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[International Controller Association]
IFRS Working Group

Discussion Paper
Multi-Column Financial Statements



Imprint

This discussion paper is an extract from the discussion paper on multi-column financial statements and the result of the work of the IFRS working group. It represents the opinion of the association and is supported by the board. For further information, refer to the discussion paper on Three-column Financial Statements.

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Preface

This discussion paper is a result of several years' work by the IFRS working group within the International Controller Association on a set of topics relating to the preparation and presentation of financial statements, particularly the preliminary work regarding management accounting. The discussion paper has its origins in IASB publications, especially in the discussion papers relating to the Financial Statement Presentation Project and the resulting impacts for management accountants. Moreover this discussion paper was influenced by the tendency of accounting to changeover from a historical documentation function to the accounting of future facts and circumstances that could be observed during the recent past. Accounting tendencies of current discussion interests are considered in the paper as well as a new concept of financial statement presentation. The dilution and decrease in information content of financial statements resulting from new accounting regulations is to be countered by creating improved transparency without adjusting the underlying accounting regulations. Due to neutral presentation of financial statements within the concept it may be applied to all accounting systems – German-GAAP, IFRS or US-GAAP. Furthermore the concept enables preparers to exhibit more extensive information, e.g. a transition between different accounting systems or business' success potentials.

This paper shall contribute to the discussion on future presentation of financial statements by delivering useful suggestions for the development of a final concept. In this respect the discussion paper is addressed to the academic community, standard setters and all other parties affected by accounting regulations. The IFRS working group would like to foster a lively discussion on the concept described. Therefore I would encourage you to join the discussion on a transparent presentation of financial statements with the IFRS working group.

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1 Initial assumptions and areas of concern in present accounting

1.1 Initial assumptions

Accounting is *not an end in itself*. The objective is to provide information about the financial position, the financial performance and the cash flows of an entity. A third party with expert knowledge should, with a reasonable amount of effort, be able to gain a true and fair view into the current state as well as into the risks and rewards of the entity in relation to the accounting period under consideration. Accounting necessarily entails inaccuracies, since it arises from the aggregation of many individual transactions that can be attached in various manners. Besides accounting transactions based on accounting records, accruals and evaluations affect financial statements. Furthermore, accounting has to consider more and more every economically relevant fact, particularly intangible values, customer-, supplier- or investor-relationship and their outflows as well as diverse types of risks.

In addition to the inherent inaccuracies of accounting in principle, there are different purposes of accounting that cause conflicting requirements.

Regulations can limit, but not avoid, wide scopes of discretion available to the actors of accounting. For that reason, accounting is only a trade-off and the picture it provides can – despite all efforts at clarity and comparability by the clear application of accounting options and scopes of discretion – only describe an approximation of reality. Due to the increasing degree of international operation preparers have to respect a number of sometimes-divergent GAAP forms. As a result, scopes of discretion within each GAAP applied at the level of subsidiaries are exercised generally so as to conform to the treatment by parent companies. Each approach for the development of current accounting standards must take account of these complex initial assumptions and incorporate them into the proposed solutions.

The suggested multi-column financial statement concept is supposed to be applicable to any accounting system and theoretically appropriate to comply with all requirements outlined above.

1.2 Areas of concern in current accounting

1.2.1 Multi purpose usage

The common plurality of purposes within accounting systems results in a low degree of fulfilment for each individual purpose. The current systems of standardised accounting are based on an integrated solution trying to compromise among divergent interests.

1.2.2 The purpose of the Integrated Reporting Framework calls for transparency from different stakeholders' points of view of value creation and varied interests in the development of flows and stocks of the six capitals intended. We have to organize our accounting for this cause in a specific structure. The table of accounts will be extended significant for being able to serve the information requirements included the concept of the multi-column financial statement. Separation of internal (management) and external accounting

An uncoordinated and intransparent separation of internal and external accounting creates or intensifies the tendency to obtain inconsistent databases and varying presentation of income with reconciliations even for experts being hard to comprehend. As a result understandability and acceptance are adversely affected. An open and easy to follow parallel presentation could in contrast considerably increase the quality of data as well as the reliability and relevance of information provided to users, enabling the utilisation of synergistic effects that have been unavailable so far.

