# STAFF PAPER

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**IASB Meeting**

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| **Project** | **Disclosure Initiative: Principles of Disclosure** |
| Paper topic | Comment letter feedback—roles of the primary financial statements and the notes |


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## Objective

1. This paper provides a detailed analysis of feedback received from comment letters on Section 3 of the *Disclosure Initiative—Principles of Disclosure* Discussion Paper. Section 3 of the Discussion Paper discusses whether a general disclosure standard should describe the roles of the different components of the financial statements and how those roles meet the objective of financial statements.

## Structure

2. This paper is structured as follows:
   (a) Key messages (paragraphs 3-6);
   (b) Background and questions in the Discussion Paper (paragraphs 7-9);
   (c) Overall feedback (paragraphs 10-16);
      (i) need for guidance (paragraphs 12-14);
      (ii) location of the guidance (paragraph 15);
      (iii) effect of technology (paragraph 16);
   (d) Primary financial statements (paragraphs 17-36);
      (i) use of the term 'primary financial statements' (paragraphs 19-20);

(ii) composition of the primary financial statements (paragraphs 21-25);

(iii) role of the primary financial statements (paragraphs 26-34);

(iv) implications of the role of the primary financial statements (paragraph 35-36);

(e) Role and content of the notes (paragraphs 37-52);

(i) role of the notes (paragraphs 39-49);

(ii) content of the notes (paragraphs 50-52);

(f) Use of the terms ‘present’ and ‘disclose’ (paragraphs 53-57);

(g) Appendix A—Excerpts from the Discussion Paper.

## Key messages

3. Most respondents agreed with the Board’s preliminary view that a general disclosure standard should describe the roles of the different components of the financial statements. However, a few of these respondents expressed concerns about the interaction with some of the Board’s other projects (paragraphs 12-15).

4. Most respondents agreed with the Board’s preliminary view on the:

(a) use of the term ‘primary financial statements’;

(b) descriptions of the roles of the primary financial statements and the notes;

(c) implications of the role of the primary financial statements; and

(d) content of the notes.

In addition, many respondents agreed with the Board’s preliminary view on the composition of the primary financial statements. However, some respondents had concerns about certain aspects of these preliminary views (paragraphs 17-52).

5. Many respondents agreed that the Board should not prescribe the meaning of the terms ‘present’ and ‘disclose’ and instead specify the intended location as either ‘in the primary financial statements’ or ‘in the notes’ when subsequently drafting IFRS Standards (paragraphs 53-57).

6. Compared with the other areas, we received relatively few comments from respondents on the discussions in this section of the Discussion Paper about the:

   (a) location of the guidance;

   (b) implications of the role of the primary financial statements; and

   (c) content of the notes.

## Background and questions in the Discussion Paper

7. IAS 1 *Presentation of Financial Statements* specifies that a complete set of financial statements comprises:

   (a) the following statements:

      (i) statement of financial position;

      (ii) statement of profit or loss and other comprehensive income;

      (iii) statement of changes in equity; and

      (iv) statement of cash flows.

   (b) notes, comprising significant accounting policies and other explanatory information.

8. The Discussion Paper observed that stakeholders perceive the information in the statements listed in paragraph 7(a) to be used more frequently and be subject to more scrutiny by users, auditors and regulators than the information in the notes. In addition, entities find it difficult to exercise judgment about what information to present in the statements listed in paragraph 7(a) instead of being disclosed in the notes. Feedback also suggested that the inconsistent use of terminology in IFRS Standards is contributing to the difficulties in exercising judgment on where to include information.

9. The feedback described in this paper includes the responses provided by stakeholders on the following question:

| **Question 4** |
| --- |
| The Board's preliminary views are that a general disclosure standard should: |

- specify that the ‘primary financial statements’ are the statements of financial position, financial performance, changes in equity and cash flows;
- describe the role of primary financial statements and the implications of that role as set out in paragraphs 3.22 and 3.24;
- describe the role of the notes as set out in paragraphs 3.28, as well as provide examples of further explanatory and supplementary information, as referred to in paragraphs 3.26-3.27; and
- include the guidance on the content of the notes proposed in paragraphs 7.3-7.7 of the *Conceptual Framework* Exposure Draft, as described in paragraph 3.7.

