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RE: Financial Accounting Standards Board
Financial Accounting Series
No. 1630-100
Discussion Paper – Preliminary Views on Financial Statement Presentation
October 16, 2008

TO: Technical Director
File Reference No. 1630-100

FROM: The Risk Management Association (RMA)
1801 Market Street
Philadelphia, PA 19103
Mark Zmiewski, Director, Strategic Learning and Research

Dear Ladies and Gentlemen:

RMA applauds the FASB and the IASB for their efforts to increase the utility of the financial statements and is pleased to respond to the Discussion Paper.

Who We Are and the Context for Our Response

RMA is a professional association that serves the financial services industry, with a particular emphasis on the measurement and management of credit risk. As such, our response is submitted in the context of how the proposed changes will impact our member institutions' ability to determine if a public or nonpublic (private) commercial entity is able to repay its debt obligation. In this response, RMA opts not to comment on the impact of the proposed changes on the financial statement presentation of financial institutions.

Your Discussion Paper's scope is limited to publicly held companies, but financial institutions extend credit to both public and private entities. The decisions made now on the proposed financial statement presentation for public entities are very likely to shape subsequent discussion of financial statement presentation for the universe of private entities. Therefore, our comments reflect our fundamental philosophy that the financial statement presentation should be consistent, regardless of public or private ownership. The population of publicly traded entities is much smaller than that of privately held entities, so any changes to the financial statement presentation must take into account the needs of both groups, as well as those who rely upon their financial information.

Further, the nature of the lending conducted with privately owned entities is primarily asset driven—the financing of working capital to support the asset conversion cycle—and longer-term financing for property, plant, and equipment purchases. Cash flow is the source of repayment in this environment, and the ability to properly match short-term needs with short-term debt and long-term needs with long-term financing is critical to financial institutions. In addition, the financial statement is often used as a tool to facilitate dialogue between the bank and the company, e.g., the understanding of simple

concepts such as debt to worth, working capital, receivable turnover, trade debt, etc., and how these play a role in the bank's decision to extend credit, how much credit, and what type of credit. Similar analysis is conducted by trade suppliers, commercial finance organizations, and other business credit entities, so these concepts are shared by a much wider audience than just commercial banks.

There are approximately 25 million private companies and 17,000 public companies in the United States. Nearly all the monies provided to private companies to support their operations come from banks and trade creditors ("credit grantors"). These small businesses are at the heart of the economic engine of the United States in terms of employment and growth. Most of their accounting requirements are handled by smaller accounting firms and individual practitioners. As a result, RMA is acutely interested in how the accounting changes will impact the quality of the reporting, the relationship between the bank and the company, and the banking industry's ability to efficiently provide credit to its private and public clients.

Scope of Our Response

RMA will respond specifically to the questions posed and, in a broad sense, to the benefits and the applicability of the presentation model to nonpublic entities. In addition, while we have identified the expected costs, we are not yet able to provide quantitative estimates. We are endeavoring to quantify these costs within the next several months and would welcome the opportunity to share our findings with you.

General Observations

In most respects, the current financial statement presentation model adequately addresses the needs of credit grantors. Nevertheless, RMA generally supports the Objectives and Principles of the proposed financial statement presentation model on the basis that disclosure of more information facilitates more thorough financial statement analysis and better credit risk decisions. However, we do have some concerns about how these Objectives and Principles will be implemented.

RMA is especially supportive of presenting the cash flow statement on a direct method basis instead of the current option of allowing either the indirect or the direct method. Over the past 25 years, RMA has taught thousands of commercial credit and lending professionals to use the direct approach as the preferred method for presentation and analytical purposes. Further, by requiring the direct method of cash flow presentation, FASB and IASB will be able to readily achieve their goal of cohesiveness without having to make any change to the existing balance sheet and income statement presentation, as the direct method serves to demonstrably link the balance sheet and income statement.

RMA feels that the additional clarity or granularity provided by disaggregation, particularly as it applies to the proposed balance sheet presentation, could be achieved with far less cost and disruption by simply adding the disaggregated information to the footnotes rather than altering the financial statement presentation. RMA further supports the continuing segregation of short-term assets and liabilities from long-term assets and liabilities to facilitate working capital analysis, to identify seasonal borrowing needs, and to measure permanent financing requirements. On the other hand, the proposed additional information for the income statement would be a welcome addition for a credit grantor.

The proposed disaggregation model also presupposes that entities have multiple access points to debt and equity. This may be true of public entities and larger private entities for which an increase in information may be useful for credit grantors. The vast majority of private entities has no access to

public debt and equity markets, however, and generally has only a single source of outside funding, credit grantors. Accordingly, disaggregation will not provide meaningful insight to credit grantors in their decision making on privately held entities.

RMA believes the proposed presentation model is more applicable to public entities and, with certain modifications, to private entities that are large and complex, i.e., they act in ways similar to their public counterparts. The typical private entity is small; the proposed model is not applicable to them because of the very simple nature of smaller businesses—e.g., relatively few accounting line items, single economic activity, etc. For this segment, perhaps the largest segment the proposed changes will impact, the model will impart little benefit to credit grantors, especially in light of the expected costs.

