Purpose of staff paper

1. Board members are asked if some parts in IAS 1 *Presentation of Financial Statements* that were copied from the now superseded *Framework* should be updated to reflect the *Conceptual Framework* that was published in September 2010.

2. There are two issues for which the staff asks decisions:

   (a) whether paragraphs 19-24 which explain the 'Objective of financial statements' should be updated to reflect the new objective of financial reporting in the *Conceptual Framework*.

   (b) whether IAS 1 should incorporate the new notion of understandability. Currently IAS 1 quotes the old definition of understandability.

3. We noted these issues when we did a high level review of the IFRSs on the possible inconsistencies with between the *Conceptual Framework* and IFRSs. Apart from IAS 1 and IAS 8 (which will be amended as part of previous annual improvements process), any other potential inconsistencies noted were less significant and in our opinion and do not need to be addressed now.

4. We propose that these issues be dealt with through the 2010-2012 cycle of *Annual Improvements*. An analysis of how dealing with these issues meets the proposed annual improvements criteria is in Appendix A.

5. We think that these issues should be dealt with by the Board rather the IFRS Interpretations Committee. However, we will ask the Interpretations Committee to review the drafting of the proposals and to ensure that there are no unintentional inconsistencies.

Background

6. The *Conceptual Framework* does not override the requirements in IFRSs. The Board previously decided that it will update IFRSs to be consistent with the new Conceptual *Framework* when it amends these IFRSs.

7. The *Conceptual Framework* is effective immediately for the Board; therefore they will apply the new guidance in developing IFRSs.

8. The Board also proposed to amend the qualitative characteristics discussed in IAS 8 *Accounting Policies, Accounting Estimates and Errors* in a previous annual improvements cycle to be consistent with the new qualitative characteristics in the updated *Conceptual Framework* and minimise confusion. The concern in that circumstance was that, the Board, preparers and auditors will otherwise be applying different qualitative characteristics in determining what is useful financial information eg determining which accounting policy should be applied.

Analysis of issues and staff recommendation

Objective of financial statements in IAS 1

9. The *Conceptual Framework* now deals with the objective of financial reporting rather than the objective of financial statements only.

10. However, IAS 1 quoted from the objective of financial statements that was in the superseded *Framework*. The objective of financial statements in IAS 1 is a reference point for management to decide whether and when departing from a particular IFRS requirement is necessary because compliance with it:

> would be so misleading that it would conflict with the objective of financial statements set out in the *Framework* …. [IAS 1 paragraph 19]

Objective of financial statements	Objective of financial reporting
IAS 1, Par. 9: The objective of financial statements is to provide information about the financial position, performance and changes in financial position of an entity that is useful to a wide range of users in making economic decisions.	Conceptual Framework, Par. OB2: The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity.

11. We have identified three options in response to this issue:

    (a) remove any reference to the *Conceptual Framework* and retain the notion of 'Objective of financial statements' as an IAS 1 requirement;

    (b) insert a footnote as a temporary solution (to inform that in applying IFRSs, the Board had developed an objective of financial reporting) and retain the current references to the Framework; or

    (c) update IAS 1 to reflect the new objective of financial reporting;

Option (a) Retain the existing objective of financial statements in IAS 1

12. Option (a) retains the concept of an objective of financial statements. It is the simplest option and leaves the door open if the Board later wants to develop a separate or more specific objective or purpose for financial statements. Some may view that developing a separate or more specific objective of financial statements is consistent with what the Board did in its Practice Statement on the presentation and disclosure of management commentary:

    > The Board agreed that the purpose of management commentary is to provide, from management's perspective, context for the financial statements. [paragraph BC26 IFRS Practice Statement *Management Commentary: A Framework for Presentation*]

13. Adopting option (a) could lead to confusion. Some may ask to clarify the relationship that would exist between the objective of financial statements in IAS 1 and the objective of financial reporting in the *Conceptual Framework*. Further, Board has not yet commenced any analysis on the boundaries of financial

reporting – ie what is the difference between financial statements and financial reports.

