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American Institute of Certified Public Accountants. Accounting Principles Board

OPINIONS OF THE ACCOUNTING PRINCIPLES BOARD

MARCH 1971

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Reporting Changes in Financial Position

In view of the broadened concept of the Funds Statement adopted in this Opinion, the Board has recommended that the title of the statement be changed to "Statement of Changes in Financial Position."

INTRODUCTION

1. In 1963 the Accounting Principles Board issued Opinion No. 3, *The Statement of Source and Application of Funds.* Support of that Opinion by the principal stock exchanges and its acceptance by the business community have resulted in a significant increase in the number of companies that present a statement of sources and uses of funds (funds statement) in annual financial reports to shareholders. Several regulatory agencies have acted recently to require funds statements in certain reports filed with them.

2. APB Opinion No. 3 encouraged but did not require presentation of a funds statement. In view of the present widespread recognition of the usefulness of information on sources and uses of funds, the Board has considered whether presentation of such a statement should be required to complement the income statement and the balance sheet. APB Opinion No. 3 also offered considerable latitude as to form and content of funds statements, and practice has varied widely. The Board has therefore also considered establishing guides for presenting such statements.

Issued by the Accounting Principles Board of the American Institute of Certified Public Accountants

3. This Opinion sets forth the Board's conclusions and supersedes APB Opinion No. 3, *The Statement of Source and Application of Funds.*[1]

DISCUSSION

4. The objectives of a funds statement are (1) to summarize the financing and investing activities of the entity, including the extent to which the enterprise has generated funds from operations during the period, and (2) to complete the disclosure of changes in financial position during the period. The information shown in a funds statement is useful to a variety of users of financial statements in making economic decisions regarding the enterprise.

5. The funds statement is related to both the income statement and the balance sheet and provides information that can be obtained only partially, or at most in piecemeal form, by interpreting them. An income statement together with a statement of retained earnings reports results of operations but does not show other changes in financial position. Comparative balance sheets can significantly augment that information, but the objectives of the funds statement require that all such information be selected, classified, and summarized in meaningful form. The funds statement cannot supplant either the income statement or the balance sheet but is intended to provide information that the other statements either do not provide or provide only indirectly about the flow of funds and changes in financial position during the period.

6. The concept of *funds* in funds statements has varied somewhat in practice, with resulting variations in the nature of the statements. For example, *funds* is sometimes interpreted to mean *cash* or its equivalent, and the resulting funds statement

[1] This Opinion amends APB Statement No. 4, *Basic Concepts and Accounting Principles Underlying Financial Statements of Business Enterprises,* to the extent that it relates to reporting changes in financial position.

is a summary of cash provided and used. Another interpretation of *funds* is that of *working capital,* i.e., current assets less current liabilities, and the resulting funds statement is a summary of working capital provided and used.[2] However, a funds statement based on either the cash or the working capital concept of funds sometimes excludes certain financing and investing activities because they do not directly affect cash or working capital during the period. For example, issuing equity securities to acquire a building is both a financing and investing transaction but does not affect either cash or working capital. To meet all of its objectives, a funds statement should disclose separately the financing and investing aspects of all significant transactions that affect financial position during a period. These transactions include acquisition or disposal of property in exchange for debt or equity securities and conversion of long-term debt or preferred stock to common stock.

OPINION

Applicability

7. The Board concludes that information concerning the financing and investing activities of a business enterprise and the changes in its financial position for a period is essential for financial statement users, particularly owners and creditors, in making economic decisions. When financial statements purporting to present both financial position (balance sheet) and results of operations (statement of income and retained earnings) are issued, a statement summarizing changes in financial position should also be presented as a basic financial statement for each period for which an income statement is presented.[3]

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2 Examples of different uses of the term *funds* are found in *"Cash Flow" Analysis and the Funds Statement,* by Perry Mason, Accounting Research Study No. 2, published by the American Institute of Certified Public Accountants in November 1961, pp. 51-56. This study contains numerous examples of other aspects of these statements. (Accounting research studies are not pronouncements of the Board or of the Institute but are published for the purpose of stimulating discussion on important accounting issues.)