RMA is not supportive of the proposed management discretion in financial statement presentation. We believe that, without more specific guidance, this approach will lead to a lack of consistency and comparability between reporting periods and between entities operating in the same industry of similar size, sophistication, and modus operandi. Without industry norms or general guidance in how to categorize similar items, different companies and different accountants may treat the same item very differently. Information with regard to how management may apply accounting principles in the course of making operating decisions would provide useful insight to users and is appropriately presented in the footnotes.

It is relevant to remember that GAAP today is not what it was 30 years ago. From its principles-based origin in 1973, GAAP has evolved, based on practical experience, into a much more rules-based approach. This proscriptive evolution has contributed to a reliable, objective, and consistently prepared financial statement presentation that can be understood intuitively by a credit grantor. A management approach, in concert with a principles-based underpinning, is at odds with the FASB and IASB goal of greater consistency in financial reporting and will substantially decrease a credit grantor's ability to efficiently provide credit.

Accounting principles and financial statement presentation should be common to both public and private entities, large and small. Therefore, RMA does not advocate a bifurcated approach where public and private entities have their own distinct set of principles and presentations.

RMA is concerned about the banking industry's general lack of knowledge about the depth, nature, and timing of the proposed changes. As part of its mission, RMA has begun to address the issue and will be an active resource going forward, but it is critical for the FASB to reach out to the credit grantor community to encourage their feedback and to inform them of the proposed changes. Over the next three years or more, the attention of banks, and risk management in particular, will be focused on dealing with problems brought on by the financial crisis: liquidity constraints, capital building, consolidation, poor-performing retail and commercial loans, reduced staff levels, expense containment, etc. Because risk managers would be the very people to lead the internal implementation of such far-reaching accounting changes, we support and encourage sufficient lead time for a methodical, well-communicated implementation.

Basis of Response

RMA is responding on behalf of the banking industry. Several representatives from RMA member institutions helped shape our response. These member institutions may submit responses on their own behalf, which may or may not conform to the response of RMA.

Responses to Individual Questions

Question	Response
1	In a general sense, the three objectives are viewed as benefits; however, these could be accomplished without a change in the balance sheet and income statement presentation simply by placing the information in the footnotes. Moreover, the cohesiveness objective is accomplished by requiring the direct method of cash flow statement presentation.
2	Information regarding how management views its business activities, financing activities, and operating activities would be beneficial; however, this could be accomplished without a change in the financial statement presentation by placing the information in the footnotes. Credit grantors look at the entire financial statement in a holistic and simultaneous manner. The proposed disaggregation scheme risks a “siloed” approach to analysis that is inconsistent with sound credit risk analysis practice.
3	Equity using the IFRS and GAAP definition should be a stand-alone category, as is the current practice.
4	Presenting discontinued operations as a stand-alone category on the balance sheet and income statement is beneficial. Information regarding where a discontinued operation lies in the company’s strategy—with business activities, financing activities, and/or operating activities—would be beneficial; however, this insight could be accomplished without a change in the financial statement presentation by placing the information in the footnotes.
5	Management discretion about how to categorize assets and liabilities provides too much latitude without guaranteeing sufficiently detailed disclosure and offers the opportunity for vast inconsistencies among similarly situated companies—e.g., companies of roughly the same size and modus operandi, in the same industry, etc.—with markedly different financial statements being the result. A management approach would hurt and not help the Board’s desire for consistent presentation of financial statements. This approach will needlessly increase the time needed to underwrite a loan. It will take more time to reconcile management’s intent relative to their interpretation and presentation of the financial statements with how a bank looks at those same financial statements. We are also concerned that companies will be able to “game” their financial position by categorizing an item one way in year one (e.g., as an operating asset) and in a completely different way in year two (e.g., as an investment asset). For users of small private entity financial statements, especially those for companies that chose to report their condition and performance via a review or compilation, an explanation of the entity’s rationale for the change in category may not even be available.
6	Disaggregating the information on the statement of financial position would not make it easier for a user to calculate key ratios. The industry has been using a common set of ratios and common sizing for nearly 100 years. The proposed presentation will not increase the utility of the ratios and will cause what is currently intuitive to become an arduous task of recasting the financials to fit the ratios.
7	RMA elects to pass on making any comment on this point at this time.
8	RMA elects to pass on making any comment on this point at this time.
9	RMA elects to pass on making any comment on this point at this time.
10	RMA elects to pass on making any comment on this point at this time.
11	An order of liquidity presentation should be left in place. It is in use today and is most applicable to small, noncomplex entities. We are not supportive of a classified financial statement presentation that would omit liquidity considerations; however, if a classified presentation is provided with liquidity ordering, it could appear in the footnotes.

