(a) if the range of possible outcomes is extremely wide and the likelihood of each outcome is exceptionally difficult to estimate: this might be the case in, for example, some major litigation.[38] In such cases, the most relevant information for users of financial statements might relate to the range of outcomes and the factors affecting their likelihoods. When that information is relevant (and can be provided at a cost that does not exceed the benefits), the entity should disclose that information, regardless of whether the entity also recognises the asset or the liability. However, in some cases, trying to capture that information in a single number as a measure for recognition in the statement of financial position may not provide any further relevant information.

(b) if an asset (or a liability) exists, but there is only a low probability that an inflow (or outflow) of economic benefits will result: in some such cases, the IASB might conclude that users of financial statements would be unlikely to include information about that inflow (or outflow) directly in their analysis. Moreover, in some such cases, measures of the resource or obligation may be exceptionally sensitive to small changes in the estimate of the probability and there may be little evidence to support such estimates.

(c) if identifying the resource or obligation is unusually difficult: for example, this may be the case for some intangible assets, particularly some of those that are generated internally instead of being acquired in a separate transaction.

(d) if measuring a resource or obligation requires unusually difficult or exceptionally subjective allocations of cash flows that do not relate solely to the item being measured.

(e) if recognising an asset is not necessary to meet the objective of financial reporting. As noted in paragraph 4.9(c) of this Discussion Paper, this is the case for internally generated goodwill.

4.27 To provide relevant information to users of financial statements, the IASB may need to require disclosure about unrecognised assets or unrecognised liabilities, including perhaps disclosure about the factors, specified by the IASB, that led the IASB to conclude that recognition is not appropriate for those assets or liabilities.

Derecognition

4.28 IFRS 9 *Financial Instruments* defines derecognition as the removal of a previously recognised financial asset or financial liability from an entity's statement of financial position.

4.29 The existing *Conceptual Framework* does not define derecognition and does not describe when derecognition should occur. Because there is no agreed conceptual approach to derecognition, different Standards have adopted different approaches. This risks causing inconsistency, with the further risk of adopting rule-based approaches rather than principle-based approaches.

38 Litigation may also be subject to existence uncertainty, as discussed in Section 2.

4.30 Paragraphs 4.31–4.51 deal with the following:

(a) consequences of derecognition (see paragraphs 4.31–4.33);

(b) the objective of derecognition (see paragraph 4.34);

(c) the control approach and the risks-and-rewards approach (see paragraphs 4.35–4.44);

(d) full or partial derecognition (see paragraphs 4.45–4.49); and

(e) summary of preliminary views on derecognition (see paragraphs 4.50–4.51).

Consequences of derecognition

4.31 Derecognition has the following consequences:

(a) the entity no longer recognises the previously recognised asset or liability;

(b) the entity may need to recognise other assets and liabilities that result from the transaction or other event that gave rise to the derecognition; and

(c) income or expense may arise from the derecognition of the previous asset or liability and the recognition of any new asset or liability.

4.32 As noted in Section 3, many economic resources comprise a bundle of rights. An entity would recognise, measure and present some of those rights separately if such separation results in the most relevant information, and if the benefits of the separation outweigh the costs. Similarly, when an entity transfers some rights associated with a resource and retains others, it would derecognise the rights that it no longer controls and continue to recognise the rights retained (ie the rights it still controls). For example, a lessor no longer controls the right of use transferred to the lessee but retains a residual interest in the underlying leased item. How an entity should account for the rights it retains in such cases is discussed in paragraphs 4.45–4.51 of this Discussion Paper.

4.33 When an asset or a liability is transferred between entities within a consolidated group (a parent and its subsidiaries), the asset or the liability is still an asset or a liability of the group as a whole. Accordingly, in consolidated financial statements, the group continues to recognise the asset or the liability.

Approaches to derecognition

4.34 The aim of accounting requirements for a transaction that may result in derecognition should be to represent faithfully both:

(a) the resources and obligations remaining after the transaction; and

(b) the changes in the resources and obligations as a result of the transaction.

4.35 Achieving those twin aims is straightforward if an entity disposes of an entire asset or an entire liability. In that case, derecognition represents faithfully two facts: that the entity no longer has rights and obligations relating to that item, and that a transaction or other event eliminated all the previous rights or obligations. Similarly, if an entity disposes of a proportion (say, 30 per cent) of all features of an asset, derecognition of that 30 per cent will represent faithfully that the entity retains 70 per cent of the asset and has disposed of 30 per cent of it.

4.36 However, achieving that twin aim is more difficult if the entity retains a component that exposes the entity disproportionately to the remaining risks or rewards arising from the previously recognised asset or liability. There are two approaches to derecognition in such cases:

(a) a control approach: derecognition is simply the mirror image of recognition. Thus, an entity would derecognise an asset or a liability when it no longer meets the criteria for recognition (or no longer exists, or is no longer an asset or a liability of the entity). This implies that the derecognition criteria for an asset would focus on the control of the asset (rather than on legal ownership or on risks and rewards) and the derecognition criteria for a liability would focus on whether the entity still has the liability.

(b) a risk-and-rewards approach: an entity should continue to recognise an asset or a liability until it is no longer exposed to most of the risks and rewards generated by that asset or liability, even if the remaining asset (or liability) would not qualify for recognition if acquired (or incurred) separately at the date when the entity disposed of the other components. Thus, whether an entity recognises an asset or a liability depends, in some circumstances, on whether the entity previously recognised that asset or liability. As a result, some use the labels 'history matters' or 'stickiness' for a risk-and-rewards approach.

4.37 Proponents of a control approach argue that it treats identical rights or obligations in the same way, regardless of whether they were recognised previously. Doing so may result in financial statements that depict an entity's economic resources and obligations more neutrally and thus more faithfully. It may also enhance financial statements by making them more comparable. In addition, unlike a risks-and-rewards approach, it avoids the need to determine whether the entity has transferred sufficient risks and rewards to derecognise the asset or the liability.

4.38 Proponents of a risks-and-rewards approach focus on cases such as the following, where they believe that derecognition would not faithfully represent the change in circumstances:

(a) a significant reduction in recognised assets or liabilities with no significant decrease in the risks borne by the entity, for example, when an entity transfers a receivable but guarantees the purchaser against all or most of the future loan losses arising from that asset (see Example 4.1); and

(b) revenue, or a gain, that arises on delivering an asset that may or must be returned to the vendor through means such as a forward contract (see Example 4.2), written put option, purchased call option or lease.