The management accounting system is future and responsibility orientated. Besides solvency and income it focuses on potentials for profit. Depending on the weight of reliability, external accounting rather tends to concentrate on the evaluation of past transactions with respect to the intentions accounting pursues. The resulting differences and correspondingly varying consequences have already been discussed. A wide range of economically unskilled managers complains quite rightly that the various income measures presented are incomprehensible. Even detailed reconciliation cannot substantially reduce these barriers. Sometimes reconciliation statements even intensify the unease among experts, since those who supply the information do not have to make the decisions resulting from them. In addition internal and external accounting systems are often institutionally separated. Intransparency is flanked by inadequate coordination resulting from questions of

authority and a lack of communication. These issues reduce management's acceptance often related to discussing the "accuracy" of various figures.

Management accounting information concurrently attains relevance for external accounting – e.g. planning approaches for the measurement of deferred taxes or continuous documentation and (historical) costing of development efforts to be capitalised – and thus has to be integrated into external accounting. An improved coordination between internal and external accounting is required with respect to data structures, criteria for recognition and measurement, a consistent financial terminology (definition of terms) as well as the compatibility of planning and reporting structures on the one hand and of the presentation structures for external accounting on the other hand.

A multi-column presentation virtually suggests itself, if the various intentions and requirements of all parties concerned are to be pursued. Such a structure enables an open, transparent and comprehensible coexistence of various purposes such as the presentation of cash flows and financial position and measurement of distributable dividends. The sophisticated assumptions concerning each of the different presentations are directly comprehensible to users and enable them to communicate appropriately. The multi-column presentation avoids the mixture of reliable information with relevant information regarding expected future cash flows for the purpose of investment decisions by description of both issues within separate columns. The presentation of different income measurements directly serves the forecast of future income. Both undistorted presentations of the financial position are usable and comparable by the management. Furthermore, the column showing distributable dividends meets the requirements of management for an appropriate presentation of accruals and responsibility.

Hence, an integration of internal and external accounting might release unrevealed synergies and considerably increase the quality of accounting data presented.

1.2.3 Consistency (coherence) of accounting for users

Accounting instruments lack a reasonable conjunction. Management should always be in a position to pay equal attention to three issues: liquidity (in varying degrees of availability), development of distributable income (of the period) and information about the finan-

cial performance (development as well as the utilisation of the indicated potentials). Only where users can consistently distinguish these issues is management able to monitor the sustainability of economic development of the entity through accounting.

Consistency – in terms of the integrated interaction between understandability, manageability and significance for the recipients of the data – is a key quality feature of accounting. It influences whether and to what extent financial statement information is used.

The illustration of the financial position and performance by a connection between the income statement and the statement of cash flows, which differs by accruals, can be interpreted as a positive example. This has particular importance due to the relevance of cash flows for management accounting purposes and represents a preliminary stage of multi-column financial statements. However, this example is not sufficient to eliminate the discrepancies concerning accounting as outlined above, but it represents a step towards the right direction.

As already indicated the mixture of contradictory principles leads to a lack of understandability of the provided data. Certainly, an explanation of relationships and backgrounds concerning recognition, accruals and evaluations on a basis of accounting transactions seems possible, but the efforts of explanation easily exceed – especially in case of repeated explanation – the efforts required for the preparation of a multi-column financial statements. Beyond that, a high demand for explanation decreases acceptance of accounting data. Moreover, most of the users are not in a position to require an entity to prepare reports tailored to their particular information needs. In this respect, the concept of multi-column financial statements might increase comprehension and acceptance for accounting as well as it might decrease the overall effort relating to preparation and communication.

