INFORMATION FOR OBSERVERS


Introduction and Purpose

1. The objective of this paper is to help frame the discussion of future long-term and short-term standards-setting work on financial instruments. This paper explores possible approaches to future projects. The aim is to ask the Boards what direction they want to proceed. The staff has assumed that any resulting project or projects will be joint ones. Consequently, convergence will be achieved as a by-product.

2. Since the objective of the paper is to obtain guidance the paper contains no staff recommendation. It is only the first step and the issues discussed in this paper are analysed at a high level.

Background

3. At their joint meeting in April 2004, the FASB and IASB agreed to consider short-term convergence efforts related to financial instruments.

4. In our discussions with selected IASB and FASB Board members, they expressed concerns that any short-term convergence project was clearly contingent upon the medium and long-term plans of both Boards regarding financial instruments. Without
knowing these plans it was unclear as to what could potentially be addressed in a short-term project that would not be reconsidered, perhaps fairly soon afterwards, in a medium or longer-term project.

5. In view of this the staff decided to progress the project by:

   a. exploring whether there are topics that could be addressed through a short-term convergence project.

   b. exploring those areas of convergence that could be addressed as a part of medium-term projects on financial instruments.

6. The staff produced a set of papers exploring various topics that could be considered as possible topics for the convergence project on financial instruments. Both Boards discussed these papers in education sessions in March 2005. Neither of the Boards made any technical decisions on the proposals in the papers.

7. Some IASB members suggested that the Board should consider the long-term objective for improving financial instruments accounting before proceeding to specific convergence issues. Other IASB members suggested the following:

   a. Simplification of accounting standards on financial instruments should be an important criterion for determining whether or not a topic is included in the convergence project.

   b. The staff should identify financial instruments topics that are considered to be especially troublesome by preparers and auditors when reconciling IFRS financial statements with US GAAP.

   c. Elimination of reconciling items should not be the only criterion for including items in the short or medium-term convergence project.

8. Some FASB members commented that the aim of any project was “Improvement, Simplification and Convergence”. They commented that the primary goal was improvement and that the project proposals put forward would address primarily convergence and the elimination of reconciling items. Consequently, FASB members suggested that the papers should start at a different point ie what should be the longer term objectives rather than focusing on the elimination of reconciling items.
9. Other FASB members stated that they would prefer to address some of the issues involving financial instruments (including whether or not to move to full fair value at this time) after they had addressed the issues involving performance reporting.

Possible Ways Forward

11. Given the differing views and objectives of the Boards, the staff considers it important that the Boards discuss the different approaches to improving financial instrument accounting and provide guidance to the staff on how it should structure its work.

12. This paper considers possible alternatives that the Boards could explore.

13. The staff has identified four alternatives that the Boards could consider. They are:

   a. Consider a fundamental change in financial instruments accounting. This could be a move to full fair value for all financial instruments.

   b. Improve the mixed attribute model for measuring financial instruments by using a model that is a comprehensive measurement framework but not full fair value for all financial instruments.

   c. Identify discrete and significant areas of financial instruments accounting, like derecognition, and improve and simplify these areas.

   d. Simplify and improve financial instruments accounting with convergence as one of the byproducts of the process. Topics would include the suggestions made by staff in the convergence papers considered by the Boards in their respective education sessions in March or some of the issues put forward to the IASB financial instruments working group at its first meeting.

Consider a fundamental change in financial instruments accounting

14. Any mixed attribute model will inevitably result in complexity as solutions for reducing the accounting mismatch arising from such a system are incorporated in the Standards. The only complete solution that has been put forward to achieve such a result is a move to measure all financial assets and liabilities at fair value. The Boards could consider a project to move towards full fair value for all financial assets and liabilities. Such a move would significantly simplify and improve the accounting for financial instruments.
However, such a move raises a number of issues of that others have struggled with, including potential measurement error, how to report unrealised gains and losses, and how to report interest on instruments measured at fair value. In addition, a move to full fair value will not remove the need for cash flow hedge accounting.

Any suggestion that the Boards should move to full fair value will raise a large controversy between the Boards and many of their constituents. The previous attempt to define a full fair value model, the JWG report, was widely criticised. The staffs are not suggesting that the Boards walk away from controversy. Rather, we suggest that the Boards consider whether this approach could gain support from a sufficient proportion of our constituents. Many of the staff consider a full fair value approach to be the clear conceptual winner. We question whether the approach is achievable in today’s climate.

*Improve the mixed attribute model for measuring financial instruments by using a model that is a comprehensive measurement framework short of full fair value for all financial instruments*

This approach builds on the Boards objectives of improving and simplifying financial instruments accounting. It offers a way to make a significant step in the direction of fair value without requiring full fair value for all financial instruments and to significantly simplify the accounting for financial instruments.

If adopted substantially as proposed or possibly if modified in deliberations, the suggested requirements would significantly simplify accounting standards for financial instruments. That alone gives a project significant value to both the Boards and its constituents, especially given the current high profile status of financial reporting.

The staff sees this as an alternative that the Boards could consider as a future project on financial instruments. Undoubtedly, any such project would be a long-term project.

*Address discrete and significant areas of financial instruments accounting*

The Boards could identify and address discrete areas within financial instruments accounting instead of aiming to address the whole spectrum of financial instruments accounting either through a fundamental change or by fundamentally altering the
mixed attribute measurement model. The aim would be to improve and simplify these specific areas in the medium to short-term.

21. For example, the Boards could consider the following areas for future work on financial instruments accounting:

   a. Derecognition

   b. Hedge Accounting

   c. Impairment

_Simplify and improve financial instruments accounting with convergence as one of the by products of the process_

33. The Boards could consider various areas in financial instruments accounting that could potentially be simplified and improved. Addressing these areas would not necessarily result in significant improvements to financial reporting but would result in the elimination of reconciling items. Topics would include the suggestions made by staff in the convergence papers considered by the Boards in their respective education sessions in March and/or some of the issues put forward to the IASB financial instruments working group at its first meeting.

35. Another area that could potentially be considered under this category is the unification or integration of the disclosure requirements under both sets of GAAP. The Boards could explore combining disclosures about financial instrument matters into one footnote; require more contexts for the disclosures and reconciling them to the balance sheet. The FASB has recently added to its agenda a relatively narrow project on disclosures related to derivatives.
INFORMATION FOR OBSERVERS

MEETING: 21 APRIL 2005, LONDON
PROJECT: PERFORMANCE REPORTING
TOPIC: AGENDA PAPER 2: PROJECT UPDATE

INTRODUCTION

1. At the April 22, 2004 joint Board meeting, the U.S. Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) (collectively, the Boards) agreed to jointly conduct their respective projects on Performance Reporting and that the work should be performed in two segments.
   A. Segment A addresses narrow differences between U.S. GAAP and International Financial Reporting Standards (IFRSs) related to required financial statements and requirements to present comparative information.
   B. Segment B is to develop standards for presentation of information on the face of the required financial statements. Specific issues include recycling, disaggregation and the use of totals/subtotals on the required financial statements.

2. The Boards also agreed to form a Joint International Group (JIG) to assist the Boards and staff in identifying issues to be considered in this project and developing proposed solutions.
3. In January 2005, the JIG met in London to discuss issues in Segment A and the longer-term Segment B issues specifically related to disaggregation and recycling. The staff is using the input from that meeting to update the project plan and sequence the issues.

4. At the April 2005 joint meeting, the staff would like the Boards’ views on the following:

**Project Scope Issues:**

1. *Is the Boards’ objective to develop a single standard that would apply broadly to all entities?*
2. *Do Board members agree that they should first develop a standard that would apply to entities other than financial institutions, and then consider the application of such a standard to financial institutions?*
3. *Do Board members agree with the staffs’ approach regarding interim financial statements and notes to financial statements?*
4. *Should the scope of this project include a comprehensive reconsideration of FASB Statement 95, Statement of Cash Flows, and IAS 7, Cash Flow Statements, including whether to require a particular method and presentation of the cash flow statement?*
5. *Do the Boards believe that there are any additional topics that should be added to either Segment A or Segment B? If so, what are these additional topics and should they be addressed in Segment A or Segment B?*

**Timing and Staffing Issues:**

6. *Should the remaining work on Segment A and Segment B be deliberated on simultaneously or sequentially as follows:*
   
   a. *Continue with one joint staff team working solely on Segment A through completion of a final standard. Work on Segment B is minimal during this time period. (Alternative I)*
   b. *Continue with one joint staff team that would complete Segment A through Board deliberations and work toward issuing a public discussion document for Segment A only. After that, the staff will work toward the issuance of a public discussion document on only Segment B issues. (Alternative II)*
   c. *Continue with two separate joint staff teams. One team will work on completion of Segment A items through a final standard. The second team*
will simultaneously work on Segment B issues through the issuance of a final standard. (Alternative III)

d. Continue with one joint staff team working on Segment A and Segment B simultaneously working toward issuing a public discussion document that includes both Segment A and Segment B issues. (Alternative IV)

7. If the Boards decide to issue a separate public discussion document for Segment A individually, what form should the public discussion document take—a Preliminary Views/Discussion Paper or an Exposure Draft?

PROJECT SCOPE ISSUES

Financial Institutions

5. The initial project proposals of both the FASB and IASB proposed a project to develop standards for the presentation of information on the face of financial statements (in particular, the income statement) that would apply broadly to all business enterprises, including financial institutions. The Boards affirmed that scope at the April 2004 joint meeting. However, representatives from financial institutions were initially excluded as JIG members, with a public announcement that a special subgroup of financial institution representatives would be selected at a later date. Both Boards discovered in their past deliberations that it was difficult for financial institutions to implement the proposed disaggregation model with meaningful results. Thus, financial institutions were initially excluded from the JIG, with the understanding a separate subgroup would likely be needed to assist the staff in better understanding and identifying issues relating to reporting by financial institutions. At the April joint meeting, the staff is asking the Boards to clarify the objective for this project and the broad approach to achieving it.

Questions for the Board

1. Is the Boards’ objective to develop a single standard that would apply broadly to all entities?

2. Do Board members agree that they should first develop a standard that would apply to entities other than financial institutions, and then consider the application of such a standard to financial institutions?
**Staff Recommendation**

6. At this early stage in the project, the staff recommends that the Boards’ objective should be the development of a single standard that would apply broadly to all business enterprises. The staff further recommends that deliberations initially focus on developing standards of presentation that would apply to entities other than financial institutions. Once those standards are sufficiently developed, the Boards could then consider how such standards might be adapted or applied to financial institutions. The staff acknowledges the difficulties encountered in past attempts to apply such a generalized disaggregation model to financial institutions. It therefore recommends the immediate formation of a JIG subgroup that would assist the staff in identifying (and resolving) application issues to be considered in the financial institutions phase of the project. The staff will use the subgroup independent to and included with the main JIG group—that is, the staff may ask the subgroup questions that might differ from those asked to the group, in order to gain clarity about their issues relating financial institutions.

7. Should the Boards later encounter difficulties in applying a generalized model to financial institutions, it can evaluate whether to develop separate standards.

**Interim Financial Statements and Notes to Financial Statements**

8. The scope of the FASB’s original project included interim financial statements and notes to financial statements. However, the proposal did not clearly state the objective of reconsidering the existing requirements in those areas. The IASB’s original project proposal was silent on these points. The staff would like to clarify the Boards’ expectations in this regard, particularly in light of work underway in other projects.

9. Both the FASB and IASB have standards on interim reporting. IAS 34 and APB 28 address recognition and measurement in interim information, and eliminating existing differences in that area is a candidate within short-term convergence. There are other differences in the scope of guidance and implementation for interim information under IAS 34 and APB 28. In particular, IAS 34 addresses the form, content, and comparative requirements. APB 28 provides guidance on required disclosures in interim financial information.

10. Both the FASB and IASB generally develop required note disclosures on a standard by standard basis. Two ongoing research projects may influence the direction of future disclosure requirements. The Canadian Accounting Standards Board is leading the Disclosure
Framework project, which aims to develop disclosure concepts (including boundaries between disclosures in the financial statements and other reporting vehicles). The New Zealand Financial Reporting Standards Board is leading the Management Commentary project. That project seeks to develop requirements (or best practices) relating to Management Commentary, including descriptions of main trends and factors underlying development, performance and position of the business of an entity (which may also be referred to as MD&A).

11. In light of those other projects and potential projects, the staff is asking the Boards to clarify the extent to which the reporting financial performance project should change existing interim reporting standards and note disclosures.

Questions for the Board

3. Do Board members agree with the staffs’ approach regarding interim financial statements and notes to financial statements?

