



ILLINOIS CPA SOCIETY.



LETTER OF COMMENT NO. 137

April 14, 2009

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The Accounting Principles Committee of the Illinois CPA Society (Committee) appreciates the opportunity to provide its perspective on the Discussion Paper, *Preliminary Views on Financial Statement Presentation*. The organization and operating procedures of the Committee are reflected in the attached Appendix A to this letter. These recommendations and comments represent the position of the Illinois CPA Society rather than any members of the Committee or of the organizations with which such members are associated.

#### Responses to questions

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.*

We believe the proposed objectives would improve the information content of financial statements. Basic financial statement analysis requires separate analysis of operating and financing decisions. Currently, those analyzing financial statements must make numerous assumptions as they disaggregate operating activities and cash flows from financing or other non-operating activities and cash flows. Management is in the best position to provide that information thus we believe the quality of financial statement analysis will improve.

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?*

As discussed in our response to question 1, we believe the separation would provide decision useful information.

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?*

We don't see this as an issue either way. It appears to be a matter of subtotals. So long as liability and equity line items are appropriately labeled, users should be indifferent to the manner of presentation.

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?*



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Discontinued operations should be separated from the ongoing operations of the business in all basic financial statements to give users information that is relevant to their decision making. Discontinued operations are no longer relevant to the future of the reporting entity and their cash flows and other information, if present, will distort the information related to the continuing business making it more difficult to assess current performance and future cash flows.

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?*

Yes. We believe that comparability can be an important ingredient of effective financial statement analysis; however categorizations that are too prescriptive may result in presentations that are not representationally faithful to the actual operations and financing aspects of the entity and, accordingly, would provide information that is less relevant.

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?*

Comparability is appropriate where items are in fact comparable. However, the financial statements should reflect the actual classifications by management and not potentially force classification that is not reflective of reality.

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?*

Basic ratio analysis will be easier under the proposal, particularly for those ratios designed to factor out financing effects in order to focus on operations. This may require a certain amount of judgment for firms to categorize asset and liabilities, as well as cash flows. However, the firms are in a better position to make those judgments than are the users.

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 it is the Boards' intent to have assets and liabilities classified based on their function. That is, for example, assets used in operations would be classified in the operations section. We believe the Board should specify that assets and liabilities be classified based on their function at the level which has responsibility for their management. That level may be lower in the organization than segment level.

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.*



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Because many similarly titled assets and liabilities may appear in both operating and financing sections, it may seem necessary to require that level of detail in segment disclosures. An increased level of disclosure is likely required at the segment level, potentially similar to the consolidating information presented by many companies due to the existence of public debt at subsidiaries.

*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?*

We believe they are appropriately defined.

*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 agree.

*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?*

We expect few entities to be exempt from this requirement. We note that depository and lending institutions have historically not presented classified balance sheets but instead have presented assets and liabilities in descending order of liquidity. We believe that practice has arisen because users have found that to be the most relevant form of presentation for such institutions.

*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?*

We note that certain, specialized industries currently have reporting models that differ from the norm. For example, real estate entities do not present in order of liquidity and neither do public utilities. The Boards need to hear from those who provide capital to these and other specialized industries whether the changes proposed are, in fact, useful.

*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 disagree. We believe the concept of “cash” the Board implicitly envisions would only exist in the form of currency held in the company safe. Even balances held in a checking account are only “cash” to the extent the bank has currency in its vault that could be handed over immediately and even that is not identified to a specific customer. In truth, “cash transactions” are not currency transactions, but transfers of claims to available balances from one depository institution to another. We note there are no depository institutions that have currency on hand in sufficient amounts to satisfy claims of their demand depositors. Accordingly, those claims require the eventual liquidation of investment securities just as would be required of a money market fund, for example.

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



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We agree that there should be separate disclosure of assets and liabilities that are measured using different bases but are concerned that the face of the balance sheet would be unwieldy. Accordingly, we support separate reporting of assets and liabilities measured on different bases in the notes to the financial statements.

*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 believe a single statement of comprehensive income is appropriate; however we do not believe this is a significant improvement in reporting.

*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 agree, but again are concerned about the level of detail in the basic financial statements. We believe the disaggregation should be confined to note disclosure.

*16. Paragraphs 3.42–3.48 propose that an entity should further **disaggregate** within each section and category in the statement of comprehensive income its revenues, expenses, gains, and losses **by their function, by their nature, or both** if doing so will enhance the usefulness of the information in predicting the entity's future cash flows. Would this level of disaggregation provide information that is decision useful to users in their capacity as capital providers? Why or why not?*

Again, we believe the levels of disaggregation proposed are an improvement in financial reporting but suggest that including the basic financial statement will lead to statements of comprehensive income that are unnecessarily complex on their face. We believe the disaggregation of detail could be done in the notes to the financial statements, possibly in conjunction with increased detail in segment reporting.

