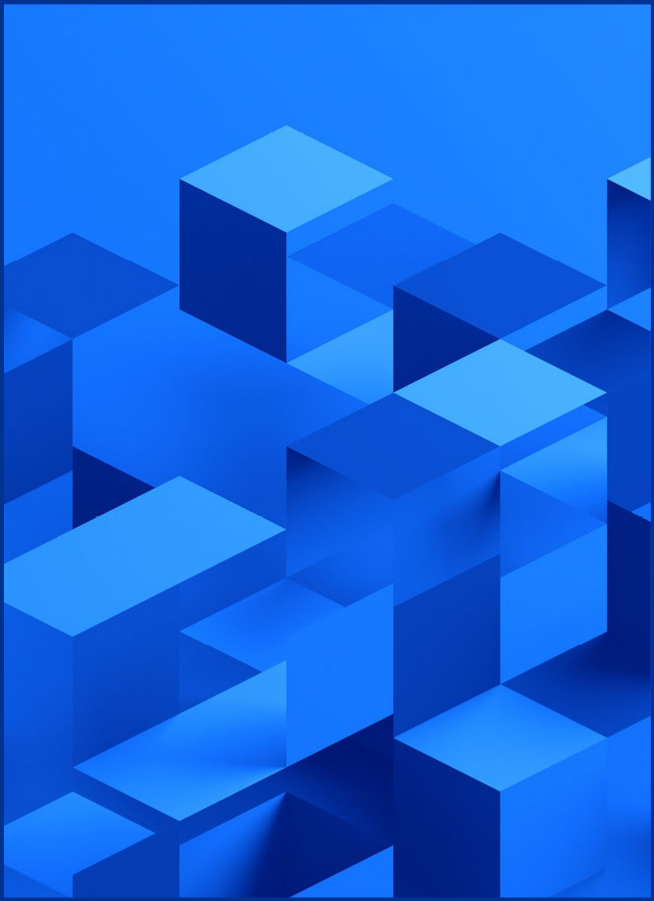
Financial statement presentation

Executive summary



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The final mile: Presentation and disclosure

In the financial statement process, considerable time is devoted to determining what items get recorded and how to account for them, but the critical final mile is determining how they need to appear – i.e. how they are presented and disclosed.

Once the debits and credits have been settled, presentation and disclosure is how that information is conveyed to financial statement users in a transparent, understandable and consistent manner. Disclosure goes ‘behind the numbers’ and is necessary to fully understand the financial statements.

Topics 205 to 280 in the FASB’s Accounting Standards Codification® are dedicated to presentation and disclosure and provide the baseline requirements. Other Topics address more detailed requirements specific to certain transactions or industries. For SEC registrants, there is yet more guidance that contains many additional requirements, which has helped shape practices over the years for all other entities.

In this Executive Summary, we provide a snapshot of many of the general requirements for financial statement presentation. Our related Handbook, Financial statement presentation, pulls together those requirements and practices to provide you with a fuller picture of how the different financial statements are constructed and how they interact with one another.

Applicability and scope

This Executive Summary discusses the presentation and general disclosure requirements relevant for financial statements prepared under US GAAP, focusing on the following Codification Topics and Subtopic:

- Subtopic 205-10 (presentation of financial statements)
- Topic 210 (balance sheet)
- Topic 220 (income statement/comprehensive income)
- Topic 235 (notes to financial statements)
- Topic 270 (interim reporting)
- Topic 275 (risks and uncertainties)
- Topic 850 (related party disclosures)
- Topic 855 (subsequent events).

Presentation and disclosures requirements in US GAAP only apply when the reporting entity has material events or transactions that underlie these requirements.

Besides discussing the requirements in these (Sub)Topics, this Executive Summary also discusses SEC regulations pertinent to presentation and disclosure of financial statements filed by SEC registrants. Much of the discussion of SEC regulations focuses on Reg S-X Article 5, which relates to commercial and industrial registrants.

This Executive Summary does not address presentation of financial information outside of the financial statements (e.g. Management's Discussion and Analysis).

Financial statements: general principles

The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to investors, lenders and other stakeholders as they make decisions about providing resources to the entity. This generally requires presentation of a full set of financial statements.

Providing financial information for comparative periods enhances the usefulness of the financial statements. Entities generally include at least one comparative period in addition to the current period.

Financial statements are generally prepared on the basis that the entity will continue to operate (i.e. a 'going concern' basis). In our experience, some entities disclose their basis of preparation as 'on a going concern basis' or basis of presentation 'in accordance with US GAAP' either in a basis of presentation or significant accounting policies note.

A full set of financial statements comprises the following statements.

