Financial Statements Unlike Any You've Seen (Part 2)

BY BRUCE POUNDER, CMA, CFM

In last month's column, I introduced you to the "Preliminary Views on Financial Statement Presentation" discussion paper issued recently by the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB). This month, I'll continue with my explanation of key concepts and issues from the paper. I'll also explain how you can help influence the Boards' ongoing standards-setting efforts in the area of financial statement presentation. But first, let's briefly review what was covered in last month's column.

The FASB/IASB discussion paper describes profound changes that the Boards believe should be made to the contents and formats of the principal financial statements. The paper includes illustrative examples of financial statements for the fictitious ToolCo (a manufacturing entity) and Bank Corp (a financial services entity). The examples reflect the Boards' thinking about what financial statements of the future should look like, which amounts to nothing less than a complete reorganization of the balance sheet, income statement, and cash-flow statement as we know them today under both U.S. Generally Accepted Accounting Principles (GAAP) and International Financial Reporting Standards (IFRS).

In this month's column, I will

- Explain three classification issues arising from the presentation model proposed in the discussion paper,
- Describe the proposed cash-to-accrual reconciliation schedule, and
- Address the entity scope of the Boards' proposed model.

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Three Classification Issues

As I described in my previous column, items in the Statement of Financial Position, Statement of Comprehensive Income, and Statement of Cash Flows would be organized in entirely new ways under the FASB's and IASB's proposed presentation model. Specifically, the items in all three statements would be classified into Operating, Investing, or Financing categories by the reporting entity's management. Unlike a more prescriptive approach to classification, this "management approach" has the potential to lower comparability of financial information among reporting entities and to invite inappropriate manipulations of reported information by management. Allowing an entity's management to decide on key reporting matters isn't new under either U.S. GAAP or IFRS, but it remains controversial.

A second classification issue arises from the proposed requirement to subcategorize assets and liabilities reported in the Statement of Financial Position as either short-term or long-term within each of the three major categories. Although it's common practice under current U.S. GAAP for reporting entities to classify balance-sheet items as current or noncurrent, U.S. GAAP doesn't currently require such classification, whereas IFRS currently do. A key difference in the proposed presentation model is that the short-term/long-term classification would be based strictly on a fixed window of time—one year—rather than on the longer of one year or the entity's operating cycle, which is the criterion used under both sets of standards today.

A third issue that arises from the proposed classification scheme is the issue of how items associated with "basket" transactions should or should not be allocated among the sections/categories of the financial statements. The FASB and IASB haven't yet reached a conclusion on how such basket-transaction items should be handled.

Cash-to-Accrual Reconciliation

The discussion paper proposes a requirement for reporting entities to present a columnar schedule that reconciles the cash-basis Statement of Cash Flows to the accrual-basis Statement of Comprehensive Income. Starting with the Business, Financing, Income Taxes, and Discontinued Operations sections of the Statement of Cash Flows (keeping in mind that the Statement of Cash Flows will have been prepared using the direct method), adjustments are then recognized for:

- Accruals, systematic allocations, and other changes that aren't remeasurements (e.g., depreciation, capital expenditures, noncash interest expense).
- Remeasurements that represent recurring changes in fair value (e.g., unrealized holding gains/losses on trading securities).
- Remeasurements other than recurring changes in fair value (e.g., impairment losses).

The cash-flow items, as adjusted, should then tie to the corresponding sections of the Statement of Comprehensive Income. The reconciliation schedule would be presented in the notes that accompany the financial statements.

Entity Scope

The Boards intend that the proposals in their discussion paper would apply to all entities except:

- Not-for-profit entities,
- Retirement benefit plans,
- Entities within the scope of the IASB's forthcoming IFRS for Private Entities (see my "Financial Reporting" column in the August 2008 issue of *Strategic Finance*), and
- Nonpublic entities, as often identified under U.S. GAAP.

With regard to the last exception, the discussion paper notes that "The FASB has not considered explicitly whether the proposals in this Discussion Paper would apply to nonpublic entities." So it's possible that the FASB may ultimately conclude that there should be no difference in the financial statement presentation models of public and nonpublic entities, but that conclusion is far from certain, and it would be nonconvergent with the IASB's view.

How to Get Involved

I often remind my clients and students that the setting and updating of financial reporting standards is more than just a "spectator sport" for accountants. The FASB and IASB adhere to similar "due processes" for promulgating standards. Those processes are designed to solicit and incorporate input from accounting professionals and other interested parties. For example, IMA's Small Business Financial and Regulatory Affairs Committee, which I chair, routinely prepares and submits formal comments on standards-setting matters, as does IMA's Financial Reporting Committee. Both Committees will certainly take advantage of the opportunity to comment on the Financial Statement Presentation discussion paper.

The FASB has made the discussion paper freely available at www.fasb.org/draft/DP_Financial_Statement_Presentation.pdf. The Boards have also taken the unusual step of making an unofficial "snapshot" brochure of the discussion paper available at www.fasb.org/draft/snapshot_discussion_paper_fsp.pdf. Additionally, and also unusually, the Boards have planned for field testing of their proposed Financial Statement Presentation model to be conducted throughout the document's comment period, which ends April 14, 2009.

Individuals and organizations can submit comments on the discussion paper by e-mail to director@fasb.org. "File Reference No. 1630-100" should be included in the subject line of the e-mail. All comments received by the FASB are considered public information. Comments will be posted to the FASB website and included as part of the project record with other project materials.

As I emphasize in *The Convergence Guidebook* (Wiley, forthcoming 2009), the FASB/IASB joint Financial Statement Presentation project is the most concrete, visible example of

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how the convergence of U.S. GAAP and IFRS will profoundly impact the practice of financial reporting in the United States and throughout the world. I encourage readers of this column to take advantage of the present opportunity to gain insight into the future of financial reporting and potentially shape the standards on which much of the work of accounting professionals is based. ■

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