FINANCIAL STATEMENT PRESENTATION
Private Company Financial Reporting Committee
July 2007

Introduction

The Financial Statement Presentation project is a joint project with the IASB. Since April 2006, the Boards have been discussing fundamental issues related to the presentation and display of information in the financial statements. The current plan is to issue an initial discussion document including the Boards' preliminary views on those issues in the fourth quarter of 2007. At the June Small Business Advisory Committee meeting, the Board discussed the following issues:

1. Disaggregation of changes in assets and liabilities
2. Discontinued operations
3. Presenting information about short and long-term assets and liabilities.

A summary of the Boards' views reached to date and illustrative financial statements are included as Exhibit 1.

ISSUE 1: DISAGGREGATION OF ASSETS AND LIABILITIES

Basis of Disaggregation

One of the project's working principles states that the financial statements should help investors and other users of the financial statements understand the causes of a change in reported amounts of individual assets and liabilities. For example, a change in an asset or liability recognized as income or expense could be due to a change in price, a transaction, or a change in estimate. An investor or other user might weigh each of those changes differently in their analysis, particularly in their assessment of the amounts, timing, and uncertainty of future cash flows.

Note: These materials are provided to facilitate understanding of the issues to be addressed at the July 26, 2007 PCFRC meeting. These materials are for discussion purposes only; they are not intended to reflect the views of the FASB or its staff. Official positions of the FASB are determined only after extensive due process and deliberations.

The Boards have been discussing application of the above working principle since October 2006. In March 2007, the Boards expressed interest in disaggregating changes in assets and liabilities that are recognized as income or expense based on the characteristics of *persistence* and *measurement subjectivity* as those are the primary factors considered in predicting future cash flows. Based on discussions with preparers and users of financial statements, the staff came to the view that *predictive value* (one aspect of persistence) should be the determining factor in deciding whether to disaggregate an amount recognized as income or expense.

Users have consistently expressed interest in segregating changes in fair value from other changes recognized in income or expense. (For discussion purposes, fair value changes include all adjustments resulting from marking an asset or liability to fair value from fair value.) As explained to the staff, users tend to view most fair value adjustments as less relevant for forecasting because the value changes are out of management's direct control and due solely to market forces. The staff is of the view that all fair value changes, regardless of their placement in the fair value hierarchy (as described in FASB Statement No. 157, *Fair Value Measurements*), should be presented together even though Level 3 changes are not due solely to market forces. Based on user interest in information that has predictive value and in separating fair value changes from other changes, the staff developed the following two-dimensional disaggregation diagram.

	Predictive Value	**No Predictive Value**
Fair Value	**Fair value changes with predictive value** ► Gain/loss on trading securities for an investment bank ► Inventory impairment for a retailer	**Fair value changes with no predictive value** ► Gain/loss on investments held for trading ► Gain/loss on derivatives
Not Fair Value	**Non-fair value changes with predictive value** ► Depreciation expense ► Credit sales ► Accrued expenses ► Bad debts ► Warranty reserves	**Non-fair value changes with no predictive value** ► Restructuring reserve ► Litigation reserve ► Loan impairment for a manufacturer ► Inventory impairment for a manufacturer

As illustrated above, amounts recognized as income or expense would be disaggregated into those that have predictive value and those that do not. Secondly, those amounts would be further disaggregated into fair value changes and other-than-fair-value changes. This would result in the following four components:

Component I: Fair value changes that have predictive value
Component II: Other-than-fair-value changes that have predictive value
Component III: Fair value changes that do not have predictive value
Component IV: Other-than-fair-value changes that do not have predictive value.

The staff is of the view that management should disaggregate (classify) the amounts recognized as income or expense into one of those four components based on their knowledge of the reported information and underlying business. This would allow a retail business, for example, to classify inventory impairment in a manner different from a manufacturing business. Putting the classification decision in the hands of management is consistent with the Boards' preliminary view that assets and liabilities should be classified into functional categories based on management's view of its business.

Format for Presenting Disaggregated Information

Once the Boards decide the basis on which to disaggregate changes in assets and liabilities, they will need to decide how to best present that information in the financial statements (most likely in the notes). The following paragraphs describe three alternative presentation formats, each of which is from a different financial statement perspective. The alternatives are illustrated in Exhibit 2. Exhibit 1 includes the illustrative financial statements on which the alternatives were based.

Alternative A: Reconciliation of Statements of Financial Position

In March 2007, the staff recommended that a columnar reconciliation of the beginning and ending statements of financial position be provided in the notes to financial statements as a means of disaggregating the changes in assets and liabilities. That reconciliation would have disaggregated the changes in each line item on the statement of financial position into a number of components. In addition to including a column for each of the components of comprehensive income (such as Components I-IV above), a reconciliation of this nature would include:

- a column for cash transactions
- captions from the statement of cash flows and statement of comprehensive income that would "link" the statement of financial position line items to the statement of comprehensive income and the statement of cash flows and
- a column for non-cash, non-income changes (to reconcile to ending balances).

The Boards agreed to consider a reconciliation of statements of financial position because it provided information about changes in assets and liabilities while at the same time achieving "line-item" cohesiveness (furthering the project's governing working principle that the financial statements should present information in a manner that portrays a cohesive financial picture). However, Board members expressed some reservations with the mechanical nature of the reconciliation and its inherent complexity.

Alternative B: Comprehensive Income Matrix

Because of various complexities associated with a statement of financial position reconciliation, such as foreign currency translation adjustments and intercompany transactions, the Boards also will consider presenting the components of comprehensive income in a matrix format. That matrix would begin with the comprehensive income statement and include a column for each of the four components. There would be no linkage to the statement of financial position or the statement of cash flows.