Staff Recommendation

12. Because the staff believes the scope of this project never included fundamental reconsideration of interim reporting requirements or note disclosures, the staff plans to change existing reporting requirements only as needed through consequential amendments made necessary by Board decisions.

13. [Not reproduced in Observer Notes]

Direct Method of Cash Flows

14. At the April 2004 joint meeting, the Boards directed the staff to evaluate whether it could make a “quick fix” to financial reporting by amending IAS 7 and Statement 95 to require the direct method of cash flow reporting.

15. In that regard, the staff undertook efforts to assess whether such a change would indeed be a “quick fix” improvement from a user perspective and the benefits would justify the potential costs of implementing it. […]

16. [Not reproduced in Observer Notes]

17. [Not reproduced in Observer Notes]

18. […] The staff is asking the Boards to clarify how the project should address possible changes to existing cash flow reporting requirements.
Questions for the Board

4. Should the scope of this project include a comprehensive reconsideration of Statement 95 and IAS 7, including whether to require a particular method and presentation of the cash flow statement?

Staff Recommendation

19. The staff recommends the project reconsider the existing cash flow reporting requirements as part of this project, with particular emphasis on improving disaggregation requirements, including totals and subtotals, and the type of categories that should be presented on the statement. As part of that process, the staff recommends that the Board consider whether to require the use of a particular method (such as the direct method), and make such a change only if it concludes such a method change enhances financial reporting.

20. [...] A change to mandate use of the direct method in addition to the indirect method does not address the more fundamental improvements to cash flow reporting that users believe are needed (alignment with the income statement and disaggregation). Preparers have expressed concerns about the implementation costs of such a change, suggesting that the benefits of such a near term change exceed the expected implementation costs. For those reasons, the staff recommends the topic of indirect vs. direct method not be addressed in Segment A. Rather, the more fundamental reconsideration of cash flow reporting should be considered as part of the Segment B issues.

Additional Topics

21. Based on JIG meeting discussions and informal Board discussions, the staff does not recommend adding any additional topics to the project at this stage.

Questions for the Board

5. Do the Boards believe that there are any additional topics that should be added to either Segment A or Segment B? If so, what are these additional topics and should they be addressed in Segment A or Segment B?
TIMING AND STAFFING ISSUES

22. This section will ask the Boards to consider the timing, staffing, and type of public discussion document(s) that should be issued in connection with this project. The staff has suggested several options for the Boards’ consideration.

23. [Not reproduced in Observer Notes]

Questions for the Board

6. Should the remaining work on Segment A and Segment B be deliberated on simultaneously or sequentially as follows:

(a) Continue with one joint staff team working solely on Segment A through completion of a final standard. Work on Segment B is minimal during this time period. (Alternative I)

(b) Continue with one joint staff team that would complete Segment A through Board deliberations and work toward issuing a public discussion document for Segment A only. After that, the staff will work toward the issuance of a public discussion document on only Segment B issues (Alternative II). The staff notes that under this plan, some work should be completed on Segment B, such as discussions at JIG meetings. The staff would provide the Board with updates of these findings throughout 2005. After that, the staff will work toward the issuance of a public discussion document on only Segment B issues.

(c) Continue with two separate joint staff teams. One team will work on completion of Segment A items through a final standard. The second team will simultaneously work on Segment B issues through the issuance of a final standard (Alternative III). The difference between Alternative II and Alternative III is that with two separate staff teams, work on Segment B can be completed more efficiently than a single team being interrupted with work on Segment A, such as redeliberations.

(d) Continue with one joint staff team working on Segment A and Segment B simultaneously working toward issuing a public discussion document that includes both Segment A and Segment B issues. (Alternative IV)

24. [Not reproduced in Observer Notes]
Staff Recommendation

25. The staff recommends Alternative II […]

THE TYPE OF FUTURE PUBLIC DOCUMENTS

Questions for the Board

7. If the Boards decide to issue a separate public discussion document for Segment A individually, what form should the public discussion document take—a Preliminary Views/Discussion Paper or an Exposure Draft?

26. [Not reproduced in Observer Notes]

Staff Recommendation

27. The staff recommends that the Boards issue an Exposure Draft for Segment A as the first step. The staff acknowledges the contentious nature of the possibility of requiring a single statement of comprehensive income and possible constituent due process concerns. The staff argues that the proposed changes are narrow and that Segment A is designed for short-term convergence, where typically no Preliminary Views/Discussion Papers are issued. The staff contends that an Exposure Draft would still provide constituents with the opportunity to comment on the proposals. An Exposure Draft would move the project forward by improving financial reporting in the short-term and would also achieve convergence faster.
INFORMATION FOR OBSERVERS

MEETING: 21 APRIL 2005, LONDON
PROJECT: PERFORMANCE REPORTING
TOPIC: AGENDA PAPER 2A: REQUIRED FINANCIAL STATEMENTS

SECTION I: PURPOSE OF THIS MEETING

1. At the April meeting, the staff will ask both the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) Board members (collectively, the Boards) for decisions on the following questions:

Question 1: What information should comprise a Full Set of Financial Statements?

- A statement that shows (at a point in time) balances of assets, liabilities, and equity as of the beginning of the period—referred to as a **Beginning of the Period Statement of Financial Position**.
- A statement that shows (at a point in time) balances of assets, liabilities, and equity as of the end of a period—referred to as the **End of the Period Statement of Financial Position**.
- A statement or two statements that show (for a period of time) the changes in assets and liabilities other than from transactions with owners in their capacity as owners—
referred to collectively as a **Statement(s) of Earnings and Comprehensive Income**.¹

- A statement that shows (for a period of time) the changes in assets and liabilities from transactions with owners in their capacity as owners—referred to as a **Statement of Changes in Equity**.
- A statement that shows inflows and outflows of cash—referred to as a **Statement of Cash Flows**.

**Question 2:** Should individual Financial Statements within the Full Set of Financial Statements be shown with equal prominence to each other?

**Question 3:** With regard to the Statement of Earnings and Comprehensive Income, should that information be presented as:

1. A single statement with a total representing all non-owner changes in financial position and no subtotal for net income or profit or loss. *(The Pure Single Statement Approach)*
2. A single statement with a total for non-owners’ changes in financial position and a required subtotal called net income or profit or loss. *(The Modified Single Statement Approach)*; or
3. Two separate statements broken down into a traditional Income Statement and a Statement of Other Comprehensive Income similar to that described in FASB Statement No. 130, *Reporting Comprehensive Income*, paragraph 22.² *(The Two-Statement Approach)*?

**Question 4:** Based on the Boards’ decisions on Questions 1 through 3, at this time, do the Boards prefer to make the proposed revision by amending their existing guidance rather than create a new replacement standard?

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¹U.S GAAP uses terms such as *net income*, *results of operations* and *earnings* inconsistently throughout the literature. The term *results of operations* is undefined in U.S GAAP and therefore, for purposes of this agenda paper the terms *net income* and *results of operations* are synonymous. Since FASB Concepts Statement No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises*, describes the concept of earnings differently than net income, the staff has not used the term *earnings* in this Agenda Paper except as used in the title of this statement. IASB literature does not define the terms *other comprehensive income* or *comprehensive income*.  
²That presentation also is described in Format B of Appendix B of Statement 130.
SECTION II: ORGANIZATION OF THE AGENDA PAPER

2. The remainder of this Agenda Paper is organized as follows:

   Section III: Definitions
   Section IV: Background and Scope
   Section V: Composition of a Full Set of Financial Statements
   Sections VI: Whether the Required Financial Statements Should Be Shown with Equal Prominence to Each Other
   Section VII: Presentation Options for the Statement of Earnings and Comprehensive Income
   Section VIII: How Should Existing Guidance Be Changed?
   Appendices [Not reproduced in Observer Notes]

SECTION III: DEFINITIONS

3. This Agenda Paper uses the following defined terms:

   Financial Statements—Information presented in a format that is highly aggregated in which similar information is grouped (classified) by its nature or functions to enhance understandability (or avoid confusion in the details).

   Notes to Financial Statements—Contain information in addition to that presented in the balance sheet, income statement, statement of changes in equity and cash flow statement. Notes provide narrative descriptions or disaggregations of items disclosed in those statements and information about items that do not qualify for recognition in those statements. (IAS 1, Presentation of Financial Statements, paragraph 11)

   Basic Financial Statement Package—Represents the combination of Financial Statements and Notes to Financial Statements.

   Financial Reporting—Represents all information that an entity provides to present and potential investors and creditors and other users in making rational investment, credit, and similar decisions. Financial Reporting is neither limited to information presented in a basic Financial Statement Package nor is it limited to audited information.

   Statement of Other Comprehensive Income—A statement that shows revenues, expenses, gains, and losses that under GAAP are included in comprehensive income but excluded from net income.
SECTION IV: BACKGROUND AND SCOPE

4. At the April 22, 2004 Joint FASB/IASB Board meeting, the Boards agreed that there is merit in researching whether a consistent set of Financial Statements should be required for all jurisdictions.

5. In Segment A, the staff did not attempt to determine if there was a need for any “new” Financial Statements (for example, a statement that shows remeasurements\(^3\) or fair value adjustments). Rather, this portion of the project is directed solely at the Financial Statements that are currently described in each of the jurisdiction’s literature and the Boards’ interest in convergence. […]

SECTION V—COMPOSITION OF A FULL SET OF FINANCIAL STATEMENTS

6. Concepts Statement 5 and IAS 1 consistently describe the type of information that should be shown as Financial Statements. IAS 1 defines what a complete set of financial statements is; there is no similar standard in U.S. GAAP. While Concepts Statement 5 provides a description of a Full Set of Financial Statements, that description has never been promulgated into U.S. GAAP. […]

7. A question has arisen as to whether existing practice should be changed to include a Beginning of the Period Statement of Financial Position in a Full (or complete) Set of Financial Statements. Arguments for and against requiring a Beginning of the Period Statement of Financial Position in a Full Set of Financial Statements are as follows:

   a. The Beginning of the Period Statement of Financial Position would enhance understandability, especially the understanding of how Financial Statements articulate with each other and facilitate the analysis of Financial Statements conducted by investors and creditors.

   b. The objective of the Statement of Financial Position is not limited to enabling investors and creditors to identify the reporting entity’s financial strengths and weaknesses and assess its liquidity and solvency. The Statement of Financial Position also provides a basis for investors and creditors to evaluate information about the reporting entity’s performance during the period.\(^4\) This includes calculating key ratios that analysts typically use both for the beginning and ending of the period. […]

   c. Although information provided in the Beginning of the Period Statement of Financial Position would generally, due to its timeliness, be less relevant than the information provided in the End of the Period Statement of Financial Position, having that information would facilitate the assessment of changes shown in the Statement of

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\(^3\)As previously defined in the IASB’s Performance Reporting project.
Earnings and Comprehensive Income, Statement of Changes in Equity, and Cash Flows.\(^5\) Having a Beginning of the Period Statement of Financial Position readily accessible will enable investors and creditors to immediately make more informed decisions without requiring added time to obtain that information. Accordingly, the perceived diminished relevance factor does not warrant the omission of the Beginning of the Period Statement of Financial Position.

d. […] Some have indicated that a Beginning of the Period Statement of Financial Position is extremely important when events that trigger restatement of Financial Statements occur (such as for entities whose functional currency is the currency of a hyperinflationary economy and entities that made accounting changes) during the period. In such case, the Beginning of the Period Statement of Financial Position would no longer be identical to the prior years’ End of Period Statement of Financial Position. Disclosure alone may be less effective in explaining the effect of particular changes to the Beginning of the Period Statement of Financial Position, which users indicate is important to their ratio calculations and general understanding of the period changes that have occurred.

e. [Not reproduced in Observer Notes]

f. It should be noted that the cost of providing the Beginning of the Period Statement of Financial Position is minimal when there are no events that trigger remeasurements. Also, the benefits of the information exceed the costs whenever events that trigger restatement of Financial Statements occur. This is because of the reasons noted in “d” above. Furthermore, restatement of the Beginning of the Period Statement of Financial Position is necessary to prepare the Statement of Earnings and Comprehensive Income and the Statement of Cash Flows. Accordingly, the requirement of presenting the Beginning of the Period Statement of Financial Position should not impose undue costs to preparers. Some however, argue that any additional costs should be avoided perhaps, because they see little added value from a Beginning of the Period Statement of Financial Position and related notes over the more current information provided by the End of the Period Statement of Financial Position and related notes.

g. Some […] noted that presenting the Beginning of the Period Statement of Financial Position would become a major exercise if all accompanying Notes to the Financial Statements also were required to be presented for the beginning of the period. They questioned whether the cost of providing that information would exceed its benefits. This is especially true when the financial statements are restated.\(^6\)

h. Some argue that although the Beginning of the Period Statement of Financial Position enhances understandability, that enhancement may not be sufficient to warrant that it

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\(^5\)Paragraph 24(b) of Concepts Statement 5 states: “Statements of earnings and comprehensive income generally reflect a great deal about the profitability of an entity during a period, but that information can be interpreted most meaningfully...if it is used in conjunction with a statement of financial position, for example, by computing rates of return on assets or equity.”