However, even if a certain understanding exists, increasing efforts for due diligence and issues concerning the limitation of destructive amounts of distributed dividends demonstrate the insufficient manageability of the financial statement data, as explained above. As a result of intransparency, decision makers do not rely on accounting data and obtain information from other sources, directly depreciating the work of accounting. Accounting quickly becomes an onerous obligation due to insufficient manageability. As soon as there

is a clear separation of principles by applying the multi-column financial statement, this may be amended and users can directly derive information about liquidity, distributable dividends and (potential) income from accounting data.

In current practice the sense of accounting utility almost disappears when problems of acceptance mix with the feeling that it is little more than an onerous obligation. Executives often prefer to avoid dealing with accounting data. Only a few consider accounting to be a helpful management tool for daily use.

An improvement in consistency would not immediately change the attitude towards accounting. However, it provides the opportunity to initiate an expedient development.

1.2.4 Degree of aggregation of financial statements

Financial statement items show a high level of aggregation, containing the risk that relevant information is not presented.

Accounting may be considered as a compact depiction of the position of an entity and is subject to the conflicting goals of relevance and information overload. In this respect, the limitation of items presented within financial statements seems useful, as long as contradictory data is not mixed and statements are obscured. At least comparability is maintained, if all preparers mix in the same way.

Sales are not comparable because the extent to which unrealised transactions have been incorporated is not obvious. Even expenses are not comparable because the multifarious characteristics of inventory measurement inextricably disappear in the aggregated data. Eventually even insiders cannot certainly estimate with any certainty the degree to which assets have been evaluated by cost, market-orientated or model-based or how these ratios change from period to period and to what extent the level of reliability is comparable.

Disaggregation by using several columns dissolves the mixture of principles and facilitates the clear distinction of valuation methods. As a result the quality of information can obviously be increased.

2 Proposals concerning multi-column presentation discussed to date

For the reasons outlined in chapter 1, various authors have considered the problem and proposed different solution approaches. An exemplary selection of these has been presented briefly below. None of the suggested models have been implemented in practice yet and even the IASB ultimately ceased pursuit of the proposal for multi-column presentation. Nonetheless, the considerations and models developed appear as suitable basis for the multi-column financial statement proposals presented in chapter 3.

- The conservative and most reliable determination of profit, A. Moxter, 1962
- Multi-column financial statements, W. Ballwieser, 1982
- Two-column financial statements, T. Siegel, 1997
- Two-column financial statements, D. Ordeltjeide 1997
- Spectrum presentation, B. Pellens, R. U. Fülbier and J. Gassen, 1997
- Reporting comprehensive income, IASB and ASB, 2001-2003
- Two-column accounting, I. M. Schmidt, 2007
- Financial statement presentation, IASB and FASB, since 2003
- Multi-column accounts, M. Gros, 2010

3 ICV multi-column financial statements

3.1 Concept

From a management accountant perspective the concepts shown in accounting research so far can raise transparency of external and internal financial statements to a new level without unreasonable effort and costs and is ideally suited for the implementation of the new integrated reporting framework. As we expect a positive cost-benefit balance, we believe in multi-column financial statement presentation as the future of accounting and see a necessity to leave the path of one-dimensional financial presentation.

The basic idea is to consider the legally required accounting information within the context of operational and strategic corporate objectives.

From an operational point of view, companies strive to preserve liquidity and raise income. Meanwhile, future income potentials are more important than income of one period sighted from a strategic perspective.

Considered in view of those accounting objectives in an operational and strategic context, the following financial statement column structure arises:

- (1) operating liquidity (to be presented in column one)
- (2/3) operating income of the period (to be presented in columns two and three [see below])
- (4) strategic income potential/information following a management approach / an integrated reporting (to be presented in column four a and b)

Column one thereby is used for liquidity presentation.

In order to generate transparency, profits respectively income should be reported in two separate columns – a distribution and an information column. The primary focus of column one to three is to differentiate and restructure obligatory reported information meanwhile column 4 follows a different method.