In addition, the Board’s preliminary views are that:

- it should not prescribe the meaning of ‘present’ as presented in the primary financial statements and the meaning of ‘disclose’ as disclosed in the notes; and
- if it uses the terms ‘present’ and ‘disclose’ when describing where to provide information in the financial statements when subsequently drafting IFRS Standards, it should also specify the intended location as either ‘in the primary financial statements’ or ‘in the notes’.

Do you agree with the Board’s preliminary views? Why or why not? If you do not agree, what do you suggest instead, and why?

## Overall feedback

10. The Board’s preliminary view is that a general disclosure standard should:

    (a) identify, and describe the role of the primary financial statements and the implications of that role; and

    (b) describe the role and content of the notes.

11. In addition to feedback about the Board’s specific preliminary views relating to the primary financial statements (paragraphs 17-36) and the notes (paragraphs 37-52), respondents also provided some overall feedback about the:

    (a) need for guidance;

    (b) location of the guidance; and

    (c) effect of technology.

### *Need for guidance*

12. Most respondents agreed that the Board should provide guidance on the respective roles and content on the primary financial statements and notes (as described in paragraph 10). Those respondents said that such guidance would help preparers and users of the financial statements identify the boundaries between the primary financial statements and the notes.

13. However, a few of those respondents cautioned the Board against overemphasising the distinction between the primary financial statements and the notes. In particular, respondents were concerned about the Board creating a perception that the information in the primary financial statements is of a higher quality, or is more important, than the information in the notes.

14. A few respondents said that the Board should not provide any guidance that will describe the respective roles of the different components of the financial statements. This was because, in their view:

    (a) preparers should have the flexibility to determine where to include information;

    (b) there is sufficient guidance in IAS 1; and

    (c) the guidance would not solve any significant reporting challenges.

### *Location of the guidance*

15. Most respondents broadly agreed that the appropriate location for the guidance in paragraph 10 would be in a general disclosure standard. Some respondents expressed concerns about how the guidance on the roles of the primary financial statement and notes in a general disclosure standard would interact with some of the Board's other projects, in particular the Primary Financial Statements and Conceptual Framework projects (see Agenda Paper 11D).

### *Effect of technology*

16. A few respondents said that the Board should consider the effect of digital reporting on the respective roles of the primary financial statements and the notes,

as developments in technology such as XBRL and big data could significantly affect how information is processed and consumed. A few of these respondents said that the distinction between primary financial statements and the notes is blurred in a digital reporting environment where information is more integrated.

## Primary financial statements

17. The Board's preliminary view is that the 'primary financial statements' are the statements of financial position, profit or loss and other comprehensive income, changes in equity and cash flows.

18. Respondents provided feedback on the:

    (a) use of the term 'primary financial statements;

    (b) composition of the primary financial statements;

    (c) role of the primary financial statements; and

    (d) implications of the role of the primary financial statements.

### *Use of the term 'primary financial statements'*

19. Most respondents agreed with using the term 'primary financial statements' to describe the statements listed in paragraph 17 because the term is widely used and well understood. A few of these respondents asked the Board to clearly state that the term 'primary' does not imply that the notes are less important. These respondents observed that the notes provide valuable information about an entity.

20. A few respondents disagreed with using the term 'primary financial statements'. This was because it could be misleading to users of financial statements by suggesting that the notes are inferior. Some respondents suggested using 'face of the financial statements' and noted that this would be consistent with US GAAP.

### *Composition of the primary financial statements*

21. Many respondents agreed that the statements listed in paragraph 17 should comprise the 'primary financial statements' because it would be consistent with

common practice. A few of these respondents asked the Board to clarify the relative importance, if any, of each statement.

22. Some other respondents that provided feedback on this area did not fully agree with the suggested composition of the primary financial statements. They said that the composition lacks flexibility because it does not consider additional relevant statements and it includes irrelevant statements.

23. Respondents that said the composition of the primary financial statements lacks flexibility because it does not consider additional relevant statements observed that:

    (a) statements other than those listed in paragraph 17 might be:

        (i) more relevant in depicting the business activity for some entities. A few respondents gave the example of retirement benefit plans and said that the statement of net assets available for benefits might not be captured by the suggested composition; or

        (ii) required in the local jurisdictions of some entities. For example, a few respondents said that the corporate law in Brazil requires the presentation of a value added statement together with the primary financial statements; and

    (b) segment information is crucial to understanding the performance of an entity.

