



The Association for
Accountants and
Financial Professionals
in Business

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Sir David Tweedie
International Accounting Standards Board
30 Cannon Street,
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Re: Staff Draft of an Exposure Draft on Financial Statement Presentation

Dear Madam and Sir:

The Financial Reporting Committee (FRC) of the Institute of Management Accountants (IMA) appreciates the opportunity to comment on the joint Financial Accounting Standards Board (FASB) and International Accounting Standards Board (IASB) Staff Draft of an Exposure Draft on Financial Statement Presentation. We are providing this input at this time, despite the recent decision to suspend the Boards' deliberations on this project, because the staffs continues to seek input from constituents and we have developed views on the issues.

FRC is the financial reporting technical committee of the IMA. It is comprised of representatives from some of the largest companies and accounting firms in the world, along with valuation experts, accounting consultants, academics and the user analyst community. The Committee reviews and responds to research studies, statements, pronouncements, pending legislation, proposals and other documents issued by domestic and international agencies and organizations.

In summary:

We remain supportive of the Boards' goals of improving financial statement presentation for the benefit of investors and developing a common standard for International and US reporting.

However, parts of the Boards' proposal are insufficiently helpful to investors or are highly costly for preparers. Thus, they do not pass any cost/benefit screen, and the Boards should drop them from further consideration. Those parts include:

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- Direct cash flow presentation,
- Radical new look and feel to the basic financial statements with confusing categories and sub-categories,
- Presenting other comprehensive income on the face of the income statement, and
- Re-measurement schedule.

In contrast, other parts of the proposal offer greater promise because they could be helpful to users. However, in some cases, compliance costs are high and likely excessive. The Boards should focus the project on these parts, and seek ways to retain benefits to users while reducing costs of compliance. Those parts include:

- Increased detail of financial statement captions relative to the minimum currently required by Regulation S-X, particularly when management uses the detail to manage the business
- Additional information about business segments
- Analyses of changes in assets and liabilities from beginning to the end of the period
- Schedule listing highly judgmental or uncertain items affecting income.

Absent changes, the costs of implementing the staffs' current overall proposal will be substantial and unacceptable. Direct costs include systems design, programming, testing, implementation, monitoring and auditing. Indirect costs include inefficiencies, distraction, and opportunity costs. For perspective, at least one of our individual larger multi-national preparer members estimate that their direct costs to comply could exceed hundreds of millions of dollars and require 3-4 years to implement (the costs and time are primarily attributable to efforts needed to comply with direct cash flow and additional by function and nature disaggregation requirements). The areas of the staffs' proposal that are most costly relate to the direct cash flow data, by nature expense detail in the income statement and segment note, and analysis of changes in assets and liabilities.

We discuss each of these points below.

Direct Method Cash Flow Statement

While the incremental benefits of the direct method are suspect, the costs of getting the data are clear and enormous. The idea fails any cost/benefit test.

We disagree with the premise in paragraph 171 that direct cash flow data provides the most relevant view of cash for investors and thus is superior to indirect presentation. Specifically, we note the following:

- In analyzing cash flows, it is most relevant to understand how businesses convert earnings into cash – a notion consistent with indirect presentation. In contrast, the direct method does not facilitate this analysis.
- Management has not sought direct-method data suggests both the power of the indirect approach and incremental weakness of direct cash-flow data. Management typically does

not collect or use direct cash flow data. Rather, to run their businesses, they rely primarily on operating-earnings metrics, supplemented by balance-sheet metrics and cash flow data from indirect-method processes. Companies have spent millions of dollars designing and installing systems to gather this data.¹

- There is no mandate from users of financial statements to impose the direct method. At best, users of financial statements are split on their interest in direct presentation. Further, nearly all users demand continued use of the indirect approach, including users who are interested in a direct presentation. This suggests that users view the indirect method as important and that they don't view the direct method as providing much actionable information on a stand-alone basis.
- Many of the benefits that some users assert the direct method provides could be achieved using an indirect method statement, supplemented by information in the analysis of changes in major asset and liabilities.

While the incremental benefits of direct cash flows are suspect, the costs of getting the data are clear and enormous – by far the highest of any proposal in the staffs' draft:

- Company systems do not capture cash flows. Doing so with the level of confidence required in today's regulatory environment would require capturing the data at the transactional level. This would involve either major revisions to many systems or entirely new systems, requiring billions of dollars of cumulative cost across companies and years to design, build, test, train people, and implement.
- The Boards' "indirect direct" approach is only modestly helpful, and would not significantly reduce costs. At a minimum, internal control requirements would require capturing "non-cash" data at the transaction level. To do so, systems would need to consider and code all transactions, the same as a direct method would require. Further, demonstrating for control purposes that the resulting "indirect direct" method produced results that are substantially similar to the pure direct method would require a direct method cash flow statement anyway.
- There are many complexities involved in preparing a direct or "indirect direct" cash flow statement. These result from multiple subsidiaries, systems and currencies. Our earlier letter discussed some of those complexities¹.