Alternative C: Reconciliation of Statements of Cash Flows and Comprehensive Income

A third alternative, not yet addressed by the Boards, would be to reconcile the statement of cash flows to the statement of comprehensive income. This reconciliation would start with the amounts and line items in the statement of cash flows, provide details about the items needed to reconcile to the statement of comprehensive income (disaggregated into the four components), and end with the amounts and line items presented in the statement of comprehensive income. This format would link the two change statements and would provide information about the changes in assets and liabilities.

Discussion Questions for Issue 1:

1. Do Committee members agree that *predictive value* is a useful and operational way to disaggregate changes in assets and liabilities recognized as income or expense if the goal is to provide information that is useful in predicting future cash flows?
2. Do Committee members agree that disaggregating fair value changes from other changes is useful and operational?
3. Do Committee members agree with using a management approach for determining the items that would be disaggregated into the four potential components?
4. From what perspective should disaggregated information be presented: the statement of financial position (as in Alternative A), the statement of comprehensive income (as in Alternative B) or the statement of cash flows (as in Alternative C)? Should there be a link between two or more of the financial statements in providing this disaggregated information?

ISSUE 2: DISCONTINUED OPERATIONS

In January 2007, the Boards agreed to converge the definition of a discontinued operation under FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, and IFRS 5, *Non-current Assets Held for Sale and Discontinued Operations*. The Boards tentatively agreed that the definition of a discontinued operation should be based on operating segments. That is, a component of an entity that has been (or will be) disposed of and meets the definition of an operating segment under FASB Statement No. 131, *Disclosures about Segments of an Enterprise and Related Information*, and IFRS 8, *Operating Segments*[1], would be reported as a discontinued operation on the face of the financial statements. In addition, the Boards tentatively decided that for all components of an entity that have been (or will be) disposed of, including those

[1] IFRS 8 was issued in November 2006 as part of IASB/FASB convergence efforts. It achieves convergence with Statement 131, except for minor differences.

reported as a discontinued operation, additional financial information (such as the major classes of: revenues and expenses; cash flows; and assets and liabilities) would be presented in the notes to financial statements.

Statement 131 (paragraph 10) and IFRS 8 (paragraph 5) define an *operating segment* as a component of an entity:

a. That engages in business activities from which it may earn revenues and incur expenses (including revenues and expenses relating to transactions with other components of the same enterprise),
b. Whose operating results are regularly reviewed by the enterprise's chief operating decision maker to make decisions about resources to be allocated to the segment and assess its performance, and
c. For which discrete financial information is available.

Statement 144 provides the following guidance on a component of an entity (paragraph 41) and an asset group (paragraph 4), as follows:

> For purposes of this Statement, a *component of an entity* comprises operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity. A component of an entity may be a reportable segment or an operating segment (as those terms are defined in paragraph 10 of Statement 131), a reporting unit (as that term is defined in Statement 142), a subsidiary, or an asset group (as that term is defined [below]).
>
> For a long-lived asset or assets to be held and used, that group (hereinafter referred to as an *asset group*) represents the lowest level for which identifiable cash flows are largely independent of the cash flows of other groups of assets and liabilities.

Non-public entities are currently excluded from the scope of Statement 131 and, therefore, many small businesses may not have considered what, in their company, would constitute a component of an entity or an operating segment. With the tentative decision to define discontinued operations based on an operating segment, non-public entities would need to apply some of the concepts in Statement 131.

The Boards decided in March that this aspect of the project (changing the definition of a discontinued operation and modifying the disclosure requirements) should be separated from the financial statement presentation project. The Boards plan to meet in the third quarter of 2007 to discuss how to apply the revised discontinued operation definition including how much information should be disclosed about a component that was disposed of. The current plan is to issue an Exposure Draft in the fourth quarter of 2007.

Discussion Questions for Issue 2:

1. What is the prevalence of discontinued operations for small/non-public entities under the current Statement 144 definition of a discontinued operation?
2. Because Statement 131 does not apply to non-public entities and the standard resulting from the discontinued operations project will, do Committee members perceive any difficulties in determining whether
    a. A component of an entity has been (or will be) disposed of, and thus the proposed disclosure requirements would apply?
    b. A component of an entity meets the definition of an operating segment and thus would be presented as a discontinued operation?

ISSUE 3: REPORTING INFORMATION ABOUT SHORT- AND LONG-TERM ASSETS AND LIABILITIES

In May 2007, the Boards addressed what information should be provided in the financial statements to help a user of the financial statements assess an entity's ability to meet its financial commitments as they come due and to invest in business opportunities. The FASB expressed the following preliminary views on that issue (the IASB expressed similar views except where noted):

a. Entities that are not financial institutions should present a classified statement of financial position. That is, entities should present short- and long-term subcategories for operating, investing, and financing assets and liabilities. [The IASB expressed a similar view, except when a presentation based on liquidity provides information that is reliable and is more relevant than short- and long-term subcategories (this is similar to what is currently required in IAS 1, *Presentation of Financial Statements*).]

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. An entity should use its judgment to determine the appropriate level of detail (such as 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). [The IASB had a similar view except that this information would be required only if the statement of financial position is presented in order of liquidity.]

c. All entities should present a maturity schedule for long-term contractual assets and liabilities.

d. All entities should disclose qualitative information about the entity's objectives, policies, and processes for managing capital and summary quantitative data about what the entity manages as capital.

Discussion Questions for Issue 3:

1. Which entities should be required to present a classified statement of financial position?

2. Which entities should be required to present detailed information (such as a maturity schedule) about short-term contractual assets and liabilities?