\(^6\)If the Boards agree that a Beginning of the Period Statement of Financial Position should be required in a Full Set of Financial Statements the full effect of this change could extend to the Notes to the Financial Statements. Notes to the Financial Statements are not addressed in this Agenda Paper as the staff has asked the Boards to clarify the scope of the project regarding Notes to the Financial Statements in the discussion related to the project plan. At this time, the staff has not attempted to identify every item in a Basic Financial Statement Package that may be affected by the change in the composition of the required financial statements. Rather the staff thought it best to wait for the Boards’ tentative decisions or leanings before expending resources on that effort.
should be required. Information becomes less relevant as it gets older and its relevance may diminish or be lost\(^7\) thereby making the costs of preparing the information greater than the benefit of the information. This would be especially true if the Boards were to require more than two periods of Full Sets of Financial Statements. The major objective of the Statement of Financial Position is to enable investors and creditors to identify the reporting entity’s financial strengths and weaknesses and assess its liquidity and solvency. The latest information would suffice to assess the liquidity and solvency of the reporting entity; hence the Beginning of the Period Statement of Financial Position for past periods may no longer be relevant. The Boards may choose to encourage presentation of the information but not require it.


   a. The Boards have already independently, in either their standards or Concepts Statements, indicated that this information is important to display.

   b. Almost all […] supported the display of this information. There was some concern that the Statement of Earnings and Comprehensive income should be two statements rather than one; however, many […] believed that both the components of earnings and comprehensive income were important to present. The staff will ask the Boards for further display decisions on the Statement of Earnings and Comprehensive Income later in this agenda paper.

   c. Currently, most regulators around the world require, at a minimum End of the Period Statement of Financial Position, Statement of Earnings (and Comprehensive Income where required), and a Statement of Cash Flows. Some regulators require a Statement of Changes in Equity, while others—including the U.S. Securities and Exchange Commission—allow the information to be disclosed in a footnote.

   d. There is a long established practice in accounting worldwide that a Full Set of Financial Statements includes a statement of financial position, a statement of earnings, a statement of shareholders’ equity, and a statement of cash flows. Some preparers were even unaware that U.S. GAAP does not require presentation of these statements.

   e. While there is no specific U.S. GAAP requirement for presentation of a Statement of Financial Position or a Statement of Earnings and Comprehensive Income, there are numerous U.S. GAAP disclosure and presentation requirements within specific Standards that describe how to report transactions or events within a particular financial statement.

   f. Auditing standards support this long established practice. AU Section 508.06, \textit{Reports on Audited Financial Statements}, of the AICPA Auditing literature describes

\(^7\)Paragraphs 56 and 57 of FASB Concepts Statement No. 2, \textit{Qualitative Characteristics of Accounting Information}, discuss timeliness as an aspect of relevance. Paragraph 56 notes: “If information is not available when it is needed or becomes available so long after the reported events that it has no value for future action, it lacks relevance and is of little or no use.”
the required financial statements in its explanation of how to report on comparative financial statements. […]

Staff Recommendation

9. With regard to the End of the Period Statement of Financial Position, the Statement of Earnings and Comprehensive Income, the Statement of Changes in Equity, and the Statement of Cash Flows, the staff recommends that the individual Financial Statements, when taken together be considered a Full Set of Financial Statements that are required to be presented in a Basic Financial Statement Package. The staff recommends that a Beginning of the Period Statement of Financial Position should be encouraged but not required in a Full Set of Financial Statements. […]

10. With regard to the Beginning of the Period Statement of Financial Position, the staff argues that although the Beginning of the Period Statement of Financial Position would provide information that is integral to the understanding of the Financial Statements for a certain period, the older Beginning of the Period Statement of Financial Position loses relevance over time and for the most part, its information usefulness is replaced by the End of the Period Statement.

11. The staff would still recommend that the Board encourage but not require inclusion of the Beginning of the Period Statement of Financial Position because of the importance of this Statement to some users. […]

SECTION VI—WHETHER THE REQUIRED FINANCIAL STATEMENTS SHOULD BE SHOWN WITH EQUAL PROMINENCE TO EACH OTHER

Question 2: Should individual Financial Statements within the Full Set of Financial Statements be shown with equal prominence to each other?

12. Inconsistencies in the requirements for presentation exist in the Statement of Changes in Equity. Both IAS and FASB Standards allow certain information to be presented in the Notes to Financial Statements rather than in a traditional Financial Statement format.

13. In Section V above, the staff recommends that presentation of a Beginning of the Period Statement of Financial Position be encouraged but not required. If the Boards were to adopt this alternative, a decision would need to be made regarding whether this encouraged information should be presented with equal prominence to the other Financial Statements.
14. Concepts Statement 5, paragraph 5, states: “The financial statements of an entity are a fundamentally related set that articulate with each other and derive from the same underlying data (footnote reference omitted).” […] 

15. IASB Framework, paragraph 20 […] 

16. Both FASB and IASB literature are clear that information provided in one financial statement generally compliments information provided in one or more of the other financial statements. It is the complementary nature of the information that gives users of the information a fuller financial picture of an entity; thus indicating that there is strong conceptual support for requiring Financial Statements considered to represent a Full Set of Financial Statements with equal prominence to each other. 

17. [Not reproduced in Observer Notes] 

18. [Not reproduced in Observer Notes] 

**Staff Recommendation**

19. The staff argues that it is essential that all recognized items of financial activity for the period be reported in the Financial Statements and therefore would recommend that the Boards require that all Financial Statements in a Full Set of Financial Statements be shown with equal prominence to each other. 

20. The staff also recommends that if the Boards encourage, but not require, a Beginning of the Period Statement of Financial Position, they require the Statement to be presented with equal prominence as the other Financial Statements in a Full Set of Financial Statements. 

21. The staff contends that this information is valuable and the Boards have an opportunity to converge on the consistent presentation of this information. Research indicates that complete and consistent presentation of Financial Statement information is important to users of the information. This provides the Boards with the opportunity to respond to this request. 

22. [Not reproduced in Observer Notes] 

23. [Not reproduced in Observer Notes]
SECTION VII: PRESENTATION OPTIONS FOR THE STATEMENT OF EARNINGS AND COMPREHENSIVE INCOME

Question 3: With regard to the Statement of Earnings and Comprehensive Income, should that information be presented using:

1. The Pure Single Statement Approach
2. The Modified Single Statement Approach
3. The Two-Statement Approach?

Issue

27. At the April 22, 2004 joint meeting, the Boards agreed that the staff should allow the Boards to consider as part of Segment A whether there should be a single statement of comprehensive income that includes a subtotal similar to the concepts of “net income from continuing operations” or “profit and loss.” This Agenda Paper discusses the merits for and against not only that approach (the Modified Single Statement Approach) but an approach that would eliminate the required subtotal net income (the Pure Single Statement Approach) and an approach that would include the required subtotal net income and present OCI items in a separate statement from the income statement (the Two-Statement Approach). The staff identified and included in this agenda paper those options that have been […] noted by some Board members […] for sake of completeness.

28. [Not reproduced in Observer Notes]

29. [Not reproduced in Observer Notes]

The Pure Single Statement Approach

30. The Pure Single Statement Approach would be the most significant change to current requirements. Similar to the Modified Single Statement Approach, this change would require that items of OCI be included on the same statement as other non-owner changes in assets and liabilities (the current traditional income statement). However, if the subtotal of net income were eliminated without a transition period it would be both significant and contentious.

31. [Not reproduced in Observer Notes]

32. [Not reproduced in Observer Notes]

33. Proponents suggest that the Pure Single Statement Approach:
a. Significantly enhances the visibility/transparency of items of other comprehensive income. (FASB Statement 130 Dissent, paragraph 67)

b. Encourages users of financial statements to focus on (or consider) the components that constitute comprehensive income rather than limiting their analysis to net income and earnings per share. (FASB Statement 130 Dissent)

c. Would not permit an enterprise to display items of other comprehensive income with less prominence and to characterize them differently from other items of comprehensive income that are currently included in net income. (FASB Statement 130 Dissent)

d. Gives users of financial statements the ability to fully view and therefore analyze economic and financial activity of an enterprise. (FASB Statement 130 Dissent)

e. Reduces undue emphasis on summary indicators and avoids focusing attention almost exclusively on “the bottom line,” earnings per share, or other highly simplified condensations.

f. Is consistent with the notion in Concepts Statement 1, paragraph 53, which states: “Management ability and performance are contributing factors, but so are events and circumstances that are often beyond the control of management, such as general economic conditions, supply and demand characteristics of enterprise inputs and outputs, price changes, and fortuitous events and circumstances.”

g. Is an all-inclusive presentation, summarizing all aspects of financial performance that are capable of being recognized in financial statements during the period. In doing so, the single statement provides the necessary link to the equity section of the balance sheet by reflecting all recorded changes in equity for the period other than from transactions with owners in their capacity as owners.

h. Is more consistent with the FASB Concepts Statements and the all-inclusive income concept. (FASB Statement 130, paragraph 67)

i. Reduces the cost to users of a multiple-step approach.8

j. Enhances analysts’ identification of earnings management and reduces the bias in their valuation judgments. It should be noted that the Hirst and Hopkins study suggests that a Pure Single Statement of Comprehensive Income is more effective than including that information in a Statement of Changes in Equity because a single statement is more transparent to users and investors. The study does not specifically address whether a Pure Single Statement Approach is more effective than a two-statement approach.9

k. Increases the likelihood that nonprofessional advisors use comprehensive income information to assess corporate performance.10

l. Is consistent with the thinking that is important for users to understand all parts of a business and to develop their own measures for assessing performance.


34. In addition, those who support a Pure Single Statement format argue that:

m. There is no overriding need to preserve the current formats for reporting financial performance such as the conventional income statement, especially when no changes to recognition and measurement are being considered in the first part of this project.

n. The format for reporting should not necessarily affect the components to be reported. Even though some may argue that a Two-Statement Approach may offer the opportunity to present more information in greater detail, that does not necessarily mean that the primary components to be reported—and the order in which they are to be reported—should necessarily be different under a single-statement format.

o. There are no conceptual or practical benefits to having multiple statements when it can be shown on a single statement and…there may be some costs to users of the multiple-statement approach (the Two-Statement Approach as described in this Agenda Paper).11

p. In practice users and preparers appear to attach different levels of significance to gains and losses reported in different statements, simply because they are reported in different statements. This issue can be avoided by capturing all the changes in a single statement. If similar information is reported in two statements rather than one, undue significance may be attached to one statement at the expense of the other. Alternatively, greater significance may be given to the distinction between the two statements than is justified in specific cases.

q. That two of the reasons (for implementing the concept of comprehensive income) were to discontinue the practice of taking certain items of comprehensive income directly to equity and to provide a vehicle for addressing future accounting issues, such as the display of unrealized gains and losses associated with financial instruments. (FASB Statement 130, paragraph 40)

r. Net income should include the effect of all of the current period’s economic transactions and other activity of the entity. (FASB Statement 130, paragraph 41)

s. The Modified Single Statement approach still allows for an inappropriate relegation of certain items of comprehensive income that are included in net income to a lesser standing having less visibility than other items of comprehensive income that are included in net income. (FASB Statement 130 Dissent)

t. While there is little demand for presentation in a single statement there is no opposition provided items of other comprehensive income are transparent.12

The Modified Single Statement Approach

35. The Modified Single Statement Approach may be acceptable as a short-term solution for those who believe that the Pure Single Statement Approach is the best answer in the long run. It should satisfy those who strongly believe there is merit in displaying all information in a single statement of comprehensive income yet not lose support of those who strongly believe there is merit in retaining net income. Those others who would prefer to eliminate net income also might find it

11 See footnote 6.
12 Taken from the results of FASB interviews done in 2001 and 2002.
acceptable to leave that issue until other display alternatives are developed. It should be noted that many of the reasons for adopting the Pure Single Statement Approach also would be applicable to the Modified Single Statement Approach and make this approach a viable solution as an interim measure.

