SMALL BUSINESS ADVISORY COMMITTEE

FASB Offices
Norwalk, Connecticut

June 20, 2007
Agenda*
(as of June 13, 2007)

9:00 a.m.	Introductory Remarks (Mr. Batavick)
9:05 a.m.	Status Reports • Report of the FASB Chairman (Mr. Herz—Attachments A-1 to A-4) • Report of the SEC (Ms. Minke-Girard) • Report of the PCAOB (Mr. Fletcher)
9:35 a.m.	Private Company Reporting Activities • The mission of the Private Company Financial Reporting Committee, its operating procedures and priorities, and how the PCFRC may interact with the SBAC (Ms. O'Dell—Attachment B, PCFRC Meeting Highlights, PCFRC May 16 Letter) • The IASB's SME project (Mr. Batavick—Article, "The Way Forward")
10:45 a.m.	BREAK
11:00 a.m.	International Convergence Issues (Ms. Bielstein—Attachment C and SEC Roadmap)
11:30 a.m.	Conceptual Framework—Reporting Entity (Mr. Bossio—Attachment D)
12:20 p.m.	Financial Statement Presentation (Attachment E and Exhibits 1 and 2)
12:30 p.m.	LUNCH
1:15 p.m.	Financial Statement Presentation—Break-out Group Discussion

2:15 p.m.	BREAK—Reconvene in Board Room
2:20 p.m.	Financial Statement Presentation—Group Discussion
2:45 p.m.	Other Current Issues and Closing Remarks
3:00 p.m.	ADJOURNMENT

*Times are approximate.

Note: These materials are provided to facilitate understanding of the issues to be addressed at the June 20, 2007 SBAC meeting. These materials are for discussion purposes only; they are not intended to reflect the views of the FASB or its staff. Official positions of the FASB are determined only after extensive due process and deliberations.

SBAC MEETING
JUNE 20, 2007
FASB CHAIRMAN’S REPORT

- **TECHNICAL ACTIVITIES**
- **PRIVATE COMPANY REPORTING**
- **CODIFICATION**
- **XBRL**

Financial Accounting Standards Board
Small Business Advisory Committee
Activities of the PCFRC
June 20, 2007

PCFRC Starts its Deliberations
1516 words
1 May 2007
The Practical Accountant
34
Vol. 40, No. 5
English

In an exclusive interview with Practical Accountant, **Judith O'Dell**, chair of the Private Company Financial Reporting Committee (PCFRC) and president of O'Dell Valuation Consulting, LLC, CPAs in Chestertown, Md., and CFO of a family owned hotel/restaurant and real estate development business, explains the mandate and processes that the PCFRC is following in considering whether there is a need for specific differences in accounting standards for private companies. Its first meeting, open to the public, will be May 10 and 11, 2007, in Chicago.

PA: Why is FASB, in conjunction with the AICPA, considering specific differences in prospective and existing accounting standards for private companies?

Judith O'Dell: Both FASB and the AICPA recognize the importance of private companies to the overall vitality of our nation's economy. Private companies create jobs and encourage entrepreneurialism, both of which are backbones of capitalism. The organizations share a commitment to the constituents of private company financial reporting, and recognize the need to carefully evaluate whether current financial reporting standards meet the needs of users of private company financial reports.

There have been many studies done in the past as to whether financial accounting and reporting standards should be different for private companies. Until recently, those prior studies indicated that there shouldn't be substantive differences based solely on whether a company was privately held. However, a recent study conducted by the AICPA indicates that there is support of certain constituent groups for differences in accounting for private companies.

In developing financial accounting and reporting standards, its conceptual framework and its thorough and open due process guides the FASB. On a number of occasions, the FASB has provided deferred effective dates and alternative measurement provisions for private companies. However, the FASB hasn't consistently articulated its analysis and consideration of whether differences in recognition, measurement, disclosure, transition, and effective date should exist for private companies, nor has it consistently asked for input on whether differences in those areas should exist for private companies.

The PCFRC was formed to provide FASB with recommendations that will help it determine whether there should be differences in prospective and existing accounting standards for private companies. Recommendations put forth by the PCFRC will be based on user needs and cost-benefit considerations. They may include differences in recognition, measurement, disclosure, presentation, transition, and effective dates. At this time, there is no consideration of specific differences in prospective and existing accounting standards. The PCFRC has just been formed, and will have its first meeting in May. At this meeting, operating procedures will be set, and an agenda of both existing and prospective standards to be studied and evaluated will be determined.

PA: Are accounting-standard bodies outside the U.S. considering special standards for private companies?

JO: The International Accounting Standards Board has just issued an exposure draft of accounting and reporting principles to be followed for entities that don't have public accountability and publish general-purpose financial statements for external users. It is entitled "Small and Medium Sized

Entities" (SME), and the full document can be downloaded from iasb.org. The approach is a simplified, self-contained set of standards that are appropriate for smaller, non-listed companies but still based on full International Financial Reporting Standards (IFRSs), with modifications based on user needs and cost-benefit considerations. These proposed standards remove choices for accounting treatment, eliminate topics not generally relevant to SMEs, and simplify recognition and measurement-thereby allowing the Board to shrink the guidance by over 85 percent compared to full IFRSs. They also enable investors, lenders, and others to compare SMEs' financial performance, financial condition, etc. Also, the Canadian Accounting Standards Board (ASB) is examining the needs of users of private company financial statements. Based upon the results of that examination, the Canadian ASB will determine and implement the most appropriate financial reporting model to meet those user needs.

The PCFRC will be monitoring these initiatives and working with both of these standard-setting bodies. However, the approach we are taking differs from that of the IASB. SME standards are meant to be a one-stop source of GAAP for those entities, whereas in the U.S. any resulting differences in U.S. GAAP would be embedded within a FASB standard (and in the future, in the FASB codification).

PA: What are the mandates of the Private Company Financial Reporting Committee?

JO: The Committee's mission is to consider differences in prospective and existing GAAP accounting standards related to private companies based on user needs and cost/benefit considerations. Committee members individually serve as a resource to the FASB, EITF, and FASB staff during the FASB staff's research phase before an exposure draft is developed. The Committee will also make formal recommendations to FASB on prospective and existing standards. The PCFRC is free to set its own agenda and meets in public. The FASB will address the Committee's recommendations.

PA: Has there been a timetable established for the committee to make its recommendations?

JO: There is no timetable. The committee will study issues and make formal recommendations to the FASB on a project-by-project basis. The committee is designed to be an ongoing FASB resource.

PA: How are you seeking input and comments from interested parties, such as private companies, CPA firms, banks, venture capitalists, etc.? Is there a formal process?

JO: The Committee, in addition to myself, is composed of four preparers of private company financial statements, four users, and four CPA practitioners from various sized firms. All meetings are open to constituents, and there will be time set aside in each meeting for attendees to address the committee. All minutes and committee agendas will be posted to the Web site (pcfr.org), which can be accessed directly and also through a link on FASB's Web site. There will be a facility on the Web site to leave comments. Also, we are developing a committee resource list-a group of individuals and organizations that have indicated a willingness to assist the committee when asked. Those who wish to be on the list can add their names and e-mail addresses on the Web site.

PA: Is there a specific Web address, e-mail address, telephone number, and mailing address for the committee?

JO: Our Web site is pcfr.org, and I can be reached at judyodell<at>dmv.com. The telephone number is (203) 956-5218, and the address is Private Company Financial Reporting Committee, Financial Accounting Standards Board, 401 Merritt 7, Norwalk CT 06856.

PA: How can interested parties track the progress of the PCFRC?

