



LETTER OF COMMENT NO. 9



**fei**<sup>SM</sup>

financial executives  
international

February 9, 2009

Russell Golden  
Technical Director  
File Reference No. 1630-100  
Financial Accounting Standards Board  
401 Merritt 7  
P. O. Box 5116  
Norwalk, CT 06856-5116

Re: Preliminary Views on Financial Statement Presentation

Dear Mr Golden:

The Committee on Corporate Reporting ("CCR") of Financial Executives International ("FEI") appreciates the opportunity to share its views on the joint Financial Accounting Standards Board ("FASB") and International Accounting Standards Board ("IASB") Discussion Paper entitled "Preliminary Views on Financial Statement Presentation" (the "proposal"). FEI is a leading international organization of senior financial executives. CCR is the senior technical committee of FEI which reviews and responds to research studies, statements, pronouncements, pending legislation, proposals and other documents issued by domestic and international agencies and organizations. This document represents the views of CCR and not necessarily the views of FEI or its members individually.

While we support the objectives underlying the proposal, there are several critical areas where we have significant concerns. We felt those concerns should be brought to the FASB and the IASB's (the "Boards") attention as early in the comment period as possible, so that the Boards will have the opportunity to consider alternative approaches as suggested below. We intend to file a second letter later in the comment period which responds to the complete listing of issues addressed in the proposal in further detail. Several of the Committees' members are participants in the joint FASB/IASB field test program on the proposal and therefore, are in a unique position to comment on the views contained within the proposal.

The discussion paper clearly outlines the purpose and objectives of the financial statement presentation project. As stated, the Boards' goal is to improve the usefulness of the information provided in an entity's financial statements to help users make decisions in their capacity as capital providers. While we agree with the Boards' broad goal, there is an underlying premise in the stated goal that management currently has certain information called for in the proposal that is not being made

available to financial statement users. CCR believes that with respect to the direct method of cash flows and disclosures of expenses by nature this is not the case. Much of the information needed to provide this reporting is not available; the systems needed to accumulate the information have not been developed; and, from a management approach perspective, the information is neither currently used in internal reporting nor is it deemed useful in managing the business. In fact, if the benefit of accumulating and reporting this information outweighed the related cost, companies would already be preparing this information internally or working with their Enterprise Resource Planning ("ERP") providers to do so.

Consequently, CCR's primary concerns related to the proposal rest in three areas: 1) the cost/benefit proposition of a direct method cash flow statement, 2) the associated reconciliation of the direct method cash flows to the statement of comprehensive income and 3) the cost/benefit proposition and usefulness of disclosures of expenses by nature. Below we will outline our concerns and recommendations in each of these areas.

#### Direct Method Cash Flow Statement

For reasons detailed below, we strongly believe that the costs to implement a direct method cash flow statement would far outweigh the benefits to be derived. We question how critical this information is to financial statement users and how specifically it will be used in practice, particularly as the information provided through the direct method is generally not compiled or prepared, and rarely if ever used by management to make business decisions. Below we have outlined what we believe are two approaches that could potentially be used to achieve presentation of a direct method cash flow statement and the challenges related to each:

- Create the direct method cash flow statement from transactional data
  - Most CCR member companies are global corporations utilizing multiple currencies and several ERP systems. Most ERP systems and the underlying accounting and consolidation systems are not designed to capture cash flows under a direct method reporting convention. These two factors would make utilizing the direct cash flow method a very costly undertaking. We believe that as proposed, many companies would need to not only convert to one ERP accounting system worldwide, but would need to be on a single instance of that ERP system. The detail transactional data would need to be captured such that a corporate entity would have the ability to match detail intercompany transaction flows on a transaction-by-transaction basis. Companies would need to fundamentally redesign reporting systems infrastructure from the bottom (transactional) level up. An implementation of such magnitude would be very costly and would take multiple years to implement, without a corresponding matching benefit to investors. This type of significant change would also further stretch the already limited resources in light of the global economic environment.
  - Expanding on the previous point, the cost would be even greater if a company's information systems were older technology than ERP systems (i.e. what are referred to as legacy systems). A mature multinational company primarily utilizing legacy systems might have

hundreds of general ledgers and even greater numbers of transactions systems, subsidiary ledgers and trial balances. The cost in terms of time and money to convert each of these systems and to develop timely reporting capability quite simply cannot be justified. *Re-programming legacy software applications must always be approached with extreme caution because of the risks involved with modifying code.*