4.39 Example 4.1 illustrates a case in which an entity sells an asset but retains some of the risk through a guarantee.

Example 4.1: sale of receivables with partial recourse[39]

Fact pattern

Entity A controls receivables with a carrying amount of CU1,000 and a fair value of CU1,000.[(a)] It sells the receivables to Bank B for cash of CU1,050. Entity A guarantees Bank B against any losses that Bank B suffers above CU140. The fair value of the guarantee is CU50.

Applying a control approach

Under a control approach, Entity A would first assess whether Bank B is holding the receivables as agent for Entity A (see paragraphs 3.31–3.32). If Entity A concludes that Bank B is holding the receivables as agent, Entity A would continue to recognise the receivables, measured at CU1,000. Entity A would also recognise cash of CU1,050 and a deposit liability of CU1,050.

If Entity A concludes that Bank B is holding the receivables as principal, Entity A would derecognise the receivables, recognising cash of CU1,050 and a guarantee liability of CU50. Entity A reports the guarantee liability in the same way as if it had issued a stand-alone guarantee of loans that it had never previously controlled.

Applying a risks-and-rewards approach

Under a risks-and-rewards approach, assume that Entity A has retained sufficient risks and rewards that it concludes that derecognition would not occur. Entity A would continue to recognise the receivables at CU1,000, and would recognise cash of CU1,050 and a deposit liability of CU1,050. Measuring the receivables at CU1,000 depicts the fact that Entity A is still exposed to some of the credit risk arising from the receivables. However, the transaction eliminated Entity's A exposure to losses below CU140. Continuing to measure the receivables at CU1,000 would not depict the reduction in risk.

(a) In this Discussion Paper, curreny amounts are denominated in 'currency untis' (CU).

4.40 Example 4.2 illustrates a sale combined with a repurchase.

39 As explained in paragraphs 1.22 and 1.24, this Discussion Paper includes examples to illustrate the problems that the IASB is seeking to address. The IASB will not necessarily amend existing requirements for the transactions illustrated in the examples.

Example 4.2: sale of a bond with repurchase agreement

Fact pattern

Entity C controls a quoted zero coupon bond with a carrying amount of CU800 (amortised cost, with an effective interest rate of 5 per cent) and a fair value of CU1,000 (reflecting a market interest rate of 4 per cent). It sells the bond to Bank D for cash of CU1,000, and contracts to buy back the bond for CU1,045 after 12 months (the difference of CU45 reflects market interest rates today for a loan secured by such a bond). Assume that the fair value of Entity C's commitment to repurchase the bond is nil.

Applying a control approach

Under a control approach, Entity C would first assess whether Bank D is holding the bond as agent for Entity C (see paragraphs 3.31–3.32). If Entity C determines that Bank D is acting as agent, Entity C would conclude that it retains control of the bond and would:

- continue to recognise the bond at CU800, both before and after the repurchase (and would accrue interest on the bond at 5 per cent);
- recognise cash of CU1,000; and
- recognise a deposit liability of CU1,000, repayable in 12 months with interest at 4.5 per cent.

If Entity C concludes that Bank D holds the bond as principal, not as agent, it would derecognise the bond, recognising:

- cash of CU1,000;
- a repurchase obligation, measured at nil in this fact pattern; and
- a gain of CU200.

On repurchasing the bond, Entity C would recognise the bond and measure it at CU1,045. It would derecognise the repurchase obligation.

If Bank D holds the bond as principal, the consequence of the control approach is that Entity C reports assets and liabilities that are comparable with those that Entity C would have reported for a stand-alone forward contract to buy the bond for CU1,045 in 12 months.

Applying a risks-and-rewards approach

Under a risks-and-rewards approach, assume that Entity C has retained sufficient risks and rewards that it concludes that derecognition would not occur. Entity C would account for the bond in the same way as if it concluded that Bank D holds the bond as agent.

Arguably, when Entity C concludes that Bank D is holding the bond as principal, the risks-and-rewards approach portrays more clearly than the control approach the fact that that the transaction had virtually no effect on the amount, timing and uncertainty of Entity C's cash flows, other than receiving cash of CU1,000 and repaying it a year later with interest.

4.41 As Examples 4.1–4.2 illustrate, there are two main sources of concern in decisions about derecognition:

(a) in some cases, derecognition results in smaller amounts in the statement of financial position, even though the entity is still exposed to risks of similar magnitude. In Example 4.1, derecognition would mean that Entity A no longer recognises its receivables (previously carried at CU1,000) even though it is still exposed to much of the credit risk arising from those receivables. Entity A would need to communicate, by appropriate presentation and disclosure, that the guarantee measured at only CU50 still exposes Entity A to much of the credit risk inherent in the receivables (see paragraph 4.43 of this Discussion Paper for one possible approach to communicating this information).

(b) in some cases, derecognition produces a gain or loss that would not arise at that time if the entity treated the cash received as arising from a financing transaction. In Example 4.2, Entity C recognises a gain if it derecognises the bond, and it subsequently measures the reacquired bond at more than its original cost.

4.42 Continuing recognition would not be the only possible solution to the concerns that Examples 4.1 and 4.2 illustrate—see paragraphs 4.43–4.44 for other possible solutions.

4.43 The concern in Example 4.1 arises because derivatives (such as the guarantee in Example 4.1) are more highly leveraged than cash instruments, such as loans. In other words, they expose entities to more concentrated risks than cash instruments do. One solution would be to change the accounting for all derivatives to show that extra leverage more directly. For instance, in Example 4.1, the issuer of such a guarantee might present receivables of CU1,000 and a deposit liability of CU1,050, rather than just a guarantee liability of CU50. If that treatment applied to all guarantees, not just those retained in a transfer, that would eliminate the pressure for continuing recognition in Example 4.1. However, it is not clear that the receivable reported under such an approach would meet the definition of an asset.