JO: Interested parties can track our progress at pcfr.org. We will disseminate information through various accounting publications like Practical Accountant, and I am already speaking at various conferences and state society meetings.

PA: Is the committee considering how specific differences in standards for private companies would affect not-for-profits and government entities?

JO: At this time, our mission is limited to private for-profit companies.

PA: What else would you like to get across about the PCFRC?

JO: The Committee will meet in person four to six times per year. We have four meetings scheduled through 2007, with the first one in Chicago in May. In December, we will be meeting in Norwalk with FASB's Small Business Advisory Committee. The response from people volunteering for the committee was overwhelming, and I talked to many highly qualified people from around the country. Those who were not selected have agreed to be part of our committee resource list. Once we have formulated a recommendation, a motion to forward that recommendation to FASB requires the affirmative vote of two-thirds of the members. The FASB and the AICPA have provided the PCFRC with adequate resources in terms of staff and a budget for committee meetings, outside research, and surveys. The Committee members are excited by the challenges we face in crafting recommendations based on user needs and cost/benefit considerations. We appreciate the support that FASB and AICPA have given us, and look forward to working closely with the Board for the benefit of private companies.

PCFRC Membership

Judith H. **O'Dell**--President, O'Dell Valuation Consulting, LLC, Chestertown, Md.

Carl Bagge--Partner, Bagge, Cennamo & Company, LLP, Windsor, Conn.

Kathy Barry--CFO, Highland Capital Partners, Lexington, Mass.

Charles Bramley--Partner, Briggs Bunting & Dougherty, Philadelphia, Pa.

Daryl Buck--Vice President and CFO, Reasor's, Inc., Tahlequah, Okla.

Michael Cain--Senior Executive Vice President, Frost Bank, San Antonio, Texas

H. Marco Kichler--Controller, Putnam, Precision Products, Inc., Sandy Hook, Conn.

Mary Ann Lawrence--Senior Vice President, Key Corporation, North Olmsted, Ohio

David Lomax--Area Underwriting Manager, Liberty Mutual Surety, Plymouth Meeting, Pa.

Jerry Murphy--CFO, Todd and Sargent Inc., Ames, Iowa

Judd Rabb--Vice President and CFO, Coldwatt, Inc., Austin, Texas

Tom Ratcliffe--Director of Accounting and Auditing, Wilson Price, Montgomery, Ala. Carisa Wisniewski--Partner, Moss Adams LLP, San Diego, Calif.

photo, **Judith O'Dell**

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SMALL BUSINESS ADVISORY COMMITTEE
INTERNATIONAL CONVERGENCE ISSUES
June 20, 2007

BACKGROUND

1. Recently, the Securities and Exchange Commission announced a series of actions it intends to take relating to the acceptance of international financial reporting standards (IFRS) as issued by the International Accounting Standards Board. The SEC plans to issue a Proposing Release in the summer of 2007 that would address eliminating the reconciliation requirement for financial statements filed using IFRS by 2009, consistent with the timetable set forth in the SEC's roadmap (the SEC roadmap is attached separately). Currently, SEC rules require foreign private issuers who report in IFRS, or any other non-U.S. GAAP, to provide a reconciliation of those financial statements to U.S. GAAP.

2. Because the elimination of the reconciliation requirement would permit some, but not all, registrants to have a choice between IFRS and U.S. GAAP, the question arises as to whether all registrants should be able to report under either IFRS or U.S. GAAP. The Commission plans to issue a Concept Release in the summer of 2007 to seek comments on whether all U.S. registrants should have that choice.

DISCUSSION AT SBAC MEETING

3. The implications for removing the reconciliation requirement and permitting U.S. registrants a choice between IFRS and U.S. GAAP are significant and numerous. This memo describes some of the potential consequences of permitting U.S. registrants a choice between IFRS and U.S. GAAP. This memo also raises the question of how best to achieve the ultimate goal of a common global financial reporting language. We will ask for SBAC member

perspectives on those issues, particularly how possible changes to the U.S. standard-setting process would affect private and not-for-profit entities.

CHOICE BETWEEN IFRS AND U.S. GAAP

4. The implications of permitting a choice between IFRS and U.S. GAAP are significant. Assuming that the FASB and IASB continue to work toward convergence of their standards, differences will diminish over time, and having a choice between IFRS and U.S. GAAP will be of little consequence once convergence is achieved. At the present time, approximately 13,500 registrants are required to report in U.S. GAAP. The broad question is: what are the benefits, costs, and consequences of permitting that choice before convergence is achieved?

5. Listed below are a series of questions to consider in thinking about the implications of a choice at the present time (some questions could apply to more than one category). Many of the issues would diminish once IFRS and U.S. GAAP have converged (and stay converged).

<u>Who May Choose IFRS</u>

a. Would the change to IFRS be a free choice or would criteria need to be established to change? For example, if a registrant follows U.S. GAAP specialized industry standards and no comparable IFRS exists, what can or should the registrant do?

b. Can a change to IFRS be implemented on a piecemeal basis (for example, foreign versus domestic operations, ordinary versus specialized industry activities)?

c. Can a registrant that is not within the scope of IFRS (for example, a not-for-profit entity that has issued publicly traded debt) choose to follow IFRS?

<u>Resources to Support Implementation of a Change</u>

d. Do registrants, particularly those with no foreign operations, presently have sufficient knowledge to prepare IFRS-based financial statements?

e. Are present accounting and internal control procedures adequate to produce IFRS-based statements?

f. Do specialists (for example, actuaries and valuation experts) presently have sufficient knowledge to provide IFRS required data?

g. Do auditors presently have sufficient knowledge to opine on IFRS?

h. Are new or amended U.S. auditing standards needed for IFRS-based financial statements? (For example, what should the auditors report say if the change is applied on a piecemeal basis, or if no applicable IFRS exists in a particular area and the registrant applied U.S. GAAP?)

i. Do analysts, loan officers, investors, regulators and other users presently have sufficient knowledge of IFRS to understand IFRS-based statements?

j. Do the IASB, IFRIC, SEC, auditing firms, etc., have sufficient staff resources to support implementation of IFRS by U.S. registrants?

Other Consequences of a Voluntary Change

k. What are the consequences of a choice between IFRS and U.S. GAAP if state and/or federal banking authorities, other regulatory bodies (such as taxing jurisdictions), existing contracts, statutes, etc., continue to require U.S. GAAP financial statements or metrics?

l. Will the IASB need to meet Sarbanes-Oxley requirements as an independent standard setter before U.S. registrants would be permitted to apply IFRS, or before foreign filers could apply IFRS without reconciliation to U.S. GAAP? Would amendments of Sarbanes-Oxley be necessary? What structure, role, staffing and funding changes would be required for the IASB if it had to meet Sarbanes-Oxley requirements? How would that impact the structure, role, staffing, and funding for the FASB?

m. Will this change increase the concentration of audits of public companies by the "Big 4"?

n. Would the existing educational and testing (for example, the CPA exam) infrastructure need to change to support use of IFRS in the United States? Will accounting curricula need to include both IFRS and U.S. GAAP to educate future preparers and auditors? Will that result in lengthening the educational process? How long would it take for textbooks to be produced to support changes in curricula?

o. How might the change affect the participation by U.S. preparers, auditors, investors and others in the standard-setting process? Many in the United States have considerable access to the FASB by attending Board meetings, liaison meetings, speaking engagements, etc. Would constituents have similar access to the IASB? Would their voice still be heard?

6. Given the significance of the issues, some have suggested that convergence efforts between the FASB and IASB should be allowed to continue for several more years and then a choice between U.S. GAAP and IFRS could be permitted, when the differences have narrowed. In the interim, efforts could

be undertaken to study, evaluate, and make necessary changes to the standard-setting and financial reporting infrastructure.