36. [Not reproduced in Observer Notes]

37. [Not reproduced in Observer Notes]

38. [Not reproduced in Observer Notes]

39. Those who support a **Modified Single Statement Approach** do so because:

   a. There is a perception among users and preparers that net income attempts to separate managerial performance from enterprise performance (comprehensive income).

   b. It is consistent with Concepts Statement 5’s discussion of a Full Set of Financial Statements which requires a Statement of Earnings and Comprehensive Income; thus by its wording suggesting that there are two parts to a single statement.

   c. It is consistent with FASB Statement 130 that requires the component of net income be shown as part of comprehensive income. The Board decided that comprehensive income should be divided into two broad display classifications, net income and other comprehensive income. The Board reasoned that the division would generally preserve a familiar touchstone for users of financial statements. (FASB Statement 130, paragraph 84)

   d. Allows for disclosure of items of other comprehensive income which “…can be as significant to measurement of an enterprise’s economic and financial performance as those items of comprehensive income that are currently included in measuring net income, and that the comparability and the neutrality of reported information are adversely affected if some items of comprehensive income are omitted from reports on economic and financial performance….items of other comprehensive income [should] be reported in a statement of financial performance, preferably in a single statement in which net income is reported as a component of comprehensive income.” (FASB Statement 130 Dissent)

   e. “If both realized and unrealized changes in market value could be revealed for what they are, separately from the results of operating activities…analysts would have more information than [they] do currently, and [they] might avoid the stock market palpitations that frequently occur because of the information content of a single aggregated number called net income or earnings per share.”

   f. Net income as a subtotal or phrase is embedded in a significant amount of business contracts, management contracts, and IASB and FASB Standards (i.e., EPS Standards). Elimination of that subtotal would cause a significant amount of cost to change contracts and standards.

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13 Financial Reporting in the 1990s and Beyond, AIMR.
The Two-Statement Approach

40. The Two-Statement Approach can be acceptable as a short-term solution. While it still allows for the separation of information that may have the same importance, it does require that the two statements be shown with equal prominence. This option most likely does not go far enough in satisfying those who support the Pure Single Statement Approach as the best answer but it does satisfy those who argue the merit in displaying total comprehensive income as well as net income (as that is determined under current GAAP). […]

41. [Not reproduced in Observer Notes]

42. [Not reproduced in Observer Notes]

43. [Not reproduced in Observer Notes]

44. Those who support a Two-Statement Approach do so because:

   a. Many argued that items identified as OCI were not performance related and that it would be not only confusing but also misleading to require that those items be included in a performance statement. They contend that OCI items should not be characterized as performance measures because of management’s inability to control the market forces that could result in those measures being volatile from period to period. (FASB Statement 130, paragraph 60)

   b. The Pure Single Statement Approach ignores the fact that current practice relies heavily on net income in comparing current period results to prior periods, in predicting the success of companies, and that companies keep this data historically.

   c. Some suggest that the Two-Statement Approach keeps volatility, which is based on market forces that are beyond the control of management and out of the Income Statement.

45. [Not reproduced in Observer Notes]

46. [Not reproduced in Observer Notes]

47. [Not reproduced in Observer Notes]

48. [Not reproduced in Observer Notes]

49. [Not reproduced in Observer Notes]
Staff Recommendation

50. The elimination of the subtotal net income could result in other costs for preparers and users. Many systems are built with language embedded about net income. If net income is abruptly eliminated, these systems would have to be modified to meet the specifications of the new standard. Rather, the staff argues that the Boards have the opportunity to eliminate differences between net income and comprehensive income in a more deliberate and evolutionary way—by further examining disaggregation models and by progressing work on Segment B.

51. […] The staff recommends that the Boards adopt the Modified Single Statement Approach. […]

SECTION VIII—HOW SHOULD EXISTING GUIDANCE BE CHANGED?

Question 4: Based on the Boards’ decisions on Questions 1 through 3, at this time, do the Boards prefer to make the proposed revision by amending their existing guidance rather than create a new replacement standard?

Staff Recommendation

52. The staff recommends that the Boards' decisions on Segment A be promulgated quickly into IFRS and U.S. GAAP, either through a new standard or by amending existing guidance. If the Boards agree with the staff recommendation, that would require amending IAS 1 and FASB consideration of the need to create a standard similar to IAS 1 in U.S. GAAP. The staff acknowledges that there may be additional changes from Segment B that may require amending the Segment A standard. The staff argues that it is more practical and expedient in the interests of convergence to amend existing guidance (and if needed issue a new U.S. standard for Segment A). The staff then recommends that the Segment A amendments to existing guidance or the new Segment A standard be re-evaluated and amended as appropriate during Segment B.
This document is provided as a convenience to observers at joint IASB/FASB Board meeting, to assist them in following the Boards’ discussions. It does not represent an official position of the IASB or the FASB. IASB and FASB Board positions are set out in their respective Standards.

Note: These notes are based on the staff paper prepared for the IASB/FASB Boards. Paragraph numbers correspond to paragraph numbers used in the joint IASB/FASB staff paper. However, because these notes are less detailed, some paragraph numbers are not used.

INFORMATION FOR OBSERVERS

MEETING: 21 APRIL 2005, LONDON
PROJECT: PERFORMANCE REPORTING
TOPIC: AGENDA PAPER 2B: COMPARATIVE FINANCIAL STATEMENTS

INTRODUCTION

1. At the April 21, 2005 joint Board meeting, the FASB and the IASB (collectively, the Boards) will be asked to consider whether and, if so, how the Boards might eliminate existing differences between International Financial Reporting Standards (IFRSs) and U.S. GAAP relating to the requirements for presenting comparative financial statements.

2. This memorandum addresses:
   i. Whether to require comparative financial information covering annual periods and the minimum number of annual periods to be presented; and
   ii. Whether to specify requirements for the presentation of financial information by those entities that voluntarily elect to provide information for periods beyond the required minimum.
3. Memorandum #2 of 3 or Agenda Paper 2A discusses the financial statements that are to be presented with equal prominence as part of a **full set of financial statements for the period**.\(^1\) In that memorandum, the staff recommends that the following financial statements be required:

   (a) End of the Period Statement of Financial Position;
   (b) Statement(s) of Earnings and Comprehensive Income;
   (c) Statement of Changes in Equity; and
   (d) Statement of Cash Flows.

4. Based on this definition, this memorandum discusses the minimum number of annual periods that should be presented.

5. The discussion in this memorandum is focused solely on reporting for annual periods. This memorandum does not address the interim financial statements and the issue of comparative information required in notes to financial statements. The staff will ask the Boards separately in Memorandum #1 of 3 or Agenda Paper 2 to clarify whether the scope of this project includes financial statements covering interim periods and disclosures in notes to financial statements. Should the Boards determine that interim reporting or notes to financial statements should be addressed in this project, the staff will prepare a separate memorandum for deliberation at future Board meetings.

6. On January 13-14, 2005, several Board members and staff met with the Joint International Group (JIG) on Performance Reporting and discussed comparative financial statements and other issues. \([…]\)

7. The staff also asked members of the FASB’s Small Business Advisory Committee (SBAC) for their input. The views of SBAC members are also incorporated in this memorandum. The staff further notes that it will continue to monitor progress of the IASB’s project on Non-Publicly Accountable Entities (formerly known as Small and Medium-sized Entities) and will bring issues to future Board meetings if necessary.

8. [Not reproduced in Observer Notes]

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\(^1\) The FASB uses the term “full set of financial statements for the period” whereas the IASB uses the term “complete set of financial statements.” The major difference between the terms is that the former refers to Statements only but the
ORGANIZATION OF THIS MEMORANDUM

9. This memorandum is organized as follows:

Part 1: Questions for the Boards
Part 2: Required Number of Annual Periods of Full Sets of Financial Statements
Part 3: Presentation of Financial Statements when Entities Elect to Provide Information Voluntarily Beyond the Minimum Requirement

Appendix: [Not reproduced in Observer Notes]

PART 1: QUESTIONS FOR THE BOARDS

10. The questions for the Boards are summarized as follows:

1. Do the Boards agree with the staff recommendation to require comparative financial information for all entities, and to limit the required information to two annual periods (the current and prior annual period)?

2. Do the Boards agree with the staff recommendation that the presentation of financial information by those entities that elect to provide information for annual periods beyond the required minimum should be encouraged but not be required?

PART 2: REQUIRED NUMBER OF ANNUAL PERIODS OF FULL SETS OF FINANCIAL STATEMENTS

11. If the Boards agree on the definition of a full set of financial statements for the period, the next issue is whether comparative financial statements should be required and the minimum required number of annual periods that should be presented.

12. Existing guidance regarding comparative financial statements differs between IFRSs and U.S. GAAP. U.S. GAAP encourages but does not require presentation of comparative financial information. Those requirements are set forth in Accounting Research Bulletin (ARB) No. 43, Restatement and Revision of Accounting Research Bulletins, Chapter 2, Section A […] Nevertheless, SEC registrants are required to provide comparative financial statements and, the latter refers to both Statements and related Notes. For discussion purposes, the term “full set of financial statements for the period” will be used as it is defined in FASB literature.

2 Not all SEC registrants are required to present all financial statements for more than one annual period. For example, small business issuers subject to Regulation S-B are required to present one Balance Sheet and two Statements of Income and Cash Flows.
therefore, nonpublic entities are the only entities that may elect to provide financial information covering only a single period.

13. IAS 1, *Presentation of Financial Statements*, generally requires comparative financial information [...] 

14. [...] Most jurisdictions (which include standard setters, securities regulators, and stock exchanges) require financial statements for two annual periods, namely the current and prior annual period. However, some jurisdictions have different requirements. For example, the SEC in the United States requires SEC registrants to present the Balance Sheet at the end of the two most recent annual periods and the Statements of Income, Cash Flows, and Changes in Equity for three annual periods.

15. [Not reproduced in Observer Notes]

16. [Not reproduced in Observer Notes]

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19. [Not reproduced in Observer Notes]

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26. [Not reproduced in Observer Notes]

27. [Not reproduced in Observer Notes]

**Staff Recommendation**

28. The staff recommends that the Boards require comparative financial information and that the Boards require two full sets of financial statements for annual periods, that is, to require financial statements for the current annual period and the prior annual period for all entities,
because most jurisdictions (including standard setters, securities regulators, and stock exchanges) currently require comparative financial information for the prior annual period and, thus, would most efficiently achieve convergence. While true convergence may not be achieved for public entities, convergence will be achieved at least at the standard setters’ level.

QUESTION FOR THE BOARDS:

1. Do the Boards agree with the staff recommendation to require comparative financial information for all entities, and to limit the required information to two annual periods (the current and prior annual period)?

PART 3: PRESENTATION OF FINANCIAL STATEMENTS WHEN ENTITIES ELECT TO PROVIDE INFORMATION VOLUNTARILY BEYOND THE MINIMUM REQUIREMENT

29. The next issue addresses whether to specify requirements for the presentation of financial information by those entities that elect to provide information for periods beyond the required minimum. The conceptual frameworks of both Boards emphasize the importance of presenting financial statements as a full set. Therefore, any information that is presented beyond the minimum requirement should also be required to be presented as a full set.

30. [Not reproduced in Observer Notes]

31. [Not reproduced in Observer Notes]

32. [Not reproduced in Observer Notes]

Staff Recommendation

33. The staff recommends that annual information presented voluntarily beyond the minimum requirement should be encouraged but not required to be presented in the form of a full set of financial statements.

QUESTION FOR THE BOARDS:

2. Do the Boards agree with the staff recommendation that the presentation of financial information by those entities that elect to provide annual information for periods beyond the required minimum should be encouraged but not required?
Introduction

1. Intraperiod tax allocation (or intraperiod allocation) is the allocation of the total tax expense or benefit for the period to various components of comprehensive income (for example, continuing operations and discontinued operations, other comprehensive income[OCI] and capital items. The IASB has considered the so called “backwards tracing” issue, which is a component of intraperiod allocation, on several occasions. The IASB first considered the question of backwards tracing in April 2003. In September and October 2004, the IASB

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1 This paper uses the phrase ‘other comprehensive income’ from US GAAP. The equivalent in IFRSs is total recognised income and expenses, other than amounts recognised in income. Items described in IFRSs as recognised directly in equity include items described under US GAAP as recognised in other comprehensive income.
and FASB staffs (the “staffs”) recast the issue as a difference in the intraperiod allocation requirements of Statements 109 and IAS 12.

2. This paper incorporates certain previous FASB Board Memoranda and IASB Agenda Papers. The following is a summary of the attachments to this Paper:
   - Agenda Paper 3A: Statement 109’s requirements on intraperiod allocation
   - Agenda Paper 3B: Tabular comparison of intraperiod allocation under US GAAP and IFRS
   - Agenda Paper 3C: IASB Agenda Paper from September 2004 [not reproduced in Observer Notes]
   - Agenda Paper 3D: IASB Agenda Paper from October 2004 [not reproduced in Observer Notes]
   - Agenda Paper 3E: Cover letter to proposed 1996 FASB staff approach
   - Agenda Paper 3F: Proposed 1996 FASB staff approach
   - Agenda Paper 3G: Comment letter analysis from proposed 1996 FASB staff approach [not reproduced in Observer Notes]
   - Agenda Paper 3H: Previous FASB backwards tracing examples.