4.44 The concern in Example 4.2 arises when a sale-and-repurchase agreement could be used to recognise a gain (or perhaps a loss) that would not arise at that time if the entity continued to hold the asset or the liability. That could occur when assets or liabilities are measured on a basis that differs from the price for which they could be transferred to another party. One solution to that concern would be to measure all assets and liabilities at fair value (or perhaps fair value less costs to sell). However, as explained in Section 6, the IASB's preliminary view is that measuring all assets and liabilities on that basis in all circumstances would not provide users of financial statements with the most relevant information.

Full or partial derecognition?

4.45 The discussion in paragraphs 4.35–4.44 of this Discussion Paper considered whether derecognition should occur when a transaction eliminates some but not all of the rights and obligations contained in an asset (or a liability). If derecognition does occur, a related question is how to account for the rights and obligations retained. Two approaches might be considered in such cases:

(a) full derecognition: derecognise the entire asset (or liability) and recognise the retained component as a new asset (or liability). If the carrying amount of the retained component differs from its previous carrying amount, a gain or loss will arise on that component.

(b) partial derecognition: continue to recognise the retained component and derecognise the component that is not retained. On the retained component, no gain will arise and, unless that component is impaired, no loss will arise.

4.46 The following are two examples where this question arises:

(a) when the terms of existing rights or obligations are changed by an agreement between two parties to amend a contract or by a change in the law. The modification may eliminate some of the existing rights or obligations and it may create new rights or obligations.

(b) in a sale-and-leaseback transaction, as illustrated in Example 4.3.

Example 4.3: sale-and-leaseback transactions

Fact pattern

Entity E controls a machine that has a remaining useful life of 10 years and a carrying amount of CU800. Entity E sells the machine to Lessor F for its fair value of CU1,000, and Lessor F simultaneously leases the machine back to Entity E for the first 6 years for lease rentals at a current market rate. Those rentals have a present value of CU600.

Applying a full derecognition approach

If Entity E derecognises the entire machine, it will:

- recognise a new asset: the right to use the machine for years 1–6, measured at CU600;
- recognise the lease obligation, measured at CU600;
- recognise cash of CU1,000; and
- recognise a gain of CU200 on disposal of the machine.

continued...

...continued

Applying a partial derecognition approach

If Entity E derecognises only part of the machine, it will:

- continue to recognise the retained component of the asset: the right to use the machine for years 1–6. For this example, assume that the retained component is measured at CU480 = CU800 × (6÷10).
- derecognise the right to use the machine from years 7–10, recognising a gain of CU80 = (CU1,000 − CU800) × (4÷10).
- recognise a deposit liability, measured at CU600.
- recognise cash of CU1,000.

4.47 In Example 4.3, the full and the partial derecognition approaches result in different measures of the retained component. In addition, the full derecognition approach may result in the recognition of a gain or loss on the retained component. In contrast, the partial derecognition approach results in no gain or loss on the retained component (although the entity would generally need to test the retained component for impairment). It is likely that the IASB would need to decide whether to apply a full derecognition approach or a partial derecognition approach when it develops or revises particular Standards, because that decision depends on the unit of account. Paragraphs 9.35–9.41 include a discussion of unit of account and explain the IASB's preliminary view that determining the unit of account is a decision that it would need to take when developing or revising particular Standards.

4.48 In sale-and-leaseback transactions, the IASB's proposals in its Exposure Draft *Leases*, published in May 2013, together with the conclusions it is expected to reach in its forthcoming Standard on revenue recognition, would typically lead to either no derecognition or full derecognition.

4.49 One other factor to be considered in such transactions is whether the component retained should be regarded as continuing to be a component of the original asset, or whether its character has changed so much that it should be regarded as an entirely new asset. For example, if the new asset exposes the holder to significant credit risk that was not present in the original asset, it may be more appropriate to regard it as a new asset, rather than as a retained component of the original asset.

Summary of preliminary views on derecognition

4.50 The derecognition criteria need to reflect how best to portray both an entity's rights and obligations and changes in those rights and obligations. In most cases, an entity will achieve this by derecognising an asset or a liability when it no longer meets the recognition criteria (or no longer exists, or is no longer an asset or a liability of the entity). However, if the entity retains a component of the asset or the liability, the IASB should determine, when developing or revising particular Standards, how the entity would best portray the changes that resulted from the transaction. Possible approaches include:

(a) enhanced disclosure;

(b) presenting any rights or obligations retained on a line item different from the line item that was used for the original rights or obligations, to highlight the greater concentration of risk; or

(c) continuing to recognise the original asset or liability, and treating the proceeds received or paid for the transfer as a loan received or granted.

4.51 It would also be a decision when developing or revising particular Standards, depending on the unit of account as discussed in paragraphs 9.35–9.41, to determine which of the following approaches to use if an entity retains components of an asset or a liability when derecognition occurs:

(a) full derecognition approach: derecognise the entire asset or liability and recognise a new asset or liability; or

(b) partial derecognition approach: continue to recognise the components retained.

Questions for respondents

Question 8

Paragraphs 4.1–4.27 discuss recognition criteria. In the IASB's preliminary view, an entity should recognise all its assets and liabilities, unless the IASB decides when developing or revising a particular Standard that an entity need not, or should not, recognise an asset or a liability because:

(a) recognising the asset (or the liability) would provide users of financial statements with information that is not relevant, or is not sufficiently relevant to justify the cost; or

(b) no measure of the asset (or the liability) would result in a faithful representation of both the asset (or the liability) and the changes in the asset (or the liability), even if all necessary descriptions and explanations are disclosed.

Do you agree? Why or why not? If you do not agree, what changes do you suggest, and why?

Question 9

In the IASB's preliminary view, as set out in paragraphs 4.28–4.51, an entity should derecognise an asset or a liability when it no longer meets the recognition criteria. (This is the control approach described in paragraph 4.36(a)). However, if the entity retains a component of an asset or a liability, the IASB should determine when developing or revising particular Standards how the entity would best portray the changes that resulted from the transaction. Possible approaches include:

(a) enhanced disclosure;

(b) presenting any rights or obligations retained on a line item different from the line item that was used for the original rights or obligations, to highlight the greater concentration of risk; or

(c) continuing to recognise the original asset or liability and treating the proceeds received or paid for the transfer as a loan received or granted.

Do you agree? Why or why not? If you do not agree, what changes do you suggest, and why?