*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 believe income taxes should be a separate section in the statement of comprehensive income and not allocated beyond discontinued operations or other comprehensive income. While we recognize that analysts will allocate income taxes to the operating and financing sections of the income statement, we believe that allocation, whether by management or by an analyst, will likely be based either on marginal or effective tax rates and therefore not add relevant information to the financial statements. In order for such allocation to be relevant, the Boards would need to specify that allocations take into consideration the specific tax jurisdictions and impacts on effective rates. While this would provide information that is more relevant in the circumstances, we do not believe the increase in complexity would justify that presentation.

*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.*

We believe this would provide decision useful information.



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*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 believe that foreign currency transactions that are clearly related to financing and investing activities or to items included in other comprehensive income should be so classified. We believe that translation gains and losses should remain classified in other comprehensive income. We believe the Boards' should leave this to management to determine just as it determines the classification of other items.

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

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

We note that despite the FASB's apparent preference for the direct method going back to the issuance of Statement 95, the direct method is rarely used in practice either by public companies or by privately owned businesses. We have no experience of users expressing a preference for the direct method. We note that for private companies, lenders are clearly in a position to have dictated use of the direct method in the preparation of financial statements over the years and they have not done so. We do not see any benefit to requiring use of the direct method and, accordingly, no rationale for requiring companies to incur the cost of converting their financial accounting systems to accomplish this.

*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?*

The cohesiveness objective suggests that classifications of cash flows should be consistent with classifications of balance sheet items associated with the cash flows. This objective can be satisfied equally well with either the direct or indirect method cash flow statement.

Both the direct and indirect method cash flow statements result in the same amount of cash flow in each of the cash flow statement sections. The difference is simply in how the amounts in the operating section are shown. For example, inventory purchases are an outflow that can affect cash flow through cost of sales (via net income) and change in inventory or through presenting purchases directly. The assets these cash flows relate to would be classified as operating, the income amount (cost of sales) would be classified as operating as well, and so would the cash flows. Cohesiveness would be preserved under either cash flow statement approach.

*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?*

While the proposed reconciliation would provide users the ability to construct an indirect method cash flow statement, there has been no evidence presented to indicate that the direct method presentation is preferable or even marginally better.

*20. What costs should the Boards consider related to using a direct method to present operating cash flows (see paragraphs 3.81–3.83)? Please distinguish between 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 question presumes there are benefits associated with presenting operating cash receipts and payments and, as we noted above, nothing in our experience suggests that these benefits exist. Accordingly, whether the costs are one-off or recurring, we do not believe the Boards should mandate that they be incurred.



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

Certain transactions involve two of the components of an entity contemplated by this proposal. The proposal does not adequately consider these types of transactions and how to handle them. In a valuation exercise, these are often referred to as free cash flow equivalents. The analyst is interested in free cash flow (cash flow associated with core business operations), but recognizes that certain non-cash transactions need to be considered in the definition of free cash flow because they serve dual purposes, only one of which is operations. For example, a capital expenditure paid for with debt rather than cash is a capital expenditure that is no different economically from one that is paid for with the cash obtained from debt financing. The current cash flow statement ignores this transaction (other than through a supplemental disclosure), requiring the analyst to adjust the cash flow statement to show this transaction as an “in and out.” It is not sufficient to say a transaction can be ignored on the cash flow statement because it involves no flow of cash. If it is equivalent to two transactions with cash flowing in opposite directions and the two elements of the transaction would appear in different sections of the cash flow statement, then it needs to be considered as an “in and out” in the cash flow statement. That is, a cash inflow in one section and a corresponding outflow in another.

Two additional examples of the dual nature of certain transactions that has led to inconsistencies in the proposal are pensions and employee stock options. Service cost is the only component of pension expense that is operating in nature. Interest cost is an increase in a debt obligation that occurs with the passage of time. That is interest and is financing in nature. Return on plan assets is a return on a non-core investment and belongs in the investing section. The problem stems from a combination of (a) not reporting plan assets and PBO separately and (b) an insistence on perfect cohesiveness across statements. If cohesiveness leads to illogical results on the income statement or cash flow statement, a source of the problem could be the assumptions about the balance sheet classification.

An employee stock option grant is the issuance of a financial claim, albeit equity, in return for services. As such, it is equivalent to an operating transaction – payment for services – and a financing transaction – the sale of a stock option. From a financial analysis perspective, an option grant is equivalent to an outflow of cash from operations and an inflow of cash from financing.

