

April 17, 2009

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LETTER OF COMMENT NO. 185

Re: October 16, 2008 Discussion Paper, Preliminary Views on Financial Statement Presentation [File Reference: 1630-100]

Dear Mr. Golden:

One of the objectives that the Council of the American Institute of Certified Public Accountants (AICPA) established for the PCPS Executive Committee is to act as an advocate for all local and regional firms and represent those firms' interests on professional issues, primarily through the Technical Issues Committee (TIC). This communication is in accordance with that objective. These comments, however, do not necessarily reflect the positions of the AICPA.

TIC has reviewed the Discussion Paper (DP) and is providing the following comments for your consideration.

#### **GENERAL COMMENTS**

Although many aspects of the new model have conceptual merit for public entities, the impetus for this project within the public company environment does not exist in the nonpublic environment. Private company statements have always been much more disaggregated than those of public companies. Therefore, financial statement users within TIC's constituency do not have difficulty discerning relationships among financial statements. In addition, most users of private company statements work directly with preparers to obtain any additional information necessary for credit analysis. As a result of these and other differences, users of private company financial statements have not expressed a need for a new financial statement presentation model. As discussed below, the transition cost (in terms of systems reconfiguration, training, etc.) for all concerned will be very expensive. Given the state of the economy and the perceived lack of need for a new model, TIC believes many private companies and their financial statement users will be resistant to implementing such dramatic changes anytime in the near future.





However, having two totally different financial statement presentation models (public and private) is equally unacceptable. Therefore, as discussed further in the response to Question 27 below, TIC encourages the Board to work with stakeholders in the private company environment to scale down the requirements and find the appropriate balance between user needs and cost/benefit considerations, including a transition plan that would take into consideration the needs of all constituents.

TIC's responses to selected questions in the DP are presented below. (Unanswered questions are excluded.) Generally, the responses are written from the private company perspective.

### SPECIFIC RESPONSES TO QUESTIONS FOR RESPONDENTS

### 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.

TIC believes that the objectives of financial statement presentation proposed in paragraphs 2.5-2.13 are conceptually sound and are likely to be decision-useful for certain types of financial statement users. However, most users of private company financial statements are satisfied with the current presentation model. As a result, when the costs of transition are presented to users of private company financial statements, many are resistant to the change and question whether the proposed model will continue to meet their existing needs and whether it can provide new, useful information that is not available under the current model.

The disaggregation objective proposed in the DP requires that an entity disaggregate its financial statements in a manner that maximizes the user's ability to assess the amount, timing, and uncertainty of the entity's future cash flows. Paragraph 2.10 states that it is important that application of the disaggregation objective should lead to sufficient but not excessive disaggregation. TIC encourages the Board to provide additional guidance to help preparers understand what the FASB considers to be sufficient disaggregation.

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?

The new format is a very principles-based approach that will require entities with complex operations to exercise judgment and provide transparent disclosures. One possible outcome in the short-term is that the capital markets may put pressure on companies operating in the same industry to classify their financial statement elements in identical categories in an effort to achieve comparability. TIC believes the users will need a very lengthy implementation period to adapt the new model to their classification needs.

Entities with simpler operations, such as those within TIC's constituency, will classify their financial statement elements within the operating category of the business section, since most of these entities use the income earned from their investing activities to build their revenue-generating capacity. As a result, most would not use the investing category at all. The separation of financing activities from business activities will probably be a more important change for users in TIC's constituency than the segregation of business activities.

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?

TIC believes equity should be presented as a section separate from the financing section rather than presenting it as a category within the financing section. The current format is familiar to financial statement preparers and users. Nothing in the DP or in TIC members' practice experience dictates a need to change this format.

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?

TIC agrees that discontinued operations should continue to be presented as a separate section within the financial statements. It has proven to be the clearest and most concise method of communicating the effects of disposing business segments and is, therefore, the most decision-useful format. It is also well understood by preparers. Requiring an entity to present information about its





discontinued operations in the relevant categories would be confusing for the users of the financial statements. Disaggregating the information would make the financial statements too lengthy and increase the number of subtotals without improving the quality of the information provided.

- 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?

TIC believes that a management approach would provide the most useful view of an entity to users of its financial statements. However, TIC is concerned that the management approach may be too flexible as written for some entities with unregulated, complex operations. If misapplied, the management approach may result in less useful information to the users of these financial statements, which would outweigh its benefits. In these cases, TIC recommends that more guidance should be provided to management to reduce subjectivity and increase the comparability of financial statements when applying the management approach to classification. TIC believes the management approach will not be a significant issue for companies with simple operations or those with close ties to users/regulators.

