MINUTES

To:	Board Members
From:	Financial Statement Presentation Team (Beckendorff (ext. 229))
Subject:	Minutes of the May 16, 2007 Financial Statement Presentation Board Meeting—Presentation of Liquidity Information, Classification Issues Related to Diversified Entities, and Segment Reporting
Date:	May 24, 2007
cc:	FASB: Bielstein, Smith, MacDonald, Leisenring, Chookaszian, Polley, Gabriele, Petrone, Lusniak, Kawanishi, Van Beek, Beckendorff, Bossio, Lott, Stoklosa, C. Smith, Cafini, Bolash, Sutay, Klimek, Allen and FASB Intranet; IASB: Barker, Gomez, N. Suzuki, and Hickey; GASB: Schermann and Reese

The Board meeting minutes are provided for the information and convenience of constituents who want to follow the Board's deliberations. All of the conclusions reported are tentative and may be changed at future Board meetings. Decisions become final only after a formal written ballot to issue a final Statement or Interpretation.

Topic:	Financial Statement Presentation— Presentation of Liquidity Information, Classification Issues Related to Diversified Entities, and Segment Reporting
Basis for Discussion:	FASB Memoranda No. 51A – C
Length of Discussion:	9:00 to 10:10 a.m.
Attendance:	
Board members present:	Herz, Batavick, Crooch, Linsmeier, Seidman, and Trott
Board members absent:	Young
Staff in charge of topics:	Lusniak, Cafini, and Petrone
Staff at Board table:	Petrone, Beckendorff, Bielstein, Cafini, Lusniak, C. Smith, and Van Beek
Other participants:	Barker, Gomez, Kawanishi, and Suzuki (by phone)

Summary of Decisions Reached:

The Board discussed two issues: (1) the presentation of liquidity information and (2) classification issues related to diversified entities, including issues related to segment reporting.

Presentation of Liquidity Information

The Board decided to revise the working principle related to presenting information about the liquidity of an entity's assets and liabilities to read as follows:

> Financial statements should present information in a manner that helps a user assess an entity's ability to meet its financial commitments as they come due and to invest in business opportunities. An entity's ability to meet its existing financial commitments includes, but is not limited to, its ability to use existing assets and to raise capital. An entity's financial commitments include those related to operations, financing, and equity holders.

In applying that working principle, the Board decided that:

1. Entities that are not financial institutions should present a classified statement of financial position.
2. Entities that are financial institutions (such as banks, investment banks, and insurance companies) should present a detailed maturity schedule for short-term contractual assets and liabilities.
3. All entities should present a maturity schedule for long-term contractual assets and liabilities.
4. All entities should disclose the following capital management information:
    a. Qualitative information about an entity's objectives, policies, and processes for managing capital, including (but not limited to):
        (1) A description of what it manages as capital
        (2) When an entity is subject to externally imposed capital requirements, the nature of those requirements, and how those requirements are incorporated into the management of capital
        (3) How it is meeting its objectives for managing capital.
    b. Summary quantitative data about what an entity manages as capital.
    c. Any changes in the above qualitative and quantitative data from the previous period.
    d. Whether during the period an entity complied with any externally imposed capital requirements to which it is subject.

e. When the entity has not complied with such externally imposed capital requirements, the consequences of such non-compliance.

Classification Issues Related to Diversified Entities and Segment Reporting

The Board decided that a consolidated reporting entity consisting of significantly different businesses (a diversified entity) should apply the classification criteria to its assets and liabilities at the reportable segment level (as that term is defined in FASB Statement No. 131, *Disclosures about Segments of an Enterprise and Related Information)*. The Board expressed the preliminary view that the segment disclosure requirements in Statement 131 should be replaced with a requirement to disclose operating and financing category information (at a minimum) for each reportable segment for each primary financial statement (that is, the statements of financial position, comprehensive income, and cash flows). Assets and liabilities that are managed by a reportable segment would be allocated to that segment and measured on a basis consistent with the amounts reported in the consolidated financial statements.

Objective of Meeting:

The objective of the meeting was for the Boards to discuss the presentation of liquidity information and classification issues related to diversified entities, including issues related to segment reporting. The objective of the meeting was met.