(ii) whether to separate some derivatives on an entity's own shares into separate components in some cases when that would produce a different result. For example, a forward contract can be viewed as a combination of a purchased option and a written option. The forward contract might be viewed as creating an obligation to settle that does not exist in the case of the purchased option.

(iii) whether puttable shares should be separated into an equity host and an embedded put option. Such a separation might be one way to seek consistency between the treatments of puttable shares and stand-alone written put options. (IAS 32 achieves consistency in a different manner, by requiring a gross presentation for written put options, both free-standing and embedded.)

(b) similarly, whether to link two or more separate instruments into a single instrument for accounting purposes.

(c) whether some obligations within a subsidiary would be reclassified from liability to equity, or vice versa, on consolidation. For example, if an entity has an obligation to transfer economic resources only on liquidation, that obligation would not be a liability of that entity. However, in some circumstances, it might be appropriate to treat it as a liability of the group in the consolidated financial statements of the entity's parent, particularly if liquidation of the entity might occur before liquidation of the parent.

(d) whether any specific guidance is needed on contractual terms that have no commercial substance, for example an option that is deeply in the money or deeply out of the money, with no genuine possibility that this will change before expiry. Paragraphs 3.98–3.108 include a discussion of contractual options that lack commercial substance.

(e) three questions on which Appendix F provides more background:

(i) how to measure the rights and obligations that arise under a written put option on an entity's own shares;

(ii) whether changes in liabilities arising under a written put option result in income or expense, or in a distribution of equity or contribution to equity; and

(iii) how to measure the rights and obligations that arise under a written put option on NCI, and where to present changes in the measures of those rights and obligations.

Puttable instruments

5.55 IAS 32 requires an entity to classify some puttable instruments as equity instruments, even though they create an obligation to transfer assets, and thus meet the definition of a financial liability. To summarise some complex and detailed requirements, this applies to financial instruments that:

(a) give the holders a pro rata residual interest in the entity's net assets, after deducting all its liabilities; but also

(b) oblige the entity to deliver cash or other assets to the holders on liquidation, or on early redemption at an amount broadly equivalent to that pro rata share.

Examples of entities that issue such instruments are some co-operative and mutual organisations.

5.56 The Basis for Conclusions on IAS 32 identifies the following concerns that would have arisen from classifying these puttable instruments as liabilities:

(a) on an ongoing basis, the liability would be recognised at not less than the amount payable on demand. This could result in the entire market capitalisation of the entity being recognised as a liability, depending on the basis for calculating the redemption value of the financial instrument.

(b) changes in the carrying amount of the liability would be recognised in profit or loss. This would result in counterintuitive accounting (if the redemption value is linked to the performance of the entity) because:

   (i) when an entity performs well, the present value of the settlement amount of the liabilities increases, and a loss would be recognised; and

   (ii) when the entity performs poorly, the present value of the settlement amount of the liability decreases, and a gain would be recognised.

(c) it is possible, again depending on the basis for calculating the redemption value, that the entity would report negative net assets because of unrecognised intangible assets and goodwill, and because the measurement of recognised assets and liabilities may not be at fair value.

(d) the statement of financial position would portray the entity as wholly, or mostly, debt-funded.

(e) distributions of profits to shareholders would be recognised as expenses. Hence, it may appear that profit or loss is a function of the distribution policy, not of performance.

5.57 The exception in IAS 32 treats some puttable instruments as if they were equity instruments. The existing *Conceptual Framework* provides no basis for that exception. In the IASB's preliminary view, its reasons given in paragraph 5.56 for creating that exception are still valid and the *Conceptual Framework* should provide a concept that underlies the exception. To reflect that suggestion, the revised *Conceptual Framework* should indicate that an entity should treat some obligations that oblige the issuer to deliver economic resources as if they were equity instruments. One consequence would be that changes in the carrying amount of those obligations would not be recognised in profit or loss. Arguably, this treatment might be appropriate if the obligations are the most subordinated (lowest ranking) class of instruments issued by an entity (such as some co-operatives or mutuals) that would otherwise report no equity. In such cases, no other class of instrument has a residual interest in the entity's assets less other liabilities. Thus, payments to holders of the most subordinated class of instruments might be regarded as akin to distributions of equity.

5.58 Identifying whether to use such an approach, and if so, when, would continue to be a decision that the IASB would make when developing or revising particular Standards. For example, the following topics might require analysis if the IASB were to undertake a project to amend IAS 32, IFRS 2 or another Standard:

(a) whether an obligation could be treated as if it were an equity claim if it would arise only on the liquidation of a subsidiary of the reporting entity; and

(b) whether some or all of these puttable instruments should be separated into an embedded put option (for which a liability would be recognised) and a host equity instrument.

5.59 The most subordinated class of instruments issued by an entity might qualify as equity instruments under the narrow equity approach mentioned in paragraph 5.30. Thus, the narrow equity approach might make it unnecessary to create an exception for puttable instruments in that class. In contrast, without such an exception, the strict obligation approach would not treat these instruments as equity.

Questions for respondents

Question 10

The definition of equity, the measurement and presentation of different classes of equity, and how to distinguish liabilities from equity instruments are discussed in paragraphs 5.1–5.59. In the IASB's preliminary view:

(a) the *Conceptual Framework* should retain the existing definition of equity as the residual interest in the assets of the entity after deducting all its liabilities.

(b) the *Conceptual Framework* should state that the IASB should use the definition of a liability to distinguish liabilities from equity instruments. Two consequences of this are:

   (i) obligations to issue equity instruments are not liabilities; and

   (ii) obligations that will arise only on liquidation of the reporting entity are not liabilities (see paragraph 3.89(a)).

(c) an entity should:

   (i) at the end of each reporting period update the measure of each class of equity claim. The IASB would determine when developing or revising particular Standards whether that measure would be a direct measure, or an allocation of total equity.

   (ii) recognise updates to those measures in the statement of changes in equity as a transfer of wealth between classes of equity claim.

(d) if an entity has issued no equity instruments, it may be appropriate to treat the most subordinated class of instruments as if it were an equity claim, with suitable disclosure. Identifying whether to use such an approach, and if so, when, would still be a decision for the IASB to take in developing or revising particular Standards.

Do you agree? Why or why not? If you do not agree, what changes do you suggest, and why?