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.

When the model is adapted for nonpublic entities, they should be exempt from the classification rules relating to reportable segments and should continue to classify their assets and liabilities at the entity level. TIC believes the current exemption from segment reporting for nonpublic entities continues to be appropriate since lenders, the primary users of private company financial statements, are not asking for this information as a basis for their credit decisions.





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?

The business section and the operating and investing categories within that section are defined appropriately. However, preparers of financial statements for private entities generally will classify their assets and liabilities in the operating category of the business section. As discussed in the response to Question 2 above, this aspect of the model is not expected to have a significant effect on most of the preparers within TIC's constituency.

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?

The financing section and the financing assets and financing liabilities categories within that section are defined appropriately. TIC agrees that the financing section should be restricted to financial assets and financial liabilities as defined in IFRSs and U.S. GAAP as proposed, since this is a practical alternative that would result in increased consistency and comparability among entities.

However, TIC believes the application guidance in paragraph 2.34 is unclear as to how management would classify either a financial asset or financial liability that is "interchangeable with other sources used to fund its business activities." The guidance should be clear as to how the existence of such interchangeable funding sources, as well as the nature of the industry, affects whether or not the item is classified as financing or operating. TIC therefore recommends that paragraph 2.34 be revised for clarity.

# **Chapter 3: Implications of the Objectives and Principles for Each Financial Statement**

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?

TIC agrees that an entity should present a classified statement of financial position except when a presentation of assets and liabilities in order of liquidity provides information that is more relevant. The industries most likely to use the liquidity format are real estate and financial services. TIC believes that the guidance provided in the DP for distinguishing which entities should present a statement of financial position in order of liquidity is adequate.

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?

TIC members were split in their response to this question. Some members agree that cash equivalents should be presented and classified in a manner similar to other short-term investments and not as part of cash. They believe cash equivalents are usually short term investments and classifying these as such, and not as part of cash, would increase the usefulness of the financial statements to the decision makers. In their view, cash is uniquely liquid and should not be combined with instruments that have stated maturity dates (no matter how short) or that cannot be drawn upon at any time without penalty. Recent events in our economy have shown that even very short-term investments have a valuation risk that did not exist before. This approach has the added advantage of simplicity since it would be readily understood by all users.

However, other TIC members believe the DP goes too far in its proposed requirement to present and classify all cash equivalents in a manner similar to other short-term investments. Certain cash equivalents such as money market accounts and overnight investments that are "swept" from business checking accounts are so near to cash that omitting them may be misleading to users. Therefore, they suggest that the Board either retain the current definition of cash equivalents for the cash flow statement or re-define the term cash equivalents to short-term investments that are almost identical to cash (i.e., highly liquid investments in the immediate, short-term).





In view of the differing opinions among TIC members, TIC suggests that the Board study this issue further and, in particular, solicit additional feedback from private company users as to their preferred definition.

- 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?
  - 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; however, TIC believes that this information would be more useful in the notes to the financial statements. For nonpublic entities, the footnote should be optional, since this level of disaggregation would be unnecessary for most financial statement users. The disaggregation of similar assets and similar liabilities that are measured on different bases will create lengthy statements of financial position, which may result in more confusing and less useful information to the users of 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?
  - TIC agrees that an entity should present comprehensive income and its components in a single statement of comprehensive income, as proposed, since this would increase comparability and consistency among financial statements of different entities.
- 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?
  - Yes. TIC believes that this information would be decision-useful and would enhance the user's understanding of the relationship between the statement of comprehensive income and the statement of financial position.
- 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?

TIC believes further disaggregation of revenues, expenses, gains and losses by their function, by their nature or both will be decision-useful for many financial statement users. Generally, most private companies provide a greater level of detail in their financial statements than public companies. Not-for-profit organizations also provide functional expenses and program information that reconciles to their natural expenses. However, some management discretion should be permitted as part of this requirement. Preparers should be allowed to exercise judgment in the level of detail provided thus balancing the two objectives to meet user needs while minimizing the cost to re-configure their accounting systems.

- 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.
  - TIC agrees with paragraph 3.55 that proposes an entity should allocate and present income taxes within the statement of comprehensive income in accordance with existing requirements due to the complexity of existing requirements over income taxes. Further allocation of income taxes into sections and categories would be too complex for preparers and would not provide useful information to the decision makers.
- 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?

TIC supports the Board's proposal to 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. Most foreign currency transaction gains and losses incurred by TIC's constituency are easily associated with a particular income statement account—usually purchases of inventory—and would not involve excessive cost to classify in the applicable financial statement category.