24. Consequently, some of those respondents recommended that a general disclosure standard should indicate that the statements listed in paragraph 17 are the minimum number of primary financial statements. A few other respondents said the list of primary financial statements should be described as a rebuttable presumption.

25. Respondents that said the composition of the primary financial statements lacks flexibility because it includes irrelevant statements observed that the:

    (a) statement of cash flows:

        (i) does not provide useful information about business activities, especially for entities in the banking industry; or

(ii) is not consistent with the Conceptual Framework because cash flows are not identified as separate elements of financial statements; and

(b) statement of changes in equity represents a disaggregation of information included in another financial statement and therefore, does not provide useful information on its own.

### *Role of the primary financial statements*

26. The Board's preliminary view is that the role of the primary financial statements is to provide a structured and comparable summary of an entity's recognised assets, liabilities, equity, income and expenses, which is useful for:

    (a) obtaining an overview of the entity's assets, liabilities, equity, income and expenses;

    (b) making comparisons between entities and reporting periods; and

    (c) identifying items or areas within the financial statements about which users of the financial statements will seek additional information in the notes.

27. Most respondents agreed with the role of the primary financial statements as described in the Discussion Paper and said that it is broadly consistent with common practice.

28. However, some of those respondents also expressed concerns about some aspects of the role of the primary financial statements described in the Discussion Paper, including:

    (a) focus on elements (paragraphs 31-32); and

    (b) other considerations (paragraphs 33-34).

29. Consequently, many respondents thought the Board would need to undertake further work to address their concerns before developing the role of the primary financial statements.

30. A few respondents disagreed with the role of the primary financial statements described in the Discussion Paper. In some cases, this was because they disagreed

with the Board providing any guidance on the roles of the primary financial statements and the notes for the reasons described in paragraph 14. In other cases, they disagreed with the role of the primary financial statements described in the Discussion Paper. Reasons for disagreement included that the description:

(a) focuses too much on the elements of financial statements (see paragraphs 31-32);

(b) is too abstract to help entities apply better judgment in communicating information more effectively;

(c) does not provide further clarity as to the role of the primary financial statements as it mainly repeats existing guidance; and

(d) would not be true in every case as the role also applies to information included in the notes.

*Focus on elements*

31. Some respondents thought that the description of the role of the primary financial statements in the Discussion Paper is too narrow. This is because it focuses too much on the elements and too little on the overall objective of providing summarised information.

32. These respondents suggested that the role should instead focus on the general purpose of communicating summarised information about financial performance, financial position, cash flows and changes in equity.

*Other considerations*

33. A few respondents thought that:

(a) the reference to both ‘structured’ and ‘comparable’ in the introductory text suggests that there is a required structure to the level of information in the primary financial statements to enable comparability across entities. A few of these respondents suggested removing the references to ‘comparable’ and ‘structured’;

(b) the role should more clearly describe how the primary financial statements contribute to providing information that is useful to users in assessing the prospects for future net cash inflows to the entity and in assessing managements stewardship of the entity's resources; and

(c) the role does not seem to accommodate some types of information presented on the face of the primary financial statements, such as information about earnings per share.

34. These respondents encouraged the Board to undertake further work to determine whether the description of the role of the primary financial statements:

(a) would meet the objective of financial statements described in the Conceptual Framework, especially as it relates to the statement of cash flows; and

(b) is sufficiently detailed to assist the Board in deciding what information to permit and require to be presented in the primary financial statements.

### *Implications of the role of the primary financial statements*

35. Most respondents agreed with the implications described in the Discussion Paper (see Appendix A1).

36. However, some respondents expressed concerns about the implication that 'information in the primary financial statement is more prominent than information in the notes'. These respondents were concerned about implying that information in the notes is less relevant. Respondents suggested that the Board make it clear that the quality of information disclosed in the notes should be the same as the quality of information provided in the primary financial statements.

