

IFRS brings a radical change to financial statement presentation



Imagine having a balance sheet that doesn't look like it balances. If there is one thing that accountants are used to doing it is quickly glancing at a balance sheet to see that the total assets equal the total of the liabilities plus equity. With the introduction of International Financial Reporting Standards (IFRS) in 2011 though, it may not be as easy to see that a balance sheet balances.

By Karine Benzacar, CMA

A discussion paper released by international accounting regulators is proposing to change the look and feel of financial statements. The new financial statement presentation is a proposal by a joint committee of the key regulators involved in the international standards — the U.S. Federal Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB). After years of deliberation since 2002, the committee released a preliminary 168-page discussion paper in October 2008 identifying changes to financial statement presentation. The public has up until April 14, 2009, to comment on the proposal, after which it will become an exposure draft and then move to become a new financial reporting standard.

Why change the look of financial statements?

The two regulatory boards are proposing a new look and feel to the statements, consistent with their objective of improving financial reporting and providing better information to the users of financial statements. The discussion paper explains that “how an entity presents information in its financial statements is vitally important because financial statements are a central feature of financial reporting — a principal means of communicating financial information to those outside an entity.”¹ The Boards contend that the existing presentation guidelines make it difficult to understand the relationship between financial statements and that information in different statements is inconsistently presented. These factors make it difficult to properly assess the financial health of an organization.

There are three objectives associated with the change. Information should be presented in the financial statements in a manner that:

- (a) Portrays a cohesive financial picture of an entity's activities. A cohesive financial picture means that the relationship between items across financial statements is clear and that an entity's financial

- statements complement each other as much as possible.
- (b) Disaggregates information so that it is useful in predicting an entity's future cash flows.
- (c) Helps users assess an entity's liquidity and financial flexibility.²

How are the statements changing?

The financial statements will have new names: an income statement will now be called a “Statement of Comprehensive Income” and a balance sheet will be called a “Statement of Financial Position.” The required statement of retained earnings will be replaced by a “Statement of Changes in Shareholder's Equity” (Exhibit 1). There is also a new statement reconciling net income to cash flow which must be included in the financial statement notes.

The new names though, are just the beginning. In order to achieve the objective of cohesiveness between the statements, the format of the statements will change. All statements are to be subdivided into the same general categories — a business section (subdivided further into operating and investing components), a financing section, income taxes, discontinued operations, and equity (Exhibit 2). These classifications are similar to how today's cash flow statement is divided.

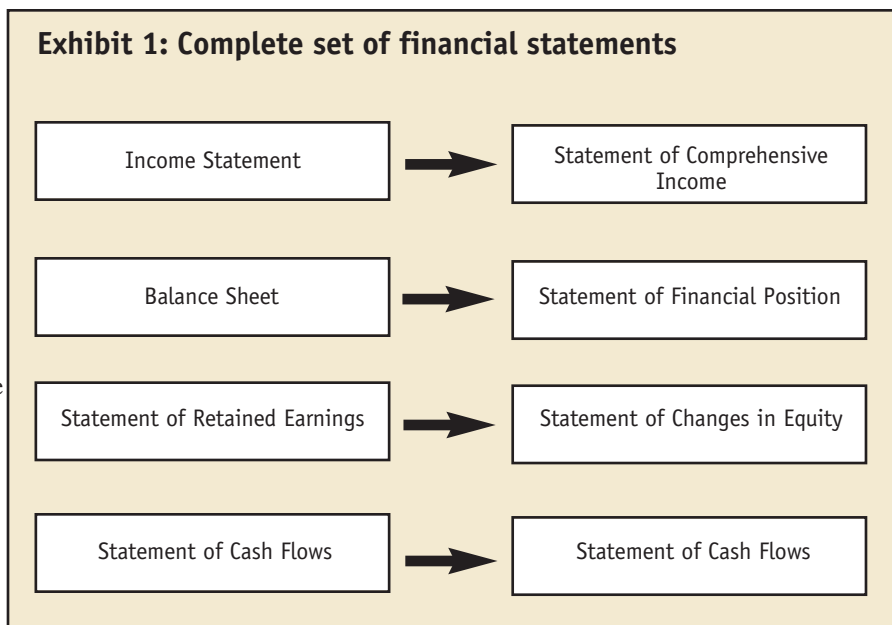


Exhibit 2: Statement Overview

Statement of Financial Position	Statement of Comprehensive Income	Statement of Cash Flows
Business <ul style="list-style-type: none"> • Operating Assets and Liabilities • Investing Assets and Liabilities 	Business <ul style="list-style-type: none"> • Operating Income • Investing Income 	Business <ul style="list-style-type: none"> • Operating Cash Flows • Investing Cash Flows
Financing <ul style="list-style-type: none"> • Financing Assets • Financing Liabilities 	Financing <ul style="list-style-type: none"> • Financing Income • Financing Expenses 	Financing <ul style="list-style-type: none"> • Financing Asset Cash Flows • Financing Liabilities Cash Flows
Income taxes	Income taxes on continuing operations	Income taxes
Discontinued Operations	Discontinued Operations (net of tax)	Discontinued Operations
	Other Comprehensive Income (net of tax)	
Equity		Equity

Joint FASB/IASB preliminary views on Financial Statement Presentation, October 2008.

