The IASB’s Financial Statement Presentation project and its potential effects on financial ratio analysis

The proposed structure of the financial statements according to the Staff Draft “Financial Statement Presentation” of the IASB enhances the possibilities of financial ratio analysis. Due to the cohesiveness principle users will be enabled to calculate a lot of profitability ratios without using any simplistic assumptions. Also the calculation of “sustainable” profits will be improved by the application of both, the disaggregation and the cohesiveness principle. A further indirect consequence of the proposed structure of the financial statements is also that the tax authorities get quite more detailed information about the entity which could be used for plausibility- and cross-checks.

1 Introduction

On July, 1st, 2010, the IASB published its Staff Draft “Financial Statement Presentation” (in the following SD-FSP). The SD-FSP contains the main results of phase B of the Financial Statement Presentation project. In general, with the Financial Statement Presentation project the IASB intends to improve the usefulness of financial information by presenting the information in a manner that communicates clearly a financial picture of an entity.

After the end of the due process of this staff draft the published standard will substitute the current IAS 1 and IAS 7. For reasons of space, the article concentrates on the changes of the structure of the financial statements and some accompanying notes which are relevant for the financial ratio analysis. Other also important changes will be neglected, e.g. note information regarding the analyses of changes in assets and liabilities, or the disaggregation of the income and expense items by their nature within the related functional grouping.

After presenting the core principles of the Financial Statement Presentation and the proposed structure of the financial statements the article shows the enhanced facilities of financial ratio analysis and will thereby focus on the additional chances of the analysis of the entity’s financial position, the analysis

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1 The Amendments of June 2011 to IAS 1 belong just as much to this phase of the Financial Statement Presentation project.
2 See SD-FSP. 43.
3 See SD-FSP. 243–255.
4 See SD-FSP. 142.
of the financial performance, and the analysis and interpretation of cash flows. Also the limitations of the financial ratio analysis related to the planned new structure of financial statements will be presented. As the financial statements are an important source of information even to the tax authorities the article ends up with some possible implications for corporate taxation.

2 Subject of the Staff Draft Financial Statement Presentation

2.1 Core Principles of the Financial Statement Presentation

According to SD-FSP 44 the presentation of information in the financial statements shall consider both, the *disaggregation principle* and the cohesiveness principle. Due to the first-mentioned principle information shall be presented in a manner that explains the activities in which an entity is engaged, and furthermore explains its financial position, its performance and its cash flows. Unless the items in the financial statements are immaterial, functions, natures and measurement bases are used as separation criteria in order to classify items in different classes.\(^5\) The disaggregation of items by *functions* refers to the primary business activities (e.g. production, marketing and selling, administration) in which the item is generated or used. The disaggregation of items by *nature* refers to the economic characteristics (e.g. nature of input factor) of different items. In addition, even similar items by function and nature should also be separated in the financial statements if different *measurement bases* are applied to these items (e.g. subdivision of financial instruments in those measured at amortised cost and those measured at fair value).

According to the *cohesiveness principle* the entity shall present information in a manner that the relationship among items and subtotals across the financial statements are clear.\(^6\) As the statement of changes in equity focuses only on a part of the balance sheet the cohesiveness principle applies only to the balance sheet (statement of financial position), the statement of comprehensive income, and the statement of cash flows. In the interaction with the disaggregation principle, both principles lead to an approximative uniform structure of sections, categories and even subcategory in the financial statements.\(^7\) At least, all these three financial statements are subdivided identically in a business section, a financing section, an income tax section and a discontinued operation section; thereby the business section itself is once more subdivided identically in an operating and an investing category.

The *classification process* of the different items shown in the financial statements starts on the classification of the assets, liabilities and equity in the

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\(^5\) See SD-FSP 47 in combination with 51.
\(^6\) See SD-FSP 44 b) in combination with 57.
\(^7\) See SD-FSP 58. According to SD-FSP 59 a *section* is the largest group of items in the financial statements, a *category* is a group of items within a section and a *subcategory* is a group of items within a category.
statement of financial position. These items are fundamental and are logically prior to the items recognised in the statements of comprehensive income and cash flows.\textsuperscript{8} However, in determining the section, category or subcategory in which to classify an asset or liability, an entity must consider the activity in which the asset or liability is used; consequently, the functional activities depicted in the statements of comprehensive income and cash flows are part of the classification process.\textsuperscript{9}

2.2 Structure of the financial statements

2.2.1 Overview

More detailed, schedule 1 presents the structure of the individual financial statements according to the proposals of the SD-FSP:

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\textsuperscript{8} This means that changes in the balance sheet items normally give rise to the related income and expenses (e.g. change of tangible fixed assets and corresponding depreciations, impairment losses, reversal of impairment losses, and gains or losses on the sale of the tangible fixed assets) and also cash flows (cash receipts from the sale or cash payments from the purchase of tangible fixed assets).