3 The Board recognizes that a statement of changes in financial position will be omitted in some circumstances; for example, from financial statements restricted for internal use only (see Statements on Auditing Procedure No. 38, paragraphs 5 and 6) and financial statements prepared for special purposes (see Statements on Auditing Procedure No. 33, Chapter 13).

These conclusions apply to all profit-oriented business entities, whether or not the reporting entity normally classifies its assets and liabilities as current and noncurrent.

Concept

8. The Board also concludes that the statement summarizing changes in financial position should be based on a broad concept embracing all changes in financial position and that the title of the statement should reflect this broad concept. The Board therefore recommends that the title be Statement of Changes in Financial Position (referred to below as "the Statement"). The Statement of each reporting entity should disclose all important aspects of its financing and investing activities regardless of whether cash or other elements of working capital are directly affected. For example, acquisitions of property by issuance of securities or in exchange for other property, and conversions of long-term debt or preferred stock to common stock, should be appropriately reflected in the Statement.

Format

9. The Board recognizes the need for flexibility in form, content, and terminology of the Statement to meet its objectives in differing circumstances. For example, a working capital format is not relevant to an entity that does not distinguish between current and noncurrent assets and liabilities. Each entity should adopt the presentation that is most informative in its circumstances. The Board believes, however, that the guides set forth in the paragraphs that follow should be applied in preparing and presenting the Statement.

10. The ability of an enterprise to provide working capital or cash from operations is an important factor in considering its financing and investing activities. Accordingly, the Statement should prominently disclose working capital or cash provided from or used in operations for the period, and the Board believes that the disclosure is most informative if the effects of extraordinary items (see APB Opinion No. 9, *Reporting the Results of Operations,* paragraphs 21 and 22) are reported separately from the effects of normal items. The State-

ment for the period should begin with income or loss before extraordinary items, if any, and add back (or deduct) items recognized in determining that income or loss which did not use (or provide) working capital or cash during the period. Items added and deducted in accordance with this procedure are not sources or uses of working capital or cash, and the related captions should make this clear, e.g., "Add – Expenses not requiring outlay of working capital in the current period." An acceptable alternative procedure, which gives the same result, is to begin with total revenue that provided working capital or cash during the period and deduct operating costs and expenses that required the outlay of working capital or cash during the period. In either case the resulting amount of working capital or cash should be appropriately described, e.g., "Working capital provided from [used in] operations for the period, exclusive of extraordinary items." This total should be immediately followed by working capital or cash provided or used by income or loss from extraordinary items, if any; extraordinary income or loss should be similarly adjusted for items recognized that did not provide or use working capital or cash during the period.

11. Provided that these guides are met, the Statement may take whatever form gives the most useful portrayal of the financing and investing activities and the changes in financial position of the reporting entity. The Statement may be in balanced form or in a form expressing the changes in financial position in terms of cash, of cash and temporary investments combined, of all quick assets, or of working capital. The Statement should disclose all important changes in financial position for the period covered; accordingly, types of transactions reported may vary substantially in relative importance from one period to another.[4]

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[4] As stated in paragraph 24 of Accounting Research Bulletin No. 51, *Consolidated Financial Statements,* in some cases parent-company financial statements (including, in conformity with this Opinion, a statement of changes in financial position) may be needed in addition to consolidated financial statements for adequate disclosure.

Content

12. Whether or not working capital flow is presented in the Statement, net changes in each element of working capital (as customarily defined) should be appropriately disclosed for at least the current period, either in the Statement or in a related tabulation.

a. If the format shows the flow of cash, changes in other elements of working capital (e.g., in receivables, inventories, and payables) constitute sources and uses of cash and should accordingly be disclosed in appropriate detail in the body of the Statement.

b. If the format shows the flow of working capital and two-year comparative balance sheets are presented, the changes in each element of working capital for the current period (but not for earlier periods) can be computed by the user of the statements. Nevertheless, the Board believes that the objectives of the Statement usually require that the net change in working capital be analyzed in appropriate detail in a tabulation accompanying the Statement, and accordingly this detail should be furnished.

