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Financial Accounting Standards Board
401 Merritt 7
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Sir David Tweedie
International Accounting Standards Board
30 Cannon Street,
London EC4M 6XH
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Re: Preliminary Views on Financial Statement Presentation

Dear Sirs:

The Financial Reporting Committee (the FRC) of the Institute of Management Accountants (IMA) appreciates the opportunity to comment on the joint Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) Discussion Paper, *Preliminary Views on Financial Statement Presentation*. FRC is the financial reporting technical committee of the IMA. The Committee reviews and responds to research studies, statements, pronouncements, pending legislation, proposals and other documents issued by domestic and international agencies and organizations.

We are supportive of the Boards' ongoing goal of ensuring an entity's financial statements provide useful information for capital providers to make informed investment decisions. However, we do not believe the preliminary views expressed in this document accomplish this goal. In fact, we believe the resulting financial reporting model would result in less useful information. We do not agree with the prescriptive nature of the proposed financial statement format and content. While the proposal does encourage a management approach in certain respects (for example, the classification between operating and investing activities), it is very prescriptive in terms of the direct cash flow and nature of income and expense elements. We believe these prescriptive elements are inconsistent with the manner in which management designs and prepares its internal management reporting. Because of this, the external financial reporting package will diverge from internal management reporting used by a company to manage its business. We do not believe this diverged reporting will be of any significant value to investors. In fact, we believe it may result in confusion and ultimately less useful information. In addition to our concerns about the usefulness of the information, we have significant concerns about whether certain critical components of the proposal are operational. Our

concerns are focused primarily on 1) the required cash flow elements (both the direct cash flow and the cash flow reconciliation requirements) and 2) the requirement to provide items by their nature in the statement of comprehensive income. Additional perspective is provided below.

Cash Flow Requirements

There are two conceptual alternative approaches for preparing a direct cash flow statement. The first is to create it through the use of indirect data – essentially using the income statement and balance sheet to "back into" a direct cash flow statement. The second is to create a direct cash flow statement from transactional level data. We do not believe either of these is an improvement over the existing indirect cash flow statement for most companies, and each has operational complexities that would make the preparation extremely costly or of questionable value. It is important to note that management is generally not generating or utilizing direct cash flow data to run their businesses. They rely primarily on operating earnings metrics, supplemented by balance sheet metrics and cash flow data generated through the use of indirect-method processes. Companies have spent millions of dollars designing and installing financial systems to gather this data. If management felt additional cash flow granularity was an important information component for understanding and running the business, they would have already made choices to invest in this or similar capabilities. Therefore, we question the necessity of this detail and the value it would provide for outside investors. Additional perspective is provided for each of these methods below.

Indirect Method of Preparing a Direct Cash flow Statement

We considered an "indirect method" of building a direct cash flow statement whereby direct cash flows are derived from indirect data. Under this approach, one would presumably utilize the income statement and balance sheet to back into the cash flow statement. However, current systems do not track balance sheet movements by income statement account, and therefore this would create significant systems work to support, particularly if it were to be cohesive with the nature and function elements of the statement of comprehensive earnings. For example, under the simplest of circumstances one could determine cash sales by adjusting recorded accrual-based sales for beginning and ending accounts receivable. This might be a feasible approach for straight-forward accounts like sales in companies that operate in relatively simple business models on a single systems platform with a single currency. However, we believe this set of circumstances would be rare. Accounts receivable ledger accounts can be impacted by many other types of transactions – for example, estimated payment discounts, sales incentives, returns, multiple elements arrangements, hedging activities, etc. Underlying account architecture would need to be re-designed to capture these and other types of balance sheet movements. This is more complex when operating under multiple systems platforms. It is further complicated when operating in multiple currencies, since the

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impacts of exchange rate changes would also need to be tracked at the transactional level or estimated at a high level.

