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STAFF PAPER

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Project	**Disclosure Initiative: Materiality**		
Paper topic	Primary financial statements *versus* notes and aggregation / disaggregation of information		
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Purpose of this paper

1. This paper considers the comments received on the Exposure Draft and should be read together with Agenda Paper 11A *Materiality - Cover paper*. It asks the Board whether members want to change their guidance on the application of materiality to the primary financial statements[1] versus the notes and to the aggregation / disaggregation of information, in the light of the comments received.

Guidance proposed in the Exposure Draft

2. The 'Presentation and disclosure in the financial statements' section of the Exposure Draft stated that 'judgement on whether information is material should be made within the context of [the primary objective of financial statements] and by considering the complete set of financial statements (ie the primary financial statements together with the notes)' (paragraph 30 of the Exposure Draft).

3. The Exposure Draft explains that an entity should 'assess whether information is material within the context of the different parts of the financial statements, for example: whether and how information should be presented separately in the

[1] As acknowledged in footnote 7 of the Exposure Draft 'the term "primary financial statements" is expected to be defined as part of the Principles of Disclosure project'. For the purpose of this paper, as well as of the Exposure Draft, the primary financial statements are assumed to comprise the statement of financial position, statement of comprehensive income, statement of changes in equity and statement of cash flows.

primary financial statements, [and] whether and how information should be included in the notes' (see paragraph 32 of the Exposure Draft).

4. Regarding how information should be aggregated / disaggregated in the financial statements the Exposure Draft quoted the guidance of IAS 1 *Presentation of Financial Statements*:

> An entity shall present separately each material class of similar items. An entity shall present separately items of a dissimilar nature or function unless they are immaterial (paragraph 29 of IAS 1).

5. The Exposure Draft provided guidance on aggregation / disaggregation, stating that:

   (a) 'a line item in the primary financial statements [which] is not individually material… does not need to be disaggregated further, and… can be aggregated with other related or similar items even if IFRS prescribes separate presentation'; and

   (b) 'an item that is not material in the primary financial statements may warrant separate presentation in the notes' (paragraph 38 of the Exposure Draft).

6. When deciding whether to aggregate information, the Exposure Draft suggested that an entity should assess 'whether any information that would be "lost" through aggregation is material' (some examples were also provided, see paragraph 39 of the Exposure Draft).

7. The Exposure Draft also discussed the different objectives and roles of the primary financial statements versus the notes; this section (paragraphs 40–48 of the Exposure Draft) reflected the Board's initial thinking in its Principles of Disclosure project. The Appendix to this paper contains these paragraphs from the Exposure Draft.

8. Of particular relevance are:

> However, an item that is not material in the primary financial statements may warrant separate presentation in the notes (paragraph 38 of the Exposure Draft).

> Although the concept of materiality does not change when applied to the notes, the context in which that concept is applied is different (paragraph 46 of the Exposure Draft).
>
> Information that is material to the financial statements, but for which separate presentation in the primary financial statements is not material, is provided in the notes (paragraph 47 of the Exposure Draft).

Summary of the feedback

9. The guidance in the Exposure Draft prompted comments on:

   (a) whether there are different levels of materiality for the primary financial statements *versus* the notes;

   (b) the application of materiality in aggregating/disaggregating information in the financial statements; and

   (c) the examples provided in the Exposure Draft.

Different levels of materiality

10. Many respondents were concerned that the proposed guidance in the Exposure Draft might imply that different levels of materiality are applied to primary financial statements and to the notes.

11. One such view was expressed by the Australian Accounting Standards Board (AASB) in their comment letter (CL89[2]):

> … the statement in paragraph 46 [of the Exposure Draft] that when the concept of materiality is applied to the notes "the context in which that concept is applied is different", might be interpreted by some as implying that different levels of materiality are applied to primary financial statements and to the notes.

[2] The reference CLxx refers to the ID number assigned to the comment letter. The comment letters can be found at http://www.ifrs.org/Current-Projects/IASB-Projects/Disclosure-Initiative/Materiality/Exposure-Draft-October-2015/Pages/Comment-letter.aspx

12. Similar views were expressed by the Institute of Chartered Accountants in England and Wales (ICAEW) CL16 and the Accounting Methodological Centre (AMC) CL59.

13. In paragraph 30, the Exposure Draft stated that judgements on whether information is material should be made by considering the complete set of financial statements (ie the financial statements as a whole). Respondents asked the Board to clarify the differences in judgements, if any, that are needed in assessing materiality in the context of the primary financial statements compared with the notes. Respondents doubted whether 'the mere reference to the different roles of the primary financial statements and the notes provides sufficient guidance' (European Financial Reporting Advisory Group (EFRAG) CL92).

Aggregation and disaggregation

14. Practical guidance was also requested on the application of materiality to the aggregation and disaggregation of information; an area that 'without further clarification in the proposed guidance (…) will remain (…) of particular difficulty in practice' (Ernst & Young (EY) CL70).

