STAFF PAPER

December 2014

IASB meeting

Project	Disclosure Initiative – Principles of Disclosure		
Paper topic	Cohesiveness in financial statements		
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Purpose of this paper

1. The Financial Statement Presentation (FSP) project developed a concept of *cohesiveness* which, as a general concept, was widely supported. This is because presenting information cohesively, ie structured in a consistent way across financial statements, highlights relationships between items of information, making the statements as a whole more understandable. However, the way the FSP project proposed applying cohesiveness in conjunction with a disaggregation principle was more controversial.

2. As part of the Principles of Disclosure project we are considering if and how a principle on cohesiveness should be included in a general disclosure Standard. The purpose of this paper is to seek the IASB's views on whether, as part of the Disclosure Initiative, the IASB should propose amending IFRS to include guidance for making information more cohesive across a complete set of financial statements.

Summary of staff recommendation

3. Our recommendation is that:

   (a) the concepts underlying cohesiveness should be included in the communication principle on linking information in IFRS financial statements; and

   (b) any changes to IFRS coming from the Disclosure Initiative should not include a separate principle requiring cohesiveness across a complete set of financial statements.

   Note: A consequence is that cohesiveness would not be described as a separate principle and nor would the term be used.

Scope of this paper

4. During the development of the FSP project, most discussions about cohesiveness focused on the presentation of line items and subtotals in the statement of profit or loss and other comprehensive income, the statement of cash flows and the statement of financial position (see paragraphs 10–13). The Principles of Disclosure project is not considering how these statements should be structured. Our focus is on considering disclosure principles that can be applied to financial statements as a whole, including disclosure in the notes.

Background

What we have heard

5. An analysis of the feedback on the FSP proposals and our consultations in the Disclosure Initiative provided consistent messages that most preparers and users of financial statements think that the clarity of the relationships between items of information in different parts of the financial statements can enhance the understandability of the financial statements as a whole. In this regard, we note the following comments from our constituents:

   (a) CFA Institute in its report, *Financial Reporting Disclosures*, stated:

> Improved cohesiveness of balances within and among the basic financial statements would improve the usefulness of financial statements by allowing investors to see the flow of transactions across the balance sheet, income statement, and statement of cash flows. Increased cohesiveness is likely to lead to the need for fewer disclosures because the necessary transparency and underlying relationships between balances that produce the financial results will be more obvious to investors.[1]

(b) the Committee of European Securities Regulators (CESR) in its response to EFRAG's consultation regarding the IASB's Discussion Paper *Preliminary views on Financial Statements Presentation* made the following comment:

> CESR believes that the objective of cohesiveness is a good one which will result in greater consistency in presentation in financial statements. Like EFRAG, CESR has however identified several cases where applying the cohesiveness principle may be difficult in practice …[2]

(c) the following comment was made, in the memo to the members of IPSASB in the IFAC/IPSASB meeting, related to cohesiveness:

> The cohesiveness principle logically is a subset of the integration principle; a type of integration that can be applied to the traditional financial statements, because of their close relationships with each other. Cohesiveness involves the use of consistent labelling and ordering of items across the different financial statements, using labels that relate to the entity's activities. This provides scope to enhance the usefulness and understandability of the financial statements. Such consistent labelling and

[1] Page 84, *Financial Reporting Disclosures*, CFA Institute, 2013.

[2] Page 1, CESR's response to EFRAG's consultation regarding the IASB's Discussion Paper, 2009.

ordering provides a more cohesive set of information about an entity's financial performance.[3]

(d) in the November 2014 meeting of the Global Preparers Forum (GPF), the members supported including a communication principle in IFRS to promote the linkage of information in financial statements, including the notes. However, some of the members suggested that the IASB should be cautious on how prescriptively that principle is applied.

6. In December 2014 the IASB will publish amendments to IAS 1 relating to how notes to the financial statements can be structured/presented in a systematic manner. The amendments include examples of how an entity could systematically order or group the notes. The feedback received in response to the Exposure Draft indicated that the proposals allow entities to present information together in a cohesive manner.

