STAFF PAPER

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IASB meeting

Project	**Disclosure Initiative – Principles of Disclosure**		
Paper topic	Role of financial statements excluding the notes		
CONTACT(S)	Prahalad Halgeri	phalgeri@ifrs.org	+44 (0)20 7246 6905
	Kristy Robinson	krobinson@ifrs.org	+44 (0)20 7246 6933

Purpose of this paper

1. This paper continues on from our discussions with the IASB in its meeting in October 2014 regarding the role of [primary] financial statements and the notes.[1] This paper focuses on financial statements excluding the notes (referred to as the 'Statements') but does not deal with the contents of those Statements or the notes.
2. The purpose of this paper is to obtain the views of the IASB on:
   (a) describing the set of Statements as 'primary financial statements' and clarifying the use of terms—'present' and 'disclose' and 'on the face' and 'in the notes';
   (b) the role of the set of Statements;
   (c) the implications of an individual statement being part of the set of Statements, including who should determine what individual statements make up that that set; and
   (d) which individual statements should comprise the set of Statements?

[1] Agenda Paper 11A(a). IASB meeting, October 2014.

Background

IFRS guidance

Current IFRS

3. Paragraph 10 of IAS 1 *Presentation of Financial Statements* specifies that a complete set of financial statements comprises:

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

   (b) a statement of profit or loss and other 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;

   (ea) comparative information in respect of the preceding period; and

   (f) a statement of financial position as at the beginning of the preceding 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.

4. Statements of financial position, profit or loss and other comprehensive income, changes in equity and cash flows as mentioned in (a)–(d) in paragraph 3 are considered as forming the set of the Statements.

Conceptual Framework

5. As part of the revision of the *Conceptual Framework* the IASB has decided to add a new chapter on presentation and disclosure. In July 2014 the IASB made some tentative decisions that the staff think are relevant to this paper, namely that the *Conceptual Framework* Exposure Draft should:

(a) not introduce the notion of primary financial statements that had been proposed in the *Conceptual Framework* Discussion Paper (the 'CF DP').

(b) state that the objective of financial statements is to provide information about an entity's assets, liabilities, equity, income and expenses that is useful to users of financial statements in assessing the prospects for future net cash inflows to the entity and in assessing management's stewardship of the entity's resources. As a result, financial statements provide information about the financial position, financial performance and cash flows of an entity.

(c) not define elements for the statement of changes in equity and for the statement of cash flows. Thus, the only elements would continue to be assets, liabilities, equity, income and expenses.

6. The CF DP explained the use of the terms presentation and disclosure as:

> In this Discussion Paper, we have used the term 'presentation' as meaning the disclosure of financial information on the face of an entity's primary financial statements.[2]
>
> 'Disclosure' has a broader meaning than presentation. Disclosure is the process of providing useful financial information about the reporting entity to users. The financial statements, including the amounts and descriptions presented in the primary financial statements and the information included in the notes to the financial statements, are, as a whole, a form of disclosure.[3]

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[2] Paragraph 7.10 of the Discussion Paper *A Review of the Conceptual Framework for Financial Reporting* published in July 2013.

[3] Paragraph 7.11 of the Discussion Paper *A Review of the Conceptual Framework for Financial Reporting* published in July 2013.

Discussion with the Accounting Standards Advisory Forum

7. In September 2014, the Accounting Standards Advisory Forum (ASAF) discussed the purposes of primary financial statements and the notes.[4] We think some of the views, as given below, expressed in that discussion are relevant for this paper:

   (a) the notes and the [primary] financial statements should have different purposes, because the primary financial statements show summarised and prominent information.

   (b) the usefulness of information should be considered as a whole and there should be no difference in the importance given to either the primary financial statements or the notes.

   (c) the notes are extensions of the primary financial statements. It was suggested not to have primary financial statements as a term and use only financial statements.

Discussion with the IASB

8. At its October 2014 meeting the IASB discussed the role of primary financial statements and the notes.[5] We think some of the views expressed in that meeting are relevant for this paper:

   (a) the members generally agreed that the financial statements excluding the notes and the notes have distinct roles;

   (b) the information in the notes does not carry the same visibility as the information in the financial statements excluding the notes (ie on the face of the financial statements);

   (c) the IASB cautioned the staff on introducing new terminology that is hitherto not used; and

   (d) the members thought the term primary financial statements is generally well understood by all constituents.

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[4] Agenda paper 4A. ASAF meeting, September 2014.

[5] Agenda Paper 11A(a). IASB meeting, October 2014.

Staff analysis

9. For the purpose of our analysis we have categorised the relevant issues about the Statements into the following sections:

   (a) terminology (paragraphs 10–27);

   (b) materiality (paragraphs 28–36); and

   (c) what the set of Statements is (paragraphs 37–47).

