)? Why or why not?

As explained above, CBI members strongly object to the compulsory use of the direct method for the cash flow statement and do not agree with the paper's arguments in its favour.

Any such change would come at a very high cost, and we do not believe that there is a significant call from shareholders and users for this proposal and therefore it would not pass a cost/benefit test.

The proposal would change the way in which transactional information is captured, and therefore by definition cannot be in accordance with the management approach that is fundamental to the Discussion Paper. The indirect method provides an important link between income and cash flow from operating activities, and it does not conflict with cohesiveness.

Most shareholders and users look for the link between profit or loss and cash flow from operating activities that the indirect method provides.

However as indicated, we do agree that there could be benefits from a more standardised (indirect) approach to presenting the cash flow statement. This would present information with more clarity than the proposed reconciliation schedule discussed at Q.23.

Question 20

What costs should the Boards consider related to using a direct method to present operating cashflows (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 operating cash receipts and payments?

This proposal would mean a significant change, at a very high cost, in the way in which data is collected and consolidated. There would also be practical difficulties in trying to allocate cash flows by function and by nature, for example involving items re-charged to functions.

The implementation of this change would take significant resources, including the time to redevelop systems and for training. Because of additional complexity in the way transactional information would be captured, we would expect that ongoing application costs would be far higher than at present (including extra audit and compliance costs).

With regard to how these costs might be reduced, we assume this might be referring to the "indirect" direct method, which means calculating direct cash flows by adjusting indirect cash flows. This would not eliminate the need to collect additional data and we would question the benefit of this to shareholders and users

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 cashflows to achieve cohesiveness?

If not, in which section or category should those effects be presented?

The appropriate presentation of the effects of basket transactions should be consistent with the principles established for using the management approach to classification.

A company should not be required to carry out arbitrary allocations just to achieve cohesiveness.

Question 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 with this proposal in principle, but there should be no conflict or duplication with IAS 17 or IFRS 7.

The information should be disclosed in the notes to the financial statements.

Question 23

Paragraph 4.19 proposes that an entity should present a schedule in the notes to financial statements that reconciles cashflows 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 cashflows? 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 dear and sufficient to prepare the reconciliation schedule? If not, please explain how the guidance should be modified.

We do not support this proposal. We do not see any additional benefit to users from the proposed reconciliation schedule, because the key information should already be disclosed in financial statements and notes under existing requirements.

There will be additional preparation costs for companies.

The proposal is also predicated on the use of the direct method for presenting the cash flow statement, which we also oppose. Any cost/benefit analysis for the reconciliation schedule must therefore include the requirement for the direct cash flow statement itself.

It will not be possible to define the way items are reported by column in a consistent manner, and arbitrary allocations will be necessary.

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 is broadly adequately addressed in existing IFRS, but additional guidance could be considered, if felt useful.

Question 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 cashflows (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 cashflows to comprehensive income? Why or why not?

No. Any benefits will be offset by the complexity created and additional costs incurred by companies.

Question 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 do not support companies presenting such information as part of the reconciliation schedule or otherwise. Under any definition, determining events or transactions that qualify as unusual or infrequent would be subject to a significant degree of subjectivity. Thus any information would be provided on an inconsistent or arbitrary basis.

The requirements of existing IFRS should be sufficient. There is an existing disclosure requirement for material items of income or expense in IAS 1 (Para 97) as well as disclosure requirements in individual standards. In addition significant items will normally be discussed in the management commentary.