Financial statement	Comments
Statement of financial position	Commonly called the balance sheet.
Income statement	Presented as a stand-alone statement or as a continuous statement of comprehensive income with other comprehensive income (OCI).
Statement of comprehensive income	Presented when an entity has OCI. Comprises both net income and OCI.
Statement of cash flows	See KPMG Handbook, Statement of cash flows.
Statement of shareholders' equity	Can be included in the notes. See KPMG Handbook, Debt and equity financing.

Financial statements are presented for the reporting period ending on the balance sheet date (reporting date). A reporting period might represent an annual or interim period. Understanding the nature and the length of the reporting period is fundamental to understanding the financial information presented and the applicable requirements. This Executive Summary discusses annual financial statements.

Financial statements are accompanied by notes and, in some cases, supplemental information.

Role of SEC regulations

Reg S-X and related SEC rules provide more specific requirements than the Codification regarding presentation of financial statements. Most notably, Reg S-X contains a list of minimum captions for the balance sheet and income statement. Reg S-X also requires registrants to provide financial statements from comparative periods in their periodic SEC filings (e.g. Form 10-K) and to file supplemental schedules in certain circumstances.

The SEC requirements technically apply only to SEC registrants. However, they are conceptually consistent with Subtopic 205-10, and therefore may be relevant to nonpublic entities. When they clarify Codification requirements, we believe they should be applied by all entities in the absence of specific Codification guidance. Further, when they go beyond the Codification requirements, they can constitute common or best practice for nonpublic entities.

Balance sheet

The balance sheet presents an entity's assets, liabilities and equity as of the reporting date – i.e. the last day of a reporting period.

Reg S-X Rule 5-02 lists the required minimum captions that commercial and industrial registrants are expected to present on the balance sheet. It also requires them to present a classified balance sheet, which distinguishes between current and noncurrent assets and current and noncurrent liabilities. Other entities often present a classified balance sheet but are not required to do so.

Two primary issues in presenting a balance sheet are the classification of assets and liabilities as either current or noncurrent, and offsetting of liabilities against related assets.

Current vs noncurrent classification

Topic 210 provides the general guidance on how to present a classified balance sheet. A classified balance sheet shows separate classifications of current assets and current liabilities, which allows the user of the balance sheet to readily determine working capital.

Current assets	Current liabilities
Assets that are reasonably expected to be realized in cash or sold or consumed during the entity's normal operating cycle	Liabilities incurred in the current operating cycle or expected to be settled within a relatively short period of time (usually 12 months) of the reporting date

Whether assets or liabilities are current depends on the entity's operating cycle. The operating cycle is commonly 12 months but can be longer in certain industries in which the average time between acquiring assets for processing and realizing their value in cash or cash equivalents is longer than 12 months. The time period used as the basis for determining if an asset or liability is classified as current or noncurrent cannot be shorter than 12 months.

Offsetting

Assets and liabilities may be offset against one another on the balance sheet only when all of the following criteria are met.

Mutual liability criterion	Each of the two parties owes the other determinable amounts.
Ability to offset criterion	The reporting party has the right to offset the amount owed with the amount owed by the other party.
Intent to offset criterion	The reporting party intends to offset.
Enforceability criterion	The right of setoff is enforceable by law.

The right of setoff has several nuances and application issues.

In addition, Subtopic 210-20 requires quantitative disclosures for offsetting of derivatives, repurchase agreements and securities lending transactions. Its objective is to allow users of the financial statements to evaluate the effect or potential effect of netting arrangements on an entity's balance sheet, including the effect of rights of setoff.

Income statement

The income statement provides a measure of the entity's operational performance, excluding OCI items. While the income statement is often presented as a part of a single continuous statement of comprehensive income along with OCI, it may also be presented as a stand-alone statement.

Reg S-X Rule 5-03 lists the required minimum captions that commercial and industrial registrants are expected to present in the income statement.

A significant issue in presenting an income statement is determining the appropriate classification of items. While the Codification provides guidance on allocating costs to discontinued operations, there is little authoritative guidance on how to allocate items among the captions in income from continuing operations. In general, each income statement caption represents similar classes of items that are relatively consistent across each industry. Further, the right of setoff (used to offset items on the balance sheet) does not apply to the income statement; however, some other Codification Topics permit or require offsetting in specific instances – e.g. recoveries on environmental losses are classified in the same caption as the related loss.

Unusual items

Unusual items require special treatment in income from continuing operations. Items need to fall in at least one of the following categories to be unusual.

Category	Characteristics of the underlying event or transaction
Unusual in nature	• High degree of abnormality; and • Clearly unrelated to, or only incidentally related to, the ordinary activities of the entity.
Infrequent in occurrence	• Not reasonably expected to recur in the foreseeable future.