Section 7—Presentation and disclosure

Introduction

7.1 Presentation and disclosure are the mechanisms by which a reporting entity communicates information about its financial position and financial performance to users of financial statements. Some aspects of presentation and disclosure are prescribed by IFRS.

7.2 Presentation and disclosure are not addressed in the existing *Conceptual Framework*. Some believe that this has led to disclosure requirements in IFRS that are not always focused on the right disclosures and are too voluminous. This omission is also seen as contributing to a lack of clarity around the presentation of profit or loss and other comprehensive income (OCI). Section 8 deals with the presentation of profit or loss and OCI. This section deals with presentation and disclosure more broadly.

7.3 In terms of disclosure, many respondents to the *Agenda Consultation 2011* told the IASB that they think that a framework for disclosure is needed to ensure that information disclosed is more relevant to investors and to reduce the burden on preparers. Responses suggested that such a framework should:

(a) provide a structured way to review the need for disclosure, simplify the disclosure process and reduce the costs to preparers;

(b) consider the costs and benefits of disclosure;

(c) include a discussion of materiality in order to ensure that only material and/or relevant amounts are disclosed; and

(d) contain clear communication objectives so that disclosure is understandable and relevant.

7.4 As a result of this feedback the IASB is looking at ways to address the concerns raised about disclosure. One aspect of that response is the development of material for the *Conceptual Framework* that the IASB would consider when setting disclosure requirements. As mentioned in paragraphs 7.6–7.8, the IASB is also considering further work in the area of disclosure.

7.5 The purpose of this section is to discuss the principles that should underlie the decisions that the IASB makes about presentation and disclosure. This section will discuss:

(a) the meaning of the terms ‘presentation’ and ‘disclosure’ and how they differ (see paragraphs 7.9–7.13);

(b) presentation in the primary financial statements, including a discussion of their purpose and the relationship between primary financial statements (see paragraphs 7.14–7.31);

(c) disclosure in the notes to the financial statements, including the scope of information to be included in the notes and the form of disclosure requirements (see paragraphs 7.32–7.42);

(d) materiality (see paragraphs 7.43–7.46); and

(e) the form of disclosure and presentation requirements (see paragraphs 7.47–7.52).

Other work on presentation and disclosure

7.6 In 2008, the IASB and the US Financial Accounting Standards Board (FASB) published a Discussion Paper *Preliminary Views on Financial Statement Presentation*.[55] In 2010, the IASB and the FASB posted on their websites a staff draft of an Exposure Draft *IFRS X Financial Statement Presentation*.[56] When relevant, this Discussion Paper incorporates principles developed during the Financial Statement Presentation project. The IASB's current work plan does not include a project to develop a Standard based on the work in that project. However, some of the issues discussed in the Financial Statement Presentation project are being considered in the *Conceptual Framework* project.

7.7 In addition, the IASB will assess, in the light of the feedback on its shorter term review of disclosure, the extent to which it should consider undertaking a broader review of presentation and disclosure.[57] In particular, in 2013 the IASB will start a research project reviewing IAS 1 *Presentation of Financial Statements*, IAS 7 *Statement of Cash Flows* and IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, including a review of the feedback it received on the Financial Statement Presentation project. The goal will be to replace those Standards, in essence creating a disclosure framework of the type mentioned in paragraph 7.3. This research will be undertaken in parallel with the *Conceptual Framework* project.

7.8 The IASB plans other work on disclosures involving possible amendments to IAS 1 and possible guidance on materiality.[58] In the light of the IASB's intention to conduct that work and a research project involving IAS 1, IAS 7 and IAS 8, this section of the Discussion Paper deals with only some aspects of disclosure. This section has been developed in the context of the primary purpose of the *Conceptual Framework*, as described in Section 1, which is to assist the IASB in developing and revising Standards.

What is meant by the terms 'presentation' and 'disclosure'?

7.9 In the context of financial reporting, the term 'presentation' attracts different meanings. Paragraph 1 of IAS 1 prescribes "the basis for presentation of general purpose financial statements to ensure comparability both with the entity's financial statements of previous periods and with the financial statements of other entities."

7.10 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 (see paragraphs 7.14–7.31 for more information on primary financial statements).

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55 http://go.ifrs.org/FSP-2008-DP-Preliminary-Views

56 http://go.ifrs.org/FSP-2010-Staff-Draft

57 http://go.ifrs.org/PR-Feedback-Statement-on-Disclosure-Forum

58 http://go.ifrs.org/Disclosure-Forum-Feedback-Statement-PDF

7.11 '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.

7.12 The notes to the financial statements disclose useful information that is not presented in the primary financial statements, for example:

(a) further disaggregation of items presented in the primary financial statements;

(b) unrecognised assets and unrecognised liabilities of the entity; and

(c) the entity's financial exposure to risks and uncertainties arising from its recognised and unrecognised assets and liabilities.

7.13 It is often an entity's own facts and circumstances, rather than guidance in IFRS, that determines what information is presented in the primary financial statements and what information is disclosed in the notes to the financial statements.

Presentation in the primary financial statements

What are primary financial statements?

7.14 Collectively, financial statements depict a view of the financial position and financial performance of an entity. IFRS does not currently use the term 'primary financial statements'. This Discussion Paper differentiates between the primary financial statements and the notes to the financial statements. The primary financial statements are:

(a) the statement of financial position;

(b) the statement of profit or loss and OCI (or the statement of profit or loss and the statement of comprehensive income);

(c) the statement of changes in equity; and

(d) the statement of cash flows.

7.15 Primary financial statements convey summarised information about an entity. Each primary financial statement communicates a different facet of that information.

7.16 As discussed in paragraph 7.2, the existing *Conceptual Framework* does not include specific guidance on presentation in the primary financial statements. The IASB thinks that such guidance would help it to decide when an item should be presented in the primary financial statements and when it should be disclosed in the notes to the financial statements. Paragraphs 7.17–7.31 set out in broad terms what should, in the IASB's preliminary view, be included in the *Conceptual Framework* as guidance on presentation.