COMMON GLOBAL FINANCIAL REPORTING LANGUAGE

7. The SEC's roadmap states that the movement toward use of a single set of globally accepted accounting standards is good for the global capital markets and for investors and creditors. If the ultimate goal is a single set of global standards, what is the best approach to achieve that goal? One approach is a single, global standard setter. If a critical mass of U.S. companies chooses to report using IFRS, do public companies in the United States need two standard setters? What is the best approach to achieve a common global financial reporting language?

8. On the topic of international convergence, the 2006 FASAC survey asked the following question: "Assume that the FASB and the IASB achieve the goal of converging standards at some point in the future. What would be the role of the FASB in a world of converged accounting standards?"

9. Many survey respondents believe the FASB would have a continuing significant role as a standard setter in a world of converged standards. Some of those respondents envisioned the FASB as a member of a governing body of a new multinational organization responsible for the development of standards; the FASB would continue to address issues of domestic importance. Others envisioned the FASB and the IASB continuing to work in parallel as they do now.

10. A few respondents to the 2006 survey envisioned a single standard-setting organization with significant U.S. representation commensurate with the size and importance of the U.S. capital markets and economy to the global markets and economy. Those respondents recognize that regulatory, legal, and societal changes would have to occur to support a single standard-setting organization.

11. Earlier sections of this memo have discussed some of those changes as they relate to entities having a choice between IFRS and U.S. GAAP. However, if the ultimate goal is a single set of standards, and if one approach to achieving that goal is a single global standard setter, other implications arise. For example:

    i. Among the FASB's constituents are private and not-for-profit entities. How would changes to the standard-setting process affect those entities?

    ii. Cultural, legal, and political differences exist internationally and influence standard setting. How would those differences affect standard setting?

    iii. How would a single organization respond to emerging issues arising in some but not all countries?

    iv. How would moving to a single standard setter affect the timeliness of improvements to financial reporting? Will it become more difficult to improve if changes to financial reporting need to be "accepted" and applied globally?

    v. How would moving to a single standard-setter be achieved? Is voluntary adoption a first step toward mandatory adoption of IFRS by all issuers?

CONCLUSION

12. As stated earlier, the implications for removing the reconciliation requirement and permitting U.S. registrants a choice between IFRS and U.S. GAAP are significant and numerous. Studying the experiences of other jurisdictions, such as Canada and European countries, that have changed from national standards to IFRS might be helpful in further understanding the potential impacts of such a change.

13. Perhaps most important, all constituents, not only public companies, should have an awareness of and be ready to respond to the SEC's releases when they are issued.

General Discussion Questions

Should U.S. registrants have the option to report under either IFRS or U.S. GAAP?

The SEC's roadmap states that the movement toward use of a single set of globally accepted accounting standards is good for the global capital markets and for investors and creditors. What is the best approach to achieve that goal, considering that among the FASB's constituents are private and not-for-profit entities?

JOINT CONCEPTUAL FRAMEWORK PROJECT:
THE CONCEPT OF A REPORTING ENTITY

Small Business Advisory Committee
June 2007

Background

1. Today, neither of the conceptual frameworks of the FASB and IASB includes discussion of a concept of a reporting entity. Filling that conceptual "hole" is one of the objectives of the conceptual framework project. The FASB and IASB (the Boards) recently completed initial deliberations and have formed a preliminary view on what the reporting entity concept should be. They plan to seek comment on that preliminary view later this year. Thus, the June SBAC discussion provides a timely opportunity to discuss the tentative decisions and, in particular, their implications for small businesses.

2. A reporting entity concept determines the boundaries and composition of a reporting entity. Developing such a concept should be particularly helpful to the Boards in developing common standards for determining when an entity or group of entities should provide **consolidated** or **combined** financial statements, and perhaps also **unconsolidated** (so-called *parent-only*) financial statements or **consolidating** or **combining** financial statements. (Consolidating or combining financial statements show, for example, parent-only and legal subsidiary information and a reconciliation of the eliminating entries for consolidated financial statements.) Matters relating to combined financial statements or combining may be of special interest to small businesses that operate in cooperation with related entities that are owned and controlled by a parent company, an individual, or a family.

Purpose of SBAC Discussion

3. The objective of this session is to inform and solicit views of SBAC members about the decisions reached on the concept of a reporting entity. The Boards are especially interested in learning more about whether the tentative decisions reached to date will result in sound concepts and principles that can be applied broadly.

4. Members will be asked if the description of a reporting entity and the notion of control applied in determining the composition of a potential group of entities are (a) satisfactory or perhaps

are either too broad and vague or too narrow and restrictive, and (b) workable for all business enterprises, whether they are operating as corporations, partnerships, or unincorporated proprietorships, widely-held or closely-held, or are big and well capitalized or small and thinly capitalized.

Key Tentative Decisions

5. Decisions that have been reached by the Boards collectively in preparation for drafting the discussion document are as follows:

   (a) The conceptual framework should describe what constitutes an entity for the purposes of financial reporting, but should not define it.

   (b) An entity for financial reporting purposes does not need to be a legal entity. Rather, an entity includes other types of arrangements or organizational structures, which could be broadly described as **a circumscribed area of economic interest to external users of financial reporting**. Examples include a company, trust, partnership, association, sole proprietorship, natural person, and, in some circumstances, a branch or segment (which may have an existence separate from its parent-owner).

   (c) An entity that meets that description—a circumscribed area of economic interest—and chooses to, or is required to, prepare general purpose external financial reports (GPEFR) is a reporting entity. The reporting entity concept should not specify (or provide guidance on) which entities should be required to prepare GPEFR.

   (d) The composition of a group entity also should be based upon control. Typically, a group would comprise a parent and other entities under its control. In addition, there might be occasions when general purpose external financial reports may be prepared for a group of entities under common control, such as combined financial statements for two or more entities under the control of a single investor, that collectively are a circumscribed area of economic interest to external users of financial statements.

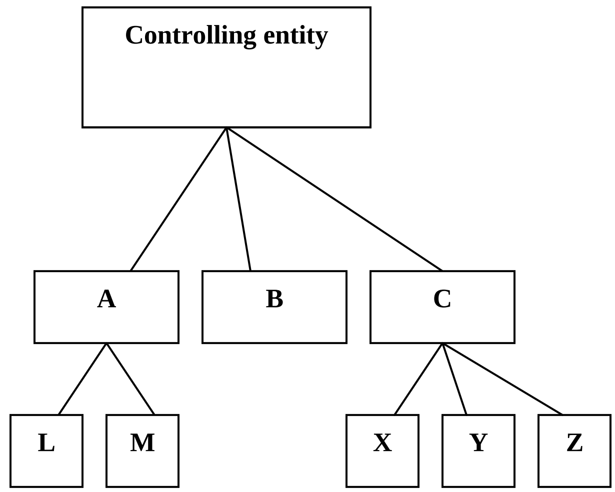
   (e) Control, in the context of one entity controlling another entity, should be defined at the conceptual level and should include the notions of **power** (to make decisions) and **benefits**.

6. Regarding the presentation of general purpose external financial statements for a group entity, the FASB and IASB reached a common preliminary view on some, but not all, issues.

The FASB decided that a parent entity must provide consolidated financial statements that present information about all of the assets, liabilities, and activities of the parent and its subsidiaries. It also decided that there may be limited circumstances in which aggregated (one-line) summary information is more decision-useful. Those circumstances would be addressed at the standards-level.