Terminology

What is the problem?

10. We think there are two main problems with respect to terminology.

11. The first problem is that inconsistent terminology used to describe the set of Statements causes confusion in the application of IFRS, especially IAS 1 *Presentation of Financial Statements*. For example, when the set of Statements is referred to as financial statements, it is often not clear whether reference is being made to the set of Statements or the complete set of financial statements (ie including the notes). This problem is mainly due to the fact that we do not have a term to describe the set of Statements that can be consistently used by all constituents, including the IASB.

12. In this context we refer to the *Disclosure Initiative* (Amendments to IAS 1), issued in December 2014, which describes how this confusion can have implications in practice. Specifically, we think that the clarity around the use of the term 'financial statements' in paragraph 30 of IAS 1 may have contributed the following misinterpretation:

> Some think that the statement in IAS 1 that an entity need not provide a specific disclosure if the information is not material means that an entity does not need to present an item in the statement(s) of profit or loss and other comprehensive income, the statement of financial position, the statement of cash flows and the statement of changes in equity, but must instead

disclose it in the notes. However, the Board noted that the concept of materiality is applicable to financial statements, which include the notes, and not only to those statements.[6]

13. The second problem is that there is no descriptor that consistently describes where information should be disclosed in a complete set of financial statements. This problem is exacerbated by the fact that there is no clear way to differentiate between the Statements and a complete set of financial statements.

14. Sometimes, 'present' and 'disclose' are used to describe where to display information. However, these terms are not always used consistently in this way in IFRS. Although the terms present and disclose are neither described in IFRS nor explained when and where they should be used, confusion arises because:

    (a) a specific meaning is being implied inconsistently in IFRS; and

    (b) that specific meaning is different from the way that they are used in the English language.

Terminology to describe the set of Statements

15. We think the problem described in paragraph 11 could be addressed by giving a specific term to describe the set of Statements that could assist all constituents, including the IASB and the staff in drafting presentation and disclosure requirements in Standards.

16. We have considered various alternative terms to describe the set of Statements including the following:

    (a) primary financial statements;

    (b) statements;

    (c) main financial statements;

    (d) summary statements; and

    (e) set of Statements.

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6 Paragraph BC30B of the *Disclosure Initiative* (Amendments to IAS 1) issued in December 2014.

17. Having considered all the available alternatives, we think that the term primary financial statements is the most suitable terminology to refer to a set of Statements, because it is generally well understood and commonly used in the context of IFRS financial statements. If a new term that is hitherto not used in the context of IFRS financial statements is introduced, it could be confusing and take a long time to get acceptability among all users, preparers, regulators etc.

18. However, some have concerns about using the term primary financial statements. These concerns generally stem from a view that the term implies a level of superiority. Those with this concern do not think that information in the primary financial statements should be construed as of higher quality and more important than information in other statements or in the notes.

19. We are of the view that explaining the meaning of the term primary financial statements in IAS 1 (or equivalent) can help to mitigate these concerns. Such an explanation could include:

    (a) the description is appropriate because the individual statements forming part of the primary financial statements provide the essential information that serves as an index/signpost to the supporting information in the notes. It means that these Statements are a starting point for a review or analysis of the entity.

    (b) reiterating that using primary financial statements to describe the set of Statements does not mean that other statements are secondary or inferior.

    (c) it also does not mean that the quality of information in other information is lower than that of the primary financial statements or is less useful/important than the information in the primary financial statements.

20. In the rest of this paper we have used the term primary financial statements to describe the set of Statements. We think that using this term helps address other issues described in paragraph 9.

Descriptors for where to disclose

21. As explained in paragraphs 13–14, the other issue we have identified regarding terminology and the Statements relates to not having a descriptor to differentiate where to disclose information in a complete set of financial statements.

22. We note that the terms *present* and *disclose* were originally intended as descriptors for where to display information but are sometimes used in different ways. A few examples of how these two terms are used in IFRS are given below:

    (a) sometimes, present refers to disclosure as a line item, subtotal or total on the face of a financial statement (for example, profit or loss section or the statement of profit or loss shall include line items that present revenue, finance costs etc.);

    (b) other times, present refers to how something is disclosed (for example, presentation of information in a tabular format);

    (c) sometimes, disclose refers to the display of information in the notes to the financial statements (for example, disclosure in the notes to the financial statements to show further sub-classifications of the line items presented); and

    (d) other times, disclose means providing information anywhere in the financial statements.

23. The question that has to be considered is whether we even need descriptors (ie present and disclose) to differentiate where to disclose information.

24. Present and disclose are terms with a common meaning in the English language. Using these terms in IFRS to indicate the location of information may not be consistent with their common English language meaning and could therefore be confusing.