IFRS guidance

Current and proposed IFRS

7. IFRS already provides some guidance on the structure, order and format of financial statements. For example, paragraphs 54 and 82 of IAS 1 *Presentation of Financial Statements* require the presentation of specified line items in the statements of financial position and comprehensive income respectively. Paragraph 60 of IAS 1 requires current assets/liabilities and non-current assets/liabilities to be separately presented in the statement of financial position, except when a presentation based on liquidity provides information that is reliable and more relevant.

8. Among December 2014 amendments to IAS 1 are changes to:

(a) clarify that an entity should use its judgement when determining how to present its notes in a systematic manner; and

(b) provide examples of systematic ordering or grouping of the notes including:

[3] Paragraph 3.33, Agenda Item 2D, IFAC/IPSASB meeting, November 2010.

(i) giving prominence to the areas of its activities that the entity considers to be most relevant to an understanding of its financial performance and financial position, such as grouping together information about particular operating activities;

(ii) grouping together information about items that are measured similarly such as assets measured at fair value; or

(iii) following the order of the line items in its statement(s) of profit or loss and other comprehensive income and statement of financial position.[4]

Conceptual Framework

9. In the Discussion Paper on the *Conceptual Framework* (the 'CF DP') the IASB noted the following about the relationships between items in the 'primary financial statements':[5]

> 7.31 No primary financial statement has primacy over the other primary statements and they should be looked at together. The way items are presented in primary financial statements helps users of financial statements to take an overall view of an entity's financial position and performance. This is easier to achieve if relationships between the statements and among items presented in them are made clear.

FSP project

10. In the *Staff Draft of Exposure Draft to Financial Statements Presentation* (the 'FSP Staff Draft') the principle of cohesiveness is described as follows: [6]

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[4] The amendments are being made to paragraphs 113 and 114 of IAS 1.

[5] The CF DP defined primary financial statements as the statement of financial position, the statement(s) of profit or loss and other comprehensive income, the statement of cash flows and the statement of changes in equity.

[6] Paragraphs 57–58, Staff Draft of Exposure Draft to Financial Statements Presentation, July 2010.

> 57 An entity shall present information in its financial statements so that the relationship among items across the financial statements is clear.
>
> 58 To present a cohesive set of financial statements, an entity shall present disaggregated information in the sections, categories and subcategory in the statements of financial position, comprehensive income and cash flows in a manner that is consistent across those three statements.

11. However, the principle of cohesiveness is often associated with how the FSP Staff Draft proposed to apply it in conjunction with its proposals on disaggregation, ie:
    (a) disaggregation (organisation into defined sections, categories and subcategories based on an entity's business and financing activities); and
    (b) cohesiveness (consistent labelling and ordering of sections, categories and subcategories across the statements).
12. For further details about the proposals in the FSP project, please see Appendix A.
13. The FSP Staff Draft proposals about cohesiveness were widely supported by users who clearly indicated that the financial statement would be more useful if they were aligned by sections and categories. Most preparers also expressed support for the cohesiveness principle and the distinction between operating and financing activities. However, many of the respondents had significant concerns about other aspects of these proposals, including:
    (a) the planned structuring of profit or loss into prescribed sections, categories and subcategories was perceived as being too prescriptive; and
    (b) the application of the cohesiveness principle across all the primary financial statements (combined with the profit or loss structure) was perceived as being severe and necessitating a direct cash flows statement and leading to a statement of financial position that, for many, was counterintuitive.

Staff Analysis

What do we mean by 'cohesiveness'?

14. The FSP Staff Draft (see paragraph 10) used the term cohesiveness to refer to the grouping, labelling and ordering of information across financial statements on a consistent basis. We use the term with the same meaning in this paper.

Why make financial statements cohesive?