7. The IASB also decided that a parent entity must provide consolidated financial statements that present information about all of the assets, liabilities, and activities of the parent and its subsidiaries. However, the IASB did not reach a decisive conclusion regarding presentation of parent-only financial statements. About half of the IASB members reached conclusions similar to those of the FASB, while the other half decided that both consolidated and parent-only financial statements should be required for groups of entities.

8. Using the following illustration, the staff will explain in more detail at the meeting the combinations of entities that would be consistent with the Boards' preliminary views.



QUESTIONS FOR DISCUSSION

9. Is the concept and description of a reporting entity (paragraph 6(b)) satisfactory or must it be more precisely defined?

10. Is it appropriate, in concept, that a reporting entity does not need to be a legal entity and may have an existence separate from its controlling parent-owner?

11. Will the preliminary views reached (paragraphs 6, 7, and discussion of illustration in paragraph 8) provide the appropriate combinations of entities for general purpose external financial reporting?

FINANCIAL STATEMENT PRESENTATION
Small Business Advisory Committee
June 2007

Introduction

The Financial Statement Presentation project is a joint project with the IASB. Since April 2006, the Boards have been discussing fundamental issues related to the presentation and display of information in the financial statements. The current plan is to issue an initial discussion document including the Boards' preliminary views on those issues in the fourth quarter of 2007. At the June SBAC meeting, the Board would like to discuss the following issues:

1. Disaggregation of changes in assets and liabilities
2. Discontinued operations
3. Presenting information about short and long-term assets and liabilities.

SBAC members will discuss the first issue in break-out sessions; they will discuss the second and third issues as a group. A summary of the Boards' views reached to date and illustrative financial statements are included as Exhibit 1.

ISSUE 1: DISAGGREGATION OF ASSETS AND LIABILITIES

Basis of Disaggregation

One of the project's working principles states that the financial statements should help investors and other users of the financial statements understand the causes of a change in reported amounts of individual assets and liabilities. For example, a change in an asset or liability recognized as income or expense could be due to a change in price, a transaction, or a change in estimate. An investor or other user might weigh each of those changes differently in their analysis, particularly in their assessment of the amounts, timing, and uncertainty of future cash flows.

The Boards have been discussing application of the above working principle since October 2006. In March 2007, the Boards expressed interest in disaggregating changes in assets and liabilities that are recognized as income or expense based on the characteristics of *persistence* and *measurement subjectivity* as those are the primary factors considered in predicting future cash flows. Based on discussions with preparers and users of financial statements, the staff came to the view that *predictive value* (one aspect of persistence) should be the determining factor in deciding whether to disaggregate an amount recognized as income or expense.

Users have consistently expressed interest in segregating changes in fair value from other changes recognized in income or expense. (For discussion purposes, fair value changes include all adjustments resulting from marking an asset or liability to fair value from fair value.) As explained to the staff, users tend to view most fair value adjustments as less relevant for forecasting because the value changes are out of management's direct control and due solely to market forces. The staff is of the view that all fair value changes, regardless of their placement in the fair value hierarchy (as described in FASB Statement No. 157, *Fair Value Measurements*), should be presented together even though Level 3 changes are not due solely to market forces. Based on user interest in information that has predictive value and in separating fair value changes from other changes, the staff developed the following two-dimensional disaggregation diagram.

	Predictive Value	**No Predictive Value**
Fair Value	**Fair value changes with predictive value** ► Gain/loss on trading securities for an investment bank ► Inventory impairment for a retailer	**Fair value changes with no predictive value** ► Gain/loss on investments held for trading ► Gain/loss on derivatives
Not Fair Value	**Non-fair value changes with predictive value** ► Depreciation expense ► Credit sales ► Accrued expenses ► Bad debts ► Warranty reserves	**Non-fair value changes with no predictive value** ► Restructuring reserve ► Litigation reserve ► Loan impairment for a manufacturer ► Inventory impairment for a manufacturer

As illustrated above, amounts recognized as income or expense would be disaggregated into those that have predictive value and those that do not. Secondly, those amounts would be further disaggregated into fair value changes and other-than-fair-value changes. This would result in the following four components:

Component I:	Fair value changes that have predictive value
Component II:	Other-than-fair-value changes that have predictive value
Component III:	Fair value changes that do not have predictive value
Component IV:	Other-than-fair-value changes that do not have predictive value.

The staff is of the view that management should disaggregate (classify) the amounts recognized as income or expense into one of those four components based on their knowledge of the reported information and underlying business. This would allow a retail business, for example, to classify inventory impairment in a manner different from a manufacturing business. Putting the classification decision in the hands of management is consistent with the Boards' preliminary view that assets and liabilities should be classified into functional categories based on management's view of its business.

Format for Presenting Disaggregated Information

Once the Boards decide the basis on which to disaggregate changes in assets and liabilities, they will need to decide how to best present that information in the financial statements (most likely in the notes). The following paragraphs describe three alternative presentation formats, each of which is from a different financial statement perspective. The alternatives are illustrated in Exhibit 2; Exhibit 1 includes the illustrative financial statements on which the alternatives were based.

Alternative A: Reconciliation of Statements of Financial Position

In March 2007, the staff recommended that a columnar reconciliation of the beginning and ending statements of financial position be provided in the notes to financial statements as a means of disaggregating the changes in assets and liabilities. That reconciliation would have disaggregated the changes in each line item on the statement of financial position into a number of components. In addition to including a column for each of the components of comprehensive income (such as Components I-IV above), a reconciliation of this nature would include:

- a column for cash transactions
- captions from the statement of cash flows and statement of comprehensive income that would "link" the statement of financial position line items to the statement of comprehensive income and the statement of cash flows and
- a column for non-cash, non-income changes (to reconcile to ending balances).

The Boards agreed to consider a reconciliation of statements of financial position because it provided information about changes in assets and liabilities while at the same time achieving "line-item" cohesiveness (furthering the project's governing working principle that the financial statements should present information in a manner that portrays a cohesive financial picture). However, Board members expressed some reservations with the mechanical nature of the reconciliation and its inherent complexity.

Alternative B: Comprehensive Income Matrix

Because of various complexities associated with a statement of financial position reconciliation, such as foreign currency translation adjustments and intercompany transactions, the Boards also will consider presenting the components of comprehensive income in a matrix format. That matrix would begin with the comprehensive income statement and include a column for each of the four components. There would be no linkage to the statement of financial position or the statement of cash flows.

Alternative C: Reconciliation of Statements of Cash Flows and Comprehensive Income

A third alternative, not yet addressed by the Boards, would be to reconcile the statement of cash flows to the statement of comprehensive income. This reconciliation would start with the amounts and line items in the statement of cash flows, provide details about the items needed to reconcile to the statement of comprehensive income (disaggregated into the four components), and end with the amounts and line items presented in the statement of comprehensive income. This format would link the two change statements and would provide information about the changes in assets and liabilities.

Discussion Questions for Issue 1:

1. Do Committee members agree that *predictive value* is a useful and operational way to disaggregate changes in assets and liabilities recognized as income or expense if the goal is to provide information that is useful in predicting future cash flows?

2. Do Committee members agree that disaggregating fair value changes from other changes is useful and operational?

3. Do Committee members agree with using a management approach for determining the items that would be disaggregated into the four potential components?

4. From what perspective should disaggregated information be presented: the statement of financial position (as in Alternative A), the statement of comprehensive income (as in Alternative B) or the statement of cash flows (as in Alternative C)? Should there be a link between two or more of the financial statements in providing this disaggregated information?