Depending on a countries accounting system or its preferences, the column concerning distributable profits (column two) can be configured according to a more or less conservative approach, e.g. with or without a disbursement barrier. Column three contains the bal-

ance sheet to be published under the respective GAAP and the associated income statement (e.g. according to German-GAAP or IFRS). Thus, the information content covered by the information column varies depending on the current accounting system or other advanced accounting concepts applied. The differences between a GAAP-based balance sheet for information purposes only (column three) and a GAAP-based balance sheet concerning distributable profits depends, however, on the definition of distributable profit for the period and the introduction of a disbursement barrier.

The preliminary considerations made by ICV's IFRS working group concerning the fourth column have initially been wide-ranging. The bandwidth includes the quantification of potential income as well as the systematic collection of obligatory and optional off-balance-sheet and off-income-statement information, which do not need to be geared to the structure of the balance sheet and the income statement. Even within the subgroups of the fourth column there are equally diverse alternatives. The quantification of potential income could contain (aggregated) output-oriented measurement approaches, such as the enterprise value indication according to the discounted cash flow method (if needed, differentiated according to strategic business units), as well as input-oriented measurement approaches which value the intangible input factors (long-term goodwill). On this occasion for the creation and preservation of long-term intangible assets either discounted cash flows or cumulative outflows (e.g. over the entire period or five years) are taken into account. Under these long-term intangible assets the IIRC capital stocks intellectual, human, social and relationship, and natural could be subsumed. Column 4 thus basically grants space to undertake an entity-specific attempt to quantify non-financial performance indicators to financial statements. Information provided in column four thereby could be (partially) limited to internal use only.

Meanwhile ICV's IFRS working group has enhanced information to be given in column 4 following a management approach and considering the concept of integrated reporting, leading to the concept shown as follows.

| | Column 1 | Column 2 | Column 3 | Column 4 | |
|-----------------|------------|---|---|--|--|
| | | | | a | b |
| | Liquidity | Distribution | Information | Goodwill | Potential Performance |
| Approach | cash flows | distribution-orientated accounting (GAAP) | future/market-oriented accounting (GAAP) | value-driving factors not taken into account | accounting for opportunities & risks |
| Examples | | depending on GAAP | - fair value - PoC - development - ... | - patents - brands - human resources - acquired orders - ... | - "sales funnel" - branding - investment bottleneck - ... |



Non-accounted according to GAAP

Figure 1: Vision of multi-column financial statements

A company's potential (opportunities and activities) should be followed by cash flow. Accordingly each potential implemented must pass all columns from right to left. Congestions or gaps indicate to possible misinterpretations, problems or missed potentials and therefore provide valuable information for management purposes.