Objective of primary financial statements

7.17 On the basis of the objective of financial reporting in Chapter 1 of the *Conceptual Framework*, this Discussion Paper proposes that the objective of primary financial statements is to provide summarised information about recognised assets, liabilities, equity, income, expenses, changes in equity and cash flows that has been classified and aggregated in a manner that is useful to users of financial statements in making decisions about providing resources to the entity.[59]

7.18 Summarised information about recognised assets, liabilities, equity, income, expenses, changes in equity and cash flows provides information about:

(a) the recognised economic resources of the entity and claims against the entity, ie information about its financial position;

(b) changes in those economic resources and claims, including information about the entity's financial performance; and

(c) how efficiently and effectively the entity's management have discharged their responsibilities to use the entity's resources.

7.19 Primary financial statements do not include unrecognised assets and liabilities and only provide a summarised view of recognised elements. As a result, the view of the entity as conveyed by primary financial statements is incomplete. Users of financial statements also need to consider the information provided by the notes to the financial statements as well as information from other sources when making decisions about providing resources to the entity.

Classification and aggregation

7.20 A key aspect of financial statement presentation is effective communication and making information understandable. Classifying, characterising and presenting information clearly and concisely makes it understandable (see paragraph QC30 of the existing *Conceptual Framework*).

7.21 Classification is the sorting of items based on shared qualities. Aggregation involves the adding together of individual items within those classifications. To present information in the primary financial statements that is understandable, an entity classifies and aggregates information about recognised elements and presents it on a summarised basis.

7.22 As indicated in paragraph 7.21, the main advantage of aggregation is that it allows an entity to disclose its activities in an understandable way. Aggregation allows an entity to highlight those items, and relationships between items, that are important to an assessment of its financial position and financial performance.

7.23 Applied appropriately, aggregation can make primary financial statements more understandable by summarising a large volume of information. However, aggregating information results in the loss of detailed information. Applied inappropriately, aggregation can obscure useful information or even result in misleading information, for example, when dissimilar items are aggregated. Consequently, financial statements should aggregate information so that useful information is not obscured by either the inclusion of a large amount of insignificant detail or by the aggregation of items that have different characteristics.

59 See paragraph OB2 of the existing *Conceptual Framework*.

7.24 The primary financial statements classify and aggregate information about the recognised elements (including changes in elements and components of elements). Section 2 discusses the elements that are presented in each primary financial statement.

7.25 Within each primary financial statement, an entity presents groups of recognised items as separate lines ('line items'). Each line item represents that group by providing a description of the aggregated group of recognised elements (or components of elements) and a monetary amount. Line items, subtotals and totals derived from those line items are used to present useful summarised information.

7.26 In order to provide information that is useful to users of financial statements in making economic decisions about providing resources to the entity, the IASB believes that classification and aggregation into line items and subtotals should be based on similar properties, such as:

(a) the function of the item—that is, the primary activities (and assets and liabilities used in those activities) in which the entity is engaged, such as selling goods, providing services, manufacturing, advertising, marketing, business development or administration;

(b) the nature of the item—that is, the economic characteristics or attributes that differentiate between items that respond differently to similar economic events, such as:

(i) wholesale revenues and retail revenues;

(ii) materials, labour, transport and energy costs; or

(iii) fixed-income investments and equity investments; or

(c) how the item is measured—Section 6 discusses measurement.

7.27 In many cases, an entity will determine what line items, subtotals and totals to present in its primary financial statements based on its individual facts and circumstances and its assessment of what is relevant at a summary level.

7.28 In some cases, the IASB may decide to require a particular item to be presented in the primary financial statements (assuming it is material to the entity). The IASB may require this if it considers that information about that item would be essential to providing a summary depiction of the financial position and financial performance of an entity that is useful to the users of its financial statements, ie existing and potential investors, lenders and other creditors.

Offsetting

7.29 Because offsetting combines dissimilar items (assets/liabilities, income/expenses, cash receipts/cash payments, contributions to equity/distributions of equity), the IASB believe that offsetting will generally not provide the most useful information for assessing an entity's financial position and financial performance.

7.30 However, the IASB may choose to require offsetting when such a presentation provides a more faithful representation of a particular position, transaction or other event. It may also choose to permit offsetting when it considers this necessary on cost-benefit grounds.

Relationship between primary financial statements

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.

Disclosure in the notes to the financial statements

7.32 As discussed in paragraph 7.2, the existing *Conceptual Framework* does not include specific guidance on disclosures in financial statements. Paragraphs 7.33–7.42 set out in broad terms what should, in the IASB's preliminary view, be included in the revised *Conceptual Framework* as guidance on disclosure.

Objective of the notes to the financial statements

7.33 The notes to the financial statements support the primary financial statements. Consequently, based on the objective of financial reporting and the objective of primary financial statements proposed in paragraph 7.17, this Discussion Paper proposes that the objective of the notes to the financial statements is to supplement the primary financial statements by providing additional useful information about:

(a) the assets, liabilities, equity, income, expenses, changes in equity and cash flows of the entity; and

(b) how efficiently and effectively the entity's management and governing board have discharged their responsibilities to use the entity's resources.

7.34 To be useful, the information provided by the notes to the financial statements needs to help users of financial statements understand the amount, timing and uncertainty of an entity's future net cash inflows. In doing so, it should help users understand how the entity's assets, liabilities, equity, income, expenses, changes in equity and cash flows reflect actions taken by management to discharge their responsibilities to use the entity's assets. Such actions could include:

(a) protecting the entity's assets from unfavourable effects of economic factors such as price and technological changes; and

(b) ensuring that the entity complies with applicable laws, regulations and contractual provisions.

Scope of the notes to the financial statements

7.35 This Discussion Paper proposes that, to meet the objective set out in paragraph 7.33, the *Conceptual Framework* should identify the following as disclosures that the IASB would normally consider requiring in a general Standard on disclosure (such as IAS 1) or in particular Standards:

(a) information about the reporting entity as a whole, to the extent necessary to understand:

  (i) the assets, liabilities, equity, income, expenses, changes in equity and cash flows of the entity; and

  (ii) how effectively the entity's management and governing board have discharged their responsibilities to use the entity's assets.

(b) the amounts recognised in the entity's primary financial statements, including changes in those amounts, for example, disaggregation of line items, roll-forwards and reconciliations;

(c) the nature and extent of the entity's unrecognised assets and liabilities;

(d) the nature and extent of risks arising from the entity's assets and liabilities (whether recognised or unrecognised); and

(e) the methods, assumptions and judgements and changes in those methods, assumptions and judgements, that affect amounts presented or otherwise disclosed.