- For illustrative purposes, some of the difficulties with using currently configured systems to prepare a direct method cash flow from transactional data are:
  - Financial transactions are created in functional currencies. Depending on the system involved, these transactions may be summarized in financial statements and supplemental data for consolidation purposes by using average exchange rates.
  - To create a cash flow statement, you cannot use average exchange rates when currencies cross and are exchanged for different currencies. These would need to be tracked based on actual flows and actual exchange rates. Even if some common exchange rates were used, there would be a difference that is due to these differing rates that would need to be “plugged”. Without significant tracking, this “plug” could not be verified with any degree of confidence. This would call into question the representational faithfulness of the information and its verifiability.
  - Intercompany transactions would also cause further complications that would lead to added costs. In order to properly eliminate intercompany activity for purposes of a direct method statement of cash flows, the activity would need to be tracked on a transaction-by-transaction basis and then converted at the actual exchange rates used in completing the transaction. An average or static rate could lead to vast differences as demonstrated by recent significant fluctuations of exchange rates over short durations.
  - Most general ledger transactional postings are generically coded. In simple terms, a company either debits or credits an account to reflect a transaction or accrual regardless of the nature of the underlying transaction (e.g. whether or not a payable is related to an expense or a capital transaction.) To capture direct cash flow impacts at the transactional level would require companies to re-engineer the systems and processes to capture full roll-forward activity through the creation of multiple sub-accounts or “transaction types.” For example, an accrued liability account would need either separate sub-accounts or distinct transaction posting codings to separate the initial accrual, payment and other accrual adjustments. Again, such system and chart of account changes would be extremely costly.
- Create the direct method cash flow statement by use of an indirect method

- Companies could “back-in” to the numbers by using existing balance sheets and supplemental data.
- Preparing certain line items such as collection of receivables, interest paid and taxes payable may be feasible by some companies using current systems. However even in this area, companies with multiple element arrangements or extensive hedging operations may have difficulty in accumulating or calculating these amounts.
- Additional difficulties would be encountered in using this approach for other expense amounts. While certain expenses such as payroll may have a unique liability account associated with it, the vast majority of expenses go through an accounts payable account. To use an indirect method, a company would need to have its accounts payable, and all its liability accounts, broken down by both function and further into the natural accounts to which they relate. This would require significant investment in time and dollar cost to add fields to existing general ledger systems around the world to track and then report this information. Alternatively, estimates would need to be used.
  - If estimates were used, they would be by necessity very broad based estimates due to the limited data available. Broad estimates would call into question the representational faithfulness of the information and its verifiability and would mitigate any potential benefits of such information to the user. If the estimates need to be more refined, a significant additional investment in systems would be required.
- We believe that any statement constructed in such a manner would have to be prepared at a highly summarized level (e.g. only certain expenses are broken out while other major categories are shown as “other expenses) or its reliability would be questionable due to the vast simplifying estimates that would need to be made. As a result, this process would yield less reliable and informative data for use in making future projections.

In our experience dealing with users of financial statements, any incremental benefit of a direct method cash flow statement would be greatly outweighed by the associated cost to the shareholders. As an alternative, we believe that the Boards should continue to allow for the use of the indirect method, with additional disaggregation of data provided in notes to the financial statements. In our communications with our financial statement users, most inquiries about future projections come in the area of either 1) increased breakdowns of expenses such as further information on Cost of Sales and Selling, General & Administrative expenses or 2) additional perspective on working capital and its impact on cash flow. This additional disaggregation of data could be provided in either the statement of comprehensive income or in the notes to the financial statements. These breakdowns would give more information about the past drivers of the results thereby allowing users to formulate their expectations of future results. We feel that this type of approach would give the best return to financial statement users vs. providing a direct method cash flow statement.

### Reconciliation of Cash Flows to Comprehensive Income

The issues discussed above also pertain to the schedule reconciling direct method cash flows to the comprehensive income statement. Under existing system configurations, it would be extremely difficult and costly to obtain the information required. If estimates were used to provide the information this would again call into question the validity of that data. The incremental costs that would be incurred to update existing systems would far outweigh any perceived benefits of this disclosure. Alternatively, if companies were permitted to use the indirect method, as suggested above, consideration could be given to providing additional disclosures regarding remeasurements that are both recurring and non-recurring fair value changes or valuation adjustments. Overall, we do not believe providing information about normal accruals is beneficial to the user.

### Expenses by Nature

The third initial area of concern relates to the proposal for an entity to further disaggregate its income and expense items by their nature to the extent that this will enhance the usefulness of the information in predicting the entity's future cash flows. Initial feedback from field test participants is that most U.S. businesses provide information by function and current systems are not configured to accumulate information by nature, calling into question a cost benefit payback. While information by nature may exist within accounting systems for most companies, processes and controls are rarely configured to accumulate information in this way. While used on a day-to-day basis, by say a department manager to manage his/her departmental budget, senior management does not use such information for decision-making purposes. As you progress further up the organization, information is generally only summarized by function above the departmental level.