\textsuperscript{9} See SD-FSP BC 81.
<table>
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<th>II.1: OCI from items that will not be reclassified subsequently in p/l (with subdivision in sections/category and subcategory analogous to the subdivision in the p/l)</th>
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**Schedule 1:** Structure of the financial statements according to the SD-FSP

In the *operating category* items are classified, which arise in the entity’s day-to-day business.\(^{10}\) This definition includes also the purchase and the sale of long-lived assets which are used in the production process of the entity. Only in the statements of financial position and comprehensive income an *operating finance subcategory* exists. This subcategory includes the financing activities which are directly related to an entity’s operating activities and which provide also a source of long-term financing for the entity.\(^{11}\) In the statement of financial position, examples are the net post-employment benefit obligations, lease obligations, or decommissioning liabilities.\(^{12}\) In the statement of comprehensive income, only the income and expenses related directly to the finance aspect of a liability or a net asset classified in the operating finance subcategory, such as interest expense, accretion expense or the return on pension plan assets shall be classified in that subcategory.\(^{13}\)

An asset or a liability that an entity uses to generate a return and any change in the value of that asset or liability shall be classified in the *investing category*. In addition there are *no significant synergies* created for the entity *by combining* an asset or a liability classified in the investing category *with other resources of the entity*.\(^{14}\) For an industrial or a non-financial services entity, examples are

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\(^{10}\) See SD-FSP 72 f.

\(^{11}\) See SD-FSP 74.

\(^{12}\) For further examples see SD-FSP 76.

\(^{13}\) See SD-FSP 78.

\(^{14}\) See SD-FSP 81 sent. 1 f.
the purchase, the use, and sale of investments, including investments in associates and joint ventures, investment property or financial assets.

The financing section includes all items that are part of an entity’s activities to obtain (or to repay) capital, except those liabilities that are classified in the operating category, the operating finance subcategory or in the discontinued operation section. Irrelevant for the classification of the items in the financing section is the use for specific activities. As the statement of comprehensive income aims to calculate the profit and loss and the comprehensive income attributed to the shareholders, the financing section of this statement includes only the financing from debts. In the other two financial statements the financing section includes both, the financing from equity and from debts. Furthermore, in the statement of financial position the financing section is subdivided in the debt and the equity category in order to present the entity’s equity unchanged to the current disclosure.

Although each of the financial statements contains an income tax section, its extent varies. In the statement of financial position the income tax section includes all current and deferred income tax items. As the statement of cash flows presents cash receipts and cash payments, in the income tax section of this financial statement, only effective income taxes can be presented. Despite of the separate presentation of an income tax section in the structure of the statement of comprehensive income the principles of allocating income tax expense or benefit in accordance with IFRSs still prevail. Therefore an entity has to present income tax expense or benefit in the discontinued operation section or in the other comprehensive income part of the statement of comprehensive income if the corresponding items that triggered these tax effects are presented in those parts of the statement of comprehensive income.

The discontinued operation section presents all assets, liabilities, income, expenses and cash flows which are disclosed as “discontinued operations” according to IFRS 5. In comparison to the present situation, in the statement of financial position the joint disclosure of assets classified as held for sale and assets included in disposal groups classified as held for sale, including discontinued operations, and of the liabilities included in disposal groups classified as held for sale, also including discontinued operations, will be removed. In the discontinued operation section, only those assets and liabilities will be shown which are related to a discontinued operation according to IFRS 5. The other assets and liabilities which belong to a disposal group but not to a discontinued operation will be presented outside the discontinued operation section, most probably in the investing category. Therefore over all financial

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15 See SD-FSP 83.
16 See SD-FSP 98 in combination with IAS 12.61 A.
17 See SD-FSP 99.
statements, the consistency in the disclosure will be improved significantly by that change.