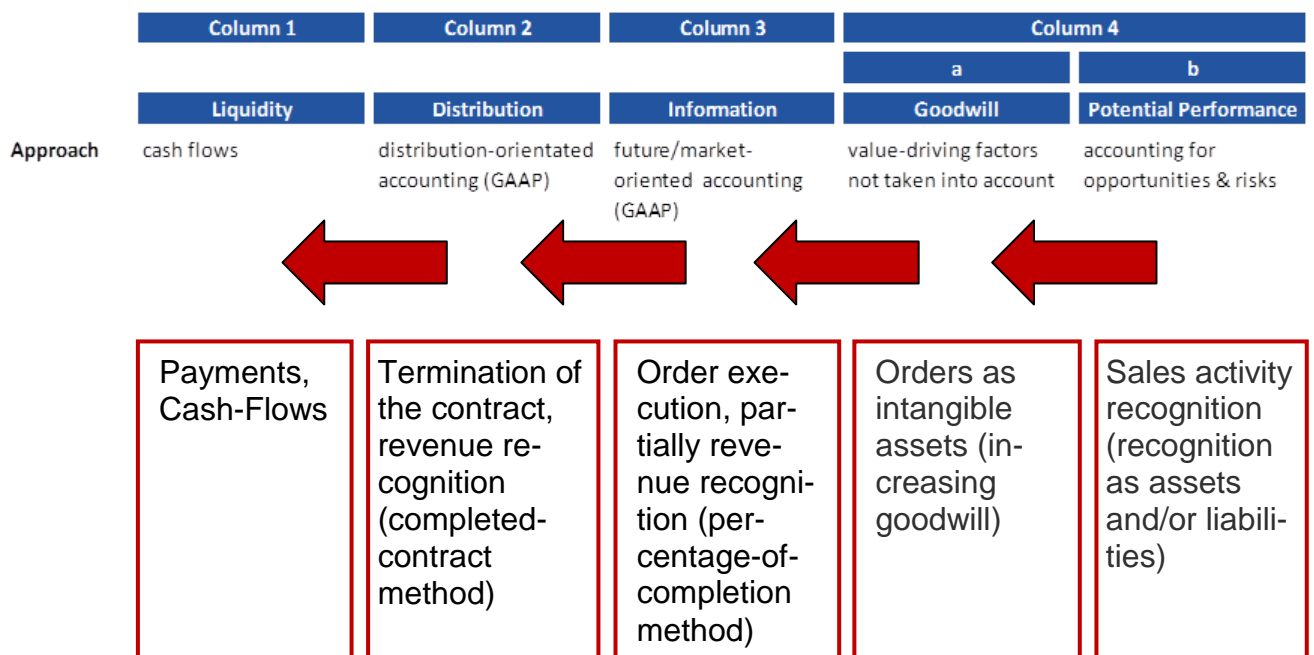


Figure 2: Multi-column financial statement flow chart

3.2 Liquidity column

Column one shows the distinct cash flow. As a result, the balance sheet describes asset outflows and equity inflows. Thus the cash flow from operating activities is opposed to the yearly income within the income statement and by cash flows from investing and financing activities being added, a comprehensive statement of cash flows is integrated into the income statement. A balance sheet showing cumulative asset outflow and equity inflow emphasizes the need for profitability expectations and investment appraisals to refer a priori to the presentation of initial payments from a management accounting perspective.

3.3 Distribution column

Column two contains the distributable dividends. While rating the distributable dividends necessary accruals and deferrals have to be taken into account for the purpose of profit determination on an accrual basis. Accounting information presented in the second column depends on the underlying GAAP. Within consolidated financial statements pursuant to the law the heading "distribution" has to be replaced. As information concerning distributable dividends is even useful for consolidated financial statement users from a strategic perspective, it seems to be reasonable to entitle the column by using the term "distributable".

3.4 Information column

For information purposes column three contains additional assets and liabilities as well as assets and liabilities assessed by using different measurement approaches. Furthermore to meet the primary user needs, corresponding revenues and expenses without distribution relevance are shown in the third column. According to current European law, the balance sheet and the income statement under German-GAAP or if applicable under IFRS adopted by the European Union are to be presented in this column. By changing the regulatory requirements hereafter, additional information could be stipulated or voluntarily approved by law as long as the dividend potential is held on the same level.

3.5 Goodwill/income potential/voluntary information column

As financial statements do not meet all information requirements set by internal users due to different primary user needs, further information can be added – if applicable on a voluntary basis for in-house use only. To satisfy the (internal) user needs, data containing future potentials or opportunities and risks could be reported by following a *value-oriented approach*. Starting with accounting for opportunities and risks by recognizing sales activities as assets (opportunities/potential income) and/or liabilities (risks/potential loss) value driving factors not taken into account within the income statement could be assessed by recognizing orders as intangible assets (increasing goodwill). Furthermore even aspects of integrated reporting could be recognized under consideration of the 6 capitals set out by the new integrated reporting framework within column 4.