The new balance sheet (Statement of Financial Position)

The biggest difference with the new format of the Statement of Financial Position (balance sheet) is that at first glance, it isn't obvious that assets balance to liabilities plus equity. The traditional balance sheet shows assets on the left side with liabilities and equity on the right, having identical totals on both sides. The new format does not separate assets and liabilities into distinct sections. Instead, assets and liabilities are netted together in each of the sections (operating, investing, financing, income taxes, and discontinued operations) of the Statement of Financial Position. How management segregates assets or liabilities into each of the different sections is subject to a fair bit of management judgment and their basis for classification must be disclosed in the financial statement notes. Totals for short-term and long-term assets in each section of the statement are optional. An entity must disclose the totals for short-term, long-term, and total assets and liabilities but they can do so either in the statement or in the notes to the financial statements. There is no familiar total for liabilities plus equity (Exhibit 3). Underlying the presentation format, the balance sheet still balances.

The new income statement (Statement of Comprehensive Income)

The Statement of Comprehensive Income is similar to today's income statement in that it calculates a subtotal for net income and then has a section for other comprehensive income (OCI). However, everything above net income is divided into the same categories that the balance sheet is classified in — an operating section, an investing section, a

financing section, income taxes, and discontinued operations. Within the OCI section, the entity must indicate to which category (operating, investing, or financing) the actual line items relate to.

Line items are further identified by function and then nature. For example, cost of goods sold must be further subdivided into materials costs, labour costs, and overhead. Details for general and administrative expenses must also be disclosed. If these guidelines result in too lengthy of a statement, the entity can summarize the statement, but they must still present the details in the financial statement notes (Exhibit 4).

The new cash flow statement

The Cash Flow Statement is the only statement that will retain its existing name. Its format is similar to today's format, but there is one significant change — the indirect method of reporting cash flow will no longer be allowed. Current GAAP allows entities to report cash flow using either a direct or an indirect method. The direct method reports cash changes based on how much cash is paid for or received as a result of various activities; the indirect method starts with income and making adjustments to arrive at cash flow. Most organizations opt to report under the indirect method since information for this format is usually more easily available from their accounting systems. A second major change is that there are no more cash equivalents. The statement reports only on changes in cash. Instead of eliminating the need to reconcile net income to cash flow using the indirect method, the regulators recognize that such a reconciliation provides valuable information to financial statement users and therefore require a new

Exhibit 3: SAMPLE STATEMENT OF FINANCIAL POSITION

BUSINESS	2010	2009
Operating		
Receivables	13,600	10,800
Less: allowance for bad debt	(400)	(200)
Inventory	5,200	4,000
Prepaid expenses	3,800	4,800
<i>Short-term assets</i>	22,200	19,400
Property, plant and equipment	6,800	4,800
Less: accumulated depreciation	(1,800)	(1,200)
Goodwill	4,000	5,000
Intangibles (net)	12,200	13,600
<i>Long-term assets</i>	21,200	22,200
Accounts payable	(3,800)	(3,200)
Accrued liabilities	(11,200)	(14,800)
<i>Short-term liabilities</i>	(15,000)	(18,000)
Accrued long-term liabilities	(1,000)	(600)
<i>Long-term liabilities</i>	(1,000)	(600)
Net operating assets	27,400	23,000
 Investing		
Available for sale assets (short-term)	400	600
Investment in sub (long-term)	1,200	1,000
Total investing assets	1,600	1,600
NET BUSINESS ASSETS	29,000	24,600
 FINANCING		
Financing assets		
Cash	28,600	18,800
Total financing assets	28,600	18,800
Financing liabilities		
Dividends payable	(600)	(600)
Short-term debt	(2,800)	(200)
<i>Short-term financing liabilities</i>	(3,400)	(800)
Long-term debt	(14,200)	(9,800)
Total financing liabilities	(17,600)	(10,600)
NET FINANCING ASSETS	11,000	8,200
 INCOME TAXES		
Short-term		
Income tax payable	(1,600)	(2,400)
Long-term		
Deferred tax assets	2,100	2,700
NET INCOME TAX ASSET	500	300
 DISCONTINUED OPERATIONS		
Assets held for sale	4,000	4,400
Liabilities related to assets held for sale	(1,600)	(1,600)
NET ASSETS HELD FOR SALE	2,400	2,800
NET ASSETS	42,900	35,900
 EQUITY		
Share capital	(9,000)	(9,200)
Retained earnings	(32,050)	(25,000)
Accumulated other comprehensive income	(1,850)	(1,700)
TOTAL EQUITY	(42,900)	(35,900)