15. Some respondents suggested the Board could consider:

> … some form of decision tree to illustrate how the concept of materiality applies to the different levels of the assessment: (a) information or line items that are individually material and warrant separate presentation either in the primary financial statements or in the notes; (b) information or line items that are not individually material, and can be aggregated with other items either in the primary financial statements or in the notes; and (c) information or line items that are not sufficiently material to warrant separate presentation in the primary financial statements, but may warrant separate presentation in the notes (RSM International Limited (RSM) CL42; a similar proposal was suggested in EFRAG's letter, CL92).

16. The Singapore Accounting Standards Council (Singapore ASC), CL93, said that:

> … entities are more likely to identify items for which separate presentation in the notes is clearly necessary, rather than to assess whether the remaining items are sufficiently similar not to be disaggregated. Therefore, unintended consequences could be avoided if disaggregation is assessed on the basis of whether items are sufficiently different to warrant separate presentation, with a residual approach for similar items.

17. These comments from Singapore ASC, together with our outreach, lead us to understand that entities are more likely to begin the preparation of financial statements with aggregated data and move on to assessing whether and how to disaggregate the data, rather than the other way around.

Examples

18. Finally, respondents had different views on the examples in the Exposure Draft on the aggregation / disaggregation of information. Some respondents, such as the International Organization of Securities Commissions (IOSCO) CL95, found that the examples provided were 'helpful and should be retained in the final guidance'. Other respondents considered them confusing and suggested either to remove them or to replace them with other 'clear-cut' examples.

Staff analysis

Single materiality assessment

19. We note that there is a single definition of materiality that refers to the relevance 'of the items to which the information relates in the context of an individual entity's financial report'[3]. Consequently in our view there is a single assessment of materiality, which should be applied to the financial statements as a whole (ie

[3] Paragraph QC11 of the Conceptual Framework for Financial Reporting (the *Conceptual Framework*).

primary financial statements together with the notes). This is consistent with the discussion set out in Agenda Paper 11D *The Materiality Process*[4].

20. The Board can therefore respond to the concerns raised about different levels of materiality by making clear that there is a single assessment of materiality that is made in the context of the financial statements as a whole.

Primary financial statements versus notes

21. Some respondents asked for clarity on the differences in judgements, if any, when assessing materiality in the context of primary financial statements compared with the notes. We recommend above that the Board should confirm that a single assessment of materiality is made in the context of the financial statements as a whole.

22. We describe in Agenda Paper 11D our view that the assessment of *where* material information should be disclosed in the financial statements (ie primary financial statements *versus* notes) is a question of how to organise the material information within the financial statements in a way that communicates the information efficiently and effectively. In other words, the question of where information should be presented in the financial statements is a matter of 'prominence' rather than 'materiality'.

23. The concept of 'prominence' will be referred to in guidance being developed by the Board in its Principles of Disclosure project. Furthermore, the different roles, contexts and objectives of the primary financial statements compared to the notes, as will be described in the Principles of Disclosure project, will help entities to decide whether an entity should present particular items of information separately in the primary financial statements, aggregate them with other information, or disclose them in the notes.

[4] The output of the first steps of the 'Materiality Process' described in Agenda Paper 11D is the identification of material information—whether to include information in the financial statements and how much detail about a particular transaction, other event or condition to include in the financial statements. The entity will use this materiality assessment to determine the amount of detail about a particular transaction, other event or condition *including the level of disaggregation* an entity would present in the financial statements.

Disaggregation versus aggregation

24. Some respondents requested specific guidance on the application of materiality to the aggregation and disaggregation of information. However, to determine the amount of detail about a particular transaction, other event or condition including the level of disaggregation an entity would present in the financial statements, the 'Materiality Process', as described in Agenda Paper 11D, should be applied. The first steps of the 'Materiality Process' lead an entity to decide whether to include information in the financial statements and how much detail about a particular transaction, other event or condition to include in the financial statements.

25. Our outreach leads us to understand that users of financial statements tend to analyse financial statements 'from the top down', in other words they think about how much disaggregation they want of the information in the financial statements, rather than thinking about how information can be aggregated. We suggest that the final IFRS Practice Statement: Application of Materiality to Financial Statements (the final *Practice Statement*) should approach the question of the level of detail needed from the perspective of how far to disaggregate aggregated information, rather than how far to aggregate detailed underlying information. This would also be consistent with how we understand many entities approach the preparation of financial statements, as explained in the Singapore ASC comment letter (CL93).

26. Using a single approach—describing this question consistently in the final *Practice Statement* from the perspective of how far to disaggregate information, should avoid the potential confusion for the reader of the final *Practice Statement*.

27. Nevertheless the final *Practice Statement* should acknowledge that according to IFRS Standards there is no preferred method, ie compilation from either an aggregation or a disaggregation perspective is acceptable and should give the same results if the same approach to assessing materiality is used.

Staff recommendation

28. We recommend that, in the final *Practice Statement*, the Board:

(a) states that a single assessment of materiality is applied to all information to be included in the financial statements. Materiality is not assessed differently for information that is presented in the primary financial statements from information that is disclosed in the notes to the financial statements.