Matters Discussed and Decisions Reached:

PRESENTATION OF LIQUIDITY INFORMATION

The Liquidity Working Principle

1. Ms. Lusniak stated that, at the February 2007 Education Session, the Board discussed adding the notion of solvency to the liquidity working principle and asked the staff to consider adding the concepts of capital adequacy and financial flexibility to the working principle. She stated that the staff had modified the liquidity working principle to read as follows:

> Financial statements should present information in a manner that helps a user assess an entity’s ability to meet its financial commitments as they come due and to invest in business opportunities. An entity’s ability to meet its existing financial commitments includes, but is not limited to, its ability to use existing assets and to

> raise capital. An entity's financial commitments include those related to operations, financing, and the payment of dividends.

She stated that the staff believes the current language addresses Board member concerns about trying to define solvency, addresses the primary reason a user wants to know about nearness to cash (to determine whether an entity can pay its financial commitments), and is more explicit about the concepts of solvency (capital adequacy and financial flexibility) without using those specific terms.

2. On behalf of Mr. Young, Mr. Herz suggested collapsing "financing and the payment of dividends" in the working principle into "providing cash flows to capital suppliers." Mr. Batavick stated that he would be reluctant to include the notion of providing cash flows and noted that the concept of "capital providers" would need clarification. Ms. Petrone suggested the last sentence of the working principle read "An entity's financial commitments include those related to operations, financing, and equity holders." All Board members agreed with revising the language of the working principle to include Ms. Petrone's suggestion.

Quantitative Disclosures

3. Ms. Lusniak stated that the staff previously recommended that there be maturity schedules to help users assess the liquidity of an entity's assets and liabilities. She noted that, while the Board agreed with the staff recommendations regarding long-term contractual maturities, there were concerns about the short-term maturity schedules and whether an entity could provide the same information using a classified statement of financial position. She stated that the Board was also concerned about what types of entities should provide more detail about short-term maturity than can be found on the statement of financial position.

4. Ms. Lusniak stated that, in keeping with the Board's preference for a principles-based requirement, the principle would be that all entities should present information about the maturities of all their contractual assets and liabilities. She stated that some entities will present more information about short-term contractual assets and liabilities and some entities will present more information about non-contractual assets and liabilities. Ms. Lusniak stated that the staff recommended the following quantitative disclosures:

a. **Entities that are not financial institutions** should present a classified statement of financial position. That is, they should present short and long-term subcategories for operating, investing, and financing assets and liabilities.

   i. An asset or liability would be classified as short-term if the shorter of the contractual maturity or the expected realization or settlement of the asset or liability is within one year.

b. **Entities that are financial institutions** (such as banks, investment banks, and insurance companies) should present a detailed maturity schedule for short-term contractual assets and liabilities.

   i. Contractual maturity dates should be used in the schedule. If the expected realization/settlement date for any asset or liability is significantly different from the contractual maturity date, the entity should explain that difference.

   ii. An entity should use its judgment to determine the amount of detail provided. For example, an entity might determine that the following time bands are appropriate: on demand, less than one month; more than one month and not more than three months; and more than three months and not more than one year.

c. **All entities** should present a maturity schedule for long-term contractual assets and liabilities. Much of this is already required to be disclosed (leases, pensions, long-term debt).

   i. Amounts presented should be undiscounted and the schedule should reconcile to the statement of financial position.

   ii. Contractual maturity dates should be used in the schedule. If the expected realization/settlement date for any asset or liability is significantly different from the contractual maturity date, the entity should explain that difference.

   iii. If short-term/long-term "placement" in the schedule differs from what is on the statement of financial position (if short- and long-term categories are presented), the entity needs to explain that difference.

5. Ms. Seidman stated that she believed the staff recommendation is more complicated than it needs to be. She suggested simplifying the issue by requiring all entities to disclose all contractual maturities and explain any differences, on a qualitative basis, between contractual and expected maturities. She stated that when talking about this issue in the context of the basic framework for the presentation of financial statements, there is already a split between operating, business, and financing. She stated that that information, combined with the segment information that will be disclosed, will provide users with a sense of an

entity's business cycle. Thus, assets and liabilities without contractual maturities (like inventory) could be assessed based on the user's knowledge of the business cycle. Mr. Herz stated that the problem with Ms. Seidman's view was that many users don't use the footnotes.