Note: Lines in italics are optional

Exhibit 4: SAMPLE STATEMENT OF COMPREHENSIVE INCOME

BUSINESS	2010	2009
Operating		
Sales-wholesale	20,000	21,800
Sales-retail	56,800	41,200
<i>Total Revenue</i>	76,800	63,000
Cost of Goods Sold		
Materials	(27,000)	(21,600)
Labour	(5,600)	(4,600)
Overhead	(200)	(200)
Change in inventory	1,200	400
<i>Total cost of goods sold</i>	(31,600)	(26,000)
<i>Gross Profit</i>	45,200	37,000
Selling Expenses		
Commissions	(1,000)	(1,000)
Advertising	(8,800)	(7,400)
Other	(5,400)	(3,000)
Total selling expense	(15,200)	(11,400)
General and administrative expenses		
Compensation	(3,000)	(2,400)
Rent	(1,000)	(1,200)
Depreciation	(1,800)	(1,600)
Other	(9,200)	(7,600)
<i>Total G&A</i>	(15,000)	(12,800)
Other operating income (expense)		
Loss on disposal of assets	(3,200)	(3,400)
Other	(1,400)	(2,600)
<i>Total other operating income (expense)</i>	(4,600)	(6,000)
Total operating income	10,400	6,800
Investing		
Dividend income	200	200
Equity in earnings of sub	400	400
Total investing income	600	600
TOTAL BUSINESS INCOME	11,000	7,400
FINANCING		
Interest income	2,000	1,000
Total financing asset income	2,000	1,000
Interest expense	(3,000)	(1,600)
Total financing liability expense	(3,000)	(1,600)
TOTAL NET FINANCING EXPENSE	(1,000)	(600)
INCOME TAXES		
Income tax expense	(2,600)	(1,800)
<i>Net profit from continuing operations</i>	7,400	5,000
DISCONTINUED OPERATIONS		
Loss on discontinued operations, net of tax	(450)	-
NET INCOME	6,950	5,000
OTHER COMPREHENSIVE INCOME		
Unrealized loss on securities, net of tax	(150)	(300)
TOTAL COMPREHENSIVE INCOME	6,800	4,700

Note: Lines in italics are optional

reconciliation statement to be included in the financial statement notes.

The new reconciliation statement

The new reconciliation schedule reconciles cash flows to comprehensive income. The left hand side of the page lists the details from the Cash Flow Statement while the right hand side lists the details from the Statement of Comprehensive Income. In between are several columns which reconcile the two.

The statement disaggregates comprehensive income into four categories:

- (a) Cash received or paid other than in transactions with owners;
- (b) Accruals other than remeasurements;
- (c) Remeasurements³ that are either recurring fair value changes or valuation adjustments; and
- (d) Remeasurements that are not recurring fair value changes or valuation adjustments.

The statement of changes in equity

The Statement of Changes in Equity is similar to the Statement of Changes in Retained Earnings, but much more comprehensive. It shows the balance of each component of equity at the beginning and end of the period and identifies the changes resulting from income, each item of OCI, transactions with owners (such as contributions, dividends, and changes in ownership interests of subsidiaries) and retrospective application or restatements (Exhibit 5).

The new financial statements formats are being proposed in order to bring new clarity and transparency to financial statement users. In some cases, the changes will

be welcome. For example, the new reconciliation schedule provides users with a lot more information than they currently have access to. In other cases though, the new format may cause confusion and may even create additional costs for users as they adjust to the new presentation. For example, many of the ratios used by bankers or stock analysts rely on totals which are no longer required to be disclosed on the balance sheet. As such, the users will need to readjust their processes of reviewing financial statements and may need to consider different ratios or different ways to arrive at their current numbers. Companies may also incur additional costs of tracking and storing information to be able to produce statements under the acceptable format. Like anything else, this is a change which will take users and entities time to adjust to. However, like all other accounting proposals, the regulators are now asking the public for their opinion and this is a such a large departure from current practices that it is sure to elicit a lot of feedback. ■

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¹ FASB/IASB discussion paper on preliminary views on Financial Statement Presentation, S1.

² FASB / IASB discussion paper on preliminary views on Financial Statement Presentation, S2.

³ IFRS allows and encourages assets and liabilities to be valued at fair value rather than at historical cost, creating what is known as “remeasurement” adjustments on the Statement of Comprehensive Income.

Exhibit 5: SAMPLE STATEMENT OF CHANGES IN EQUITY

	Share capital	Retained earnings	Foreign currency translation adjustment-consolidated subsidiary	Foreign currency translation adjustment-Associate A	Reval. surplus	Unrealised gain on cash flow hedge	Unrealised gain on available-for-sale financial assets	Total Equity
Balance at 31 Dec 2008	253,000	56,050	10,040	7,400	160	6,200	1,200	334,050
Issue of share capital	15,600							15,600
Dividends		(16,000)						(16,000)
Total comprehensive income		89,608	(298)	(260)		338	3,055	92,442
Balance at 31 Dec 2009	268,600	129,658	9,742	7,140	160	6,538	4,255	426,092
Issue of share capital	16,848							16,848
Dividends		(17,280)						(17,280)
Total comprehensive income		107,694	419	(281)	731	365	3,439	112,366
Balance at 31 Dec 2010	285,448	220,072	10,160	6,859	891	6,903	7,694	538,026