Basic revenues would be one of the simplest examples. Additional difficulties would be encountered in using this approach for operating and other expense amounts. Certain expenses such as payroll may have a unique liability account associated with them. However, the vast majority of expenses go through accounts payable or other accrual accounts. To use an indirect method, a company would need to have its accounts payable and all of its other liability accounts broken down by both function and further into the natural accounts to which they relate. This would require significant investment in time and dollar cost to add fields to existing general ledger systems around the world to track and then report this information. Alternatively, estimates would need to be used. Even then, certain areas would be limited to fairly summary-level data (e.g., not all expense categories may be capable of being broken out separately and certain major categories are typically grouped as "other expenses), and estimates would still be required for certain items (e.g., currency impacts). The more a particular estimate would need to be refined, the more significant the required additional investment in systems would be.

Estimates used under an indirect approach would by necessity be very broad-based due to the limited data available. Further, the reliability of the data would be questionable due to the vast simplifying estimates that would need to be made. These factors would call into question the representational faithfulness of the information and its verifiability. They would also raise significant controls issues under Sarbanes-Oxley, since the underlying estimations techniques may not be compatible with current control design or testing expectations.

Net, we believe that any direct method cash flow statement constructed using an indirect approach would yield less reliable and informative data for future projections.

Direct Cash Flows from Transactional Level Data

We believe the only way to accurately prepare a Statement of Cash Flows using the direct method is to capture the cash flow data at the transactional level. However, transactional-level cash flow data is not currently available for the vast majority of companies. In fact, most ERP systems used by companies are not even configured to capture the required data, and as discussed further in our comments below, the nature of the data needed to comply with the proposal would most likely require a fundamental redesign of an entity's systems and processes at all levels, from the lowest level transactional activities through the consolidated level reporting systems. This would represent a material project for companies, with cost estimates equal to or likely higher than those anticipated for U.S. companies in a potential IFRS conversion.

We believe some additional perspective would be helpful to the Boards on the relative costs that would be incurred by companies to comply with cash flow elements of this

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proposal.   Companies' information systems architectures include transactional systems which gather and aggregate data for specific needs, and ledger and other reporting components that aggregate and summarize that data (less detail) at various levels, ultimately to consolidated level. In order to prepare the cash flow and related reconciliation data needed to comply with the proposal, distinct transactional level detail would be required to separately capture the various "movement types" within any account (accruals and reversals, payments, receipts, etc.). ERP systems could not be configured to capture that data at higher levels absent the reconfiguration at the transactional level. Even under the best of circumstances wherein a company operates under a standard operating platform with a single ERP system, such a re-tooling of the financial reporting systems from the bottom up represents an extremely expensive endeavor. In instances involving multiple platforms, ERP and legacy systems, the costs could be prohibitive.

The items below further illustrate the complexity, and therefore cost, of redesigning transactional systems up through aggregation.

- Significant risk of volumetric issues within ERP or legacy systems from the need to maintain the transactional level detail though all the consolidation processes. Within general ledger systems, all entries posted to accounts would require coding by "transaction types" (similar to fixed asset movements which designate if the movement is an addition, a disposal, depreciation, etc.) in order to support the direct cash flow statement and the reconciliation. In the same way, any liability movement would need to be classified as establishing the accrual, making payment against the accrual, adjusting the accrual, etc. Further, within areas such as accounts payable, not only would each transaction need to be tagged and tracked through to consolidation level with its "transaction type", but also with a tag for the type of expense (function and nature). This poses not only work process issues (adding multiple steps to something as simple as recording a new accounts payable) but also significant systems volumetric issues when each transaction, including its multiple new tags, must be aggregated up through one massive consolidation level to support the multi-dimensional nature of the proposed reporting and reconciliations. Importantly, this volumetric issue cannot be solved through re-engineering of existing processes and systems. It will likely involve significant investments in physical systems infrastructures, adding to the costs of complying with the proposal.
- Often, the lowest level transactional systems are non-standard around the globe. In order to support consolidated reporting of transactional level data, all supporting transactional systems would either need to be standardized, or interfaces developed to enable aggregating the data from different systems for reporting purposes. It is not unusual for a large multinational company to have many different general ledger systems, each supported by multiple non-standard transactional systems and charts of accounts. Often times, companies have

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multiple instances of ERP systems or a combination of ERP and legacy systems. This further complicates compliance.