(b) explains that the decision about where material information should be disclosed (ie primary financial statements *versus* notes) is a question of how to organise the material information within the financial statements in a way that communicates the information effectively and efficiently. Step 3 of the proposed 'Materiality Process' (see Agenda Paper 11D) provides guidance on the organisation of information in the financial statements. The Principles of Disclosure project will consider this issue further.

(c) describes the process of assessing the level of detail that needs to be included in an entity's financial statements from the perspective of assessing how far to disaggregate the entity's information. Determining how far to disaggregate aggregated information, or how far to aggregate information for inclusion in financial statements, should lead to the same conclusion. However, starting from the perspective of how far to disaggregate information is better aligned with how primary users tend to analyse an entity's financial statements.

Questions for the Board

Question 1—single materiality assessment
Do you agree that, in the final *Practice Statement*, the Board should state that a single assessment of materiality is applied to all information to be included in the financial statements?

Question 2—primary financial statements vs notes
Do you agree that, in the final *Practice Statement*, the Board should explain that the decision about where material information should be disclosed (ie primary financial statements *versus* notes) is a question of how to organise the material information within the financial statements in a way that communicates the information effectively and efficiently?

Question 3—disaggregation vs aggregation
Do you agree that, in the final *Practice Statement*, the Board should describe the process of assessing the level of detail that needs to be included in an entity's financial statements from the perspective of assessing how far to disaggregate the entity's information?

Appendix

Extract from the Exposure Draft

Primary financial statements versus the notes

Primary financial statements

40 The primary financial statements provide a structured summary of the entity's:

(a) recognised assets, liabilities, equity, income and expenses;
(b) cash flows; and
(c) contributions from, or distributions to, holders of equity claims.

41 The role of the primary financial statements in meeting the objective of financial statements is to provide information that gives an overview of the financial position and performance of an entity. Such an overview may be useful for the primary users as follows:

(a) obtaining essential information about the entity's assets, liabilities, equity, income, expenses, cash flows and contributions and distributions from/to holders of equity claims;
(b) understanding the past financial position and performance of the entity in order to forecast net cash inflows and to understand trends;
(c) making high-level comparisons between entities and reporting periods; and/or
(d) identifying areas of particular interest for which the user could expect to find additional information in the notes.[5]

42 When assessing which line items should be presented on the face of a primary financial statement, management considers how to provide a representative summary of the financial information of the entity—for example, it considers which items or classes of items should be presented separately because of their relative size or their nature. Management should also consider the degree of similarity or difference between individual line items when determining whether those items should be combined or presented separately.

43 Management considers whether an item is material by considering it relative to individual line items, subtotals and totals on the face of an individual statement, as well as to each overall individual statement. Management should also consider the relationships between each of the primary financial statements. When presenting line items, management should assess which items serve as useful signposts to link the face of the statements with the detail in the notes to help the primary users navigate through the financial statements.

44 If recognised items are not presented separately in the primary financial statements, then management considers how they should be aggregated with other items (see paragraphs 37–39).

[5] The guidance in paragraphs 41, 45 and 47 is drafted in line with the IASB's initial thinking during its Principles of Disclosure project—see paragraph BC21 of the Basis for Conclusions on this [draft] Practice Statement.

Notes

45 Because of their structure, the amount and type of detail that can be included in the primary financial statements is limited. The notes:

(a) explain the information presented in the primary financial statements in greater detail; and

(b) supplement the primary financial statements with additional information that is necessary to meet the objective of financial statements (see paragraph 30).[6]

46 Although the concept of materiality does not change when applied to the notes, the context in which that concept is applied is different. This is because the notes have a different role from the primary financial statements in meeting the objective of financial statements (see paragraphs 40–44). Consequently, this may result in different conclusions regarding whether information is material in the different contexts and whether further disaggregation in the notes is necessary compared to the face of a primary financial statement.

47 One of the main objectives of the notes, as an integral part of the financial statements, is to amplify and explain the items in the primary financial statements. Information that is material to the financial statements, but for which separate presentation in the primary financial statements is not material, is provided in the notes. Nevertheless, if information is material in the context of the primary financial statements then disclosure in the notes is not sufficient. For example, management may decide to present only a single amount for total revenue on the face of the statement of comprehensive income. In the notes management should disaggregate the amount and disclose further information, as appropriate, to enable the primary users to understand the nature, amount, timing and uncertainty of the revenue and related cash flows.[7]

48 In addition to amplifying and explaining the items in the primary financial statements, the notes also provide any other financial information that is necessary to meet the objective of financial statements (see paragraph 30) and could reasonably be expected to influence decisions of the primary users. Some information typically found in note disclosures does not relate to line items in the primary financial statements; such as material non-adjusting events after the balance sheet date. Furthermore, some information relates to items that are not recognised, such as contingent liabilities.

[6] The guidance in paragraphs 41, 45 and 47 is drafted in line with the IASB's initial thinking during its Principles of Disclosure project—see paragraph BC21 of this [draft] Practice Statement.

[7] The guidance in paragraphs 41, 45 and 47 is drafted in line with the IASB's initial thinking during its Principles of Disclosure project—see paragraph BC21 of this [draft] Practice Statement.