The Boards need not require a direct method cash flow statement even if it were to conclude that specific direct cash flow measures may be relevant to users. For example, some users have suggested that cash received from customers versus from other "non-core" sources would be useful. To meet user needs, the Boards could further evaluate the need for and potentially require specific metrics rather than requiring an entirely different basis for presentation of a core financial statement.

¹ See our March 26, 2009 letter to the Boards on the document, "Preliminary Views on Financial Statement Presentation," for discussion.

Radical New Look and Feel of Financial Statements (New Classifications and Cohesiveness)

We question the usefulness of the radical new look and feel of the financial statements. Further, the costs of educating constituents, restructuring reporting and user systems, recalibrating metrics and models would be huge – way out of line with highly uncertain and modest benefits.

We question the usefulness of the new categories and sub-categories for the following reasons:

- Companies have not implemented central features of the staffs' proposal in preparing financial statements to manage the business, even though central parts of the staffs' approach have been discussed for years. We doubt that outside users of the statements would benefit either.
- We find the many categories and subcategories confusing and distracting. In particular, the loss of traditional asset/liability and current/noncurrent classifications could mask working capital and liquidity issues. For example, companies could report debt and other liabilities and related interest in different sections, undermining credit analysis.
- We are not aware of analyst requesting or attempting projections of financial data that follow the approach outlined by the staffs, suggesting sell-side analysts fail to see the benefits.
- We are not aware of user demand for wholesale changes in the look and feel of the financial statements. In contrast, the basic model of financial statements continues to be the basis for financial modeling, without major complaint.
- The staffs' draft results in arbitrary differences in treatment of similar items. For example, a business combination in an enterprise's line of business likely goes into a new "multi-category" section – not an operating or investing activity (paragraph 100). However, an equity method investment is investing (paragraph 82 a/f), and an intangible acquisition is operating (paragraph 73). Arbitrary classification results in undue complexity and risks confusing users.

While the benefits are questionable, the costs of changing the very foundation of financial reporting would surely be enormous. Costs related to the following need to be considered:

- Companies would need to design, test and implement reporting and control systems to tag and aggregate financial data into different classifications
- Auditors would need to expand audit procedures to test controls and results of new reporting
- Users would need to design, test and implement their data systems and models to accommodate the new classifications
- Users would need to recalibrate their key metrics for valuing companies and measuring credit risk
- All constituents would require significant training in the preparation and use of the new format

We share the staffs' view that users would benefit from understanding operating items in the financial statements separate from investing, financing and peripheral aspects of a company's business. However, they don't need and are not demanding a complete overhaul of the financial statements to gain that understanding. The statements already allow users to distinguish between some of those items. To further assist users, the Boards should consider requiring disclosure in a separate schedule the assets, liabilities, elements of income and operating cash flows that management considers to be non-operating. Any such required disclosure should be based on management's view of "non-operating".

Presenting Other Comprehensive Income on the Face of the Income Statement

We disagree with presenting other comprehensive income (OCI) on the face of the income statement, and favor a two-statement approach.² The Committee's views are summarized below:

- Elements of OCI are meaningless to users as elements of income and do not help them predict the amount, timing and uncertainty of cash flows. We are not aware of any users that include OCI in their measure of income. Including them on the income statement does not improve their relevance. Instead, it distracts focus on what matters.
- A single statement of comprehensive income will confuse or at a minimum force users to sift through more information to find the information they want. It would de-emphasize net income as a useful measure while giving the illusion of importance to OCI elements.
- Current reporting already meets the Boards' stated objectives for reporting comprehensive income.
- The shortcoming in reporting OCI is not due to the manner or geography of its reporting, but by the lack of concept behind OCI elements. In a future project, the Boards should holistically address OCI and develop principles for its use and recycling into income.
- We disagree with the requirement in paragraph 139 to disaggregate OCI items into operating, investing and financing components. We doubt the usefulness of that dissection given the confusion over OCI generally.

We appreciate that the Boards recently re-deliberated this issue in the OCI project, and agreed to allow a two-statement approach.

Re-Measurement Schedule

We are confused by the logic and purpose of the re-measurement schedule, as the staffs' draft defines it. We suggest the staffs rethink that schedule, and perhaps change it to list the income effects of highly uncertain estimates and judgments.