25. Furthermore, we think that it is not necessary to distinguish between the terms present and disclose if the location of where to display information is clearly identified, ie disclosure of information in the primary financial statements or disclosure in the notes to the financial statements.

26. Alternatively, if it is considered necessary to describe and distinguish between present and disclose, the following approaches could be followed:

    (a) use the term present in the context of displaying items that are recognised elements in the financial statements (for example, presenting property, plant and equipment in the statement of financial position or notes information) and use disclose in all other cases;

    (b) use present in the context of displaying information in the primary financial statements and disclose when displaying information in the notes to the financial statements; or

    (c) use present when displaying quantitative information and disclose in other cases.

Staff recommendation

27. The staff recommends that

    (a) the IASB should describe financial statements excluding the notes as primary financial statements with explanations of what it means (as discussed in paragraphs 15–20).

    (b) the terms present and disclose should not be used in IFRS to denote where information is displayed in a complete set of financial statements for the reasons described in paragraphs 21–26. In our view, based on a decision about the terminology used to describe the financial statements excluding the notes (see paragraph 27(a)), reference to disclosure in either the primary financial statements or in the notes is preferable.

Materiality

What is the problem?

28. In the context of primary financial statements, we think that the main problem is the decision about what makes the information important enough to be displayed 'on the face' (ie in the primary financial statements) or 'in the notes', and what makes an individual statement important enough to be presented as one of the primary financial statements.

29. We also note that presentation and disclosure requirements in some Standards give a choice about where to place information. We think that having clarity on the role of primary financial statements and the notes could minimise the need for such placement choices in individual Standards. An example of a disclosure requirement, with placement choice, is the choice of presenting analysis in the notes or in the statement of comprehensive income.[7]

30. Before we address these issues, we think it is important to understand the role of primary financial statements and the implications of a statement becoming part of the set of primary financial statements.

Role of primary financial statements

31. Based on the IASB's discussions at its October 2014 meeting, we think that primary financial statements and their role in meeting the objective of financial statements can be described as follows:

    (a) the primary financial statements are a structured and comparable summary of information about an entity's recognised assets, liabilities, equity, income and expenses; and

    (b) their role in meeting the objective of financial statements is to provide information that is necessary to give an overview of the financial position and performance of an entity that is useful for:

        (i) obtaining essential information about the assets, liabilities, equity, income and expenses;

        (ii) making rudimentary comparisions between entities and reporting periods; and/or

        (iii) identifying areas of particular interest within a complete set of financial statements for which an investor could necessarily expect to find additional information in the notes.

[7] See paragraph 33(b) of IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*.

Implications of being a primary financial statement

32. We think there are some implications when a particular statement is seen as a primary financial statement. The implications include the following:

(a) when a Statement is included as part of the primary financial statements it is presented before the notes in order to provide an overview of the financial information. Since the individual statements forming part of the primary financial statements are presented ahead of the notes, primary financial statements get greater visibility.

(b) it is presumed that each primary financial statement is required to be disclosed in a complete set of financial statements, ie materiality cannot be used to determine whether individual primary financial statements should be disclosed.

(c) all items recognised in the balance sheet or the income statement are depicted in words or by a monetary amount and included in the balance sheet or the income statement totals.[8] Similarly, as primary financial statements are a structured summary, items presented in other statements forming part of the primary financial statements are also included in the totals for that statement.

(d) because the primary financial statements have a distinct and different role/purpose in meeting the objective of financial statements from the notes, a decision on whether information is material must be based on that specific role/purpose. It means that an item that may not be material for the primary financial statements may be material for the notes. Specifically, since the pupose of the primary financial statements is to provide an overview or summary of information (about the recognised elements), the level of aggregation is higher than that applied to the notes. Consequently, a different (often higher) level of materiality threshold is applied while presenting information in the primary financial statements.

[8] See paragraph 4.37 of the *Conceptual Framework for Financial Reporting*.

33. Since comparability is a key characteristic of the primary financial statements, it is important that there is uniformity in terms of what individual statements make up the primary financial statements. Accordingly, we are of the view that only the IASB should decide which individual statements make up the primary financial statements.

Materiality in the context of primary financial statements

34. As part of the Disclosure Initiative project, the IASB is working on a materiality Practice Statement that would guide the preparers with the application of materiality.

35. We think that the Practice Statement combined with the clear understanding of the role of primary financial statements and the implications of being part of the primary financial statements would be helpful and sufficient in deciding whether information should be displayed on the face (ie primary financial statements) or in the notes.

Staff recommendation

36. The staff recommends that:

    (a) IAS 1 (or equivalent) should include a description of the role of primary financial statements based on our discussion in paragraph 31.

    (b) IAS 1 (or equivalent) should include a description of the implications of a particular statement forming part of the primary financial statements based on our discussion in paragraph 32.