2.2.2 Peculiarities of the structure of the financial statements

In addition, due to the different objectives of the single financial statements each one has some peculiarities in its structure:

For the statement of financial position, the peculiarities in the structure are:

- operating finance subcategory,
- subdivision of the financing section in a debt and an equity category\textsuperscript{19}, and
- in general\textsuperscript{20}, classification of assets and liabilities as short-term or long-term items according to their maturity or their expected date of realisation or settlement.\textsuperscript{21} In the opposite to the present situation\textsuperscript{22}, the length of the “normal operating cycle” has not any relevance for the classification of assets and liabilities as short-term or long-term. Furthermore, also the income tax assets and income tax liabilities have to be subdivided in that manner.\textsuperscript{23}

The peculiarities of the structure of the statement of comprehensive income are:

- Paramount to the subdivision in sections, categories and subcategory is the presentation of the statement of comprehensive income in two parts, the income statement and the other comprehensive income, whereby the items of the other comprehensive income are classified in those which will never be reclassified subsequently to profit or loss and those which will be reclassified subsequently to profit or loss when specific conditions are met.\textsuperscript{24} Therefore, the subdivision in sections, categories and subcategory follows on the next level. In general, even all items of the other comprehensive income have to be allocated to the operating category (including the operating finance subcategory), the investing category, the financing section or the discontinued operation section.\textsuperscript{25} The one and only exception is the foreign currency translation adjustment of a consolidated subsidiary (or a proportionate consolidated joint venture).\textsuperscript{26}

\textsuperscript{19} See section 2.2.1.

\textsuperscript{20} The one and only exception is that a presentation on liquidity provides even more relevant information (SD-FSP 115). See also the current regulation in IAS 1.60.

\textsuperscript{21} See SD-FSP 122.

\textsuperscript{22} See IAS 1.66 a) and IAS 1.69 a).

\textsuperscript{23} See SD-FSP 123. In the present situation, according to IAS 1.56 all deferred tax assets and deferred tax liabilities are classified as non-current items.

\textsuperscript{24} See IAS 1.82 A in combination with SD-FSP 136.

\textsuperscript{25} In the case of presenting the items of the other comprehensive income net of related tax effects (see SD-FSP 161 a), the classifications of those items to the sections, categories and subcategory include the related tax effects. In that case no income tax section is presented in the other comprehensive income part.

\textsuperscript{26} Please remark that IFRS 11 abolished the possibility of proportionate consolidation of jointly controlled entities in the consolidated financial statements.

\textsuperscript{27} See SD-SP 139.
Multi-category transaction section: Not only the statement of comprehensive income but also the statement of cash flows contain a multi-category transaction section. In this section of those financial statements the net effects on comprehensive income or cash flows of an acquisition that results in the recognition of assets and liabilities in more than one section or category in the statement of financial position shall be classified. Similarly, the net effects of a disposal transaction (that is not a disposal of a discontinued operation) resulting in the derecognition of assets and liabilities in more than one section or category in the statement of financial position shall also be classified in the multi-category transaction section of the statements of comprehensive income and cash flows.28 

- income tax allocation in the statement of comprehensive income and 
- a separate operating finance subcategory29.

Furthermore, according to SD-FSP.155 all unusual or infrequently occurring items shall be presented separately in the appropriate section, category or subcategory in the statement of comprehensive income. This disclosure requirement is supplemented by the note information about remeasurements. In this note the entity shall present the different types of remeasurements (at least separation of regular remeasurements, e.g. fair value adjustments of financial assets at fair value through profit or loss or investment properties, and irregular remeasurements, e.g. impairment losses for long-lived assets, including goodwill) in each section, category and subcategory of the statement of comprehensive income.30

As already mentioned, the peculiarity of the structure of the statement of cash flows is the multi-category transaction section. Beside it, the main change in the statement of cash flows is the cancellation of the choice of presenting cash flows from operating activities using either the direct or the indirect method31. According to SD-FSP.168 and 170 an entity shall present its gross cash receipts and gross cash payments in all sections and categories of the statement of cash flows. Although the direct method of presenting the statement of cash flows is only permitted the preparers of the financial statements are allowed to use a direct-indirect approach to set up this statement.32 This method starts with the preparation of the statement of cash flows using the indirect approach. In the next step the profit or loss in that statement of cash flows is substituted by the income and expenses of the income statement. In the following steps these income and expenses are netted against the change