Paragraph BC 219 says that the purpose of the re-measurement schedule is to "...help users of financial statements in assessing the extent to which the various components of comprehensive income will recur in the future." However, GAAP and the staffs' proposal already require or

² See our letter to the FASB and IASB on the exposure draft on Comprehensive Income dated July 15, 2010 discussing reasons for our view.

propose several other means of achieving that objective. For example, GAAP and the draft require disclosure of unusual or infrequently occurring events or transactions. Also, the analysis of changes in assets and liabilities requires disclosure of noncash transactions that are neither recurring nor routine.

The staffs' premise is that re-measurements "...should have a relatively low correlation with the changes in those same prices or estimates in future periods." We are not aware of data to suggest that premise is true.

To identify non-persistent items in income, users benefit from information about unusual and non-recurring transactions and events (which the staffs' draft addresses), and uncertainty in judgments and estimates (which existing disclosures partially address). Current requirements regarding judgments and estimates tend to focus on uncertainty in the measurement of balance sheet items, and disclosures are in different places in the notes to financial statements and in MD&A.

Users could benefit from a single schedule that lists the income effects of highly uncertain estimates and judgments. The schedule would help flag non-recurring items in income. While the correlation between uncertain measures and non-recurring items is not perfect, the two are often related. The schedule would help users size the uncertainty and risk affecting net income, an obvious goal of forecasting, risk assessment, and valuation. We acknowledge that developing a workable definition of what might fit within this schedule would be challenging. Accordingly, further outreach to preparers and users would be advisable before proposing such an approach.

Increased Detail of Financial Statement Captions

The staffs' draft includes the helpful notion to disaggregate information to the level of detail that is useful in predicting an entity's cash flows. Many companies today provide extensive detail about their revenues and expenses often to meet user's requests and needs for information. In our experience, providing detail beyond the requirements of Regulation S-X is often helpful to users.

The nature of the detail users find helpful depends on the particular company's circumstances. However, we suspect that the most frequent requests for more detail relate to the following:

- Revenues for major product lines or services, particularly for single-segment companies. (Segment reporting provides critical detail for multi-segment companies, and often provides the equivalent of major product-line information.)
- Costs and expenses related to each disclosed revenue stream so that users can understand the relative profitability of major product lines.
- Components of major costs driving margins and operating earnings. Examples of major costs often relate to labor, key materials, occupancy, transportation, energy, marketing and advertizing, selling, R&D, and bad debts.

- Major components included in “other” captions on the balance sheet and income and cash flow statements (amounts in these captions are often not correlated to a company’s business operations).
- Additional details related to business segments (we discuss this in the next section).

Possible user benefits of reporting more detail in the above areas include:

- Better understanding of the sources of revenues and relative profitability of those sources (this is particularly relevant if growth rates and profitability are diverse).
- Better understanding of the nature of costs and their behavior in various economic conditions. That in turn, helps users forecast the future and assess a company’s risks and opportunities.
- Greater insight into a company’s business model and how it compares to competitors’ models.
- Increased confidence in audited data, whereas auditors do not audit references to revenue and cost data cited in MD&A.

Despite the appeal of expanding the detail in financial statements, there are severe practical problems, including:

- Many companies, including single segment companies, sponsor dozens of product lines. Deciding how to group them for financial reporting would be difficult and somewhat arbitrary. Most companies report product and service line revenues for internal purposes to manage the business that are more detailed than appropriate for external reporting.
- Determining the profitability of major product lines or services may require difficult and arbitrary allocations of costs and expenses.
- Disclosing revenues from major product lines and their related profitability would provide competitively harmful information for many public companies.
- Determining components of major costs at a consolidated level would be difficult and costly for some companies to gather and report because:
 - Many companies do not report components of costs at a consolidated level for internal purposes. Instead, those companies budget, report and forecast those costs at a much lower level in the company – the point at which operating managers can control them. For example, costs of goods sold at the consolidated level often includes no detail of the cost components within that broad category. The actual detail can be housed in ad hoc and non-standard repositories and formats to best meet individual business unit needs.
 - Companies do analyze disaggregated cost data at the consolidated reporting level for senior management, the board and to prepare MD&A. However, such analysis evolves over time based on underlying business and external variables that impact trends. For example, they could focus on certain material costs that significantly changed during one period, and heavy marketing to support a new product launch the next period. Because these analysis needs are ad hoc and evolve over time, standard systems generally do not exist to capture the disaggregated data on a consistent basis at a consolidated level. Rather, employees often perform that

analysis at a disaggregated level, utilizing the same ad hoc and non-standard information repositories noted in the preceding bullet point. This may be at the individual budget or cost center level where the company reports and controls those costs. Employees analyze and aggregate the results of this analysis depending on their particular situation.