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?*

If the Boards believe the financial statements should allow users to make inferences about future cash flows, then this information must be disclosed to facilitate that analysis.

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

*a. Would the proposed **reconciliation schedule** increase users’ understanding of the amount, timing, and uncertainty of an entity’s future cash flows? Why or why not? Please include a discussion of the costs and benefits of providing the reconciliation schedule.*



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We believe it would clearly provide a great deal of information, however as noted above, the disclosure could become so complex as to be incomprehensible. We note that many analysts and academic researchers would likely point to the increased transparency as a deterrent to earnings management.

*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.*

We have no suggestions as to components to add or delete.

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

The guidance appears sufficiently clear.

*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 believe the disclosures called for by SFAS No. 157 provide sufficient information for users.

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

It is likely the cash flow reconciliation of a financial serviced entity will be largely unusable because of the volume of transactions (e.g., deposits and withdrawals in a banking environment). We note that many financial services entities already have significant portions of their assets and liabilities recorded at fair value. They provide extensive disclosure of balances as well as reconciliations for those items included in Level 3. That presentation appears consistent with the format in Appendix B and we believe it would be more useful.

*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?*

We do not believe the Board needs to specify reporting details at this level. We suggest the manner or style of calling attention to unusual or infrequent items be left to management's discretion.

*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?*

Existing guidance is sufficient to determine what sorts of items are extraordinary and the column for their presentation should be equally restrictive.



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

We believe the Boards should allow some experimentation in this area, but we are concerned that some items that are inherently more complex (e.g., disclosures around derivative financial instruments and hedging activity, or off-balance sheet financing activities) may be difficult to decipher in a narrative format. In the end, we do believe that users will demand the information they need and that management will respond to that demand.

*27. As noted in paragraph 1.18(c), the FASB has not yet considered the **application of the proposed presentation model to nonpublic entities**. What issues should the FASB consider about the application of the proposed presentation model to nonpublic entities? If you are a user of financial statements for a nonpublic 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.*

Nonpublic entities have capital providers (owners and lenders) who are much closer to the operations and to management than is the case with public companies. Additionally, lenders are in the position to demand more detailed information, and get that information if they desire. Our committee members note that some lenders demand private companies provide not only annual reports, but also quarterly and monthly reports. If lenders to nonpublic companies desire this level of detail or style of reporting, they will request it. Nonpublic owners are typically few in number and do not demand formal reporting beyond the annual financial statements. We believe the Boards should limit this project to public entities.

#### Additional comments

We suggest two matters for the Boards to consider. First, it seems to clear to us that the Boards believe that classification of operating, financing and investing activities will be balance sheet driven. That is, that entities will identify their operating, financing and investing assets and liabilities and the relevant income statement classifications will follow. We suggest that both management and analysts, who focus on operating earnings, will drive the classification from the perspective of the income statement to achieve the best possible results for operating earnings. While some may argue that this can be done currently, we note there is not a balance sheet classification into operating and non-operating assets and liabilities that would support a particular classification decision by management. The ability to specify the balance sheet classification with a view to its income statement impact should be at the forefront of the Boards' deliberations in this matter.

Finally, we suggest the Boards consider the implications of their deliberations on financial statement presentation on other standards in process. For example, we note the revenue recognition project is considering contracts with customers as arising from an "entity's ordinary activities." The Boards should ensure they have common definitions across standards such that what constitute "ordinary activities" for revenue recognition and what constitute "business activities" for financial statement presentation are consistent.

We appreciate the opportunity to offer our comments.

Sincerely,

**John Hepp, CPA**

Chair, Accounting Principles Committee





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APPENDIX A  
ILLINOIS CPA SOCIETY  
ACCOUNTING PRINCIPLES COMMITTEE  
ORGANIZATION AND OPERATING PROCEDURES  
2008-2009

The Accounting Principles Committee of the Illinois CPA Society (Committee) is composed of the following technically qualified, experienced members appointed from industry, education and public accounting. These members have Committee service ranging from newly appointed to more than 20 years. The Committee is an appointed senior technical committee of the Society and has been delegated the authority to issue written positions representing the Society on matters regarding the setting of accounting standards. The Committee's comments reflect solely the views of the Committee, and do not purport to represent the views of their business affiliations.

The Committee usually operates by assigning Subcommittees of its members to study and discuss fully exposure documents proposing additions to or revisions of accounting standards. The Subcommittee ordinarily develops a proposed response that is considered, discussed and voted on by the full Committee. Support by the full Committee then results in the issuance of a formal response, which at times, includes a minority viewpoint.

Current members of the Committee and their business affiliations are as follows:

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Walter J. Jagiello, CPA	Walter J. Jagiello, CPA
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Paul E. Pierson, CPA	Illinois CPA Society
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