28 See SD-FSP 100.  
29 See sect. 2.2.1.  
30 See SD-FSP 233–242.  
31 See IAS 7.18.  
32 See SD-FSP. BC 180.
of the particular corresponding balance sheet items in order to derive approximately the cash receipts and the cash payments.\footnote{See SD-FSP . 192, SD-FSP . BC 180 and SD-FSP . Implementation Guidance. Example 5 and also Auer, Cash-flow-Statements im Einzel- und Konzernabschluss, 1998, pp. 150.}

**Example:**
The sales revenue of the reporting period amounts to 10,000 currency units (CU), the other operating expenses (including an increase of the valuation allowance of the trade receivables by 100 CU) amount to 1,000 CU. After deducting the valuation allowance the balance sheet item trade receivables increased during the reporting period by 500 CU.

As the increase of the valuation allowance by 100 CU has no cash effect at all the other operating expenses must be reduced by 100 CU in order to derive the other operating payments; this amount is netted against the change of the balance sheet item trade receivables (1). After this reclassification has taken place, the rise of the trade receivables by 600 CU is charged against the sales revenue because to the extent the trade receivables increase no cash receipts from sales are generated by the entity (2).

<table>
<thead>
<tr>
<th>Statement of cash flows (indirect method)</th>
<th>reclassifications</th>
<th>Statement of cash flows (direct method)</th>
</tr>
</thead>
<tbody>
<tr>
<td>sales revenue</td>
<td>10,000</td>
<td>receipts from sales 9,400</td>
</tr>
<tr>
<td>other operating expenses</td>
<td>-1,000</td>
<td>other operating payments -900</td>
</tr>
<tr>
<td>Change of trade receivables</td>
<td>-500</td>
<td>+100 (1)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>+600 (2)</td>
</tr>
</tbody>
</table>

**Schedule 2:** Deriving the statement of cash flows by using the direct-indirect approach

### 3 Additional chances of the financial ratio analysis

#### 3.1 Analysis of the financial position

Due to the proposed structure of the financial statements users get additional information about the constitution of the entity's assets. Assets and liabilities are not only subdivided by their function but also by the period of time to be realised or settled. As already mentioned\footnote{See sect. 2.2.2.}, only those assets or liabilities are classified as short-term if either their contractual maturity or their expected date of realisation is within one year of the reporting date. All other assets and liabilities are classified as long-term items.\footnote{See SD-FSP . 122.} According to the present disclosure rules the classification of balance sheet items as short-term or long-term items is based also on the length of the entity's normal operating cycle\footnote{See IAS 1.66 a) and IAS 1.69 a).}.
so that even assets and liabilities which will be realised or settled in years could be classified as short-term if the entity’s normal operating cycle covers several years (e.g. whisky distillery). As the financial ratios that describe the financial position (e.g. short-term and long-term solvency ratios37) also require a subdivision of balance sheet items based on the length of time for realisation or settlement these ratios could be determined easily if the classification of the SD-FSP applies. In this case there will be no need of using any simplistic assumptions.

Furthermore, due to the proposed structure of the statement of financial position users get better information about the non-operating assets which are shown in the investing category and the discontinued operation section. The separate disclosure of the non-operating assets in two segments of the statement of financial position reflects the different intentions of the entity to dispose those assets. From an economic point of view, these non-operating assets indicate the amount of assets the entity can dispose without endangering to the entity’s core business. Although the book value of the non-operating assets will not be equivalent to the corresponding sales proceeds, nevertheless in many cases the valuation of the assets in the investing category and in the discontinued operation section at the measurement bases according to current IAS/IFRS38 may be at least a reasonable appraisal for the expected cash inflows. The proceeds from the disposal of the non-operating assets could be spend for repayments of liabilities, for investing in the operating or investing category, or for repayments to the shareholders.

In addition, the subdivision of the liabilities in different sections and categories enables users of the financial statements to evaluate the possibilities of reducing the entity’s debts. The liabilities classified in the discontinued operation section and in the investing category are in most cases closely linked with the corresponding assets classified in the discontinued operation section resp. in the investing category. Therefore these liabilities will most probably be extinguished by a disposal of the corresponding assets. In the opposite, as the liabilities classified in the operating finance subcategory are directly linked with the entity’s core business there are only limited possibilities of reducing those debts.