6. Messrs. Trott, Crooch, and Herz supported the staff recommendation. Mr. Trott stated that he believed it was a move in the right direction. He stated that the recommendation would provide some structure allowing information to be presented in a format that could provide users with information on current assets and current liabilities (such as quick ratios). Mr. Trott suggested that in future illustrations of the proposed format for the statement of financial position that short-term assets be separated from short-term liabilities within each of the sections instead of being randomly grouped together as they are in the current set of financial statements. Mr. Trott noted that constituents would provide feedback on this issue in response to the Preliminary Views.

7. Mr. Linsmeier stated that he agreed with Mr. Trott and that he supported the staff recommendation based on the belief that the Preliminary Views will include questions, especially regarding the following two issues.

a. Which entities should present a classified statement of financial position and why.
b. What information should be disclosed about contractual maturities and should financial and non-financial institutions provide the same information.

8. Mr. Linsmeier stated that it would be useful to clarify in the Preliminary Views why it is only useful for non-financial institutions to provide a classified statement of financial position and ask whether that reasoning makes sense. In his view, it is not useful for a financial institution to provide a classified statement of financial position, because their long-term assets and liabilities have short-term liquidity implications. Thus, classifying any item as long-term could be misleading.

9. Mr. Trott stated that his reasoning of why only non-financial institutions should provide classified statements of financial position was different than Mr. Linsmeier's. In his view, financial institutions should not provide a classified statement of financial position because the contractual maturities of many of the financial instruments held by financial institutions do not indicate their liquidity. For example, a financial institution's stock

portfolio is not liquid because of contractual maturities but because there is a liquid market for the stocks. Mr. Trott stated that inventory held by non-financial institutions does not have that same form of liquidity, and it is better presented in a short-term/long-term classification (a classified statement of financial position). Mr. Herz noted that there is a conversion cycle for non-financial institutions but not one for financial institutions.

10. Mr. Batavick stated that he agreed with the staff recommendation for purposes of the Preliminary View because it was consistent with the objectives of the project. He stated that he had some concerns regarding the operationality of the staff recommendation and noted that the proposed limited field tests would help address his concerns.

Qualitative Disclosures

11. Ms. Lusniak stated that the qualitative disclosures focus on capital adequacy and financial flexibility. She stated that the staff recommends an entity disclose the capital management information as described below (she noted that these requirements were the same as those recently added to IAS 1, *Presentation of Financial Statements*):

a. Qualitative information about an entity's objectives, policies, and processes for managing capital, including (but not limited to):
    i. A description of what it manages as capital
    ii. When an entity is subject to externally imposed capital requirements, the nature of those requirements, and how those requirements are incorporated into the management of capital
    iii. How it is meeting its objectives for managing capital.

b. Summary quantitative data about what an entity manages as capital. Some entities regard some financial liabilities (for example, some forms of subordinated debt) as part of capital. Other entities regard capital as excluding some components of equity (for example, components arising from cash flow hedges).

c. Any changes in the above qualitative and quantitative data from the previous period.

d. Whether during the period an entity complied with any externally imposed capital requirements to which it is subject.

e. When the entity has not complied with such externally imposed capital requirements, the consequences of such non-compliance.

12. Ms. Lusniak added that IAS 1 states that "when an aggregate disclosure of capital requirements and how capital is managed would not provide useful information or distorts a financial statement user's understanding of an entity's capital resources, the entity should

disclose separate information for each capital requirement to which the entity is subject." The staff recommends that the financial statement presentation document include a similar requirement.

13. Ms. Lusniak stated that the staff did not recommend requiring the following liquidity risk management disclosures because they are forward looking and are similar to existing MD&A disclosures (she noted that these disclosures were similar to what is in IFRS 7, *Financial Instruments: Disclosures*, except that they would cover financial assets as well as financial liabilities):

> Qualitative information about an entity's objectives, policies, and processes for managing liquidity risk inherent in financial assets and liabilities, including a description of an entity's ability to meet its expected future cash outflows over the near term. The factors that an entity might consider in providing this disclosure include, but are not limited to, whether the entity:
>
> a. Expects some of its liabilities to be paid later than the earliest date on which the entity can be required to pay (as may be the case for customer deposits placed with a bank)
> b. Expects some of its undrawn loan commitments not to be drawn
> c. Holds financial assets for which there is a liquid market and that are readily saleable to meet liquidity needs
> d. Has committed borrowing facilities (for example, commercial paper facilities) or other lines of credit (for example, stand-by credit facilities) that it can access to meet liquidity needs
> e. Holds financial assets for which there is not a liquid market, but which are expected to generate cash inflows (principal or interest) that will be available to meet cash outflows on liabilities
> f. Holds deposits at central banks to meet liquidity needs
> g. Has very diverse funding sources or
> h. Has significant concentrations of liquidity risk in either its assets or its funding sources.