14. Option (a) would mean replacing any reference to the objective of financial statements as set out in the *Framework* to cross-reference with the objective of financial statements described in IAS 1. For example (added text is underlined):

    9. The objective of financial statements is to provide information about the financial position, performance and changes in financial position of an entity that is useful to a wide range of users in making economic decisions.

    19. In the extremely rare circumstances in which management concludes that compliance with a requirement in an IFRS would be so misleading that it would conflict with the objective of financial statements set out in ~~the *Framework*~~ paragraph 9, the entity shall depart from that requirement in the manner set out in paragraph 20 if the relevant regulatory framework requires, or otherwise does not prohibit, such a departure.

15. Appendix B lists the changes to be made if the Board chooses option (a).

Option (b) Add a footnote

16. Option (b) is inserting a footnote that signals the new concept of 'Objective of financial reporting' in the Conceptual Framework and defers the revision of IAS 1 to a separate project. Option (b) has the same advantages and disadvantage of option (a), but it acknowledges that the Board has developed an objective of financial reporting.

17. A footnote could look like this (added text is underlined):

Purpose of financial statements*

9 Financial statements are a structured representation of the financial position and financial performance of an entity. The objective of financial statements is to provide information about the financial position, financial performance and cash flows of an entity that is useful to a wide range of users in making economic decisions. Financial statements also show the results of the management's stewardship of the resources entrusted to it.

* This section includes references to the objective of financial statements according to the *Framework for the Preparation and Presentation of Financial Statements*. In September 2010 the IASB replaced the *Framework for the Preparation and Presentation of Financial Statements* with the *Conceptual*

> *Framework for Financial Reporting.* This resulted in the replacement of the objective of financial statements by the objective of financial reporting."

Option (c) Update IAS 1 with the objective of financial reporting

18. Option (c) is updating IAS 1 to reflect the new objective of financial reporting. Adopting option (c) acknowledges that the objective of financial statements in IAS 1 and in the superseded *Framework* is synonymous with the objective of financial reporting.

19. However, we recommend option (c) because:

    (a) the concepts underpinning the objective of financial statements in IAS 1 are the same as the concepts in the objective of financial reporting in the *Conceptual Framework*. This is consistent with the Board's objective when it developed the objective of financial reporting with the US FASB for the *Conceptual Framework* – to clarify and converge the objective of financial reporting in US GAAP and the *Framework*. (Note: although the objective of financial statements is to provide useful information to a wide range of users, the superseded *Framework* stated that Board would focus on the needs of investors to meet the objective of financial statements.) Having different words for the same concept potentially creates confusion and translation problems;

    (b) it would result in overall consistency with IAS 1 and the new *Conceptual Framework*; and

    (c) it is consistent with the work done on financial statement presentation project where the staff draft only refers to the objective of financial reporting rather than the objective of financial statements (http://www.ifrs.org/NR/rdonlyres/61E20DBC-DFF6-4BAB-80CD-949A1DF7E95C/0/FSPStandard.pdf).

20. The main proposed amendment to IAS 1 is below (added text is underlined, and deleted text is struckthrough). Other consequential amendments are in Appendix B.

Financial statements

~~Purpose of financial statements~~ Objective of general purpose financial reporting

Staff note:

The existing paragraph 9 has been renumbered as paragraph 9A. The new paragraph 9 is copied from paragraphs OB2 and OB12 in the *Conceptual Framework*. We included paragraph OB12 because it explains the link between the objective of financial reporting and how a complete set of financial statements (set out in paragraph 10 in IAS 1, also copied below) meets the objective of financial reporting.

9 The objective of financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity. General purpose financial reports provide information about the financial position of a reporting entity, which is information about the entity's financial economic resources and claims against the reporting entity. General purpose financial reports also provide information about the effects of transactions and other events that change a reporting entity's economic resources and claims. Both types of information provide useful input for decisions about providing resources to an entity.