ISSUE 2: DISCONTINUED OPERATIONS

In January 2007, the Boards agreed to converge the definition of a discontinued operation under FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, and IFRS 5, *Non-current Assets Held for Sale and Discontinued Operations*. The Boards tentatively agreed that the definition of a discontinued operation should be based on operating segments. That is, a component of an entity that has been (or will be) disposed of and meets the definition of an operating segment under FASB Statement No. 131, *Disclosures about Segments of an Enterprise and Related Information*, and IFRS 8, *Operating Segments*[1], would be reported as a discontinued operation on the face of the financial statements. In addition, the Boards tentatively decided that for all components of an entity that have been (or will be) disposed of, including those reported as a discontinued operation, additional financial information (such as the major classes of: revenues and expenses; cash flows; and assets and liabilities) would be presented in the notes to financial statements.

Statement 131 (paragraph 10) and IFRS 8 (paragraph 5) define an *operating segment* as a component of an entity:

a. That engages in business activities from which it may earn revenues and incur expenses (including revenues and expenses relating to transactions with other components of the same enterprise),
b. Whose operating results are regularly reviewed by the enterprise's chief operating decision maker to make decisions about resources to be allocated to the segment and assess its performance, and
c. For which discrete financial information is available.

Statement 144 provides the following guidance on a *component of an entity* (paragraph 41) and an *asset group* (paragraph 4), as follows:

> For purposes of this Statement, a *component of an entity* comprises operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity. A component of an entity may be a reportable segment or an operating segment (as those terms are defined in paragraph 10 of Statement 131), a reporting unit (as that term is defined in Statement 142), a subsidiary, or an asset group (as that term is defined [below]).
>
> For a long-lived asset or assets to be held and used, that group (hereinafter referred to as an *asset group*) represents the lowest level for which identifiable cash flows are largely independent of the cash flows of other groups of assets and liabilities.

Non-public entities are currently excluded from the scope of Statement 131 and, therefore, many small businesses may not have considered what, in their company, would constitute a component of an entity or an operating segment.

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[1] IFRS 8 was issued in November 2006 as part of IASB/FASB convergence efforts. It achieves convergence with Statement 131, except for minor differences.

With the tentative decision to define discontinued operations based on an operating segment, non-public entities would need to apply some of the concepts in Statement 131.

The Boards decided in March that this aspect of the project (changing the definition of a discontinued operation and modifying the disclosure requirements) should be separated from the financial statement presentation project. The Boards plan to meet in the third quarter of 2007 to discuss how to apply the revised discontinued operation definition including how much information should be disclosed about a component that was disposed of. The current plan is to issue an Exposure Draft in the fourth quarter of 2007.

Discussion Questions for Issue 2:

1. What is the prevalence of discontinued operations for small/non-public entities under the current Statement 144 definition of a discontinued operation?

2. Because Statement 131 does not apply to non-public entities and the standard resulting from the discontinued operations project will, do Committee members perceive any difficulties in determining whether

    a. A component of an entity has been (or will be) disposed of, and thus the proposed disclosure requirements would apply?

    b. A component of an entity meets the definition of an operating segment and thus would be presented as a discontinued operation?

ISSUE 3: REPORTING INFORMATION ABOUT SHORT- AND LONG-TERM ASSETS AND LIABILITIES

In May 2007, the Boards addressed what information should be provided in the financial statements to help a user of the financial statements assess an entity's ability to meet its financial commitments as they come due and to invest in business opportunities. The FASB expressed the following preliminary views on that issue (the IASB expressed similar views except where noted):

a. Entities that are not financial institutions should present a classified statement of financial position. That is, entities should present short- and long-term subcategories for operating, investing, and financing assets and liabilities. [The IASB expressed a similar view, except when a presentation based on liquidity provides information that is reliable and is more relevant than short- and long-term subcategories (this is similar to what is currently required in IAS 1, *Presentation of Financial Statements*).]

b. Entities that are financial institutions (such as banks, investment banks, and insurance companies) should present a detailed maturity schedule for short-term contractual assets and liabilities. An entity should use its judgment to determine the appropriate level of detail (such as on demand; less than one month; more than one month and not more than three months; and more than three months and not more than one year). [The IASB had a similar view except that this information would be required only if the statement of financial position is presented in order of liquidity.]

c. All entities should present a maturity schedule for long-term contractual assets and liabilities.

d. All entities should disclose qualitative information about the entity's objectives, policies, and processes for managing capital and summary quantitative data about what the entity manages as capital.

Discussion Questions for Issue 3:

1. Which entities should be required to present a classified statement of financial position?

2. Which entities should be required to present detailed information (such as a maturity schedule) about short-term contractual assets and liabilities?

EXHIBIT 1

FINANCIAL STATEMENT PRESENTATION PROJECT

Phase B: Summary of Tentative Preliminary Views and Illustrative Sample Financial Statements Reflective of Meetings through May 16, 2007

[Note: The staff has prepared this summary of the Boards' tentative preliminary views for information purposes only. All of the views are tentative and may be changed at future Board meetings.]

BACKGROUND AND OBJECTIVE

1. The financial statement presentation project is a joint project between the International Accounting Standards Board (the IASB) and the Financial Accounting Standards Board (the FASB) (collectively, the Boards). Since April 2006, the Boards have been discussing fundamental issues related to the presentation and display of information in each of the basic financial statements (Phase B). The Boards' goal is to issue an initial discussion document on those issues in the fourth quarter of 2007. That discussion document will be in the form of a Discussion Paper for the IASB and a Preliminary Views document for the FASB.

2. The Boards took on this joint project to establish a common, high-quality standard for presentation of information in the basic financial statements, including the classification and display of line items and the aggregation of line items into subtotals and totals. The objective of this standard is to present information in the individual financial statements (and among the financial statements) in ways that improve the ability of investors, creditors, and other financial statement users to:

    a. Understand an entity's present and past financial position
    b. Understand the past operating, financing, and other activities that caused an entity's financial position to change and the components of those changes
    c. Use that financial statement information (along with information from other sources) to assess the amounts, timing, and uncertainty of an entity's future cash flows.

PROJECT WORKING PRINCIPLES

3. Financial statements should present information in a manner that:

    a. Portrays a cohesive financial picture of an entity.

b. Separates an entity’s financing activities from its business and other activities and further separates financing activities between transactions with owners in their capacity as owners and all other financing activities.

c. Helps a user assess an entity’s ability to meet its financial commitments as they come due and to invest in business opportunities. An entity’s ability to meet its existing financial commitments includes, but is not limited to, its ability to use existing assets to generate cash inflows and to raise capital. An entity’s financial commitments include those related to operations, financing, and equity holders.

d. Helps a user understand:

   (1) The basis on which assets and liabilities are measured

   (2) The uncertainty in measurements of individual assets and liabilities

   (3) What causes a change in reported amounts of individual assets and liabilities.

e. Disaggregates line items if that disaggregation enhances the usefulness of that information in predicting future cash flows.

f. Helps a user to assess:

   (1) An entity's ability to generate future cash inflows

   (2) The difference between cash transactions and accrual accounting

   (3) The effects of noncash activities during the period on an entity's financial position.

The above are **working principles** that will be the basis for the Boards financial statement presentation decisions.

WORKING FORMAT

4. The following table represents the working format for presenting information within the basic financial statements—the statement of financial position, the statement of comprehensive income, the statement of cash flows, and the statement of changes in equity. The working format will apply to all business entities, including financial institutions.

Statement of Financial Position	Statement of Comprehensive Income	Statement of Cash Flows
Business ◆ Operating assets and liabilities ◆ Investing assets and liabilities	**Business** ◆ Operating income ◆ Investment income	**Business** ◆ Operating cash flows ◆ Investing cash flows
Discontinued operations	**Discontinued operations**	**Discontinued operations**
Financing ◆ Financing assets ◆ Financing liabilities	**Financing** ◆ Financing income ◆ Financing expenses	**Financing** ◆ Financing asset cash flows ◆ Financing liability cash flows
Equity		**Equity**
Income taxes	**Income taxes**	**Income taxes**
	Statement of Changes in Equity	

Note: The Boards have not addressed totals, subtotals, or the order in which sections would be presented; nor have they finalized the labels of the categories and sections.