    (c) in order to provide an overview that is useful in providing a rudimentary comparison across entities, the decision as to which individual statements should be part of primary financial statements should be decided by the IASB as discussed in paragraph 33.

    (d) the Practice Statement being developed by the IASB should be useful to decide what information should be displayed in the primary financial statements and in the notes (see paragraph 34). Consequently, we think that no further work is required as part of this project.

What is a set of Statements?

What is the problem?

37. The discussion on terminology and materiality brings us to the main question regarding the primary financial statements, which is, what are these primary financial statements (ie what is a set of Statements?) or, in other words, which individual statements make up a set of primary financial statements?

38. We note differing views on what primary financial statements are and whether there is sufficient guidance in IFRS that specifies what primary financial statements are. For example:

    (a) some consider only the statements of financial position and profit or loss and comprehensive income as primary financials statements:

    (b) some others consider statements of financial position, profit or loss and comprehensive income and cash flows as primary financials statements; and

    (c) some would like to consider segment reporting as part the primary financial statements.

39. We do not think there is much of a debate about the statement of financial position and profit or loss and comprehensive income because these are generally considered as part of the primary financial statements.

40. We think that the problem about what individual statements make a set of primary financial statement can be addressed in two ways as discussed in the following paragraphs.

Current guidance is sufficient

41. One view is that the current guidance in IAS 1 (see paragraph 3) clearly specifies what constitutes primary financial statements and is well understood and applied in practice. Consequently, there is no need to revisit what the primary financial statements are.

42. According to this view, the statements of financial position, profit or loss and comprehensive income, cash flows and changes in equity together are referred to as primary financial statements.

43. If this view is followed, we think that the problem with respect to terminology and materiality can be addressed without revisiting the question about what the primary financial statements are. Providing further guidance in a general disclosure Standard on the following would be sufficient:

(a) terminology (ie primary financial statements as discussed in paragraph 17);

(b) the role of the primary financial statements as discussed in paragraph 31; and

(c) the implication of being part of the primary financial statements as discussed in paragraph 32.

Develop additional guidance

44. The other view is that the IASB could build on its work to develop additional guidance on the role of the primary financial statements and to introduce a term to describe them (as discussed in paragraph 17).

45. Additional guidance under this option would include:

(a) developing criteria in IAS 1 (or equivalent) that could be used to determine when a particular statement should form part of the primary financial statements. The criteria should be based on the role of primary financial statements as discussed in paragraph 31.

(b) a reassessment of the current set of primary financial statements as described in paragraph 42, using the criteria developed in paragraph 45(a) to reconfirm whether or not these should continue to form part of the primary financial statements. The conclusions of the reassessment may be explained in the IAS 1 (or equivalent) or in the Basis for Conclusions.

46. Even though considering the current IFRS guidance as sufficient is the simpler option, we think that developing additional guidance could have the following advantages:

(a) developing criteria, as described in paragraph 45(a), would be useful to the IASB and the staff in assessing if any other information or statement should be included as part of the primary financial statements, either in this project or in another project in the future (for example, a Performance Reporting project).

(b) a reassessment of the current set of Statements on the criteria developed to reconfirm our understanding of the current guidance in IFRS.

Staff recommendation

47. The staff recommends that:

(a) the IASB should develop additional guidance by describing criteria as discussed in paragraph 45(a) and perform a reassessment of the current set of primary financial statements as discussed in paragraph 45(b); and

(b) the IASB document the criteria and conclusions of the reassessment in a general disclosure Standard.

Summary of the staff recommendations:

48. The staff recommends that:

(a) the IASB should describe financial statements excluding the notes as primary financial statements with explanations of what they mean (see paragraph 27(a)).

(b) there is no need to include descriptors for where to display information and, therefore, there is no need to describe the terms present and disclose in IAS 1 (or equivalent) as discussed in paragraph 27(b).

(c) IAS 1 (or equivalent) should include a description of the role of primary financial statements based on our discussion in paragraph 36(a).

(d) IAS 1 (or equivalent) should include a description of the implications of a particular statement forming part of the primary financial statements based on our discussion in paragraph 36(b).

(e) in order to ensure uniformity in a set of primary financial statements, the decision as to which individual statements shall be part of the primary financial statements should be decided by the IASB as discussed in paragraph 36(c).

(f) the Practice Statement being developed by the IASB should be useful to decide what information should be displayed in the primary financial statements and in the notes. Consequently, no further work is required as part of this project (see paragraph 36(d)).

(g) the IASB should develop additional guidance by describing criteria as discussed in paragraph 47(a) and perform a reassessment of the current set of primary financial statements as discussed in paragraph 47(a), and document the criteria and conclusions of the reassessment in a general disclosure Standard (see paragraph 47(b)).

Question
Does the IASB agree with the staff's recommendations in paragraph 48?