- 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?
  - 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?

The direct method of presenting operating cash flows may provide information that is decision useful; however, TIC is concerned that this information would be too costly to gather for many private entities. TIC has also found that the direct method is more useful for some types of industries (e.g., construction contracting) than for others (e.g., financial services). Therefore, TIC recommends that the Board continue to allow either the direct method or the indirect method for presenting operating cash flows, thereby allowing financial statement users to dictate the presentation that best serves their needs.

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?

Preparers within TIC's constituency would have both one-time and ongoing application costs to use the direct method to present operating cash flows. A





significant one-time implementation cost would be the need to update and reconfigure financial reporting information systems so that the entity is able to obtain the new required cash receipts and cash payments information at the detailed level proposed in this Discussion Paper. An ongoing application cost for nonpublic entities would be the need to hire a third party to assist management in preparing the statement of cash flows under the direct method, since many entities would not have the in-house expertise to deal with the level of detail required and the complexity of the direct method.

## **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?

TIC supports the Board's proposal to require an entity that presents assets and liabilities in order of liquidity in its statement of financial position to disclose information about the maturities of its short-term contractual assets and liabilities in the notes to financial statements. Also, TIC believes such disclosures would be equally useful for entities that present a classified balance sheet and recommend that maturities be a requirement for all entities.

- 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.
  - 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 clear and sufficient to prepare the reconciliation schedule? If not, please explain how the guidance should be modified.





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. However, TIC is concerned this information will be very costly and time consuming to gather and compile. In addition, it will add to the cost of audits, compilations and reviews. This proposed schedule may be very confusing and difficult to understand for many users of private company financial statements; and therefore, the costs of preparing this schedule will greatly outweigh any benefits it may provide.

- 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?

As discussed above, TIC is not supportive of the reconciliation schedule for nonpublic entities. TIC's response below is presented on the assumption that the reconciliation becomes a requirement.

TIC would not support the addition of a memo column in the reconciliation schedule to draw users' attention to so-called "less persistent and more subjective" components of line items in the balance sheet or statement of comprehensive income. Such items would be disclosed at management's discretion and would not be consistently applied among entities since the guidance in paragraph 4.51 is not operational in practice. In addition, disclosure of events or transactions that fall outside the scope of APB Opinion No. 30 (i.e.,





those that are neither extraordinary, unusual nor infrequent) would not provide reliable, predictive information to users about future cash flows and could be misleading. TIC considers the criteria in APB Opinion No. 30 appropriate and believes no further disclosure of "less persistent or more subjective" events is necessary for users.

### Question 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 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.

TIC believes that the existing financial statement model meets the objectives and needs of the current users of the financial statements of nonpublic entities. The project objectives discussed in the Discussion Paper do not seem to portray the needs of the users of nonpublic entity financial statements. These users have not expressed a need to have more cohesive and disaggregated financial statements. Users of nonpublic entity financial statements have information systems in place to analyze the information already provided in the current financial statement presentation model and would incur unnecessary costs to update and adapt their lending models to the proposed presentation model. Similarly, nonpublic entities would also have to incur high costs to restructure their information systems and to provide training to their accounting departments.

However, TIC believes that if the FASB does proceed with implementing the proposed financial statement presentation model for public entities, then a variation of the proposal should also apply to nonpublic entities.

Having two separate financial statement presentation models for public and nonpublic entities would not be in the public interest and would add too much complexity for all constituents. Universities would need to teach two separate types of financial statement presentations, and accounting firms would be required to have separate staff for public and nonpublic entity clients. In addition, a user could not easily compare the financial statements of public and nonpublic entities. Nonpublic entities that were considering going public would have to plan for the additional cost of recasting their financial statements into the





proposed financial statement presentation model.

Since two separate and distinct presentation models would not be a practical alternative, TIC suggests the following modifications to the proposed model to provide cost-effective alternatives for nonpublic entities:

- Appropriately scale back disclosures and tailor the model to private entities; for example;
  - Continue to offer the option of preparing the statement of cash flows under either the direct or indirect methods;
  - Eliminate the proposed reconciliation schedule that would reconcile cash flows to comprehensive income;
- Consider establishing a phased-in transition period.

TIC believes the FASB should begin a comprehensive study as soon as possible to consider these and other modifications that may be necessary to meet the needs of private company users.

TIC appreciates the opportunity to present these comments on behalf of PCPS member firms. We would be pleased to discuss our comments with you at your convenience.

Sincerely,

Stephen Bodine, Chair

Stephen Bodine

PCPS Technical Issues Committee

cc: PCPS Executive and Technical Issues Committee