Cohesiveness of the Financial Statements

5. The overall goal of the working format is to present a cohesive financial picture of an entity such that the relationships between items on the different financial statements are clear (sometimes thought of in terms of articulation or linkage). To achieve that goal, assets and liabilities would be classified based on the guidelines presented below. Changes in those assets and liabilities would be classified consistently in the statement of comprehensive income and the statement of cash flows. To the extent practicable, consistent classification should be achieved at the line-item level.

Classification Guidelines and Related Disclosures

6. Following the guidelines below, an entity would classify all of its assets, liabilities, and equity items into one of the categories or sections in the working format. An entity would be required to explain, as a matter of accounting policy, its basis (or bases) for classifying assets and liabilities in the financing categories, the investing category, and the operating category. Any change in the basis for classification would be viewed as a change in accounting policy and would be implemented through retrospective application to prior periods.

7. An entity consisting of different businesses would apply the classification criteria to its assets and liabilities at the reportable segment level (as that term is defined in FASB Statement No. 131, *Disclosures about Segments of an Enterprise and Related*

Information, and IFRS 8 *Operating Segments*). (Refer to related decision in the Segment Reporting section below.)

8. The ***Operating category*** (in the **Business section)** would include assets and liabilities that management views as integral to its main business activities and unrelated to financing those activities. Operating assets and liabilities would be included in the same category; they would not be separated into operating assets and operating liabilities.
    a. Examples of items classified in the operating category of a non-financial entity are: accounts receivable, accounts payable, inventory, PP&E, intangible assets, and pension obligations.
    b. Examples of items classified in the operating category of a financial institution are: cash, commercial paper, money market funds, available-for-sale financial instruments, trading portfolio assets and liabilities, deposits, loans, property and equipment, intangible assets, insurance liabilities, and pension obligations, plus financial instruments held to hedge any of these items.

9. The ***Investing category*** (in the **Business section**) would include assets and liabilities that are not related to financing the entity's business activities that management views as not integral to its main business activities (referred to as investing assets and liabilities).
    a. Examples of items classified in the investing category of a non-financial entity are: held-to-maturity financial instruments and financial instruments held to hedge items included in the investing category.
    b. An example of an item classified in the investing category of a financial institution is: an investment in associates.

10. The **Financing section** would include financial assets and financial liabilities that management views as part of the financing of the entity's business activities (referred to as *financing assets and liabilities*). Amounts relating to financing liabilities would be presented in the *financing liabilities category* and amounts relating to financing assets would be presented in the *financing assets category* in each of the financial statements.
    a. In determining whether a financial asset or liability should be included in the financing section, an entity should consider whether the item is interchangeable with other sources of financing and whether the item can be characterized as independent of specific business activities.
    b. Examples of financial assets and financial liabilities that would generally be included in the financing section of a non-financial entity are: cash, commercial paper, money market funds, available-for-sale financial

instruments, bank loans, and bonds, plus financial instruments held to hedge any of these items. The assets would be included in the financing assets category, the liabilities in the financing liabilities category.

c. Examples of financial assets and financial liabilities that would generally be included in the financing section of a financial institution are: certain short-term and long-term debt instruments.

11. The **Equity section** in the statement of financial position would include all equity items. Changes in equity items would be presented in the equity section of the statement of cash flows and in the statement of changes in equity.

12. All *income taxes*, including taxes related to transactions with owners, would be presented separately in an **Income Taxes section**.

    a. Income taxes would not be allocated to continuing operations, discontinued operations, and so forth (that is, all items, including discontinued operations and other comprehensive income (OCI) items would be presented on a pre-tax basis).

    b. The notes to financial statements will include information to assist users in analyzing income tax information due to this change in presentation. (The Boards have yet to discuss possible disclosure requirements.)

13. Discontinued operations would be presented separately in the **Discontinued Operations section**.

    a. A discontinued component of an entity would be reported in the discontinued operations section only if that component is an *operating segment*, as defined in Statement 131 and IFRS 8. (This is a change to the definition of a *discontinued operation* currently in FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets,* and IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*.)

    b. The IASB is of the view that the assets and liabilities of discontinued operations should be presented on a gross basis on the statement of financial position (that is, two amounts). The FASB is of the view that a single amount (net assets) should be presented on the statement of financial position.

    c. Profit (loss) of the discontinued operation and any gain (loss) from measurement to fair value or disposal could be combined and presented on the face of the statement of comprehensive income as a single amount.

    d. Total cash flows related to the discontinued operations could be combined and presented in the statements of cash flows as a single amount.

    e. An entity would be required to disclose the following information in the notes to financial statements for both a component reported in the discontinued operation section and a discontinued component that was reported in the business section because it was not an operating segment.

- Information currently required to be disclosed about discontinued components expanded to include information about major classes of: revenues and expenses; cash flows; and assets and liabilities.

f. The Boards subsequently decided that the guidance on reporting a discontinued operation and the additional disclosures for components that have been or will be disposed of should be separated from the financial statement presentation project.

14. **Extraordinary items** would not be presented as a separate section or category in the financial statements and the concept of extraordinary items would be eliminated.

The Statement of Financial Position

15. Assets or liabilities that are measured differently would be presented in separate line items on the statement of financial position (that is, an entity would not be able to combine items with different measurement bases and present them in a single line item).

16. An entity would present a classified statement of financial position (that is classify all assets and liabilities into short-term and long-term subcategories) except:

    a. If the entity is a financial institution (such as a bank, investment bank, or insurance company) (FASB view).

    b. When a presentation based on liquidity provides information that is reliable and is more relevant (IASB view—as in IAS 1 *Presentation of Financial Statements*).

The Statement of Comprehensive Income

17. On the statement of comprehensive income an entity would be required to present (a) information based on the primary activities (functions) in which it engages and (b) for each of those functions, information about the significant related expenses (by their nature) that would provide information useful in predicting future cash flows. In addition, an entity would be required to separately report any expense that is important in understanding its operating results that may not relate to a functional line item (for example, impairment of goodwill).

    a. Certain entities (for example, entities in a service industry), would not be required to present information based on functions at a more detailed level than is required by the functional separation of operating, investing and financing activities. Those entities would present their significant expenses (by their nature) for each of those higher-level activities.

b. An entity would be encouraged to present the by-nature expense information on the face of the statement of comprehensive income. If that presentation is impractical, an entity could elect to present that information in the notes.

18. The Boards expressed their view that all current period changes in assets and liabilities should be presented in one of the functional categories on the statement of comprehensive income, thereby rendering OCI and the mechanism of recycling unnecessary. The Boards believe that achieving that view is a long-term goal. To achieve it, current standards that require recognition of amounts in OCI will need to be changed. The Boards acknowledged that, as an interim step, OCI items might need to be presented in a separate section of the statement of comprehensive income.