3. Backwards tracing is a slang term that has been used in this project and for many years at the FASB and IASB. The staffs believe this slang term means very different things to different people.

4. For many on the FASB staff, backwards tracing was defined in a FASB Board memorandum dated November 20, 1991:

   Backwards tracing remeasures in the current year the after-tax amount of gains and losses that occurred and were reported in prior years. The objective is to “correct” the after-tax amounts for events reported in prior years.

5. Paragraphs 26—28 of Statement 109 indicate that whenever there is a change in tax rate (or law), valuation allowance, or tax status of an enterprise (referred to as changes in tax rates, etc herein), the effect of that change shall be included in
As a result of the view that current and deferred tax impacts of changes in tax rates, etc. are generally changes in net income of the period of the change, some at the FASB believe that “as a result of backwards tracing] the after tax amount of the other event—for example, a gain or loss reported in the current year—suffers.” In other words, if the effect of the change in tax rate, etc. were allocated to a component of other comprehensive income, it would not be available to allocate income from continuing operations in the current period. The view that all changes in tax rates, etc. should always impact income from continuing operations, regardless of whether part of the impact is from a transaction that has not impacted income from continuing operations, informs the view that the current year “suffers.”

6. To certain IASB staff and Board members, backwards tracing is defined by the principles expressed in paragraphs 57, 58, and 58(a) of IAS 12. Paragraph 57 states, “Accounting for the current and deferred tax effects of a transaction or other event is consistent with the accounting for the transaction or event itself.” Paragraphs 58 and 58(a) states.\(^3\)

> Current and deferred tax should be recognized as income or an expense and included in the net profit or loss for the period, except to the extent that the tax arises from: (a) a transaction or event which is recognized, in the same or a different period, directly in equity….

7. Thus, to some on the IASB staff and Board, backwards tracing is simply accounting for the current and deferred tax effects of all equity items in a consistent manner with the accounting for the underlying transaction itself.

8. A further complication to the understanding of backwards tracing is the financial statement classification of accumulated other comprehensive income (AOCI). Some assert that AOCI is not equity, per se, since it does not arise from contributed capital. Others believe that AOCI is equity because it meets

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\(^2\) With certain exceptions related to valuation allowances for deferred tax assets acquired in business combinations and certain capital related items.

\(^3\) Paragraph 58(b) is not relevant and so is not reproduced here.
the Concepts Statement 6 definition of equity discussed in paragraph 60, which states, “In a business enterprise, equity is the ownership interest” and footnote 29 which states:

This Statement defines equity of business enterprises only as a whole, although the discussion notes that different owners of an enterprise may have different kinds of ownership rights and that equity has various sources. In financial statements of business enterprises, various distinctions within equity, such as those between common stockholders' equity and preferred stockholders' equity, between contributed capital and earned capital, or between stated or legal capital and other equity, are primarily matters of display that are beyond the scope of this Statement.

9. Therefore, differences in views in what some believe is an equity account can further cloud the discussion of this difference between IFRS and US GAAP. For sake of clarity, this paper will use the following terms:
   - Equity—consistent with footnote 29 cited above, when this paper refers to equity, it will include all components of shareholders’ equity, including AOCI.
   - Capital—when this paper uses the term capital, it refers only to contributed capital.

10. As a result of the foregoing, the staffs caution both staff and Board members to be mindful of their use of language when discussing this issue. It is the staffs’ view that the use of slang, perhaps more than other factors, could frustrate a resolution of this difference between IAS 12 and Statement 109.

11. Statement 109 has detailed guidance on intraperiod allocation, which is reproduced in Agenda Paper 3A. IAS 12 is silent on intraperiod allocation other than requiring that current and deferred tax should be charged or credited directly to equity if the tax relates to items that are charged or credited, in the same or a different period, directly to equity.

12. These requirements in Statement 109 and IAS 12 have caused a large SEC reconciling item, as follows. The tax effect arising in the year relating to gains
and losses of the year recognised in OCI or capital is, under both standards, recognised in OCI or capital. However, the effect of changes in tax rates, tax law, tax status and most changes in valuation allowances attributable to gains and losses recognised in OCI or capital in previous years is recognised in OCI or capital under IAS 12 but in income from continuing operations under Statement 109. A tabular comparison of the intraperiod allocation under US GAAP and IFRS is attached as Agenda Paper 3B.

13. The IASB has discussed this difference on the following occasions:

April 2003: The IASB considered the question of allocation of the effects of changes in tax rates to OCI or capital under the two standards, but not the other requirements of Statement 109 relating to intraperiod allocation. The IASB staff recommended that IAS 12 not be amended to converge with Statement 109 and that the IASB should ask the FASB to consider amending Statement 109 to converge with IAS 12 on the matter of tax effects attributable to gains and losses recognised in OCI or capital. One Board member strongly disagreed with the staffs’ recommendation not to amend IAS 12. That Board member noted that in this situation, the change that an entity is accounting for is a change in an asset or liability, and that change should flow through the income statement. Furthermore, that Board member thinks it is almost impossible to illustrate how to make the allocation required by IAS 12, as it is extremely complex. Finally, that Board member also pointed out that the FASB reconsidered this aspect of Statement 109 several times and always concluded that, in fact, it was impracticable. Accordingly, the IASB directed the IASB staff to work with the FASB to document the practical issues surrounding this issue.

September and October 2004 Educational sessions: The IASB considered the Statement 109 requirements for intraperiod allocation as a whole. The IASB

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4 The September and October 2004 IASB Agenda Papers are attached to this paper as Agenda Paper 3C and Agenda Paper 3D. These papers are attached for the benefit of FASB Board members and the staffs encourage FASB Board members to review these papers prior to reading the staff analysis. The papers
expressed concern with the allocation methodology prescribed by Statement 109 and directed the staffs to develop a paper outlining alternative allocation methodologies that also address the differences between IAS 12 and Statement 109 on items that give rise to the requirement to trace backwards.

14. This paper sets out the following options for the Boards to consider:

   Option A: Do not converge on intraperiod allocation at this time. The FASB and IASB Boards could separately deliberate intraperiod allocation if either Board believes improvements in their standard is advisable.

   Option B: Converge the intraperiod allocation principles in IAS 12 with the detailed intraperiod allocation requirements in Statement 109. This would effectively result in retaining the intraperiod allocation guidance in Statement 109, amended to require allocation to the components of income, OCI or capital of changes in (1) tax rates, (2) tax laws, (3) tax status of an entity and (4) valuation allowances.

15. The staffs have also considered but have rejected a comprehensive rethink of the requirements for intraperiod allocation, including the requirements for operating loss carryforwards and carrybacks. The staffs believe this level of effort is beyond the scope of a short-term convergence project.

16. The staffs plan to discuss this paper with the Boards at separate meetings before a discussion at the joint meeting in April.

17. While the FASB staff has a divided view, the staffs recommend Option B. For IFRS, the staffs’ recommendation would require amending IAS 12 to adopt the FASB’s detailed guidance on intraperiod allocation. For US GAAP, the staffs’ recommendation would require amending Statement 109 to permit the allocation of changes in tax rates, etc. to all components of equity.

include a review of the so called backwards tracing issue (including a tabular summary of the requirements of both standards) as well as detailed information on intraperiod allocation under US GAAP.
18. Because IAS 12 is largely silent on the question of intraperiod allocation, most of the requirements of Statement 109 can be regarded as consistent with IAS 12 and need not give rise to reconciling items. The exceptions are the requirements in Statement 109 on changes in tax rates, etc. which require such changes to be recognised in income from continuing operations even when they relate to items previously recognised in OCI or capital (with certain limited exceptions as discussed in paragraph 37 of Statement 109). IAS 12 requires the effect of such changes to be recognised in OCI or capital.

19. Consistent with other decisions in the short-term convergence project, the staffs recommend that the IASB include in IAS 12 the requirements in Statement 109 on intraperiod allocation, to the extent that they are not inconsistent with the existing requirements of IAS 12. Doing so ensures that convergence on those requirements is achieved and will eliminate any diversity in practice that may currently exist under IAS 12 or may potentially develop when IAS 12 has been fully implemented by entities required to adopt IFRS.

20. The staffs do not consider it appropriate in the short-term convergence project to devote time to developing a new system of intraperiod allocation when one exists already in US GAAP. [not reproduced in Observer Notes] If the intraperiod allocation requirements of Statement 109 (except the requirements relating to changes in tax rates etc) is adopted by IAS 12, the only remaining difference between Statements 109 and IAS 12 in this area would be the allocation of changes in tax rates, etc.

21. In relation to these matters, the staffs recommend the IAS 12 approach of allocating the effect of the changes to all components of equity. In fact, during 1996, the FASB conducted a limited exposure of an approach similar to the staffs’ recommendation. The FASB considered whether to amend the requirements of Statement 109 relating to changes in tax rates etc on two occasions since Statement 109 was published.
FASB Deliberations —1993

22. In August 1993, the Revenue Recognition Act of 1993 was enacted in the United States and increased the top corporate tax rate from 34 percent to 35 percent. In anticipation of the change in tax rates and as a result of the change in rates, the Board received several unsolicited comment letters in 1992 and 1993 seeking the FASB to reconsider paragraph 27.5

23. The FASB staff prepared a Board memo summarizing the issues and on September 29, 1993, the FASB voted (6 to 1) that the reconsideration of the backwards tracing issue should not be added to the Board’s agenda.

FASB Deliberations—1995-1997

24. During the period from 1995–1997, the FASB met on several occasions to consider staff research conducted in response to another round of constituent requests that it reconsider the backwards tracing aspects of Statement 109. In April 1996, the FASB voted to 4 to 3 to add the topic to the agenda. However, under the prior supermajority rules that applied at that time, the Board did not add the topic to the agenda.

25. After the April 1996 FASB decision, the FASB staff developed a draft approach for allocating the tax effects of changes in tax rates, etc. to all equity items. Despite the previous decision not to add the topic to the agenda, for various reasons the FASB directed the FASB staff to distribute a letter to certain constituents along with a draft approach for review and comment. In response to circulation of the draft approach, the FASB received 28 comment letters, with 23 respondents indicating they favored redeliberation of the issue, and 21 respondents indicating they believed the draft approach was a “workable approach.” However, on July 23, 1997, the FASB voted 4-2 (with one

5 Paragraph 27 describes the reporting of the adjustment to deferred taxes for the effect of an enacted change in tax rates. Paragraph 27 states “Deferred tax liabilities and assets shall be adjusted for the effect of a change in tax laws or rates. The effect shall be included in income from continuing operations for the period that includes the enactment date [emphasis added].”
abstention) to discontinue the research project on backwards tracing. A cover
letter, the draft approach, and a summary of the responses received are set out in
Agenda Papers 3E, 3F, and 3G.

26. [not reproduced in Observer Notes]

*Alternatives and Staffs’ Recommendation*

27. [not reproduced in Observer Notes]

28. [not reproduced in Observer Notes]

29. [not reproduced in Observer Notes]

30. [not reproduced in Observer Notes]

31. [not reproduced in Observer Notes]

32. [not reproduced in Observer Notes]

33. [not reproduced in Observer Notes].

34. [not reproduced in Observer Notes]:

35. [not reproduced in Observer Notes]

36. [not reproduced in Observer Notes].

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38. [not reproduced in Observer Notes]

39. [not reproduced in Observer Notes]

40. [not reproduced in Observer Notes]

41. [not reproduced in Observer Notes]

42. [not reproduced in Observer Notes].
43. [not reproduced in Observer Notes]

44. As noted above, the staffs recommend Option B, i.e. that the Boards converge on this issue by IAS 12 including the Statement 109 requirements on intraperiod allocation, amended in Statement 109 to require allocation of changes in tax rates, etc. to the components of operating income, OCI and capital in which was recognised the tax income or expense that is affected by the change.
Agenda Paper 3A: Statement 109’s requirements on intraperiod allocation

London 2005 allocation guidance

**Intraperiod Tax Allocation**

35. Income tax expense or benefit for the year shall be allocated among continuing operations, discontinued operations, extraordinary items, other comprehensive income, and items charged or credited directly to shareholders' equity (paragraph 36). The amount allocated to continuing operations is the tax effect of the pretax income or loss from continuing operations that occurred during the year, plus or minus income tax effects of (a) changes in circumstances that cause a change in judgment about the realization of deferred tax assets in future years (paragraph 26), (b) changes in tax laws or rates (paragraph 27), (c) changes in tax status (paragraph 28), and (d) tax-deductible dividends paid to shareholders (except as set forth in paragraph 36 for dividends paid on unallocated shares held by an employee stock ownership plan [ESOP] or any other stock compensation arrangement). The remainder is allocated to items other than continuing operations in accordance with the provisions of paragraph 38.