38 See for the measurement of the assets included in the discontinued operation section IFRS 5.15. Most of the financial assets (IAS 39.46, especially the financial assets at fair value through profit or loss and the available-for-sale financial assets; in the future: IFRS 9 chapter 4.1.4 in combination with chapter 4.1.2) are measured at fair value, or there is an accounting option between fair value and amortised cost (investment property according to IAS 40.30 and in the separate financial statements investments in subsidiaries, joint ventures and associates according to IAS 27.10).
3.2 Analysis of the financial performance

3.2.1 Calculation of “sustainable” profits

Schedule 3 shows the possibilities of classifying income and expenses by using the proposed structure of the statement of comprehensive income if income and expenses are subdivided by their different origin and regularity.

<table>
<thead>
<tr>
<th>Origin of income and expenses</th>
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<tbody>
<tr>
<td>Business section</td>
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<tr>
<td>Operating category</td>
</tr>
<tr>
<td>Income and expenses (residual amounts)</td>
</tr>
<tr>
<td>Remeasurement effects, regularly recognised (e.g. fair value adjustments of investment property, valuation of inventories)</td>
</tr>
<tr>
<td>Remeasurement effects, not regularly recognised (e.g. asset impairment of goodwill and other long-term fixed assets)</td>
</tr>
<tr>
<td>Unusual and infrequently occurring income and expenses</td>
</tr>
<tr>
<td>Discontinued operation section</td>
</tr>
<tr>
<td>Multi-category transaction section</td>
</tr>
</tbody>
</table>

Schedule 3: Possibilities of classifying income and expenses

Due to the separate disclosure of all unusual and infrequently occurring items, and the note information about the regularly and not regularly recognised remeasurement effects for each section, category and subcategory of the statement of comprehensive income, users are enabled to calculate “sustainable” profit ratios (for each section or category). The users can arrange the “sustainable” profits according to their assessments regarding the sustainability of several classes of income and expenses. If a close definition is applied the sustainable profits include only the “income and expenses (residual amounts)” in schedule 3 (profit from continuing operations before all remeasurement effects and before unusual and infrequently occurring items). If users and financial analysts prefer a broader approach sustainable profits could also contain the regular remeasurement effects which are recognised at the end of each reporting period. As in general income and expenses of the other comprehensive income are classified in sections and categories in the same way as in the income statement, and the note information regarding the remeasurements in each section and category even applies for the other comprehensive income, users can also include in their definition of sustainable profits (from the sections and categories) the regular remeasurement effects recognised in the other comprehensive income. Moreover, users can distinguish between the remeasurement...

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39 See sect. 2.2.2.
40 See SD-FSP 233 sent. 2.
effects in the other comprehensive income from items that will be reclassified subsequently in profit or loss when specific conditions are met and the other comprehensive income from items that will not be reclassified subsequently in profit or loss.

3.2.2 Calculation of profitability ratios

Due to the cohesiveness principle of the proposed structure users will be enabled to calculate a lot of profitability ratios without using any simplistic assumptions. Especially the profitability ratios that use the assets as denominator (often called as “return on assets” ratios) can be determined easily.

\[
\text{return on operating assets} = \frac{\text{profit/loss from operating category}}{\text{assets classified in the operating category}} \times 100
\]

\[
\text{return on investing assets} = \frac{\text{profit/loss from investing category}}{\text{assets classified in the investing category}} \times 100
\]

\[
\text{average finance costs} = \frac{\text{net loss from financing section}}{\text{net liabilities classified in the financing section}} \times 100
\]

The first and the second mentioned ratios indicate the profitability of the assets invested or classified in these categories. The users can also decide to include in the profit from operating (or investing) category in whole or in part the corresponding other comprehensive income. Moreover, users can adjust these profit ratios by eliminating the remeasurement effects or unusual and infrequently occurring items. Due to the separate disclosure of the operating finance subcategory users can decide to integrate or to exclude the (net) liabilities and the corresponding (net) interests in the average finance costs. An exclusion of the items of this subcategory from the determination of the average finance costs can be argued as the financing aspects of items classified in this subcategory are often not in the responsibility of the entity’s finance management (e.g. imputed interest rates of post-employment benefit obligations or decommissioning liabilities). In an ex post and aggregate analysis, on a pre-tax profit level users can assess if the management acted in a favourable way for the shareholders (e.g. investing in the category with the highest profitability ratio, or reduction of debts if the average finance costs are higher than the maximum of both “return on assets” ratios).