19. In further discussions of the interim step toward their long-term goal:

a. The FASB expressed the view that OCI items other than foreign currency translation adjustments should be classified on the statement of comprehensive income consistent with the classification of the asset or liability that gives rise to those items. For example, an unrealized gain or loss on an available-for-sale security classified in the investing category on the statement of financial position would be classified in the investing category on the statement of comprehensive income. A subcategory within each functional category would distinguish items of income and expense that are OCI components from those that are not. Accordingly, all current period changes in assets and liabilities would be recognized in one of the functional sections or categories on the statement of comprehensive income.

b. The FASB also expressed the view that an OCI item should continue to be reclassified, as required by other standards, within the functional category in which the item was initially recognized. The FASB discussed but did not reach a view on how foreign currency translation adjustments should be classified on the statement of comprehensive income.

c. The IASB did not reach a view on how OCI items should be presented in the statement of comprehensive income. The IASB agreed that more than one alternative should be included in the discussion document including one that would present OCI items separately from other income and expense items. The IASB asked the staff to develop possible alternative presentations for discussion at a future meeting.

d. The IASB expressed the view that in the statement of comprehensive income, foreign currency translation adjustments related to consolidated subsidiaries and proportionately consolidated joint ventures should be classified in the operating category, and foreign currency translation adjustments related to equity method investments should be classified in the same category as the equity method investment.

20. To achieve the Boards' long-term goal of presenting OCI items in the same manner as all other changes in assets and liabilities, both Boards' decided to address the standards that give rise to other comprehensive income items individually and separately, rather than as part of the financial statement presentation project.

The Statement of Cash Flows

21. The FASB is of the view that information similar to that currently presented on a statement of cash flows prepared using the direct method should be presented in the financial statements. The majority of IASB Board members expressed a preference for not requiring use of the direct method of reporting operating cash flows.
22. A reconciliation of operating income and cash flows from operating activities should continue to be provided. In addition, information about noncash activities should also be presented. However, the Boards acknowledged that the statement of cash flows may not be the most effective way to present that information and directed the staff to explore the possibility of presenting that information as part of a broader disclosure that will be discussed at a future meeting.
23. The notion of *cash equivalents* should not be retained in financial statement presentation. The definition of cash in existing literature would be retained and the statement of cash flows would present information on movements of cash only. The Boards directed the staff to consider whether net amounts of receipts and payments related to items previously classified as cash equivalents would continue to be permitted for presentation on the statement of cash flows.

The Statement of Changes in Equity

24. The statement of changes in equity should include details of the change in the beginning and ending balance of each component of equity (except for accumulated OCI, which would be presented in the aggregate on the statement of changes in equity and the details for each OCI item in the notes to financial statements). In addition, proceeds from capital transactions should be presented in the aggregate on the statement of changes in equity.

Notes to Financial Statements

Accounting Policy

25. An entity would be required to explain, as a matter of accounting policy, its basis (or bases) for classifying assets and liabilities in the financing categories, the investing category, and the operating category.

Liquidity Information

26. An entity that does not present a classified statement of financial position would present a detailed maturity schedule for short-term contractual assets and liabilities. An entity should use its judgment to determine the appropriate level of detail (such as on demand; less than one month; more than one month and not more than three months; and more than three months and not more than one year).

27. An entity would present a maturity schedule for long-term contractual assets and liabilities.

28. An entity would disclose qualitative and quantitative capital management information.

Measurement Information

29. Information about the measurement basis (or bases) of the assets and liabilities presented on the statement of financial position would be disclosed in the summary of significant accounting policies. In deciding whether a particular accounting policy should be disclosed, management would consider whether disclosure would assist users in understanding how transactions, other events, and conditions are reflected in the financial statements.

30. The notes to financial statements should include a description of any significant uncertainty in the current measure of assets and liabilities and an explanation of why the measured amount was selected. Individual accounting standards would include more specific disclosures about measurement uncertainty as appropriate.

31. The financial statements should provide information that will allow a user to distinguish between the various changes in assets and liabilities, noting that some are due to fair value changes and changes in estimates (that is, remeasurements)

while other changes in assets and liabilities are not due to remeasurements, but are due to cash transactions or accruals. To present information that would allow a user to understand the cause of a change in reported amounts of assets and liabilities and to achieve line-item cohesiveness, the Boards agreed to consider a reconciliation of beginning and ending statements of financial position. In June 2007, the Boards will further discuss which types of changes should be presented separately, which should be aggregated, and the manner in which that information should be presented.

Segment Reporting

32. The IASB is of the view that an entity that classifies similar assets and liabilities in different categories should disclose operating and financing category information by reportable segment for each primary financial statement (i.e., the statements of financial position, comprehensive income, and cash flows). That information can be combined for reportable segments that classify similar assets and liabilities similarly. (The IASB will address at a future meeting possible similar changes to segment disclosures that would apply to all entities.)

33. The FASB is of the view that segment disclosure requirements in Statement 131 would be replaced with a requirement to disclose operating and financing category information (at a minimum) for each reportable segment for each primary financial statement (that is, the statements of financial position, comprehensive income, and cash flows). Assets and liabilities that are managed by a reportable segment would be allocated to that segment and measured on a basis consistent with the amounts reported in the consolidated financial statements.

ILLUSTRATIVE SAMPLE FINANCIAL STATEMENTS

34. The following pages utilize sample financial statements for a manufacturing entity to illustrate the Boards' preliminary views through April. [Not all of the Boards' views are included in these sample financial statements (primarily those related to note disclosures, which are described in the first part of this Exhibit).]

35. The sample financial statements are based on data from a report of the CFA Institute, Centre for Financial Market Integrity, *A Comprehensive Business Reporting Model, Financial Reporting for Investors* (CFA Report). That report does not include data to prepare a 2005 statement of comprehensive income, statement of cash flows, or statement of changes in shareholders' equity. Accordingly, the staff made assumptions to complete those 2005 change statements. The staff made other modifying assumptions to the data in the CFA Report in order to illustrate the Boards' views.

36. Not all aspects of the sample financial statements have been discussed by or represent the current position of the Boards. Specifically, the Boards have yet to discuss subtotals, totals, and the order in which the sections and categories are presented. Accordingly, those aspects of the sample financial statements are not necessarily representative of the Boards' position on those issues.

STATEMENT OF FINANCIAL POSITION	2006	2005
BUSINESS		
Operating assets		
Accounts receivable	842,600	595,000
Less: Allowance for bad debts	(25,278)	(20,000)
Inventory	403,750	850,000
Leased asset	25,756	-
Building	4,232,755	3,600,000
Less: Accumulated depreciation	(256,500)	(100,000)
Total operating assets	5,223,083	4,925,000
Operating liabilities		
Accounts payable	(375,000)	(850,000)
Accrued liabilities	(78,000)	(28,000)
Advances from customers	(190,000)	(15,000)
Dividends payable	(35,000)	-
Current portion of lease liability	(9,208)	-
Share-based compensation liability	(13,500)	(6,000)
Asset retirement obligation	(9,255)	-
Loss contingency	(2,600)	-
Lease liability (excl current portion)	(24,870)	-
Accrued pension liability	(4,800)	(2,400)
Total operating liabilities	(742,233)	(901,400)
Net operating assets	4,480,850	4,023,600
Investing assets		
Available-for-sale securities	191,100	-
Investment in affiliate--equity method	412,250	-
Investment in affiliate--at fair value	310,840	-
Total investing assets	914,190	-
Net business assets	5,395,040	4,023,600
FINANCING		
Financing assets		
Cash	5,940,991	4,000,000
Total financing assets	5,940,991	4,000,000
Financing liabilities		
Interest payable	(125,000)	-
Short-term debt	(500,000)	-
Bonds payable	(2,500,000)	-
Total financing (liabilities)	(3,125,000)	-
Net financing assets	2,815,991	4,000,000
INCOME TAXES		
Income tax payable	(75,451)	(54,639)
Deferred tax liability	(56,819)	(23,699)
Net income tax (liabilities)	(132,270)	(78,338)
Total net assets	8,078,761	7,945,262
EQUITY		
Common stock and APIC	(5,000,000)	(5,000,000)
Treasury stock	100,000	100,000
Retained earnings	(2,853,484)	(2,890,635)
Accumulated OCI	(325,277)	(154,627)
Total (equity)	(8,078,761)	(7,945,262)