## Role and content of the notes

37. The Board's preliminary views are that:

(a) the role of the notes is to:

(i) provide further information necessary to disaggregate, reconcile and explain the items recognised in the primary financial statements; and

   (ii) supplement the primary financial statements with other information that is necessary to meet the objective of financial statements;

(b) further explanatory and supplementary information on the role of the notes should also be provided, as listed in paragraphs 3.26-3.27 of the Discussion Paper (see Appendix A2); and

(c) guidance on the content of the notes should also be provided, similar to the guidance in paragraphs 7.3-7.7 of the *Conceptual Framework* Exposure Draft (see Appendix A3).

38. Respondents provided feedback on the:

(a) role of the notes (paragraphs 39-49); and

(b) content of the notes (paragraphs 50-52).

### *Role of the notes*

39. Most respondents broadly agreed with the role of the notes as described in the Discussion Paper and said that description is consistent with common practice

40. However, some of these respondents also expressed concerns about some aspects of the role of notes described in the Discussion Paper, including:

(a) supplementing the primary financial statements with other information (paragraph 43-45);

(b) reference to ‘reconcile’ (paragraph 46-47); and

(c) incomplete description of the role (paragraph 48-49).

41. Consequently, some respondents thought the Board would need to undertake further work to address their concerns before developing the role of the notes.

42. A few respondents disagreed with the proposed role of the notes. In some cases, this was because they disagreed with the Board providing any guidance on the roles of the primary financial statements and the notes for the reasons described in paragraph 14. Other respondents added that, in their view, a description of the role of the notes is not necessary or helpful because the notes contain a wide range of information.

### *Supplementing the primary financial statements with other information*

43. A few respondents expressed concerns regarding the proposal that the role of the notes is to 'supplement the primary financial statements with other information that is necessary to meet the objective of the financial statements'. This is because respondents thought this appears to be a 'catch-all' phrase. Respondents said that this description:

(a) does not effectively describe the boundaries between the notes and financial information that are not included in the financial statements, such as those in the Management Commentary section of the annual report; and

(b) could give rise to an additional implementation burden for preparers if they need to ensure that all information included in the notes is needed to meet the objective of financial statements. They added that this might be a problem if, for example, preparers include additional information to comply with local regulatory or legal requirements.

44. Consequently, some of those respondents expressed concerns about the example in the Discussion Paper that supplementary information that should be included in the notes includes information about an entity's exposure to various types of risks. A few respondents were concerned that risks that they thought should not be reported in the financial statements would be captured. For example, respondents thought that risks such as political risk, climate change, and technology risk would be more appropriately provided in the Management Commentary section of the annual report.

45. A few respondents suggested that the Board should not be too prescriptive in describing the role of the notes to allow entities the flexibility to 'tell their story'. Conversely, other respondents suggested that the Board provide additional examples of information that should not be included in the notes because it falls outside the boundary of the notes.

### *Reference to 'reconcile'*

46. A few respondents thought that the reference to 'reconcile' in the role of the notes creates confusion about the boundaries between the notes and some of the primary

financial statements. These respondents thought that the statement of cash flows and statement of changes in equity are essentially forms of reconciliation and therefore, reconciling items in the primary financial statements is not a sole objective of the notes.

47. A few of these respondents suggested that the Board delete ‘reconcile’ from the description of the role of the notes.

*Incomplete description*

48. A few respondents said that the role of the notes is broader than has been articulated in the Discussion Paper. These respondents thought that the notes:

    (a) provide independent information on items that are not included in the primary financial statements, such as some related party transactions, segment information, and information on unrecognised items; and

    (b) are also useful in making comparisons between entities and reporting periods.

49. These respondents suggested that the Board assess the completeness of the role of the notes described in the Discussion Paper and whether it is sufficiently detailed enough to assist the Board in deciding what information to permit and require to be disclosed in the notes.

### *Content of the notes*

50. Most respondents said that they agree with the Board providing guidance on the content of the notes based on the guidance in the *Conceptual Framework* Exposure Draft.

51. A few respondents expressed concerns about the guidance that forward-looking information about likely or possible future transactions and events should be included in the notes. These respondents were concerned that the application of this guidance might be difficult to audit if it were included as a requirement in a general disclosure standard.

52. A few respondents said that:

(a) the Board should not be too prescriptive in describing the guidance on the content of the notes, in order to allow entities the flexibility to disclose only useful information; and

(b) the content of the notes described in the Discussion Paper does not capture some information which the Board had previously decided should be included in the notes.