In support of this assertion, we suggest the Board's staff review the annual reports of a sample of major corporations – specifically the list of executive officers. We submit you will find operating officers with functional titles such as 'Vice President – Strategy' or 'Vice President – Manufacturing' etc. You will not find executive officers with titles such as 'Vice President – Overhead Costs'. This highlights our point that companies do not manage on transactional level revenue and cost data; they manage on the basis of functions and information systems are designed around this objective. If information by nature were mandated, then significant investments in systems would be required. These changes and investments need to be made not in a top-level consolidation gathering system but in each general ledger system that a corporation has in its global operations. This would be a significant investment in both manpower and dollars for systems that a company will not use to run its business. Importantly, this investment would not be limited to designing new report-writing capabilities to accumulate and extract the more detailed information. In many companies, it would also require significant investments in hardware, since current systems would not have the capacity/volumetrics to support the added data load. Another concern involves the allocation of costs from one department to another, or from one function to another. Allocations are typically made as single transfers of costs without regard to the nature or details comprising that allocation. We believe a robust cost benefit analysis should be completed to assist the Boards in their deliberations.

Further complications exist if a company is a manufacturer. Many manufacturing companies use cost systems that employ a standard costing protocol. In some cases, costs are accumulated and aggregated across factories and products. Cost systems then distribute actual costs across units using a standard bill of materials. Once

inventory items are "shipped" from inventory into cost of sales, the dollar value of the inventory is moved from inventory to cost of sales. In doing so, the characteristics of the costs (as accumulated in the bill of materials) are lost. Standard systems are unable to recompile the cost information in cost of sales to produce cost information by nature. As an alternative, companies could disclose the standard approximate percentage by nature based upon estimates using a standard bill of materials and relative product mix for the period. We believe such information would be most useful to an investor and strikes a reasonable cost-benefit balance.

We feel that additional information may be useful to investors in some of these areas; however, a prescriptive solution will not be helpful, as all corporations are not run in the same manner. We feel that use of a method such as Statement of Financial Accounting Standards No. 131, *Disclosures about Segments of an Enterprise and Related Information*, where information disclosed is based on what management currently uses to run the business would serve investors best. As discussed above, specific areas that we feel would be helpful to investors would be further breakdowns of large financial statement lines such as Cost of Sales and Selling, General & Administrative expense. These added disclosures should be based on a concept of "disclosure of the significant drivers of the business". For instance, marketing expense might be a significant driver to one business but not to another. Likewise, certain businesses may feel that certain expenses by nature are significant drivers to their business and would be a required and informative disclosure. One could argue that a "management approach" would diminish comparability between similar companies. However, the current proposal would also result in comparability issues. For example depending on how a company manages its supply chain, the nature of expenses within cost of sales could be completely incomparable depending on whether a company sources and distributes all of its products, outsources the production and distribution of all its products or uses a mix. The same could be said for administrative expenses depending on the use of outside service providers. In the end, users will not be able to compare and contrast a company's relative costs with other companies' costs at the "nature" level.

#### Summary

We have outlined some of the major issues driving the cost factors, but request that the Boards solicit specific feedback regarding the relative importance and specific use of this information. Only when both the costs and the benefits are fully explored will the Boards be able to complete the cost benefit analysis. To add perspective on how prohibitive the costs related to this proposal may be, we provide as an example, the situation of one of our members. Company A is a large multi-national Fortune 100 company that invested approximately \$1 billion over a three-year period in developing one ERP system with a limited number of instances and a common chart of accounts. Even with that investment having been made, that company believes that they would need to spend an additional \$25 - \$50 million in order to be able to fully comply with the direct cash flow method as outlined in the proposal. We believe that for some companies it is even possible that the implementation of the necessary changes to comply with the requirements of the proposal would be a more costly and intensive effort than the conversion to International Financial Reporting Standards.

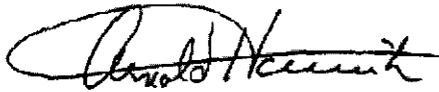
We also ask that the Boards review and consider the alternatives discussed herein. We believe that these alternatives would still preserve the overall objectives of the project while significantly decreasing the costs required to achieve these objectives.

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We appreciate the Boards' consideration of these matters and welcome the opportunity to discuss any and all related matters.

Sincerely,

A handwritten signature in black ink, appearing to read "Arnold Hanish". The signature is fluid and cursive, with a large initial "A" and "H".

Arnold C. Hanish  
Chairman, Committee on Corporate Reporting  
Financial Executives International

Cc: International Accounting Standards Board