3.6 Specific aspects related to consolidated financial statements

3.6.1 Theoretical preliminary considerations

As mentioned before, multi-column accounting can raise financial statement transparency to a new level without unreasonable effort and costs. As decidedly measurement approaches exist for single columns, nevertheless, there is no interference with measurement approaches and accounting rules overall. In this respect, remarks made so far similarly apply to consolidated financial statements.

As consolidated financial statements are supposed to present all economically bound and consolidated entities as if they legally constitute one unit, the same measurement approaches and accounting rules have to be applied by all entities consolidated. With multi-column presentation in mind, each column can contain modifications (e.g. regarding date, currency or disclosure) due to consolidation. Beside that, in consequence even cross-column effects can occur.

3.6.2 Accounting adjustments

In case of a change in the accounting system used for a consolidated financial statement, remeasurements may be necessary respectively different accounting rules may have to be applied. This usually has to be done in the context of level II adjustments. As these are measurement issues, this does not affect the liquidity column.

3.6.2.1 Level II adjustments

Level II adjustments contain adjustments regarding group-wide accounting rules and measurement approaches. Effects following those adjustments can be classified into three categories:

- adjustments within a column
- shifts between columns
- reclassifications

Adjustments within a column are necessary when issues are recognised identically within financial and consolidated financial statements but different measurement approaches are

used. For example, these adjustments take place when different depreciation methods, economic lifetimes or residual values are used. In addition, they can be required in case of different accounting rules for financial and consolidated financial statements. The percentage of completion (PoC) method is cited as an example in this instance. While this method is e.g. not graded for use within financial statements under German-GAAP, it has to be used within the contractor's financial statement under IFRS when the legal prerequisites are satisfied. The liquidity column is not affected by these adjustments.

Shifts between columns arise when issues have to be treated and thus accounted differently. Hedging is to be cited as an example in this instance. In case of hedges on a consolidated financial statement level without hedging relationships on the tier of separate financial statements, shifts are necessary within both, the distribution and the information column. Other situations in mind, shifts between columns could – even when unlikely – affect the liquidity column as well.

Reclassifications are required in cases of identical measurement approaches used but different disclosure rules occur. They can be compared with reclassifications within financial statements; however they affect more than one column due to the cash effect. For instance, tax receivables can cause these reclassifications as they can contain tax prepayments as well as tax receivables due to losses incurred. Depending on the accounting system they are disclosed as other accounts receivable (German-GAAP) or as tax receivables (IFRS).

3.6.2.2 Level III adjustments

Level III adjustments capture hidden reserves, hidden charges and assets not accounted for yet emerged within the scope of purchase price allocations as they are only purchased from a group perspective. As there are no corresponding assets and charges at the level of separate financial statements, they can be scheduled within consolidated financial statements analogously to assets purchased within financial statements. To this extent the appropriate rules pertaining to financial statements are applicable. A typical example is the accounting for a customer base. Historical costs are to be featured within the liquidity

column, whilst corresponding depreciation is to be disclosed within the distribution column.

3.6.3 Consolidation

Depending on item and column, different consolidation steps are necessary. In general it is necessary to analyse each column regarding consolidation needs and then to undertake the required consolidation entries. In principle, two types of consolidation can arise:

- column consolidation (within one column)
- cross column consolidation (between several columns)

Column consolidation is done in cases of group-wide measurement approaches and accounting rules applying to each group entity. A reclassification or remeasurement is not necessary.

Column and cross column consolidation apply to all types of consolidation: capital, debt and income consolidation. In this context, offsetting differences and intercompany profits are important in particular, whereas genuine and false offsetting differences are treated differently. *Genuine offsetting differences* usually follow from recognition rules and measurement approaches, whereas the entities involved have to use various values for one issue despite a consistent application. Genuine offsetting differences always rest upon the underlying issue and typically arise in cases of column consolidation. Exchange rate differences are to be cited as an example in this instance. *False offsetting differences* typically arise when issues are expensed the wrong way or with delay. If these differences have not been adjusted at level II, adjustment needs to be conducted as part of consolidation. False offsetting differences trigger both, column and cross column consolidation.