## Use of the terms 'present' and 'disclose'

53. The Discussion Paper included two possible approaches that the Board could use to address the identified inconsistent use of the terms 'present' and 'disclose' in IFRS Standards:

(a) prescribe the meaning of the terms; or

(b) specify the intended location as either 'in the primary financial statements' or 'in the notes', when subsequently drafting IFRS Standards.

54. Many respondents agreed with the Board's preliminary views that it should not prescribe the meaning of the terms 'present' and 'disclose' and instead specify the intended location as either 'in the primary financial statements' or 'in the notes' when subsequently drafting IFRS Standards. Those respondents thought there is limited benefit in prescribing the meaning of 'present' and 'disclose' because the terms are widely understood and appropriately applied in practice. A few of these respondents suggested that the Board also clarify the intended location of information for existing Standards.

55. A few respondents said that the Board should prescribe the meaning of 'present' and 'disclose'. Some of these respondents said that specifying the location of information in the financial statements only when subsequently drafting IFRS Standards could confuse stakeholders, if existing Standards are also not clarified in this manner. However, these respondents thought that reviewing existing Standards to specify their intended location would cause unnecessary complexity. Consequently, they thought that prescribing the meaning of the terms 'present'

and ‘disclose’ would provide a cost-effective approach to clarify the use of the terms in IFRS Standards.

56. A few other respondents said that they were indifferent as to which of the approaches in the Discussion Paper that the Board uses because both would lead to the same outcome.

57. A few respondents disagreed with either of the approaches described in the Discussion Paper. In other words, these respondents thought the Board should not do anything to address concerns about the use of ‘present’ and ‘disclose’ in IFRS Standards. This is because, in their opinion, entities should be given flexibility to decide where to include information. These respondents also noted that determining the appropriate location of information in the financial statements requires judgments including materiality considerations, entity-specific factors and the type of transaction.

## Appendix A—Excerpts from the Discussion Paper

A1. The Discussion Paper summarises the implications of the role of the primary financial statements, as follows:

(a) information in the primary financial statements is more prominent than information in the notes;

(b) it is presumed that each primary financial statement will be included in a complete set of financial statements;

(c) all line items in a primary financial statement are depicted in words and by a monetary amount, and are included in the totals for that statement;[1]

(d) all recognised elements are included in the totals in the primary financial statements; and

(e) a decision on whether to present information as a separate line item in the primary financial statements is made after considering the role of the primary financial statements. If information is not shown as a line item in the primary financial statements because it is aggregated there with other information, it might need to be disclosed separately in the notes. [2]

A2. The Discussion Paper provides examples of the role of the notes, as follows:

(a) the notes provide further explanation of information provided in the primary financial statements. Examples of such further explanatory information includes:

i. disaggregation and reconciliations of line items in the primary financial statements;

ii. descriptions of the nature of the items included in the primary financial statements; and

iii. information about the methods, assumptions and judgments used in recognising and measuring the items included in the primary financial statements; and

(b) notes supplement information in the primary financial statements by including additional information necessary to satisfy the objective of financial statements. Examples of such supplementary information includes:

i. information about the nature and extent of an entity's unrecognised elements; and

ii. information about an entity's exposure to various types of risks, such as market risk or credit risk, arising from both recognised and unrecognised elements.

[1] On the basis of paragraph 5.2 of the *Conceptual Framework* Exposure Draft

[2] Further guidance may be developed on this implication in other projects in the Disclosure Initiative (see paragraphs 3.12-3.13 of the Discussion Paper).

A3. The Discussion Paper summarises the proposed guidance in paragraphs 7.3-7.7 of the *Conceptual Framework* Exposure Draft that the notes include information about:

(a) the nature of both recognised and unrecognised elements and about the risks arising from them;

(b) the methods, assumptions and judgments, and changes in those methods, assumptions and judgments, that affect the amounts presented or disclosed;

(c) transactions and events that have occurred after the end of the reporting period if such information is necessary to meet the objective of financial statements described in paragraph 3.4 of the *Conceptual Framework* Exposure Draft;

(d) forward-looking information about likely or possible future transactions and events, only if it provides relevant information about an entity's assets, liabilities and equity that existed at the end of, or during, the period (even if they are unrecognised) or income and expenses for the period; and

(e) comparative information about preceding periods.