In addition, due to the proposed structure of the statement of comprehensive income the economic substance of other profitability ratios, especially of the margins on sales, will also be improved significantly. The separation of the income and expenses classified in the investing category will improve the

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41 See sect. 3.2.1.

42 Moreover the average finance costs can also be used for the calculation of the financial leverage.
assertion of all ratios that are based on the relationship between profit and sales from operating activities. Therefore ratios, like the profit margin on sales, or the EBIT or EBITDA on sales, can be calculated without any simplistic assumptions and have a much more predicative value. As already mentioned, these margins can also be adjusted easily by remeasurement effects or unusual and infrequently occurring items.

3.3 Analysis of cash flows

At first sight the change in the structure of the statement of cash flows seems to be not as significant compared with the changes in the structure of the other two financial statements, nevertheless the extent and the substance of the cash flows presented in the statement of cash flows according to the SD-FSP are quite different compared to the current situation. One reason is that the statement of cash flows is prepared by using the direct approach.\(^{43}\) The IASB argues that the presentation of cash flows by using the direct approach is advantageous because it

- is more intuitive and understandable to a broad range of users of financial statements,
- improves the ability to predict future cash flows,
- improves insight into an entity’s cash conversion cycle and the relationship between revenues and expenses presented in the statements of comprehensive income and cash flows,
- when accompanied by a reconciliation of operating cash flows to operating income, links the statement of financial position and the statement of cash flows.\(^{44}\)

As already mentioned,\(^{45}\) the extent of the operating category is completely different compared with the current definition of the cash flows from operating activities. Therefore the cash flows from operating category include also the capital expenditures for tangible fixed assets or intangibles used for running the entity’s core business and corresponding to this the proceeds from the sale of those long-lived assets. (The only exceptions are the payments for the acquisition of assets which have to be classified in the multi-category transaction section\(^ {46}\) and analogous to this the proceeds from the disposal of assets classified in more than one section or category.) As the capital expenditures for the acquisition of long-lived assets that could be attributed directly to the operating category and also the proceeds from the sale of these assets are classified in the operating category the cash flows from operating category might be called as the entity’s “operating free cash flows”. At present, the free cash flows could only be calculated approximately by adding up the cash flows arising from operating

\(^{43}\) See sect. 2.2.2.
\(^{44}\) See SD-FSPBC 172.
\(^{45}\) See sect. 2.2.1.
\(^{46}\) See sect. 2.2.2.
activities and from investing activities. As the cash flows from operating category (i.e. “operating free cash flows”) do not contain the cash flows from other entrepreneurial activities that do not belong to the entity’s core business, for financial analyses, the cash flows from operating category are much more suited than current approximative computations of the entity’s free cash flows.

Due to the changed content of the cash flows the predicative value of a lot of cash flow ratios that are based on the cash flows from operating category will be improved. The cash flows from operating category can be assumed to be a more realistic appraisal for the facilities of the entity to repay debts or to pay dividends, and in the case of negative cash flows from operating category for the need of additional capital. A further example is the “operating cash flow to total liabilities ratio”\(^{48}\); this ratio is used to estimate the period of time an entity needs for paying back all its debts. By applying the proposed structure of the financial statements this ratio could be determined as the proportion of cash flows from operating category to the liabilities classified in the financing section. Under the simplistic assumption that the cash flows from operating category are constant over the next years, this ratio indicates the number of years the entity needs to extinguish completely its liabilities shown in the financing section. In comparison to the traditional computation, this ratio takes into account the need of cash flows to be invested in the operating category (especially capital expenditures for tangible fixed assets or intangibles) as the cash flows from operating category include those payments. Moreover, this ratio focuses only on the liabilities classified in the financing section and excludes consciously those liabilities which are directly linked with the entity’s core business (i.e. operating finance subcategory). Therefore, the appraisal for the period of extinguishing the entity’s debts is more realistic.