Intercompany profit elimination is, for example, necessary in case of goods sold still on stock at the reporting date. Inventories then have to be adjusted by the supplier's profits. Usually, a column consolidation has to be done to achieve these adjustments. With intercompany supplies settled, intercompany profit elimination takes place within the liquidity column. Otherwise it takes place within the distribution column. Only in cases of false offsetting differences arising in the context of intercompany profit elimination, is a cross column consolidation necessary.

When M&A *transactions* are executed, additional adjustments have to be taken into account while historical costs have to be assigned to the assets purchased and shown within the consolidated financial statement regardless of whether or not they have been capitalised. Thus, any goodwill arising from a purchase price allocation is also part of an acquisition transaction and accordingly has to be disclosed in the liquidity column. The same is with provisions.

To sum up, one could say that multi-column presentation is beside its benefits associated with slight additional costs relating to consolidation. The main problems causing additional costs are to identify the issues which have to be consolidated thus the consolidation process could run system-supported and that cash flow statements requested by law require a liquidity driven way of thinking while consolidation is performed.¹

¹ Cf. re. consolidated statements of cash flow, *Finanzierungsrechnung* [Statement of cash flows], expert panel of Schmalenbach-Gesellschaft (2012); Eiselt, A./Müller, S. (2008), p. 57-75.

4 Summary, implementation opportunities, future prospects

Current GAAP constitute compromises between divergent disclosure purposes, such as distribution, tax assessment, information and corporate control, or regarding a single accounting purpose, for example concerning different user needs. Hence, a dilemma arises between accounting data reliability and its relevance for decision-making. A multi-column financial statement presentation as shown can solve this dilemma to a great extent. Additionally, accounting transparency could be increased considerably. Whilst column one is used for inflow- and outflow-presentation, column two and three contain corresponding revenues and expenses. Depending on a country's accounting system or its preferences, the column concerning distributable profits (column two) can be configured according to a more or less conservative approach, e.g. with or without a disbursement barrier or with or without the usage of accounting options. The differences between a GAAP-based balance sheet for information purposes only (column three) and a GAAP-based balance sheet concerning distributable profits does, however, depend on the definition of distributable profit for the period and the inclusion of a disbursement barrier. Where a barrier is included items categorised as non-distributable are only shown in column two.

With liquidity data integrated in the income statement as well as the balance sheet, an increase in the interest of internal and external users could be achieved. Even though a multi-column financial statement presentation should not be mandatory for all entities, a positive effect potentially ensuing for small and medium sized entities is of general interest for increasing management quality as illiquidity is one of the main reasons for bankruptcy.

As shown practitioners, researchers and standard setters already discuss multi-column financial statements. In concrete terms, the IASB is working on a comprehensive draft to revise financial statement presentation according to IAS 1 and IAS 7. Thereby, one could expect a mandatory direction for direct cash flow presentation within the statement of cash flows as stated above, which again would reduce the effort related to a multi-column financial statement presentation.

As management accountants are committed to a transparent presentation and have been accustomed to handle multi dimensional figures for decades, a combined liquidity, distribution and information presentation should induce intensive usage instead of confusion.



The bandwidth of additional information could also include the quantification of potential income and the systematic collection of obligatory and optional off-balance-sheet and off-income-statement information, and even more frequent use is imaginable.

Ultimately, it is for lawmakers to adopt the meaningful changes presented, but therefore further discussions and tests will surely be necessary.

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About the IFRS working group

The IFRS working group is working at the interface between financial and management accounting mainly focussing the effects of financial statement presentation on management accounting. We work to support management accountants in coping with changes in the accounting landscape. Furthermore we make our contribution to the further development of accounting considering the needs of management accountants.

The working group consists of management accountants, university lecturers, business consultants and auditors. All members are involved in the working group on a voluntary basis.

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