Question	Response
12	Cash equivalents should be presented as part of short-term investments and not included with cash. It is important to know the make-up and marketability, i.e., liquidity and quality of the investments.
13	Information on similar assets and liabilities that are measured on different bases should be presented on separate lines if, and only if, the balances are material, or they should be shown in the footnotes.
14	The current financial statement presentation model handles this adequately, namely a single statement of comprehensive income, inclusive of a subtotal of profit/loss/net income and a total for “other” comprehensive income, all of which is beneficial.
15	Details regarding the items within “other” comprehensive income are beneficial and should appear in the footnotes. Large material items could be shown on the financial statement and the remaining items grouped as one entry—other (e.g., other comprehensive income).
16	Presenting income statement information with regard to function and nature would be beneficial and should appear in the footnotes. Knowing the fixed and variable elements of cost of goods sold and operating expenses would be very helpful to cash flow analysis and for projections. We propose that this information be included in the footnotes.
17	Tax information should appear in one category and not be classified.
18	RMA elects to pass on making any comment on this point at this time.
19A	RMA is very supportive of presenting the cash flow statement on a direct method basis. Over the past 25 years, RMA has taught thousands of commercial credit and lending professionals using this approach as the preferred one for presentation and analytical purposes.
19B	By including the direct method of cash flow presentation, FASB and IASB will be able to readily achieve their goal of cohesiveness without having to make any change to the existing balance sheet and income statement presentation.
19C	There would be no need to reconcile the direct and indirect methods if FASB moves to the direct method as <i>the</i> cash flow presentation. The indirect method has little to no relevance to credit grantors serving private entities’ needs and marginal analytic value to credit grantors serving public entities.
20	There would be no costs to banks as this is what banks are using already.
21	RMA elects to pass on making any comment on this point at this time.
22	The current financial statement presentation model handles this already; namely, an entity should report the maturities of its short-term contractual assets and liabilities in the notes to the financial statements, and all entities should present this information.
23	Presenting the cash flow statement on a direct method basis would meet the credit grantors’ needs and eliminate the need for a reconciling statement.
24	RMA elects to pass on making any comment on this point at this time.
25	RMA elects to pass on making any comment on this point at this time.
26	RMA elects to pass on making any comment on this point at this time.

Question	Response
27	<p>With regard to the applicability of the proposed changes to private entities and in the spirit of the potential for additional information that could be used to make quality lending decisions, by and large, the Objectives and Principles would be applicable.</p> <p>For private entities at the larger end of the scale—i.e., size of company and complexity of operation more closely resemble a publicly traded company—the proposed changes are more beneficial than for their smaller counterparts. For large private entities, a management approach would provide too much latitude without guaranteeing sufficiently detailed disclosure and would offer the opportunity for vast inconsistencies among similarly situated companies—e.g., companies of roughly the same size and modus operandi, in the same industry, etc.—with markedly different financial statements being the result. A management approach would hurt and not help the Board’s desire for consistently presented financial statements.</p> <p>For smaller private entities, which make up the majority of business enterprises, we believe:</p> <ol style="list-style-type: none"> 1. The additional information and presentation format is not going to apply. They have a fairly simple financial statement with a simple modus operandi, and the statement would most likely not look too different from today. 2. Additional information is typically available via schedule(s) obtained from the company; thus, including them in the footnotes, for instance, while formalizing the process, is not needed.

Costs

Currently Identifiable Tangible Costs—

To Banks ONLY

1. Training staff in accounting and credit risk analysis/financial statement analysis.
 - a. Ensuring that all bank staff is current with both GAAP financial statement presentation and the proposed financial statement presentation. Some entities, especially smaller entities, may elect to use GAAP during a transition period.
2. Financial statement spreading software replacement, upgrade, and training.
3. Training and legal documentation associated with rewriting and renegotiating loan covenants, defined differently under IFRS.
4. Database/data warehouse programming to accommodate different layout of financial statements.
5. Re-engineering of small business credit scoring models.
6. Replacement of all risk rating models and validation of new models.
7. Training customers.

To RMA

1. Training staff in accounting and credit risk analysis/financial statement analysis.
2. Revision of all training materials.
3. Revision of financial statement database product—*RMA Statement Studies*: collection, analysis, presentation, deliverables, and storage.
4. Research into the identification of possible new credit risk concepts and financial ratios that might be used given the proposed financial statement presentation.

Currently Identifiable, Yet to Be Quantified Costs—

1. A credit grantor's use of the financial statements will not change as a result of the proposed model; however, use will become much more complicated because the credit grantor will have to recast the proposed presentation into the current presentation used for years.
2. The timing of the delivery of financial statements from the client will be extended due to the added complexity.
3. Credit grantors may rely more heavily on the use of less desirable information, e.g., tax returns, for making commercial loan decisions.
4. Lack of comparability between companies in the same industries operating in substantially the same manner.
5. The continued retreat from audited financial statements for private entities.
6. Increase in type II errors. Because the new and unfamiliar format would be subject to increased management discretion in classifying assets and liabilities, the resulting financial presentation is likely to be so incomparable to previous data that credit grantors might be inclined to deny credit to companies that merit approval.
7. Increase in regulatory costs.

In conclusion, RMA looks forward to working with the FASB and IASB on this important initiative and plans to respond to the formal notice of change when it is made available for comment.