Furthermore, due to the cohesiveness principle ratios that bring subtotals of the financial statements in relation to each other are additional examples for the enhanced possibilities of financial statements analysis. Beside the cash flows from operating category to the liabilities classified in the financing section ratio, further examples are the cash flow margin on sales (i.e. proportion of cash flows from operating category and the sales from operating category) or the cash flow return on operating or investing assets (i.e. proportion of cash flows from operating or investing category and the assets from the respective category).

4 Limitations of the financial ratio analysis

Despite of the improved possibilities of financial statement analysis some limitations remain. The main limitations of financial ratio analysis regarding the proposed structure of the financial statements are:

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– exceptions from a complete cohesive structure over all financial statements,
– classification of assets and liabilities with multiple functions, and
– the subdivision of the statement of comprehensive income in two parts.

(1) **Exceptions from a complete cohesive structure over all financial statements**

Although the structure follows the cohesiveness principle to a large extent nevertheless there exist some exceptions due to factual or practical reasons. The main exceptions from a complete cohesive structure of the statements of financial position, comprehensive income and cash flows are listed in sec. 2.2.2 of this article as peculiarities of the structure of the financial statements. The incomplete cohesive structure of the financial statements prevents additional analyses or biases the predicative value of some financial ratios. For example, due to the implementation of a *multi-category transaction section* in the statement of comprehensive income not all gains and losses of the disposal of assets and liabilities which could be attributed to the business (including operating and investing category) and financing sections are classified in these sections and instead of it included in the multi-category transaction section. As in the statement of financial position no multi-category transaction section exists numerator and denominator of the “return on assets” ratios\(^{49}\) are not entirely consistent.

(2) **Classification of assets and liabilities with multiple functions**

The Boards acknowledge the problem of classification of assets and liabilities that are used for more than one function. “For example, an entity’s headquarters building might be used as part of the entity’s operating activities and it might also be a real estate investment.”\(^{50}\) In this case the Boards propose that the entity shall classify such assets and liabilities with multiple functions in the section or category of predominant use.\(^{51}\)

Even if this solution can be accepted for practical reasons, and also the case of two approximative equivalent important uses is neglected which includes some kind of discretionary decision, the problem of classifying income, expenses, cash inflows, and cash outflows related to the asset resp. liability with more than one use still remains. In the case of classifying the entity’s headquarters building in the investing category, according to SD-FSP. 137 and 168 also the income and expenses, and the cash flows which are related to this asset have to be classified in the investing category. Nevertheless, this classification of the entity’s headquarters building biases the picture of the entity’s performance in both, the operating, and the investing category. Regarding the operating category, no expenses for using the entity’s headquarters building are recognised in the operating category although the building is used for the entity’s core business.

\(^{49}\) See sect. 3.2.2.

\(^{50}\) SD-FSP. 106 sent. 3.

\(^{51}\) See SD-FSP. 106 sent. 2.
These expenses attributable to the operating category reduce the profit from investing category. From an economic point of view, rents for the use of the building for purposes of the operating category must be charged from the investing to the operating category. If the operating and the investing category are organised in different legal business units rents can be charged without any difficulties. In the other case this problem could not be solved as the SD-FSP does not allow to present “hypothetical inter-category” income or cash flows.

(3) Subdivision of the statement of comprehensive income in two parts
The SD-FSP deals only with the presentation and the disclosure of the financial statements, including corresponding note information, and does not care about related questions of recognition at all. Therefore in the SD-FSP, the separation of the income statement and the other comprehensive income part of the statement of comprehensive income still remains. The IASB acknowledges the problem of a missing conceptual basis for subdividing income and expenses in the statement of comprehensive income but without giving any perspective for solving this matter. “To address this issue, the IASB attempted to find a common conceptual basis but feedback suggests that it would be very difficult to do so in the short term.”52 Due to this, all judgements that management has to exercise in the process of applying the entity’s accounting policy retain their relevance for classifying income and expenses in the different parts of the statement of comprehensive income (e.g. classification of financial assets according to IAS 39 depending on the managerial intentions and on application of the fair value option, application of hedge accounting depending on the documentation of the requirements according to IAS 39.8853).