7.36 In setting disclosure guidance in IFRSs, the objective is not to have entities provide information that enables a user of financial statements to recalculate the amounts recognised in the primary financial statements. Instead, disclosure guidance needs to result in entities providing sufficient information to enable a user of financial statements to identify the key drivers of the entity's financial position and performance and to understand the key risks arising from its assets and liabilities, and the key facts that cause uncertainties about measurements used in the financial statements.

7.37 Information about management's view of the entity's performance, position and progress in the context of its stated plans and its strategies for achieving those plans belongs outside financial statements, for example, in management commentary.[60]

Forward-looking information

7.38 Financial statements, and therefore notes, provide information about existing assets and liabilities, and changes in those existing assets and liabilities. The notes provide further detail of recognised amounts (disaggregation, descriptions, risks) and unrecognised (but existing) assets and liabilities. Notes to the financial statements do not usually include information about plans or future assets and future liabilities.

7.39 Forward-looking information is information about the future, for example, information about prospects and plans. The IFRS Practice Statement *Management Commentary: A framework for presentation* notes that forward-looking information is subjective and its preparation requires the exercise of professional judgement. The IASB's preliminary view is that it should require forward-looking

60 See paragraphs 12–14 of the IFRS Practice Statement *Management Commentary: A framework for presentation*.

information to be included in the notes to the financial statements only if it provides relevant information about assets and liabilities that existed at the end of the reporting period or during the reporting period. Paragraph 7.35 identifies such information that may be relevant. For example, if the measurement of an asset or a liability is based on future cash flows, information about the methods, assumptions and judgements used to estimate those cash flows is needed in order to understand the reported measures. Information is also needed to understand the sensitivity of those measures to:

(a) the variability in future outcomes (risk); and

(b) the range of the assumptions and judgements that management could reasonably have made to arrive at those measures.

7.40 Other types of forward-looking information may provide relevant information and could be presented outside the financial statements, for example, in management commentary if the entity prepares one.

Types of disclosures in the notes to the financial statements

7.41 When developing disclosure requirements in IFRSs, the IASB can consider different forms of disclosure (for example, disaggregations, descriptions, roll-forwards, sensitivity analysis) depending on the nature of the item in question. Using the objective of the notes to the financial statements (see paragraph 7.33) and the listing of types of useful information that would meet that objective (see paragraph 7.35), Table 7.1 provides some examples of the types of disclosures that may provide that information. A single note in the financial statements may combine two or more of these types of disclosures. In addition, one disclosure might provide two types of useful information. For example, a maturity analysis of a liability provides further information about the obligation but also provides information about liquidity risk. Similarly, a single note might provide information about a group of assets, transactions relating to those assets, risks arising from them and methods used to account for them.

Table 7.1: examples of disclosures split by type of useful information

Type of information	Examples of disclosures in the notes to the financial statements
Reporting entity	• Information about subsidiaries, associates, parent etc. • Description of business model. • Going concern. • Description of non-adjusting events after the reporting date.

Amounts recognised in the primary financial statements	• Disaggregation of line items in the primary financial statements, including:
	    • analysis of a single amount (for example, a line item, transaction or event);
	    • analysis by function, nature or measurement where different to that provided in the primary financial statements;
	    • maturity analysis;
	    • roll-forwards;
	    • operating segments; and
	    • related party transactions.
	• Relationship between line items (for example, hedging, offsetting).

Unrecognised assets or liabilities	• Description of amount and nature of unrecognised assets or liabilities. • Description of why the items have not been recognised.
Risks	• The types of financial risks faced by the entity, including its sources and exposures. • How the entity has managed those risks. • How management of risks has impacted its financial statements.
Methods, assumptions and judgements	• Accounting policies. • Description of measurement methodologies, including key assumptions and inputs. • Quantification of the sensitivity of recognised or disclosed measures to changes in key assumptions and inputs to provide information about measurement uncertainty. • Description and quantification of alternative measurements.

Comparative information

7.42 A complete set of IFRS financial statements includes information about the preceding period ('comparative information'). Presentation of additional comparative information is permitted and, in some circumstances, required.[61] Comparative information provides trend information from which to assess the financial statements of the current period and therefore provides relevant information. It follows that comparative information is an integral part of an entity's financial statements for the current period.

Materiality

7.43 Paragraph QC11 of Chapter 3 of the *Conceptual Framework* states that:

> Information is material if omitting it or misstating it could influence decisions that users make on the basis of financial information about a specific reporting entity. In other words, materiality is an entity-specific aspect of relevance based on the nature or magnitude, or both, of the items to which the information relates in the context of an individual entity's financial report. Consequently, the Board cannot specify a uniform quantitative threshold for materiality or predetermine what could be material in a particular situation.

7.44 In addition, IAS 1 states that an entity:

(a) need not provide a specific disclosure required by a Standard if the information is not material;[62] and

(b) should provide additional disclosures when compliance with the specific requirements in IFRS is insufficient to enable users of financial statements to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance.[63]

7.45 The IASB believes that the concept of materiality is clearly described in the existing *Conceptual Framework*. Consequently, the IASB does not propose to amend, or add to, that description.

7.46 However, how the concept of materiality is applied in practice is seen by many as a major cause of the current disclosure problem in financial reporting. That problem is often identified as a failure to use professional judgement when considering materiality. It is thought by some to have resulted in both the disclosure of too much irrelevant information and not enough relevant information. As a result, the IASB is considering providing additional material on the application of materiality, by amending its Standards or by providing educational material (see paragraphs 7.7–7.8). In particular, this additional material on materiality would seek to emphasise the following:

(a) if information to meet a disclosure requirement in a Standard is not considered material, the entity may omit it from its financial statements;

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61 See paragraphs 10(ea) and 38-44 of IAS 1.

62 See paragraph 31 of IAS 1.

63 See paragraph 17(c) of IAS 1.

(b) disclosures additional to those specifically required by a Standard may be required for material items in order to meet the disclosure objective of that Standard or to meet the objective of financial reporting;

(c) disclosure of immaterial information can impair the understandability of material information that is also disclosed; and

(d) just because a line item presented in a primary financial statement is determined to be material, it does not automatically follow that all IFRS disclosures pertaining to that line item are material to the entity's financial statements. An entity would assess the materiality of each disclosure requirement individually.