Comprehensive income

Comprehensive income comprises net income and OCI. These elements together represent the change in the entity's equity from all sources except from investments by and distributions to owners.

Comprehensive income

Net income + OCI + Transactions with owners in their capacity as owners = **Change in equity**

OCI is simply any revenues, expenses, gains and losses that affect an entity's equity but are not reported in net income. Only items specifically identified in US GAAP as OCI items can be reported as OCI – e.g. Subtopic 830-30 characterizes foreign currency translation adjustments as OCI. There is no conceptual basis for which items are recorded in OCI (instead of net income) and later reclassified to net income.

An entity presents a statement of comprehensive income only when it has OCI; otherwise, it presents just an income statement. There are two formats for a statement of comprehensive income.

Single-statement	Two-statement
Single continuous statement containing both net income and OCI	Separate but consecutive statements with the income statement first and comprehensive income statement second

Just as with the income statement, Reg S-X Rule 5-03 lists minimum captions that commercial and industrial registrants are required to present in the statement of comprehensive income.

An entity is permitted to present each of the components of OCI either:

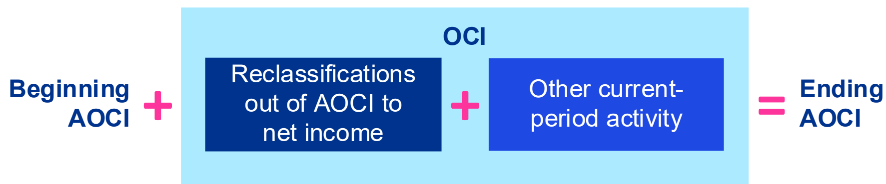
- net of the related tax effects; or
- before the related tax effects, with one amount shown for the aggregate income tax expense or benefit related to the total of OCI items.

Regardless of the presentation approach, the tax effect for each component of OCI must be either presented in the statement of comprehensive income or disclosed in the notes.

Accumulated other comprehensive income

The total of OCI for the period is transferred to accumulated other comprehensive income (AOCI, a component of equity) at the reporting date. Amounts transferred to AOCI remain there until an event occurs that requires them to be reclassified to net income.

The following diagram depicts how the reporting date AOCI balance and the changes to AOCI during the period are presented in financial statements.



Because OCI items accumulate in AOCI and components of AOCI are reclassified to net income at some point, they affect not only the statement of comprehensive income, but also the balance sheet, statement of changes in equity and notes.

Reclassifications of AOCI amounts to net income are presented in the appropriate captions of the income statement. The effects of significant reclassification adjustments on individual captions are provided either on the face of the income statement or in the notes.

Notes to financial statements

The notes to financial statements (notes) supplement, explain or amplify the information presented in the financial statements. Importantly, disclosure is not an acceptable alternative to the proper application of US GAAP.

Each Codification Topic (with a few exceptions) has disclosure requirements relating to its accounting subject. In addition, the notes provide information about:

- Financial statement captions
- The reporting entity
- Past events and current conditions and circumstances that have not been recognized but could affect the entity's future cash flows

Other considerations involved in preparing the notes include:

Materiality	Disclosure of immaterial items is not required.
Prior year	Disclosures from the prior year are repeated to the extent they continue to be of significance.

Reg S-X requires additional disclosures from registrants. Further, throughout the Codification, entities meeting the definition of a 'public entity' or 'public business entity' are required to make additional disclosures beyond those required for nonpublic entities.

Topic 235 requires disclosure of all significant accounting policies. An accounting policy is 'significant' if it has a material impact, either quantitatively or qualitatively, on the financial statements presented. Typically, the first note in the financial statements is the accounting policies note. The term 'accounting policy' broadly includes accounting principles, methods and techniques.

Risks and uncertainties

Topic 275 requires entities to disclose risks and uncertainties that could significantly affect the amounts reported in the financial statements in the near term or the near-term functioning of the reporting entity. The Topic requires disclosures of such risks and uncertainties in four risk areas, but an entity may disclose risks and uncertainties from other sources.

Risk area	General disclosure requirements
Nature of operations	Describe major products or services and principal markets, including their location.
Estimates in general	Explain that preparation of financial statements in conformity with US GAAP requires use of management's estimates.
Certain significant estimates	When it is reasonably possible that an estimate will change materially in the near term, disclose this fact and indicate the nature of the uncertainty.
Current vulnerabilities due to concentrations	Disclose concentrations in certain areas when: • the concentration makes the entity vulnerable to the risk of near-term severe impact; and • it is at least reasonably possible that events could occur to cause such severe impact.