- Reporting consolidated costs and expense detail in audited financial statements would require major changes to systems and processes for many companies. Those changes would aggregate cost data from many cost centers and require design, programming, testing, implementation and audit work. Those changes would be costly and provide limited usefulness to management in managing the business.

Because both the benefits and costs of reporting additional detail are significant and largely uncertain, we encourage the Boards to perform more work before deciding how to proceed. That work should verify with users the utility of greater line-item detail, using case examples where possible. The work should also seek to quantify the frequency, extent and costs of major system changes that would result from reporting additional cost information. With the benefit of that work, the Boards will be in better position to gauge whether the benefits are worth the high costs.

Further work could also surface middle-ground solutions that could retain much of the benefits but at reduced cost. For example, perhaps companies could disclose some information at minimal cost, such as more detail about revenues and costs by function.

Additional Information About Business Segments

We appreciate that users view segment data as valuable. For a multi-segment company, the user's unit of analysis is often the business segment. In concept, many users would like complete financial statements for each business segment. Management could also refer to the additional data when explaining the company's financial performance.

However, for important practical reasons, the Boards have restricted the segment data that companies report as follows:

- Segment reporting relies on information the company uses to manage the business, even if that information is inconsistent with GAAP. This concept reduces costs of collecting data.
- Segment reporting has restricted data reported to vital measures. This concept reduces the need to produce information solely for disclosure. It also reduces the competitive disadvantage of reporting sensitive segment data.

Both of these concepts remain important, and we know of no developments in recent years that has reduced their relevance.

In contrast, the FASB staff draft proposes to abandon both concepts. It would require companies to report income and expense items, operating profit, assets, liabilities and cash flows regardless

of whether management uses this information to manage the business. It also greatly expands segment information beyond the vital few disclosures currently required.

Complying with the staff draft would impose significant costs on companies:

- As discussed in the preceding issue, reporting costs by nature would require major and costly systems modifications for many companies.
- Reporting operating profit, assets, liabilities, and cash flows by segment would also require major and costly systems modifications for many companies. The reason is that some companies manage certain assets and liabilities, such as receivables and payables centrally, and out of the control of the business segments. They do not allocate those assets and liabilities to the segments in managing their business, and doing so would require work solely to meet a reporting requirement. Many companies do not compute segment cash flow. Doing so would obviously require segment operating balance sheets, and a process of preparing and aggregating cash flow worksheets.
- The additional segment disclosures would provide competitively sensitive information that would inform competitors, customers and suppliers, to the company's disadvantage.

Our sense is that the costs of disclosing all the new segment information outweigh its benefits. As an alternative, the FASB could consider scaling back the proposal to reduce costs, while retaining key benefits for users. Some ideas to consider in the tradeoff include the following:

- Dropping income and expenses by nature. Instead, companies could report income and expense items by function or nature, depending on the information reviewed by segment management.
- Reporting operating assets and liabilities based on the information reviewed by senior management, without allocating assets and liabilities managed centrally. Companies would then describe the assets and liabilities not allocated to segments.
- Dropping segment cash flows. Instead, companies could explain the nature of the segment's assets and liabilities not allocated to the segments, so that users could gain a sense of segment cash flows. For example, companies could explain the customary terms and collection experience of receivables and payables generated by the segments and managed centrally.

Analysis of Changes in Assets and Liabilities

The analysis of changes in assets and liabilities could help users gain insight into quality of earnings and cash flows. For example, it can assist users in:

- Quantifying the effect of non-routine transactions and events that the user could choose to exclude from income measures when analyzing sustainable earnings
- Quantifying the effect of judgments and estimates inherent in accounting allowances and allocations. Users could use that data in assessing the sustainability of earnings and cash flows and the uncertainty of those measures.

- Understanding the reasons why account balances change and how they respond to changes in economic circumstances. That knowledge, in turn, can help users forecast financial performance.

Despite its potential usefulness, many companies do not accumulate the information to prepare the analysis. Doing so would require building up analyses across entities and reporting systems. The cost and effort of designing, programming, testing, implementing, and auditing the systems to prepare the data would be costly and significant.

In light of the high costs, we suggest that the Boards continue to gather facts about the benefits and cost, and seek ways to reduce costs without sacrificing major benefits.

For example, the criteria in paragraph 244 of the staffs' draft could require analysis of nearly every asset and liability caption in the financial statements. In contrast, we believe that more selective criteria could reduce costs without sacrificing major benefits to users.

We are encouraged that the Boards are gathering facts and views from users and preparers. We urge the Boards to focus the project on areas that offer the greatest benefit for users while seeking ways to reduce the costs of compliance. We hope our comments assist the Boards in focusing the project and evaluating alternatives.

We would be pleased to discuss our views with the Boards or staffs at your convenience.

Sincerely,



Allan Cohen
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Institute of Management Accountants