- In addition, there are other technical complexities of maintaining and reporting such low level data. For example:
    - o Complexities arise when operating in multiple currencies. Under existing accounting practice, companies translate earnings at average exchange rates during the reporting periods. The cash flow statement does present the exchange impact on cash, but this is at a very high level and generally contains an element of estimation. Under a direct cash flow methodology, transactions would need to be tracked at the transactional level based on actual currencies of the flows, and then translated and aggregated at average exchange rates at the total company level. This is further complicated if the transactions cross multiple currencies.
    - o Intercompany transactions, which under current practice are generally eliminated at the highest levels of consolidation, would need to be tracked at the lowest transactional level in order to be eliminated from the transactional cash flow data reported in the direct cash flow statement and reconciliation.

As stated above, we do not believe there is significant information value to be gained by the direct cash flow statement or the reconciliation disclosure. This is based on the fact that internal management does not use or desire this data to manage the business, nor are we aware of a significant need from our outside investors. Further, we have not identified feasible alternatives to comply with the proposal which would appropriately balance the significant cost against any limited benefit. We did consider using high level estimates, as well as an indirect approach, as alternatives to tracking detailed transactional data. However, these high level estimates would be of questionable information value and likely not of sufficient quality to support an audit in a Sarbanes-Oxley environment.

Accordingly, we strongly urge the Boards to retain the option to prepare cash flow information using the indirect method. For those limited instances in which a direct cash flow method may be perceived as beneficial and feasible by the company's management, we support continuing to allow the choice to present a direct method cash flow.

Comprehensive Earnings by Function and Nature

We do appreciate the desire for further breakdown of the high level cost line items presented in most companies' income statements. We understand from some analysts that the primary driver of this desire is to better understand a company's operating leverage (e.g., to better understand a company's fixed vs. variable cost elements in order to better assess its ability to respond to future sales fluctuations). We do not believe the proposal's prescriptive approach addresses this desire. In the long-term, very few cost

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elements (if any) are truly fixed. In today's business environment, companies can and do respond to significant fluctuations in product demand by increasing and reducing "fixed" costs, even in the short-term, by investing in plant capacity or eliminating it. In addition, companies have different approaches to sourcing their products. For example, one company may source 100% of their products internally, in which case the nature of its cost of sales expense would include the traditional classifications such as labor, materials, depreciation, overhead, etc. However, another comparable company in the same industry may use contract manufacturing for 100% of their products, in which case the nature of its cost of sales expense could be 100% acquired materials. A third company in the same industry could utilize a mix of internal and external sourcing. The same situation could and does exist for companies' sourcing of general and administrative resources. Because of this, we question the value of these prescriptive, detailed cost break-outs.

Consistent with our views expressed above on direct method cash flow data, given that management may not currently capture and utilize operating data by both function and nature, we question the relevance of this proposed additional data to investors. The Proposal's stated objectives are to 1) portray a cohesive financial picture of an entity's activities, 2) disaggregate information so that it is useful in predicting an entity's future cash flows, and 3) help users asses an entity's liquidity and financial flexibility. It appears that the requirement to provide cost elements by their nature is meant to address points 2) and 3). The preceding paragraph provides specific perspective on why we do not believe the proposal will accomplish these objectives. Beyond this specific perspective, we believe it is important to step back and re-assess this issue more broadly. We do not believe highly prescriptive solutions are the most effective means in which to provide investors with decision-useful information. In fact, we believe prescriptive approaches can often result in "check the box," compliance driven approaches that provide very little insight into how a company truly manages its business. To the extent the prescriptive approach deviates from how a company actually manages its business, not only does the approach provide little if any insight, it can often be misleading.