14. The Board agreed with the staff recommendation to require disclosure of the capital management information and not to require disclosure of the liquidity risk information. Mr. Linsmeier suggested clarifying what is meant by "capital" in the capital management disclosures. He suggested that capital management disclosure (a (i)) read "A description of what it manages as capital, operating as well as financing and equity." Mr. Linsmeier stated that this would make it clear that capital includes capital within all of the sections of the financial statements. Mr. Batavick questioned whether the disaggregation requirement following capital management disclosure (e) was necessary. He stated that rephrasing the

requirement as a positive lead-in statement to the disclosures would be more effective. The Board agreed with Mr. Linsmeier's and Mr. Batavick's suggestions.

DIVERSIFIED ENTITIES AND SEGMENT REPORTING

Application of Classification Guidelines

15. Ms. Cafini stated that, in January, the Boards decided to include its preliminary view on how a consolidated reporting entity consisting of significantly different businesses (a diversified entity) should apply the classification guidance to its assets and liabilities. She stated that in it's discussions of how banks might classify their assets and liabilities between the operating, investing, and financing categories, the question arose as to how a consolidated reporting entity that includes both a manufacturing business and a finance business should classify its financial instruments—whether they should be in the same or different categories. Ms. Cafini stated that an entity that is diversified like this may have similar types of assets and liabilities that function differently in its different business models.

16. Ms. Cafini stated that, with regard to Issue 1, the staff proposes three possible alternatives for determining how a diversified entity should classify its assets and liabilities:

> <u>Alternative A:</u> the classification criteria would be set at the **consolidated reporting level**, thus all segments of the reporting entity would classify their assets and liabilities in the same manner.
>
> <u>Alternative B:</u> the classification criteria would be set at the **reportable segment level** and, thus at the consolidated level, similar assets and liabilities could be classified differently.
>
> <u>Alternative C:</u> the classification criteria would be set at some **other lower level**, such as a reporting unit or an operating segment that is not a reportable segment.

17. Ms. Cafini stated that the staff recommends Alternative B—setting the classification criteria at the reportable segment level. She stated that because reportable segments contain operating segments that are similar in nature and economic behavior, similar assets and liabilities at this level are therefore presumed to be used in a similar manner (such as operating or as financing).

18. All Board members agreed the classification criteria should be set at the reportable segment level. Mr. Batavick stated that applying the classification criteria at this level

would provide the most useful information and was consistent with the "eyes of management" approach.

Changes to Segment Reporting Requirements

19. The Board decided to address Issue 3 before Issue 2 since a decision on Issue 3 could make Issue 2 a moot point. Ms. Cafini stated that the staff would like the Board to address possible changes to segment disclosures that may make those disclosures more consistent with the Boards preliminary views on presentation in the primary financial statements. She stated that the staff recommends that the initial discussion document include the Board's preliminary views on the following two questions that would apply to **all** entities:

a. Should the amounts presented in segment disclosures be measured on a basis consistent with amounts presented in the consolidated financial statements? (The staff believes that they should; however, this is more than a presentation issue.)
b. Should the financial information reported by segment include more than what is currently required?[1] Possibilities include (this might be in addition to what's required already or instead of):
    i. Providing the same line items as on each of the primary financial statements for each reportable segment.
    ii. Providing operating category line items as on each primary financial statement for each reportable segment.
    iii. Provide only summary financial information, such as subtotals for each category, from each of the primary financial statements for each reportable segment.

20. Mr. Trott stated that if the "building base" is the reportable segment (decision made in Issue 1), then that (segment) information becomes more critical to the understanding of the consolidated entity. Mr. Herz added that professional users have consistently expressed that segment information is very useful to them.

21. Ms. Cafini asked if Board members agreed with the staff recommendation that amounts presented in segment disclosures should be measured on a basis consistent with amounts presented in consolidated financial statements.