36. The tax effects of the following items occurring during the year are charged or credited directly to other comprehensive income or to related components of shareholders' equity:

a. Adjustments of the opening balance of retained earnings for certain changes in accounting principles or a correction of an error.

b. Gains and losses included in comprehensive income but excluded from net income (for example, translation adjustments under Statement 52 and changes in the unrealized holding gains and losses of securities classified as available-for-sale under FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*).

c. An increase or decrease in contributed capital (for example, deductible expenditures reported as a reduction of the proceeds from issuing capital stock).
d. An increase in the tax basis of assets acquired in a taxable business combination accounted for as a pooling of interests and for which a tax benefit is recognized at the date of the business combination. FASB Statement No. 141, Business Combinations, prohibits the use of the pooling-of-interests method for all business combinations initiated after June 30, 2001.

e. Expenses for employee stock options recognized differently for financial reporting and tax purposes (refer to paragraphs 41-44 of FASB Statement No. 123, Accounting for Stock-Based Compensation, and paragraph 17 of APB Opinion No. 25, Accounting for Stock Issued to Employees).

f. Dividends that are paid on unallocated shares held by an ESOP and that are charged to retained earnings.

g. Deductible temporary differences and carryforwards that existed at the date of a quasi reorganization (except as set forth in paragraph 39).

37. The tax benefit of an operating loss carryforward or carryback (other than those carryforwards referred to at the end of this paragraph) shall be reported in the same manner as the source of the income or loss in the current year and not in the same manner as (a) the source of the operating loss carryforward or taxes paid in a prior year or (b) the source of expected future income that will result in realization of a deferred tax asset for an operating loss carryforward from the current year. The only exceptions are as follows:

a. Tax effects of deductible temporary differences and carryforwards that existed at the date of a purchase business combination and for which a tax benefit is initially recognized in subsequent years in accordance with the provisions of paragraph 30.

b. Tax effects of deductible temporary differences and carryforwards that are allocated to shareholders' equity in accordance with the provisions of paragraph 36 (items (c) and (e)-(g)).
If there is only one item other than continuing operations, the portion of income tax expense or benefit for the year that remains after the allocation to continuing operations is allocated to that item. If there are two or more items other than continuing operations, the amount that remains after the allocation to continuing operations shall be allocated among those other items in proportion to their individual effects on income tax expense or benefit for the year. When there are two or more items other than continuing operations, the sum of the separately calculated, individual effects of each item sometimes may not equal the amount of income tax expense or benefit for the year that remains after the allocation to continuing operations. In those circumstances, the procedures to allocate the remaining amount to items other than continuing operations are as follows:

a. Determine the effect on income tax expense or benefit for the year of the total net loss for all net loss items

b. Apportion the tax benefit determined in (a) ratably to each net loss item

c. Determine the amount that remains, that is, the difference between (1) the amount to be allocated to all items other than continuing operations and (2) the amount allocated to all net loss items

d. Apportion the tax expense determined in (c) ratably to each net gain item

Refer to paragraphs 273-276 for additional guidance

Application guidance: Intraperiod Tax Allocation

273. If there is only one item other than continuing operations, the portion of income tax expense or benefit for the year that remains after the allocation to continuing operations is allocated to that item. If there are two or more items other than continuing operations, the amount that remains after the allocation to continuing operations is allocated among those other items in proportion to their individual effects on income tax expense or benefit for the year.
The following example illustrates allocation of income tax expense if there is only one item other than income from continuing operations. The assumptions are as follows:

a. The enterprise's pretax financial income and taxable income are the same.

b. The enterprise's ordinary loss from continuing operations is $500.

c. The enterprise also has an extraordinary gain of $900 that is a capital gain for tax purposes.

d. The tax rate is 40 percent on ordinary income and 30 percent on capital gains. Income taxes currently payable are $120 ($400 at 30 percent).

Income tax expense is allocated between the pretax loss from operations and the extraordinary gain as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total income tax expense</td>
<td>$120</td>
</tr>
<tr>
<td>Tax benefit allocated to the loss from operations</td>
<td>(150)</td>
</tr>
<tr>
<td>Incremental tax expense allocated to the extraordinary gain</td>
<td>$270</td>
</tr>
</tbody>
</table>

The effect of the $500 loss from continuing operations was to offset an equal amount of capital gains that otherwise would be taxed at a 30 percent tax rate. Thus, $150 ($500 at 30 percent) of tax benefit is allocated to continuing operations. The $270 incremental effect of the extraordinary gain is the difference between $120 of total tax expense and the $150 tax benefit from continuing operations.

The following example illustrates allocation of the tax benefit of a tax credit carryforward that is recognized as a deferred tax asset in the current year. The assumptions are as follows:

a. The enterprise's pretax financial income and taxable income are the same.
b. Pretax financial income for the year comprises $300 from continuing operations and $400 from an extraordinary gain.

c. The tax rate is 40 percent. Taxes payable for the year are zero because $330 of tax credits that arose in the current year more than offset the $280 of tax otherwise payable on $700 of taxable income.

d. A $50 deferred tax asset is recognized for the $50 ($330 - $280) tax credit carryforward. Based on the weight of available evidence, management concludes that no valuation allowance is necessary.

Income tax expense or benefit is allocated between pretax income from continuing operations and the extraordinary gain as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total income tax benefit</td>
<td>$(50)</td>
</tr>
<tr>
<td>Tax expense (benefit) allocated to income from continuing operations:</td>
<td></td>
</tr>
<tr>
<td>Tax (before tax credits) on $300 of taxable income at 40 percent</td>
<td>$120</td>
</tr>
<tr>
<td>Tax credits</td>
<td>(330)</td>
</tr>
</tbody>
</table>

Income taxes are sometimes allocated directly to shareholders' equity or to other comprehensive income. The following example illustrates the allocation of income taxes for translation adjustments under Statement 52 to other comprehensive income.
a. A foreign subsidiary has earnings of FC600 for year 2. Its net assets (and unremitted earnings) are FC1,000 and FC1,600 at the end of years 1 and 2, respectively.

b. The foreign currency is the functional currency. For year 2, translated amounts are as follows:

<table>
<thead>
<tr>
<th>Foreign Currency</th>
<th>Exchange Rate</th>
<th>Dollars</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unremitted earnings, beginning of year</td>
<td>000 FC1 = $1.20</td>
<td></td>
</tr>
<tr>
<td>Earnings for the year</td>
<td>600 FC = $1.10</td>
<td></td>
</tr>
<tr>
<td>Unremitted earnings, end of year</td>
<td>600 FC1 = $1.00</td>
<td>600</td>
</tr>
</tbody>
</table>

c. A $260 translation adjustment ($1,200 + $660 - $1,600) is reported in other comprehensive income and accumulated in shareholders' equity for year 2.

d. The U.S. parent expects that all of the foreign subsidiary's unremitted earnings will be remitted in the foreseeable future, and under Opinion 23, a deferred U.S. tax liability is recognized for those unremitted earnings.

e. The U.S. parent accrues the deferred tax liability at a 20 percent tax rate (that is, net of foreign tax credits, foreign tax credit carryforwards, and so forth). An analysis of the net investment in the foreign subsidiary and the related deferred tax liability for year 2 is as follows:
<table>
<thead>
<tr>
<th></th>
<th>Net Investment</th>
<th>Deferred Tax Liability</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balances, beginning of year</td>
<td>$1,200</td>
<td></td>
</tr>
<tr>
<td>Earnings and related taxes</td>
<td>660</td>
<td>132</td>
</tr>
<tr>
<td>Translation adjustment and related taxes</td>
<td>(260)</td>
<td></td>
</tr>
<tr>
<td>Balances, end of year</td>
<td>$1,600</td>
<td></td>
</tr>
</tbody>
</table>

f. For year 2, $132 of deferred taxes are charged against earnings, and $52 of deferred taxes are reported in other comprehensive income and accumulated in shareholders' equity.
INFORMATION FOR OBSERVERS


Project: Short-term convergence: income taxes

IASB Agenda Paper 3B

Intraperiod tax allocation examples:

General assumptions:

- Year 1 is the first year of operations
- Tax rate is 40% for all periods unless otherwise indicated
- Where several components of net income are presented, the amounts are shown gross in the accompanying examples in US GAAP table to facilitate understanding of the example. In the IFRS table, the amounts have been shown net of tax simply to enable both tables to fit on one page to facilitate analysis.
Where valuation allowances are eliminated (or, initial recognition for IFRS), the rationale behind the elimination of the valuation allowance could have a significant impact on the intraperiod allocation.

**Example 1:**

- An enterprise has $100 loss from continuing operations in the current year before income taxes
- An enterprise has a $100 income from discontinued operations in the current year before income taxes
- The tax rate is 40%

<table>
<thead>
<tr>
<th></th>
<th>US GAAP</th>
<th>IFRS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loss from continuing operations before income taxes</td>
<td>(100)</td>
<td>(100)</td>
</tr>
<tr>
<td>Income tax benefit</td>
<td>40</td>
<td>40</td>
</tr>
<tr>
<td>Loss from operations</td>
<td>(60)</td>
<td>(60)</td>
</tr>
<tr>
<td>Discontinued operations</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>Income tax (expense) benefit</td>
<td>(40)</td>
<td>(40)</td>
</tr>
<tr>
<td>Discontinued operations, net of tax</td>
<td>60</td>
<td>60</td>
</tr>
<tr>
<td>Net income</td>
<td>-0-</td>
<td>-0-</td>
</tr>
</tbody>
</table>
Example 2:

- An enterprise has $100 loss from continuing operations in Year 1 before taxes
- An enterprise expects to have $100 income from discontinued operations in Year 2 and no income from continuing operations before income taxes
- The tax rate is 40%, and there is a one year carryforward of net operating losses for tax purposes

<table>
<thead>
<tr>
<th></th>
<th>US GAAP</th>
<th>IFRS</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Year 1</td>
<td>Year 2</td>
</tr>
<tr>
<td>Loss from continuing operations before income taxes</td>
<td>(100)</td>
<td>-</td>
</tr>
<tr>
<td>Income tax benefit</td>
<td>40</td>
<td>-</td>
</tr>
<tr>
<td>Loss from operations</td>
<td>(60)</td>
<td>-</td>
</tr>
<tr>
<td>Discontinued operations before income taxes</td>
<td>-</td>
<td>100</td>
</tr>
<tr>
<td>Income tax (expense) benefit</td>
<td>(40)</td>
<td></td>
</tr>
<tr>
<td>Discontinued operations, net of tax</td>
<td></td>
<td>60</td>
</tr>
<tr>
<td>Net income</td>
<td>(60)</td>
<td>60</td>
</tr>
</tbody>
</table>
Example 3:

- An enterprise has (before income taxes)
  - $100 loss from continuing operations and $100 loss from discontinued operations in year 1
  - $100 income from discontinued operations in year 3
  - $100 income from continuing operations in year 4

- Valuation allowance
  - Full valuation allowance recognized in year 1
  - Valuation allowance eliminated in year 2