Financial Statements

9A ~~Financial statements are a structured representation of the financial position and financial performance of an entity. The objective of financial statements is to provide information about the financial position, financial performance and cash flows of an entity that is useful to a wide range of users in making economic decisions. Financial statements also show the results of the management's stewardship of the resources entrusted to it.~~ To meet the~~this~~ objective of general purpose financial reporting, financial statements provide information about an entity's:

(a) assets;

(b) liabilities;

(c) equity;

(d) income and expenses, including gains and losses;

(e) contributions by and distributions to owners in their capacity as owners; and

(f) cash flows.

This information, along with other information in the notes, assists users~~ of financial statements~~ in assessing the prospects for ~~predicting the entity's~~ future net cash inflows to an entity and, in particular, their timing and certainty.

Complete set of financial statements

10 A complete set of financial statements comprises:

(a) **a statement of financial position as at the end of the period;**

(b) **a statement of comprehensive income for the period;**

(c) **a statement of changes in equity for the period;**

(d) **a statement of cash flows for the period;**

(e) **notes, comprising a summary of significant accounting policies and other explanatory information; and**

(f) a statement of financial position as at the beginning of the earliest comparative period when an entity applies an accounting policy retrospectively or makes a retrospective restatement of items in its financial statements, or when it reclassifies items in its financial statements.

Question 1
The staff recommends option (c), to update IAS 1 to reflect that the objective of financial statements should be replaced with the objective of financial reporting. Do you agree?

Issue 2: Understandability

21. The definition of understandability is now different:

    (a) users' *minimum* level of knowledge is no longer meant to include an accounting-specific knowledge; and

    (b) users are responsible for *actually* studying the reported financial information with reasonable diligence and no longer merely *willing* to *study* the information diligently.

22. IAS 1 quotes the old definition of understandability in the superseded *Framework* and we propose that it should be updated to reflect the latest definition.

23. We propose the following edits to paragraph 7 of IAS 1:

> Chapter 3 in the ~~The~~ *Conceptual Framework* ~~*for the Preparation and Presentation of Financial Statements*~~ ~~states in paragraph 25~~ that 'Financial reports are prepared for users who ~~are assumed to~~ have a reasonable knowledge of business and economic activities ~~and accounting~~ and who review and analyse ~~a willingness to study~~ the information ~~with reasonable diligence~~ diligently.'

Question 2
The staff recommend updating the definition of understandability in IAS 1 to be consistent with that in the *Conceptual Framework*. Do you agree with the staff recommendation?

Appendix A: Annual Improvements criteria assessment

A1. We think that the proposed amendment to IAS 1 meets the proposed annual improvements criteria.

Criteria	Yes?
1) The proposed annual improvement has to meet one of both of the following characteristics a) Clarifying—the proposed amendment would improve IFRSs by: • clarifying unclear wording in existing IFRSs, or • providing guidance where an absence of guidance is causing concern. A clarifying amendment maintains consistency with the existing principles within the applicable IFRSs. It does not propose a new principle, or a change to an existing principle. b) Correcting—the proposed amendment would improve IFRSs by: • resolving a conflict between existing requirements of IFRSs and providing a straightforward rationale for which existing requirement should be applied, or • addressing an oversight or relatively minor unintended consequence of the existing requirements of IFRSs. A correcting amendment does not propose a new principle or a change to an existing principle, but may create an exception from an existing principle.	✔ Updating IAS 1 to be consistent with the *Conceptual Framework* will ensure that preparers and the Board will be applying the same concepts with the same meaning and words. ✔
3) The proposed amendment has a narrow and well-defined purpose, ie the consequences of the proposed change have been considered sufficiently and identified.	✔
4) It is probable that the IASB will reach conclusion on the issue on a timely basis. Inability to reach agreement on a timely basis may indicate that the cause of the issue is more fundamental than can be resolved within annual improvements.	✔

Criteria	Yes?
5) If the proposed amendment would amend IFRSs that are the subject of a current or planned IASB project, there must be a pressing need to make the amendment sooner than the project would.	Although there is a financial statement presentation project, the Board is, for the next six months, focusing on the four MOU projects and issues arising from the annual improvements. We think that addressing the issues discussed via an annual improvements is faster than amending IAS 1 via the financial statement presentation project.