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[1] Current segment reporting guidance requires disclosure of the following for each reportable segment: a measure of profit or loss, total assets, revenues from external customers, revenues from transactions with other operating segments, interest revenue, interest expense, depreciation expense, depletion expense, amortization expense, unusual items, equity in net income of an equity method investee, income tax expense or benefit, extraordinary items, and significant non cash items (not already reported).

22. Ms. Seidman stated that the Basis for Conclusions of Statement 131 explained why that Board did not require consistent measurement bases, and she was unable to provide any change in GAAP or other information to show that the prior Board's conclusion was no longer valid. She stated that she would prefer to say something like, "To the extent that it is possible, present the information in accordance with GAAP. Otherwise, do something reasonable and disclose it." Ms. Seidman stated that she preferred that type of language because she did not want the FASB to have to provide guidance on how to allocate items amongst segments. She stated that, under Statement 131, segment reporting already has to reconcile to GAAP and that she would envision entities to continue doing that, hopefully with a narrower set of items.

23. Mr. Linsmeier stated that he believed items that are managed by segment should be allocated to a segment rather than put into a reconciliation model. He stated that, to make those allocations, management should develop and disclose allocation principles that are not prescribed in current GAAP. Mr. Linsmeier stated that items should not be allocated on an "if possible" basis. He stated that items that are managed by segment should always be allocated, and any allocation principles that management uses to do that should be disclosed. He stated that items not managed by segment should go into a reconciliation column and reconcile back to GAAP by line item.

24. The Board agreed that the amounts presented for segment information should be measured on a basis consistent with the amounts presented on the consolidated financial statements. If, within the operating and financing sections, items are managed by segment, management should allocate those items amongst segments and disclose any allocation policy used. If items are not managed by segment, they should go into a reconciling column.

25. Ms. Cafini asked the Board if the reportable segment financial information presented in the financial statements should include **more** information about assets, liabilities, cash flows, revenues, expenses, gains, and losses that would be presented consistent with the working format; and, if so, to what degree.

26. Mr. Linsmeier stated that entities should provide operating category line items as on each primary financial statement for each reportable segment. He stated, however, that he was concerned about entities that would classify similar items differently amongst segments.

For example, he stated that an entity might have cash in the operating and financing sections, so providing segment information for only the operating section would not provide a complete picture. He stated that those types of entities should provide segment information for their financing section as well. Ms. Seidman added that, if this additional segment information was to replace current requirements, only requiring the operating section segment information would result in the loss of interest expense information that is currently required (as it would be classified in the financing section).

27. Mr. Herz stated that, for purposes of the Preliminary View, he believed entities with more than one reportable segment should break-out everything to the extent possible. That is, entities with more than one reportable segment would be required to provide a consolidating schedule, by segment, for each of the primary financial statements (the statement of financial position, the statement of comprehensive income, and the statement of cash flows). He noted that this might be "overkill," but it would eliminate the issue of what entities have to present what segment information and what entities qualify as "diversified" entities. Mr. Herz also stated that he believed this is the type of segment information that users have been asking for.

28. Mr. Linsmeier stated that he believed entities should be required, at a minimum, to provide operating and financing category line items as on each primary financial statement for each reportable segment and allow entities to provide more if they wish to.

29. The Board agreed that entities should present, at a minimum, for all three primary financial statements, the operating and financing categories, by line item, for each reportable segment. The Board agreed that this information would replace current segment disclosures required by Statement 131. The Board did not decide where this information should be presented (whether in the notes or in a new primary statement).

30. Having reached a decision on Issue 3, which would apply to all entities, including diversified entities, the Board did not need to address Issue 2.

Project Plans

31. Mr. Batavick asked the staff what major issues were still open for the financial statement presentation project. Ms. Petrone stated that the biggest remaining issue was the reconciliation (the disaggregation of changes in assets and liabilities), which was discussed

at the March 2007 Board meeting. She stated that the staff plans to bring that issue back to the Boards in June along with some issues on "basket purchases" and items that do not work well with the cohesive principle (such as foreign currency translation). Ms. Petrone stated the staff plans to bring the remaining miscellaneous issues to the Boards in July. After that, the staff plans to work with a few companies on how their financial statements might be recast based on the package of preliminary views. The Boards would address any issues arising from those efforts in the fall.

Follow-Up Items:

32. None.

General Announcements:

33. None.