Many of the operational issues presented by the direct cash flow and reconciliation requirements are also present in the proposal's requirement to provide comprehensive earnings data by both function and nature. Most companies' external and internal management reporting frameworks report income statement elements based on their function. The nature of certain expense elements may be available at some level within the information systems. However, the nature of the expenses is generally only tracked for departmental or organizational budgeting purposes. It is not utilized by more senior levels of management to run the company or make significant operating or investing decisions. Further, systems are not configured to accumulate the data at a consolidated level, so supporting processes to fully control the quality and accuracy of the data may not exist. Thus, the same cost and volumetric issues that exist in the cash flow discussion above would exist if companies were forced to present earnings elements by both function and nature. We do not believe the required investment to comply with these

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requirements is worthwhile, particularly given the questionable investor benefit, as discussed above.

Additional complexities would exist in presenting costs by their nature in a manufacturing company. Most manufacturing companies utilize standard costing systems. These systems may aggregate and bucket costs by their nature in the source systems. However, once they are applied to inventory, they lose their nature. Individual cost elements are combined, along with various variance costs, and passed to the balance sheet as in-process and finished goods inventory. It would be virtually impossible to disaggregate these costs back into their underlying nature as they pass back to the income statement at time of sale.

Accordingly, we believe that any proposal to provide an additional level of expense detail should be based on a management approach. It should utilize the functional data already used by management to analyze and manage the business. To the extent a company also utilizes "by nature" expense information to manage its business and allocate resources, companies could be given the option to provide that data. To the extent management utilizes additional key breakouts of currently disclosed functional expenses to manage the business, companies could also be given the option to provide that data. Any such additional breakouts should not be based on a hierarchy, with a "one size fits all" account structure, but instead allow flexibility for communicating the nature of the individual business. This additional level of breakout, in line with how management views the business, would provide relevant disclosure, without requiring fundamental redesign of systems. Of course, any additional disclosure requirements would need to be tested against the risk of disclosing sensitive competitive detail.

Cohesiveness Concept

The Discussion Paper also proposes a "cohesiveness" concept whereby each of the primary financial statements would be segregated into operating, investing and financing sections. While we do not see major operational issues with complying with these requirements, we question how these classification changes would enhance the information value of the statements. We do not have members of our committee that have significant experience in the Board's current field-testing of this proposal. We believe valuable learnings will come from those tests and we withhold judgment on these provisions until the test results are fully analyzed. However, we do have the following specific observations:

- To the extent the Boards ultimately decide to proceed with some form of a cohesiveness concept, we would strongly favor the Boards' proposed management approach as opposed to a prescriptive approach. We believe this would be more meaningful to investors, based on the same rationale used to support the management approach to segment reporting.

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- We believe the definitions of business, operating, investing and financing are generally workable. Importantly, we believe this should be principle-based, with companies allowed to classify items consistent with how they manage the business. While this may result in similar items being treated differently by similar companies, we believe it would be more insightful to investors.
- With respect to the Statement of Financial Position, we believe that the multiple disaggregations could result in losing perspective on the overall financial condition and liquidity of the entity, including its working capital positions.
- We do not agree with the requirement to classify cash equivalents in a manner similar to short term investments. Many companies utilize cash equivalents as a key component of their cash management program. They are highly liquid and can be readily converted to cash to satisfy operating needs. As such, it is also used as a mechanism to manage cash flow. We suspect that a by-product of presenting cash equivalents with other short-term investments in the statement of financial condition is that changes in cash equivalents would also be treated as an investing activity in the cash flow statement. This is inconsistent with how companies use these instruments to manage operating cash flows and believe this would be misleading to investors.
- With respect to the Statement of Comprehensive Income, we agree that discontinued operations should be separated from continuing operations and financing activities. We also agree with the proposed treatment and allocation of income taxes between continuing operations, discontinued operations and elements of other comprehensive income. Finally, we believe companies should retain the ability to present unusual items separately in order to provide needed transparency to investors. Our interaction with analysts indicates that the ability to derive "core" operating income data is critical to them. As defined, the operating section would likely collect all items not specifically defined as investing or financing. This would likely include a large portion of unusual or infrequent items. In order to provide optimal transparency, companies should retain the ability to separately report these types of items within the operating earnings section. In fact, limiting separate presentation to the current definition of unusual or infrequent events may be too restrictive to be of the greatest use to investors.
- With respect to the statement of cash flows, we do have concerns about the impact on capital expenditure and business combination activities. These would appear to fall under operating activities for most companies. While certain companies and analysts may currently view and evaluate normal ongoing capital expenditures as part of their operating cash metrics (e.g., "free cash flow"), major capital initiatives and acquisitions are not. Thus, including them in operating cash flows will not provide any predictive value regarding future operating cash flows, and will result in the proliferation of non-GAAP disclosures to enable users to assess a company's "core" cash flows.