Topic 275 disclosures may be aggregated in one note or disclosed together with disclosures required by other Topics.

Related parties

Transactions between related parties are typically accounted for in accordance with their terms, in the same manner as transactions between unrelated parties. However, related-party transactions can trigger certain qualitative and quantitative disclosure requirements under Topic 850 because they are presumed to not be at arm's length.

The following table includes examples of related entities or individuals.

Principal owners	Affiliates
Management	Trusts for the benefit of employees
Immediate family members of principal owners and management	Investments under significant influence

Required disclosures

Related-party transactions can trigger the Topic 850 disclosure requirements summarized below. However, these requirements are not triggered when a related-party transaction:

- is immaterial;
- occurred in the ordinary course of business; or
- is eliminated in the preparation of the consolidated or combined financial statements.

Qualitative information	Quantitative information
• Nature of the relationship • Description of the transactions • Change in terms from the prior period presented • Terms and manner of settlement	• Dollar amount of the transaction (for each income statement presented) • Amounts due from or to related parties (for each balance sheet presented)

Subsequent events

Subsequent events are events or transactions that occur after the reporting date (i.e. balance sheet date) but before the financial statements are issued (SEC filers) or are available to be issued (non-SEC filers).

There are two broad categories of subsequent events.

Recognized events (Type 1)	Nonrecognized events (Type 2)
• Events or transactions that provide additional evidence about conditions that existed at the reporting date • Require adjustment to the financial statements to reflect the impact of events or transactions, and possible specific disclosures	• Events that provide evidence about conditions that did not exist at the reporting date but arose subsequent to that date • May require disclosure in the notes but the financial statements are not adjusted

Recognized subsequent events

Subsequent events are recognized when they provide additional evidence relevant to:

- an accounting judgment, such as confirmation that a liability has been incurred or an asset has been impaired at the reporting date; or
- the measurement of an estimate at the reporting date.

Nonrecognized subsequent events

Generally, a nonrecognized subsequent event is disclosed if the event is expected to have a material effect on the financial statements when recognized, or if not disclosing it would otherwise be misleading.

Quantitative disclosure of the estimated financial effect of a nonrecognized subsequent event is required, if such an estimate can be made. This estimate is based on facts available at the date the financial statements are issued (available to be issued).

Interim reporting

Interim financial statements are for periods shorter than a fiscal year. SEC registrants generally must file them on a quarterly basis. Nonpublic companies are not required by US GAAP to prepare interim financial statements; however, they may prepare them voluntarily or due to contractual requirements.

Topic 270 applies to all entities that prepare interim financial statements (whether public or nonpublic). However, Topic 270 exempts entities that are not 'publicly traded entities' (a defined term) from some of its provisions.

Types of interim financial statements

Interim financial statements generally comprise a full set of financial statements. However, entities can choose the level of detail to provide in those statements. The three types to choose from are as follows.

Complete financial statements	These statements (including their notes) are presented in the same way as annual statements.
Limited notes financial statements	These statements are presented in the same way as annual statements, except the required notes are limited in scope.
Condensed financial statements	These statements are condensed and have limited notes.

The presentation and disclosure guidance in Topic 270 applies to the latter two types. Regardless of the type of interim financial statements, entities issuing interim financial statements follow the interim accounting principles and practices in Topic 270.

Interim accounting principles and practices

The fundamental characteristic of interim financial statements is that each interim period is an integral part of the related annual period. Therefore, interim financial statements are generally based on the accounting principles and practices used in an entity's latest annual financial statements until the entity changes an accounting principle and complies with the requirements in Topic 250 (accounting changes and error corrections). However, certain accounting principles and practices often are modified so that interim period results better relate to the annual period.

SEC requirements

SEC regulations contain additional requirements for registrants in relation to the frequency and content of their interim financial statements. The Securities Exchange Act of 1934 requires most registrants to file a quarterly report with the SEC, which includes interim financial statements. The quarterly report is filed on a Form 10-Q, the format and contents of which are defined by the SEC's rules and regulations.

The detailed requirements in SEC regulations and other guidance are conceptually consistent with Topic 270. While these SEC sources may go beyond the requirements in Topic 270, and therefore are not required for nonpublic entities, they may constitute common or best practice.

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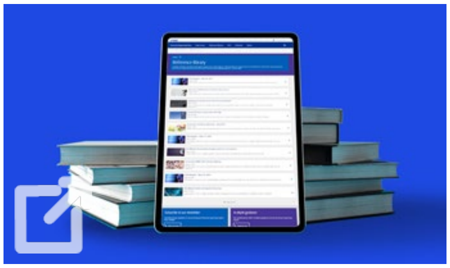

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