<table>
<thead>
<tr>
<th>US GAAP</th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
<th>Year 4</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income (loss) from continuing operations before income taxes</td>
<td>(100)</td>
<td>-</td>
<td>100</td>
<td></td>
</tr>
<tr>
<td>Income tax (expense) benefit</td>
<td>80</td>
<td>-</td>
<td>(40)</td>
<td></td>
</tr>
<tr>
<td>Income (loss) from operations</td>
<td>(100)</td>
<td>80</td>
<td>60</td>
<td></td>
</tr>
<tr>
<td>Discontinued operations before income taxes</td>
<td>(100)</td>
<td>-</td>
<td>100</td>
<td></td>
</tr>
<tr>
<td>Income tax expense</td>
<td>-</td>
<td>(40)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Discontinued operations, net of taxes</td>
<td>(100)</td>
<td>-</td>
<td>60</td>
<td></td>
</tr>
<tr>
<td>Net income (loss)</td>
<td>(200)</td>
<td>80</td>
<td>60</td>
<td>60</td>
</tr>
<tr>
<td>Deferred tax asset</td>
<td>80</td>
<td>80</td>
<td>40</td>
<td>-</td>
</tr>
<tr>
<td>Valuation Allowance</td>
<td>(80)</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Net deferred tax asset</td>
<td>-</td>
<td>80</td>
<td>40</td>
<td>-</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>IFRS</th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
<th>Year 4</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income (loss) from continuing operations before income taxes</td>
<td>(100)</td>
<td>-</td>
<td>-</td>
<td>100</td>
</tr>
<tr>
<td>Income tax (expense) benefit</td>
<td>-</td>
<td>40</td>
<td>-</td>
<td>(40)</td>
</tr>
<tr>
<td>Income (loss) from operations</td>
<td>(100)</td>
<td>40</td>
<td>-</td>
<td>60</td>
</tr>
<tr>
<td>Discontinued operations, net of taxes</td>
<td>(100)</td>
<td>40</td>
<td>60</td>
<td></td>
</tr>
<tr>
<td>Net income (loss)</td>
<td>(200)</td>
<td>80</td>
<td>60</td>
<td>60</td>
</tr>
<tr>
<td>Deferred tax asset</td>
<td>-</td>
<td>80</td>
<td>40</td>
<td>-</td>
</tr>
<tr>
<td>Unrecognized DTA</td>
<td>80</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
</tbody>
</table>
Example 4:

- An enterprise has (before income taxes)
  - $100 loss from discontinued operations and a $100 extraordinary loss\(^1\) in year 1
  - $200 income from continuing operations in year 4

- Valuation allowance
  - Full valuation allowance recognized in year 1
  - Valuation allowance reduced by $40 in year 2
  - Valuation allowance reduced by $40 in year 3

<table>
<thead>
<tr>
<th></th>
<th>US GAAP</th>
<th>IFRS</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Year 1</td>
<td>Year 2</td>
</tr>
<tr>
<td>Income (loss) from continuing operations before income taxes</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Income tax (expense) benefit</td>
<td>-</td>
<td>40</td>
</tr>
<tr>
<td>Income (loss) from operations</td>
<td>-</td>
<td>40</td>
</tr>
<tr>
<td>Discontinued operations before income taxes</td>
<td>(100)</td>
<td>-</td>
</tr>
<tr>
<td>Income tax benefit (expense)</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Discontinued operations net of tax</td>
<td>(100)</td>
<td>-</td>
</tr>
<tr>
<td>Extraordinary Item</td>
<td>(100)</td>
<td>-</td>
</tr>
<tr>
<td>Net income (loss)</td>
<td>(200)</td>
<td>40</td>
</tr>
<tr>
<td>Deferred tax asset</td>
<td>80</td>
<td>80</td>
</tr>
<tr>
<td>Valuation Allowance</td>
<td>(80)</td>
<td>(40)</td>
</tr>
<tr>
<td>Net deferred tax asset</td>
<td>-</td>
<td>40</td>
</tr>
</tbody>
</table>

\(^1\) Since extraordinary items are not permitted under IFRS, the extraordinary item in this example is shown as income from continuing operations in the IFRS table.
Example 5:

- An enterprise has (before income taxes)
  - $100 loss from discontinued operations and a $100 extraordinary loss\(^2\) in year 1
  - $50 income from continuing operations in years 2 and 3

- Valuation allowance
  - Full valuation allowance recognized in year 1
  - Valuation allowance reduced in year 2 to $20

<table>
<thead>
<tr>
<th></th>
<th>US GAAP</th>
<th>IFRS</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Year 1</td>
<td>Year 2</td>
</tr>
<tr>
<td>Income (loss) from continuing operations before income taxes</td>
<td>-</td>
<td>50</td>
</tr>
<tr>
<td>Income tax (expense) benefit</td>
<td>-</td>
<td>40</td>
</tr>
<tr>
<td>Income (loss) from operations</td>
<td>-</td>
<td>90</td>
</tr>
<tr>
<td>Discontinued operations before income taxes</td>
<td>(100)</td>
<td>-</td>
</tr>
<tr>
<td>Income tax benefit (expense)</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Discontinued operations net of tax</td>
<td>(100)</td>
<td>-</td>
</tr>
<tr>
<td>Extraordinary Item</td>
<td>(100)</td>
<td>-</td>
</tr>
<tr>
<td>Net income (loss)</td>
<td>(200)</td>
<td>90</td>
</tr>
<tr>
<td>Deferred tax asset</td>
<td>80</td>
<td>60</td>
</tr>
<tr>
<td>Valuation Allowance</td>
<td>(80)</td>
<td>(20)</td>
</tr>
<tr>
<td>Net deferred tax asset</td>
<td>-</td>
<td>40</td>
</tr>
</tbody>
</table>

\(^2\) Since extraordinary items are not permitted under IFRS, the extraordinary item in this example is shown as income from continuing operations in the IFRS table.
Example 6:

- An enterprise has (before income taxes)
  - $100 loss from continuing operations and $100 unrealized loss on AFS securities in year 1
  - No subsequent appreciation/depreciation; sale of securities in year 4
- Deferred tax asset
  - Full valuation allowance recognized in year 1 and it is eliminated in year 2
- The tax rate is 30% in year 1 and changes in year 3 to 40%
- Capital gains can be offset against ordinary income

<table>
<thead>
<tr>
<th></th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
<th>Year 4</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>US GAAP</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income (loss) from continuing operations before income taxes</td>
<td>(100)</td>
<td>-</td>
<td></td>
<td>(70)</td>
</tr>
<tr>
<td>Income tax (expense) benefit</td>
<td>60</td>
<td>20</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>Income (loss) from operations</td>
<td>(100)</td>
<td>60</td>
<td>20</td>
<td>(70)</td>
</tr>
<tr>
<td>Net income (loss)</td>
<td>(100)</td>
<td>60</td>
<td>20</td>
<td>(70)</td>
</tr>
<tr>
<td>Net unrealized (loss) on AFS securities</td>
<td>(100)</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Income tax benefit</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Accumulated OCI</td>
<td>(100)</td>
<td>(100)</td>
<td>(100)</td>
<td>-</td>
</tr>
<tr>
<td>Deferred tax asset</td>
<td>60</td>
<td>60</td>
<td>80</td>
<td>40</td>
</tr>
<tr>
<td>Valuation Allowance</td>
<td>(60)</td>
<td>0</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Net deferred tax asset</td>
<td>60</td>
<td>60</td>
<td>80</td>
<td>40</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
<th>Year 4</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>IFRS</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income (loss) from continuing operations before income taxes</td>
<td>(100)</td>
<td>-</td>
<td></td>
<td>(60)</td>
</tr>
<tr>
<td>Income tax (expense) benefit</td>
<td>-</td>
<td>30</td>
<td>10</td>
<td>-</td>
</tr>
<tr>
<td>Income (loss) from operations</td>
<td>-</td>
<td>-</td>
<td>(60)</td>
<td></td>
</tr>
<tr>
<td>Net income (loss)</td>
<td>(100)</td>
<td>30</td>
<td>(60)</td>
<td></td>
</tr>
<tr>
<td>Net unrealized (loss) on AFS securities</td>
<td>(100)</td>
<td>(100)</td>
<td>(70)</td>
<td>-</td>
</tr>
<tr>
<td>Income tax benefit</td>
<td>-</td>
<td>30</td>
<td>10</td>
<td>-</td>
</tr>
<tr>
<td>Accumulated OCI</td>
<td>(100)</td>
<td>(70)</td>
<td>(60)</td>
<td>-</td>
</tr>
<tr>
<td>Deferred tax asset</td>
<td>-</td>
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<td>40</td>
</tr>
<tr>
<td>unrecognized deferred tax asset</td>
<td>60</td>
<td>-</td>
<td>-</td>
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INFORMATION FOR OBSERVERS

Project: Conceptual Framework


Introduction

1. The IASB and FASB will discuss the following issues relating to objectives of financial reporting:

   OB.1 Is the purpose of financial reporting to provide information to a wide range of users or to existing common shareholders only?

   OB.2 Is the role of financial reporting to assist in decision-making or to compile past transactions?

   OB.3 What is the role of accountability or stewardship?

   OB.4 What is (or should be) the interaction between financial reporting and management’s perspective?

   OB.5 What is the objective of the balance sheet (or other individual financial statements), in particular, can/should it be used to assess solvency?
OB.6  Does XBRL make obsolete general purpose financial statements? Should there be different financial reporting packages for different types of users instead of one general purpose package?

OB.7  Should financial reporting include environmental and social information?

**Issue OB.1 - Is the purpose of financial reporting to provide information to a wide range of users or to existing common shareholders only?**

*Wide range of users or existing common shareholders only?*

5. Both present frameworks begin discussing the objectives of financial reporting\(^1\) in terms of information that is useful to a wide range of users in making economic decisions. Both list a wide variety of present and potential users.\(^2\)

6. Both frameworks narrow that focus to a particular group of users.\(^3\) That narrowing is for pragmatic reasons (eg a focus is needed to avoid being vague or highly abstract), and because meeting the information needs of that particular group of users is likely to meet most of the needs of other users. The IASB framework focuses on the information needs of ‘investors’ (and their advisors).\(^4\) The FASB framework focuses on ‘investors’ and ‘creditors’ (and their advisors), with ‘investors’ including debt security holders.\(^5\)

7. Neither framework adopts the view that, in concept, financial reporting should focus on the information needs of existing common shareholders only.

8. Similarly, a brief review of the frameworks of other standard-setters shows that, although some of those frameworks focus on a particular group (or groups) of users, none adopt the view that financial reporting should focus on the information needs of existing common shareholders only. For example, the UK framework notes that “although there continues to be debate about for whom precisely they [financial statements] are prepared, there is no

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\(^1\) The staff paper uses the phrase ‘financial reporting’ rather than ‘financial statements’ simply for convenience. The topic of what the boundaries of financial reporting should be (eg whether it should extend beyond the financial statements) is to be addressed at a later date, as part of the project phase on presentation and disclosure.

\(^2\) IASB *Framework*, paragraph 9, discusses investors, employees, lenders, suppliers and other trade creditors, customers, governments and their agencies, and the public; FASB CON1, paragraph 24, mentions owners, lenders, suppliers, potential investors and creditors, employees, directors, customers, financial analysts and advisors, brokers, underwriters, stock exchanges, lawyers, economists, taxing authorise, regulatory authorities, legislators, financial press and reporting agencies, labor unions, trade associations, business researchers, teachers and students, and the public.

\(^3\) IASB *Framework*, paragraph 10; FASB CON1, paragraph 30.

\(^4\) IASB *Framework*, paragraph 9(a) and (c).

\(^5\) FASB CON1, paragraph 35.
doubt that they are prepared for a range of persons that extends beyond existing investors.”

9. Some constituents disagree with the view taken in the existing frameworks, and instead argue that, in concept, financial reporting should focus upon the information needs of existing common shareholders only.

10. These different views about the focus of financial reporting may arise from two competing accounting theories—the proprietary theory and the entity theory. Under the proprietary theory, no fundamental distinction is drawn between the entity and its owners, i.e., the entity does not exist separately from the owners for accounting purposes. The primary focus is to report information useful to the owners, and therefore the financial statements are prepared from their perspective. Under the entity theory, the entity is regarded as having a separate existence from the owners. The financial statements are prepared from the perspective of the entity, not its owners.

14. By deciding whether to confirm the existing objectives, or modify those objectives to focus on the information needs of existing common shareholders, the Boards will be, in effect, choosing between an entity perspective and a proprietary perspective. The existing objective of providing information for a wide range of users is consistent with an entity perspective. If the Boards were to decide instead that financial reporting should focus on the information needs of existing common shareholders, this would be consistent with a proprietary perspective.

15. In the staff view, the Boards should confirm the existing objectives. Even though common shareholders (and their advisors) are major users of financial reports, many other users require information about the entity. For example, other users include present and prospective holders of other kinds of shares, bonds, options and other types of securities; present and prospective suppliers, customers, employees and their advisors; and the general public.

16. Also, the wider the applicability of the framework—across different jurisdictions and different sectors—the more problematic it becomes to apply an approach that focuses on the information needs of existing common shareholders only. For example, although focusing on the information needs of common shareholders might work in countries that use a “shareholder” corporate governance model (e.g., Australia, Canada, UK and US), it is unlikely to be satisfactory in countries that use a “stakeholder” corporate governance model.

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6 ASB Statement of Principles, paragraph 1.2.
model (eg France, Germany and Japan). Furthermore, looking ahead to other sectors, it is
doubtful that a focus on the information needs of existing owners would work when
applied to entities that have no profit-seeking owners. Adopting a broader focus is more
likely to result in a framework, and accounting standards, that are more broadly applicable.

Should some users be identified as the primary users?