13. The effects of other financing and investing activities should be individually disclosed. For example, both outlays for acquisitions and proceeds from retirements of property should be reported;[5] both long-term borrowings and repayments of long-term debt should be reported; and outlays for purchases[6] of consolidated subsidiaries should be summarized in the consolidated Statement by major categories of assets obtained and obligations assumed. Related items should be shown in proximity when the result contributes to the clarity of the Statement. Individual immaterial items may be combined.

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[5] However, normal trade-ins to replace equipment should ordinarily be reported on a net basis.

[6] When a business combination is accounted for as a pooling of interests, financial statements (including, in conformity with this Opinion, statements of changes in financial position) of the separate companies should be restated on a combined basis for all periods presented. See APB Opinion No. 16, *Business Combinations,* paragraph 57.

14. In addition to working capital or cash provided from operations (see paragraph 10) and changes in elements of working capital (see paragraph 12), the Statement should clearly disclose:

a. Outlays for purchase of long-term assets (identifying separately such items as investments, property, and intangibles).

b. Proceeds from sale (or working capital or cash provided by sale) of long-term assets (identifying separately such items as investments, property, and intangibles) not in the normal course of business, less related expenses involving the current use of working capital or cash.

c. Conversion of long-term debt or preferred stock to common stock.

d. Issuance, assumption, redemption, and repayment of long-term debt.

e. Issuance, redemption, or purchase of capital stock for cash or for assets other than cash.

f. Dividends in cash or in kind or other distributions to shareholders (except stock dividends and stock split-ups as defined in ARB No. 43, Chapter 7B – *Stock Dividends and Stock Split-Ups*).

Terminology

15. The amount of working capital or cash provided from operations is not a substitute for or an improvement upon properly determined net income as a measure of results of operations and the consequent effect on financial position. Terms referring to "cash" should not be used to describe amounts provided from operations unless all non-cash items have been appropriately adjusted. The adjusted amount should be described accurately, in conformity with the nature of the adjustments, e.g., "Cash provided from operations for the period" or "Working capital provided from operations for the period" as appropriate. The Board strongly recommends that isolated statistics of working capital or cash provided from operations, especially per-share amounts, not be presented in

annual reports to shareholders. If any per-share data relating to flow of working capital or cash are presented, they should as a minimum include amounts for inflow from operations, inflow from other sources, and total outflow, and each per-share amount should be clearly identified with the corresponding total amount shown in the Statement.

EFFECTIVE DATE

16. This Opinion shall be effective for fiscal periods ending after September 30, 1971. However, the Board encourages earlier application of the provisions of this Opinion.

The Opinion entitled "Reporting Changes in Financial Position" was adopted by the assenting votes of seventeen members of the Board. Mr. Halvorson dissented.

Mr. Halvorson dissents to this Opinion because he believes the Board is going outside its province, if not its authority, in imposing a requirement that a summary of changes in financial position become one of the basic financial statements. He does not dispute the usefulness of such a statement in connection with many, if not most, financial reports but he believes the requirement of it as a necessary submission is not supported by the Opinion because he is unable to find a basis for concluding that a balance sheet may be issued alone without the necessity for submission of a statement of changes in financial position, and that an income statement similarly may be issued alone without the necessity for an accompanying statement of changes in financial position, but that if a balance sheet is issued in conjunction with an income statement, the joint presentation must be supplemented by a statement of changes in financial position.

NOTES

Opinions of the Accounting Principles Board present the conclusions of at least two-thirds of the members of the Board, which is the senior technical body of the Institute authorized to issue pronouncements on accounting principles.

Board Opinions are considered appropriate in all circumstances covered but need not be applied to immaterial items.

Covering all possible conditions and circumstances in an Opinion of the Accounting Principles Board is usually impracticable. The substance of transactions and the principles, guides, rules, and criteria described in Opinions should control the accounting for transactions not expressly covered.

Unless otherwise stated, Opinions of the Board are not intended to be retroactive.

Council of the Institute has resolved that Institute members should disclose departures from Board Opinions in their reports as independent auditors when the effect of the departures on the financial statements is material or see to it that such departures are disclosed in notes to the financial statements and, where practicable, should disclose their effects on the financial statements (Special Bulletin, Disclosure of Departures from Opinions of the Accounting Principles Board, *October 1964). Members of the Institute must assume the burden of justifying any such departures.*

Accounting Principles Board (1971)

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