Appendix B
Other drafting consequences for options (a) and (c)

Option (a) Remove any reference to the* Framework *and retain the existing objective of financial statements in IAS 1

Paragraph 19	In the extremely rare circumstances in which management concludes that compliance with a requirement in an IFRS would be so misleading that it would conflict with the objective of financial statements set out in ~~the *Framework*~~ paragraph 9, the entity shall depart from that requirement in the manner set out in paragraph 20 if the relevant regulatory framework requires, or otherwise does not prohibit, such a departure.
Paragraph 20(c)	the title of the IFRS from which the entity has departed, the nature of the departure, including the treatment that the IFRS would require, the reason why that treatment would be so misleading in the circumstances that it would conflict with the objective of financial statements set out in ~~the *Framework*~~ paragraph 9, and the treatment adopted […].
Paragraphs 23 and 23(a)	In the extremely rare circumstances in which management concludes that compliance with a requirement in an IFRS would be so misleading that it would conflict with the objective of financial statements set out in ~~the *Framework*~~ paragraph 9, but the relevant regulatory framework prohibits departure from the requirement, the entity shall, to the maximum extent possible, reduce the perceived misleading aspects of compliance by disclosing: (a) the title of the IFRS in question, the nature of the requirement, and the reason why management has concluded that complying with that requirement is so misleading in the circumstances that it conflicts with the objective of financial statements set out in ~~the *Framework*~~ paragraph 9 […].
Paragraphs 24 and 24(b)	[…] When assessing whether complying with a specific requirement in an IFRS would be so misleading that it would conflict with the objective of financial statements set out in ~~the *Framework*~~ paragraph 9, management considers: […] (b) how the entity's circumstances differ from those of other entities that comply with the requirement. If other entities in similar circumstances comply with the requirement, there is a rebuttable presumption that the entity's compliance with the requirement would not be so misleading that it would conflict with the objective of financial statements set out in ~~the *Framework*~~ paragraph 9.

Staff Recommendation – option (c) Update IAS 1

Paragraph 19	In the extremely rare circumstances in which management concludes that compliance with a requirement in an IFRS would be so misleading that it would conflict with the objective of general purpose financial reporting ~~statements~~ set out in the *Conceptual Framework*, the entity shall depart from that requirement in the manner set out in paragraph 20 if the relevant regulatory framework requires, or otherwise does not prohibit, such a departure.
Paragraph 20(c)	the title of the IFRS from which the entity has departed, the nature of the departure, including the treatment that the IFRS would require, the reason why that treatment would be so misleading in the circumstances that it would conflict with the objective of general purpose financial reporting ~~statements~~ set out in the *Conceptual Framework*, and the treatment adopted […].
Paragraph 20(c)	the title of the IFRS from which the entity has departed, the nature of the departure, including the treatment that the IFRS would require, the reason why that treatment would be so misleading in the circumstances that it would conflict with the objective of general purpose financial reporting ~~statements~~ set out in the *Conceptual Framework*, and the treatment adopted […].
Paragraphs 23 and 23(a)	In the extremely rare circumstances in which management concludes that compliance with a requirement in an IFRS would be so misleading that it would conflict with the objective of general purpose financial reporting ~~statements~~ set out in the *Conceptual Framework*, but the relevant regulatory framework prohibits departure from the requirement, the entity shall, to the maximum extent possible, reduce the perceived misleading aspects of compliance by disclosing: (a) the title of the IFRS in question, the nature of the requirement, and the reason why management has concluded that complying with that requirement is so misleading in the circumstances that it conflicts with the objective of general purpose financial reporting ~~statements~~ set out in the *Conceptual Framework* […].
Paragraphs 24 and 24(b)	[…] When assessing whether complying with a specific requirement in an IFRS would be so misleading that it would conflict with the objective of general purpose financial reporting ~~statements~~ set out in the *Conceptual Framework*, management considers: […] (b) how the entity's circumstances differ from those of other entities that comply with the requirement. If other entities in similar circumstances comply with the requirement, there is a rebuttable presumption that the entity's compliance with the requirement would not be so misleading that it would conflict with the objective of general purpose financial reporting ~~statements~~ set out in the *Conceptual Framework*.