STATEMENT OF COMPREHENSIVE INCOME	2006	2005
BUSINESS		
Operating		
Sales	2,775,000	2,580,750
Cost of goods sold		
Change in inventory	(446,250)	(415,013)
Materials	(1,275,000)	(1,185,750)
Labor	(110,000)	(102,300)
Overhead - depreciation of building	(100,000)	(93,000)
Overhead - depreciation of leased asset	(5,944)	(5,528)
Total cost of goods sold	(1,937,194)	(1,801,590)
Selling expenses		
Compensation expense	(85,000)	(79,050)
Pension expense	(2,000)	(1,860)
Bad debt expense (decreased allowance)	(6,278)	(15,412)
Other operating expenses	(70,000)	(65,100)
Total selling expenses	(163,278)	(161,422)
General and administrative expenses		
Rent expense	(120,000)	(111,600)
Pension expense	(1,600)	(1,488)
Stock compensation expense	(7,500)	(6,975)
Depreciation expense	(77,000)	(71,610)
Accretion expense on ARO	(500)	(465)
Research and development	(1,120)	(1,042)
Total G&A expenses	(207,720)	(193,180)
Other operating expenses		
Compensation expense	(15,000)	(13,950)
Litigation expense	(2,600)	-
Interest expense on lease liability	(2,378)	-
Loss on sale of receivables	(200)	-
Gain on sale of building	2,000	-
Other operating expenses	(80,000)	(74,400)
Total other operating expenses	(98,178)	(88,350)
Net operating income	368,630	336,208
Other comprehensive income		
Gain on revaluation of building	160,000	148,800
Actuarial gain on pension obligation	-	4,580
Comprehensive operating income	528,630	489,588
Investing		
Equity in earnings of affiliate	12,250	11,393
Fair value adjustment on affiliate	840	781
Realized gain on available-for-sale	450	-
Dividend income	9,250	8,603
Net investing income	22,790	20,776
Other comprehensive income		
Unrealized gain on available-for-sale sec.	10,650	1,247
Comprehensive investing income	33,440	22,023
FINANCING		
Interest expense	(250,000)	-
Comprehensive financing (expense)	(250,000)	-
INCOME TAXES		
Current tax expense	(75,451)	(70,169)
Deferred tax expense	(33,120)	(30,802)
Comprehensive income tax (expense)	(108,571)	(100,971)
Total comprehensive income	203,499	410,640

STATEMENT OF CASH FLOWS	2006	2005
Cash flows from business activities		
Operating (DIRECT)		
Cash received from sales	2,700,000	2,511,000
Cash paid for goods sold		
Cash paid for inventory purchases	(1,750,000)	(1,627,500)
Cash paid for labor	(110,000)	(102,300)
Total cash paid for goods sold	(1,860,000)	(1,729,800)
Cash paid for selling activities		
Cash paid for compensation	(85,000)	(79,050)
Cash contributions to pension plan	(700)	(651)
Cash paid for other expenses	(45,000)	(41,850)
Total cash paid for selling activities	(130,700)	(121,551)
Cash paid for general and admin activities		
Cash paid for rent	(120,000)	(111,600)
Cash contributions to pension plan	(500)	(465)
Total cash paid for G&A activities	(120,500)	(112,065)
Cash paid for other operating activities		
Cash paid for compensation	(15,000)	(13,950)
Cash received from sale of receivables	1,200	-
Cash paid for research and development	(1,120)	(845)
Cash paid for capital expenditures	(500,000)	(250,000)
Cash received from sale of building	17,500	-
Cash paid for other expenses	(55,000)	(51,150)
Total cash paid for other oper actitvities	(552,420)	(315,945)
Net cash provided by operating activities	36,380	231,639
Investing		
Purchase of investment in affiliates	(710,000)	-
Puchase of available-for-sale securities	(185,000)	-
Sale of available-for-sale securities	5,000	-
Dividends received	9,250	8,603
Net cash used in investing activities	(880,750)	8,603
Net cash used in business activities	(844,370)	240,242
Cash flows from financing activities		
Financing liabilities		
Interest paid	(125,000)	-
Proceeds from issuance of short-term debt	500,000	-
Proceeds from issuance of bonds	2,500,000	-
Net cash provided by financing activities	2,875,000	-
Cash flows from income taxes		
Net cash used in income tax activities	(54,639)	(50,814)
Net cash provided by acts with non-equity holders	1,975,991	189,427
Cash flows from equity activities		
Dividends paid	(35,000)	(32,550)
Net cash used in equity activities	(35,000)	(32,550)
Change in cash	1,940,991	156,877
Beginning cash	4,000,000	3,843,123
Ending cash	5,940,991	4,000,000

STATEMENT OF CASH FLOWS	2006	2005
Cash flows from business activities		
Operating (INDIRECT)		
Comprehensive operating income	528,630	489,588
Adjustments to reconcile comprehensive		
operating income to net cash provided		
by operating activities:		
Change in operating assets/liabilities:		
Accounts receivable	(247,600)	(207,984)
Less: Allowance for bad debts	5,278	4,434
Accounts payable	(475,000)	(412,599)
Accrued liabilities	50,000	42,000
Advances from customers	175,000	147,000
Current portion of lease liability	9,208	7,735
Inventory	446,250	274,850
Share-based compensation liability	7,500	6,300
Asset retirement obligation	9,255	7,774
Loss contingency	2,600	2,184
Leased asset	(25,756)	(21,635)
Lease liability (excl current portion)	24,870	20,891
Accrued pension liability	2,400	2,016
Building	(632,755)	(262,512)
Less: Accumulated depreciation	156,500	131,598
Net cash provided by operating activities	36,380	231,639
Investing		
Purchase of investment in affiliates	(710,000)	-
Puchase of available-for-sale securities	(185,000)	-
Sale of available-for-sale securities	5,000	-
Dividends received	9,250	8,603
Net cash used in investing activities	(880,750)	8,603
Net cash used in business activities	(844,370)	240,242
Cash flows from financing activities		
Financing liabilities		
Interest paid	(125,000)	-
Proceeds from issuance of short-term debt	500,000	-
Proceeds from issuance of bonds	2,500,000	-
Net cash provided by financing activities	2,875,000	-
Cash flows from income taxes		
Net cash used in income tax activities	(54,639)	(50,814)
Net cash provided by acts with non-equity holders	1,975,991	189,427
Cash flows from equity activities		
Dividends paid	(35,000)	(32,550)
Net cash used in equity activities	(35,000)	(32,550)
Change in cash	1,940,991	156,877
Beginning cash	4,000,000	3,843,123
Ending cash	5,940,991	4,000,000

STATEMENT OF SHAREHOLDERS' EQUITY

	Common Stock and APIC	Treasury Stock	Retained Earnings	Accumulated Other Comprehensive Income	Total Sharholders' Equity
Balance at December 31, 2004	**5,000,000**	**(100,000)**	**2,957,978**	**-**	**7,857,978**
Comprehensive Income	-	-	2,657	154,627	157,284
Dividends	-	-	(70,000)	-	(70,000)
Balance at December 31, 2005	**5,000,000**	**(100,000)**	**2,890,635**	**154,627**	**7,945,262**
Comprehensive Income	-	-	32,849	170,650	203,499
Dividends	-	-	(70,000)	-	(70,000)
Balance at December 31, 2006	**5,000,000**	**(100,000)**	**2,853,484**	**325,277**	**8,078,761**