15. In the process of preparing a complete set of financial statements, an entity will consider how to aggregate and structure information about individual transactions and events. The way the information is structured and organised (ordered, grouped or labelled) helps to communicate information about an entity's financial position or performance. When information is ordered, grouped or labelled consistently across different parts of the financial statements, it can help make the relationships between the information in different parts easier to understand. This is because information that is presented cohesively:

    (a) associates related information across different parts of the financial statements;

    (b) makes different parts of the financial statements complement each other better, ie the different parts are more integrated;

    (c) brings consistency to the way information is presented—lack of consistency makes it difficult for a user of financial statements to compare information in different parts of the financial statements;

    (d) may result in useful information being segregated and presented separately;

    (e) may make the effect of particular transactions and events across the different components of the financial statements more visible; and

    (f) may reduce redundant/irrelevant information that can arise when related information is otherwise disclosed separately.

16. However, as feedback received as part of the FSP project highlights, if the concept of cohesiveness is applied too strictly it may mean that relevant ways to display information in one part of the financial statements could be sacrificed in favour of consistency with another part of the financial statements. This could result in the disclosure of less relevant information. For example, if line items and subtotals in the statement of financial position are presented on the basis of an entity's activities, eg operating, investing and financing, an entity has foregone the opportunity to present line items on the basis of current/non-current or liquidity (see paragraph 60 of IAS 1, which permits such a presentation). Some may see liquidity or current/non-current information in the statement of financial position as more relevant than an activity-based classification.

Should IFRS include a principle on cohesiveness?

17. If IFRS includes a general principle on cohesiveness we think such guidance could be either:

    (a) a principle in a disclosure Standard that **requires** an entity to structure and organise information in the financial statements in a cohesive manner. The basis for such structuring and organising information would either be determined by the entity or specified in IFRS.

    (b) As part of a communication principle in a disclosure Standard that explains to preparers the advantages of presenting information in a structured and cohesive manner, with examples of how information can be structured and organised.

18. Each of these options is discussed below.

A requirement

19. In this option, IFRS would include guidance that requires an entity to structure and organise (group, label and order) information in its financial statements in a cohesive manner. IFRS would need to specify what components of the financial statements should be displayed cohesively. Likewise, the basis for the consistent structure would need to be determined by the entity or specified in IFRS.

20. If the IASB wanted to introduce a requirement to make information cohesive across financial statements we think this work would need to start with how information should be presented in the primary financial statements and in particular the statement of comprehensive income. This is beyond the scope of the work we are undertaking in the Principles of Disclosure Project. The structure of these would be more appropriately considered as part of the IASB's research project on performance reporting.

A communication principle

21. In its October 2014 meeting the IASB discussed whether IFRS should include a set of communication principles, based on the qualitative characteristics of understandability, comparability and faithful representation.[7] One of these principles related to highlighting the relationships between information, specifically:

> [Entities should make disclosures that] are linked. Disclosures should highlight the relationships between information within the financial statements and other parts of the financial report. For example, relationships can be highlighted by use of cross-referencing, grouping of disclosures and by hyperlinks. Relationships can also be highlighted through consistent use of terminology in different sections of the financial report.[8]

22. We think this principle is consistent with the concept of cohesiveness developed in the FSP project, ie an entity shall present information in its financial statements so that the relationship among items across the financial statements is clear (see paragraph 10).

23. We think that this communication principle would, if developed as part of IFRS, provide a principle that directly relates to highlighting relationships between information within the financial statements.

[7] Agenda Paper 11A(b), IASB meeting, October 2014.

[8] Paragraph 34(a)(v), AP11A(b), IASB meeting, October 2014.

24. In order to deal more directly with cohesiveness, we recommend expanding the last sentence of the principle to state:

> Relationships can also be highlighted through consistent use of terminology, <u>grouping and ordering</u> in different sections of the financial report. <u>Highlighting relationships between information within the financial statements and other parts of the financial report makes such statements and reports more understandable.</u>
>
> [amendments underlined]

25. In addition, illustrative examples could be provided to show the different ways in which statements could be presented cohesively.