Furthermore, unchanged to the current disclosure the entity has the choice of presenting the assets and liabilities based on liquidity instead of presenting balance sheet items based on the length of period to be realised or settled (current and non-current items) depending on which kind of presentation provides more relevant information.54 Despite of this choice, according to IAS 1.61 the entity has to disclose in the notes for each asset or liability line item that combines amounts expected to be recovered or settled, (a) no more than twelve months after the balance sheet date, and (b) more than twelve months after the balance sheet date, the amount expected to be recovered or settled after more than twelve months. Therefore even in the case the entity presents assets and liabilities in the statement of financial position based on liquidity, users can approximately derive the balance sheet structure based on the length of time for realisation or settlement. The SD-FSP cancels the note information of IAS 1.6155. Corresponding to this in the case of presenting the assets

54 See IAS 1.60 and SD-FSP. 115.
55 See SD-FSP. IG Table of Concordance.
and liabilities based on the liquidity, users and financial analysts will no more be able to determine the financial ratios that are usually used to describe the entity’s financial position\textsuperscript{56}.

5 Possible implications for corporate taxations

The structure of the financial statements according to the SD-FSP tends to improve especially the insight of the primary user groups of the financial statements (i.e. existing and potential investors, lenders and other creditors). As the proposed structure of the financial statements leads also to a higher level of transparency and shows relationships across the financial statements also the tax authorities may prefer this kind of presentation. In particular, the tax authorities might be interested in:

- Due to the high level of disaggregation, the disclosure of unusual and infrequently occurring income and expense items, and the note information about remeasurement effects tax authorities could increase the plausibility- or cross-checks by comparing the financial data of the entity with the corresponding data of similar entities or entities busied in the same branch.
- Especially the analysis of the entity’s profit or loss is improved significantly.\textsuperscript{57} This includes also the analysis of items recognised outside the profit or loss.
- Furthermore the development of financial ratios with a quite high predictive value can be compared over time.
- Due to the cohesiveness principle and also the application of the direct method for presenting the statement of cash flows tax authorities are also enabled to make quite interesting cross checks between the profit and loss from the different sections and categories and the cash flows from the corresponding sections and categories. By this analysis, tax authorities get, for example, aggregated information about expenses without cash outflows and information about cash receipts which have not be recognised as income. These information can be used for further investigations of the underlying facts by the tax authorities.

6 Conclusions

With the SD-FSP the Boards propose a structure of the statements of financial position, comprehensive income, and cash flows that considers the cohesiveness and the disaggregation principle. The planned new structure of these financial statements leads to enhanced facilities of financial ratio analysis. The users of the financial statements get additional information about the entity’s financial position, especially the non-operating assets, and the short-term and long-term solvency ratios that could be calculated without any simplistic

\textsuperscript{56} See sect. 3.1.

\textsuperscript{57} Compare schedule 3.
assumptions. Furthermore, users can calculate “sustainable” profit ratios (for each section or category) according to their assessments regarding the sustainability of several classes of income and expenses. Due to the cohesiveness principle of the proposed structure users will be enabled to calculate a lot of profitability ratios. This information helps users to evaluate how effectively and efficiently management discharged their responsibilities to use the entity’s resources. Due to the proposed structure also the content of the cash flows changes significantly. As the cash flows from the operating category on the one hand include the capital expenditures for the acquisition of long-lived assets used in the entity’s core business, but on the other hand exclude cash flows from other entrepreneurial activities which do not belong to the entity’s core business, for financial analyses, the character of the cash flows from operating category changes towards an “operating free cash flows”. For purposes of analyzing the financial statements, this cash flow is much more suited than current approximations to the entity’s free cash flows.

As the proposed structure of the financial statements is not completely cohesive, assets and liabilities with multiple functions are classified in the section or category of predominant use, and the subdivision of the statement of comprehensive income in two parts still remains, even the financial statement analysis based on the SD-FSP is not perfect because due to these limitations the predicative value of some financial ratios could be biased. In the case of presenting the assets and liabilities based on liquidity, users will no more be able to determine the common solvency ratios as the note information according to IAS 1.61 is canceled.

A further indirect consequence of the proposed structure of the financial statements is also that tax authorities get quite more detailed information about the entity. For example, tax authorities might improve their plausibility- or cross-checks by comparing the financial data of the entity with corresponding data of similar entities or entities busied in the same branch. Moreover, tax authorities will also benefit from the increased facilities of analyzing profit or loss. Another example of the enhanced possibilities for tax authorities is the combination of information provided in the statements of cash flows and comprehensive income in order to detect cash receipts which have not been recognised as income, or expenses without any related cash outflow in the same period.

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