Form of disclosure and presentation requirements

7.47 Paragraphs 7.48–7.52 set out in broad terms what should, in the IASB's preliminary view, be included in the *Conceptual Framework* as guidance on the form and communication aspects of disclosure and presentation requirements.

Disclosure objectives

7.48 Each Standard that proposes disclosure and presentation requirements should have a clear objective. This objective would guide entities when identifying the best disclosures and presentation to meet the objective. The IASB should provide guidance that enables an entity to determine whether the specified information would be material in the context of an entity's financial statements. This may result in some disclosures not being made if they are not material or, conversely, additional disclosures being made when they are material.

Communication principles

7.49 The objective of financial reporting is to provide useful information to users of financial statements. To achieve this, disclosure guidance in Standards should seek to promote disclosure (including presentation) in the financial statements as a form of communication guided by Standards, as opposed to a mechanism whose sole purpose is compliance with specific requirements of Standards.

7.50 Consequently, in developing disclosure guidance in IFRSs, the IASB not only needs to consider what information would be useful in the circumstances of a wide range of entities (ie a faithful representation of relevant information), but should also develop guidance that promotes effective communication of that information. Effective communication reflects the fundamental qualitative characteristic of faithful representation and the enhancing qualitative characteristics of understandability and comparability. As a result, this Discussion Paper proposes that the IASB should consider the following communication principles when it sets disclosure requirements:

(a) disclosure guidance should seek to promote the disclosure of useful information that is entity-specific. In other words, disclosure guidance should be aimed at emphasising the aspects of transactions, events or circumstances, and the way they have been accounted for, in order to enhance a user's understanding of that entity. Disclosure guidance should therefore discourage the use of 'boilerplate' or generally available information that is not specific to the entity as this can impair the understandability of useful information.

(b) disclosure guidance should result in disclosures that are clear, balanced and understandable. Guidance should therefore give entities the flexibility to write disclosures as simply and directly as possible without:

  (i) a loss of useful information; and

  (ii) unnecessarily increasing the length of the financial statements.

(c) disclosure guidance should enable an entity to organise disclosures in a manner that highlights to a user of financial statements what is important. Consequently, where possible, disclosure guidance should enable an entity to determine the order of disclosures or the emphasis given within a single disclosure.

(d) disclosures should be linked. Disclosure guidance in IFRS should therefore result in disclosures that help users of financial statements to understand the relationships between the items in the primary financial statements and the information disclosed in the notes. Where appropriate, disclosure guidance should require or permit entities to show the relationship between the information disclosed in different notes and also, where possible, with other published information, such as disclosures in management commentary, if there is one. IFRSs should therefore permit the use of cross-referencing where possible and appropriate.

(e) disclosure guidance should not result in the duplication of the same information in different parts of the financial statements. The IASB should therefore review existing IFRSs when developing new disclosure guidance to minimise any duplication. Links between disclosures (for example, cross-referencing) may be appropriate in some circumstances (see 7.50(d)).

(f) disclosure guidance should seek to optimise comparability without compromising the usefulness of the information disclosed. When developing disclosure guidance, the IASB needs to weigh up the need for the information to be comparable among entities and across reporting periods against the need to give entities the flexibility to determine what and how information is disclosed in the most understandable manner. This assessment will determine whether the IASB permits or requires disclosures and whether Standards stipulate the form of disclosure, for example, in tables rather than descriptions.

Financial statements in an electronic format

7.51 Financial statements can be delivered on paper or electronically. The form of delivery affects the accessibility of information in financial statements rather than the content. For many users of financial statements, accessing financial information electronically, for example, through an entity's website or using eXtensible Business Reporting Language (XBRL), makes it easier to consume the financial information.

7.52 When developing presentation and disclosure requirements, the IASB may need to consider the impact of technology and to support advances in its application and wider use. Possible aspects that the IASB may consider include:

(a) flexibility in the order and level of aggregation of information; and

(b) consistent use of terminology, totals and subtotals so that the relationships between different disclosure items and presentation items can be precisely identified and can therefore be faithfully represented in an electronic format.

Questions for respondents

Question 16

This section sets out the IASB's preliminary views about the scope and content of presentation and disclosure guidance that should be included in the *Conceptual Framework*. In developing its preliminary views, the IASB has been influenced by two main factors:

(a) the primary purpose of the *Conceptual Framework*, which is to assist the IASB in developing and revising Standards (see Section 1); and

(b) other work that the IASB intends to undertake in the area of disclosure (see paragraphs 7.6–7.8), including:

   (i) a research project involving IAS 1, IAS 7 and IAS 8, as well as a review of feedback received on the Financial Statement Presentation project;

   (ii) amendments to IAS 1; and

   (iii) additional guidance or education material on materiality.

Within this context, do you agree with the IASB's preliminary views about the scope and content of guidance that should be included in the *Conceptual Framework* on:

(a) presentation in the primary financial statements, including:

   (i) what the primary financial statements are;

   (ii) the objective of primary financial statements;

   (iii) classification and aggregation;

   (iv) offsetting; and

   (v) the relationship between primary financial statements.

(b) disclosure in the notes to the financial statements, including:

   (i) the objective of the notes to the financial statements; and

   (ii) the scope of the notes to the financial statements, including the types of information and disclosures that are relevant to meet the objective of the notes to the financial statements, forward-looking information and comparative information.

Why or why not? If you think additional guidance is needed, please specify what additional guidance on presentation and disclosure should be included in the *Conceptual Framework*.

Question 17
Paragraph 7.45 describes the IASB's preliminary view that the concept of materiality is clearly described in the existing *Conceptual Framework*. Consequently, the IASB does not propose to amend, or add to, the guidance in the *Conceptual Framework* on materiality. However, the IASB is considering developing additional guidance or education material on materiality outside of the *Conceptual Framework* project. Do you agree with this approach? Why or why not?

Question 18
The form of disclosure requirements, including the IASB's preliminary view that it should consider the communication principles in paragraph 7.50 when it develops or amends disclosure guidance in IFRSs, is discussed in paragraphs 7.48–7.52. Do you agree that communication principles should be part of the *Conceptual Framework*? Why or why not? If you agree they should be included, do you agree with the communication principles proposed? Why or why not?