26. We think that a principle that explains why cohesiveness improves financial statements has the following advantages over a requirement:

    (a) preparers can use their judgement to determine whether cohesiveness enhances the understandability of its financial statements based on its individual facts and circumstances; and

    (b) responds to the aims of the cohesiveness principle developed in the FSP project, which received broad support.

27. The main disadvantage of not being prescriptive on cohesiveness could be that information may not be comparable across entities if entities develop distinct methods of displaying information in the financial statements.

Communication principle—notes to the financial statements

28. The FSP project focused on the main financial statements, and not the accompanying notes. The IAS 1 Amendments will clarify that an entity should use its judgement when determining how to present its notes in a systematic manner, including how they should be grouped and ordered (see paragraph 8). We think that these amendments will complement a communication principle dealing with the consistent grouping and ordering of information across financial statements in a cohesive way. This is because we think grouping and ordering notes to achieve a cohesive presentation across different parts of the financial statements is a systematic basis for the purposes of paragraph 113 of IAS 1.

29. Thus both the IAS 1 Amendments and the communication principles work together to enable an entity to group or order the notes in a systematic and cohesive way to effectively communicate information about its financial position and financial performance. The IAS 1 Amendments provide good examples about how this might be done.

30. We also think that the flexibility in ordering and grouping the notes described in the IAS 1 Amendments will also enable an entity to determine how it responds to any developments about cohesiveness within the primary financial statements that may come out of the Performance Reporting project.

31. Given that we think that the purpose of the notes is to further explain and supplement the primary financial statements an entity may determine that flowing the structure presented in those statements through to the notes makes the financial statements as a whole more understandable.

32. We therefore do not think that we need to provide any further guidance in IFRS about how the principle of cohesiveness should be applied to the notes.

Staff Recommendation

33. The staff recommends that:

    (a) the principle of cohesiveness should be included in the communication principle on linking information in IFRS financial statements; and

    (b) any changes to IFRS coming from the Disclosure Initiative should not include a separate principle requiring cohesiveness across a complete set of financial statements

Questions
Does the IASB agree with the staff recommendations in paragraph 33?

Appendix A—Cohesiveness in the FSP project

Cohesiveness principle

A1. The core principle of the FSP project was the premise that disaggregation and cohesiveness principles work together to enhance the understandability of an entity's financial statement information. The aim of the cohesiveness principle, in the FSP project, was to clarify the relationship between items across financial statements and to have an entity's financial statements complement each other as much as possible.

A2. The cohesiveness principle required an entity to present information in its financial statements so that the relationship among items across the financial statements is clear. In order to present a cohesive set of financial statements, an entity would have been required to present disaggregated information in the sections, categories and subcategory in the statements of financial position, comprehensive income and cash flows in a manner that is consistent across those three statements.

A3. The FSP project prescribed the sections, categories and subcategories as given below:

(a) a business section, containing:
  (i) an operating category:
    (1) an operating finance subcategory.
  (ii) an investing category.
(b) a financing section, containing:
  (i) a debt category; and
  (ii) an equity category.
(c) an income tax section.
(d) a discontinued operation section.
(e) a multi-category transaction section.

Feedback on cohesiveness principle

A4. The IASB/FASB staff conducted an outreach related to the FSP project wherein the staff heard views on cohesiveness and categorisations. In relation to cohesiveness the following was noted:[9]

(a) the cohesiveness principle was widely supported by users, who clearly indicated that more useful information would be available if financial statements are aligned by sections and categories. Some of the benefits cited by analysts are:

(i) the linkage across the financial statements and greater line item disaggregation caused by new categorisation would result in useful information; and

(ii) the presentation could lead to new performance measurements based on net operating returns and assets.

(b) most preparers expressed support for the cohesiveness principle and the distinction between operating and financing activities. Some preparers and users raised concerns regarding the complexity and readability of the statement of financial position.

(c) some preparers voiced concerns about the relative loss of flexibility in the classification of items as given in the staff draft.

[9] Appendix E, IASB Agenda Reference 1: Outreach Summary and Project Direction, March 2011.