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Single Statement of Comprehensive Income

We do not support the requirement to present a single statement of comprehensive income. We believe the primary focus of companies and their investors is operating and net income. These components capture the traditional operating activities that management can influence in generating a return to investors. By their very nature, the "other comprehensive income" items do not relate to the core business results. These items are presented separately within the statement of shareholders' equity, so users have full access to them. Inclusion of the other comprehensive income items on the face of a primary financial statement will potentially result in confusion to the users. Accordingly, we see no value in requiring their presentation in a single statement of comprehensive income. If the Boards are concerned that the presentation of other comprehensive income items within the shareholders' equity statement is not transparent enough, one alternative that would not take away from the current income statement focus on net earnings would be to segregate the other comprehensive income items in a new statement of comprehensive income, separate and apart from the income statement and shareholder's equity statement (i.e., create a fifth statement). Such a statement could begin with net income and then reflect the elements of other comprehensive income, and could be accompanied with enhanced disclosures of the nature of items included in the statement. We recognize that companies already have the option of providing a single statement of comprehensive income. However, few companies presently do so and requiring this approach may be a modest improvement from the status quo.

Financial Reporting Control Considerations

We believe this proposal will result in significant issues related to companies' controls over financial reporting; particularly the requirements to provide direct cash flow and expense elements by their nature. A critical component to most companies' internal control structure is the entity level controls inherent in "profit proofing" of results (analytic review of results relative to forecasts or expectations). These are carried out by accounting, finance and management professionals responsible for delivering results. As noted throughout this comment letter, many of the prescriptive requirements in the proposal are not, and will not, be used by management to operate or assess the performance of the underlying business, so the external financial reporting package will diverge from how a company manages and assesses its business results. This will make it very difficult to provide analytical perspective on the balances, since the data would merely be the result of a top-level data exercise performed in a centralized organization. This will render the critical entity-level "profit proofing" controls ineffective in many cases. We are concerned that this will lead to increased incidents of financial statement errors and resulting restatements, as well as the related SOX controls issues. We question the wisdom of putting the accounting profession in this position in the absence of a clear benefit and mandate to move to a new financial statement presentation model.

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Conclusion

Net, we do not believe the proposed changes will provide more useful information to investors or represent an improvement in financial reporting, particularly given that the data is generally not even used by management to run the business. Further, we believe the costs to comply with the proposed requirements far exceed any perceived benefit of providing the data externally. We believe the fundamental changes required to companies' ERP systems to capture the direct cash flow information and expenses by their nature will be dramatic (of equal and likely greater magnitude to current estimates on IFRS conversion) and we are aware of no compelling justification for the change. We are pleased that the Boards have taken the opportunity to run pilot programs with certain companies and we look forward to the results of those pilots.

We would be pleased to discuss these comments with the Boards at your convenience.

Sincerely,

Mick Homan
Chair, Financial Reporting Committee
Institute of Management Accountants