20. If the Boards agree that the objective of financial reporting should be to provide
information to a wide range of users, rather than focusing on the information needs of
existing common shareholders only, a related issue is whether one particular group (or
groups) of users should be identified as the primary users and, if so, which group of users.

21. Although identifying the primary users seems necessary for pragmatic reasons (eg to avoid
the objectives being vague or highly abstract), there is a danger that it could result in a
quasi-proprietary perspective being applied, especially if the primary user group is defined
narrowly. For example, there seems little point in concluding that financial reporting
should provide information to a wide range of users if the framework then identifies the
existing common shareholders as the primary users.

22. In the staff view, to be consistent with the entity perspective and avoid a quasi-proprietary
perspective being applied, the primary user group should be broader than existing common
shareholders and equity participants in general.

23. Exactly how broad is another question. For example, the FASB and Canadian frameworks
both identify the primary users as investors and creditors (and their advisors), whereas the
Australian framework identifies a somewhat broader range of users—the primary user
groups are resource providers (eg investors, lenders, suppliers, employees), recipients of
goods and services (eg customers), and parties performing a review or oversight function
(eg analysts, regulatory authorities).

26. On balance, the staff recommends that the primary users be identified as present and
potential investors and creditors, and their advisors.

27. The staff will ask the Boards whether they agree that:

(a) In concept, financial reports should be prepared from the entity’s perspective and
should aim to provide information to a wide range of users, rather than focusing on
the information needs of existing common shareholders only.
(b) Nevertheless, the framework should identify the primary users, for pragmatic rather than conceptual reasons, for example, so that the framework is not vague or highly abstract.

(c) To avoid conclusion (b) undermining conclusion (a), the primary user group should be broader than existing common shareholders and other equity participants.

(d) The primary users should be identified as present and potential investors and creditors, and their advisors.

Issues OB.2 and OB.3 - What are the roles of decision usefulness and stewardship (accountability)?

28. This section encompasses two related issues:

(a) Is the role of financial reporting to assist in decision-making or to compile past transactions (Issue OB.2)?

(b) What is the role of stewardship or accountability (Issue OB.3)?

29. The staff observes that the discussion of the objectives of financial reporting in both the IASB and FASB frameworks focus on decision-usefulness, ie the overriding objective is to provide information that is useful in making economic decisions.7

30. Both also discuss the accountability or stewardship of management.8 Although the IASB framework arguably gives greater prominence to stewardship (than the FASB framework does), it makes clear that users who wish to assess the stewardship of management do so in order that they may make economic decisions, for example, whether to hold or sell their investment or whether to reappoint or replace the management.9 Hence, stewardship is a subset of (rather than being distinct from) the overall objective of decision-usefulness. Similarly, the FASB framework discusses stewardship10 as a subset of its discussion about the objective of providing information about an entity’s economic resources, the claims to those resources and changes in them, and that objective is itself a subset of the broader objective of providing information that is useful in making investment, credit and similar decisions.

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7 For example, IASB Framework, paragraph 12; FASB CON1, paragraph 34.
8 For simplicity, this section typically uses the phrase “stewardship” rather than “accountability”, but the terms are interchangeable.
9 IASB Framework, paragraph 14.
10 FASB CON1, paragraphs 50-53.
31. One might conclude from the above that stewardship plays a minor role in the objectives of financial reporting, and is subservient to the broader objective of decision-usefulness. Some might even argue that its inclusion is no longer necessary, ie its inclusion in the existing frameworks is largely for historical reasons—in the past, stewardship assumed a greater role but has now become less important.

32. However, most of the recent frameworks of other standard-setters continue to include stewardship in their discussion of objectives, which suggests that it should continue to have a role. Indeed, some give stewardship as much prominence as decision-usefulness. In some cases, the reason for doing so seems to relate to sector neutrality. For example, the New Zealand framework, which applies to all sectors, notes that financial reporting has both an accountability (stewardship) role and an informative (decision-usefulness) role, and that the relative importance of these roles may vary for different users and different sectors. For example, users of the financial reports of public sector entities may be more interested in accountability.\textsuperscript{11} Similarly, the Canadian framework notes that information about the discharge of stewardship responsibilities is especially important in the not-for-profit sector.\textsuperscript{12}

33. Thus, it could be concluded that, for the private (ie non-government) business sector, stewardship continues to have a role, but one that is a subset of the broader objective of decision-usefulness; whereas in the not-for-profit and public sectors, stewardship has a much larger role, which is distinct from (rather than a subset of) decision-usefulness.

34. However, the Boards do not need to decide now whether the role of stewardship should differ across different sectors. The Boards have agreed to begin the conceptual framework project by focusing on entities in the private (ie non-government) business sector. Later, the Boards will consider the applicability of the concepts to other sectors.

35. The staff recommends that the roles of stewardship and decision-usefulness in the two Boards’ existing frameworks be retained unchanged, ie stewardship continues to have a role, but one that is a subset of the broader objective of decision-usefulness, at least for the private business sector.

**Issue OB.4 – What is (or should be) the interaction between financial reporting and management’s perspective?**

36. This issue could be looked at in a number of ways:

\textsuperscript{11} ICANZ Statement of Concepts for General Purpose Financial Reporting, paragraph 3.1.
\textsuperscript{12} Financial Statement Concepts, CICA Handbook Section 1000, paragraph .14.
(a) Should financial reporting aim to provide information that is useful to management?

(b) Should management’s expectations or viewpoint influence or be reflected in the information that is presented in the financial reports?

(c) Should the financial reports include management commentary to “tell its side of the story”?

37. On the first point, the staff observes that both the Boards’ frameworks make it clear that the objective of financial reporting is to provide information to external users, who lack the authority to prescribe the information they require from an entity, and therefore must use information provided by management. Hence, although management is also interested in information about the entity, management’s primary role in external financial reporting is communicating information to others.¹³

38. The second point is closely related to another issue concerning whether standard-setters are consistent in their views about the role of management’s perspective. Sometimes, this notion receives “bad press”, for example, in discussions about measurement. On other occasions, it seems acceptable to take account of management’s perspective, such as in segment reporting and the classification of financial instruments as held-to-maturity or available-for-sale. Consistent with the Boards’ previous decisions about project planning, this issue will be addressed later in the project.¹⁴

39. The third issue cannot be addressed until the Boards conclude what the boundaries of financial reporting should be, in particular, whether financial reporting should include management commentary. As noted below (paragraph 56), the provision of such information is currently outside the scope of the IASB framework but inside the scope of the FASB framework.¹⁵ This gives rise to a convergence issue that the Boards have previously agreed will be addressed later in the project.¹⁶

Issue OB.5 – Should the individual financial statements provide information to assist users to assess solvency?

41. The existing frameworks discuss the individual financial statements in terms of providing information to help users assess the entity’s ability to generate cash flows, including the

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¹³ FASB CON1, paragraph 29; IASB Framework, paragraph 11. Some frameworks of other standard-setters make similar points, eg AASB SAC 2 Objective of General Purpose Financial Reporting, paragraphs 7 and 20.

¹⁴ This issue will be addressed as part of the project phase dealing with measurement concepts.

¹⁵ Even though management commentary is outside the scope of the IASB Framework, at present, it should be noted that the IASB has a research project on the topic.

¹⁶ This issue will be addressed as part of the project phase on presentation and disclosure (Phase E of the draft project plan discussed by the Boards in February).
timing and uncertainty of those cash flows, information that in turn is intended to assist users in making economic decisions.\textsuperscript{17} This includes information about liquidity and solvency.\textsuperscript{18} In other words, assisting users in assessing an entity’s liquidity and solvency is one—but not the only—objective of the information provided in the individual financial statements.

42. The notion that information provided in the financial statements should assist users in assessing an entity’s liquidity and solvency seems consistent with the overall objective of decision-usefulness. For example, a prospective lender who is considering advancing funds to an entity would be interested in assessing the entity’s liquidity and solvency, such as its ability to generate cash flows sufficient to meet interest and/or principal repayments, and the likelihood of the entity going into liquidation.

43. Although it seems reasonable that individual financial statements should provide users with information to assist them in assessing an entity’s liquidity and solvency, that objective should be consistent with the overall objective of financial reporting—providing information that is useful to a wide range of users in making economic decisions (assuming that the Boards confirm that overall objective). In particular, it would be inconsistent with that overall objective of providing information to a \textit{wide range of users} if the information provided in the individual financial statements was focused on meeting the information needs of \textit{particular} users that primarily use the financial statements to help them assess an entity’s liquidity and solvency, such as lending institutions or bank regulators.

\textbf{Issue OB.6 – Should financial reporting continue to be general purpose?}

46. The IASB and FASB frameworks, along with the frameworks of other standard-setters, relate to \textit{general purpose} financial reporting, to meet the \textit{common} information needs of users.\textsuperscript{19}

47. However, some have questioned whether XBRL and other advances in technology make obsolete the concept of general purpose financial reports. In other words, now that it is more practicable to do so, should entities prepare (or make available the information necessary to assemble) different financial reporting packages for different types of users, instead of a single package for all users?

\textsuperscript{17} For example, IASB \textit{Framework}, paragraphs 15-21.
\textsuperscript{18} For example, FASB CON1, paragraphs 41 and 49; IASB \textit{Framework}, paragraph 16.
\textsuperscript{19} In some cases, the frameworks of other standard-setters do not explicitly refer to “general purpose” financial reports, but nevertheless appear to use the same notion.
49. For example, rather than producing a single performance statement, entities could provide different performance statements for different types of users, for example, different classes of equity participants. Rather than reporting a single estimate for a particular item, entities could report a range of estimates, perhaps ranging from “conservative” to “optimistic”, from which individual risk-adverse or risk-seeking users could select.

50. However, this approach would require users of financial reports (and their advisors) to have a much greater understanding of accounting than they do at present, to enable users to make informed choices about which package to select, or which information to select to assemble their own package. Many users of financial reports are not accounting experts, and may not have the time or inclination to acquire such expertise.

52. There are also cost-benefit considerations. If entities were required to provide a variety of different reporting packages, or the information sufficient for users to assemble their own reporting packages, that would likely expand considerably the amount of information that entities would be required to provide.

53. For the time being at least, the staff concludes that users’ information needs seem best served by the preparation of general purpose financial reports and therefore recommends that the Boards do not change that objective.

**Issue OB.7 - Should financial reporting include environmental and social information?**

56. This issue relates to boundaries of financial reporting. There are differences between the two Boards’ frameworks in this respect. The IASB framework applies to general purpose financial statements.\(^\text{20}\) That is, the primary financial statements (income statement, balance sheet, etc) and the accompanying notes (and other statements and explanatory material that are an integral part of the financial statements), but not additional financial or non-financial information, such as directors’ reports, management discussion and analysis, etc. The FASB framework applies to general purpose external financial reporting.\(^\text{21}\) This includes not only the financial statements, but also other financial and non-financial information. This includes, for example, “descriptions of an enterprise’s social or environmental impact…”\(^\text{22}\)

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\(^{20}\) IASB *Framework*, paragraphs 6 and 7.

\(^{21}\) FASB CON1, paragraphs 5–8.

\(^{22}\) FASB CON1, paragraph 8.
57. The issue of what should be the boundaries of financial reporting will be addressed later in the project, consistent with the Boards’ previous decisions about project planning. Therefore, the question of whether financial reporting should include environmental and social information will be addressed at that time.

Summary

58. This section summarises the above discussion. For Issues OB.1, OB.2, OB.3, OB.5 and OB.6, the staff asks whether the Boards agree with the staff conclusions, summarised below. The Boards are not asked to reach decisions about Issues OB.4 and OB.7, because they relate to topics to be addressed later in the project, consistent with the Boards’ previous decisions about project planning.

Issue OB1: Is the purpose of financial reporting to provide information to a wide range of users or to existing common shareholders only?

59. Do the Boards agree that:

(a) In concept, financial reports should be prepared from the entity’s perspective and should aim to provide information to a wide range of users, rather than focusing on the information needs of existing common shareholders only.

(b) Nevertheless, the framework should identify the primary users, for pragmatic rather than conceptual reasons, for example, so that the framework is not vague or highly abstract.

(c) To avoid conclusion (b) undermining conclusion (a), the primary user group should be broader than existing common shareholders and equity participants in general.

(d) The primary users should be identified as existing and potential investors and creditors, and their advisors.

Issues OB.2 and OB.3: What are the roles of decision usefulness and stewardship (accountability)?

60. Do the Boards agree that the roles of decision-usefulness and stewardship in the two Boards’ existing frameworks should be retained unchanged, ie stewardship continues to have a role, which is a subset of the broader objective of decision-usefulness, at least for the private (ie non-governmental) business sector?

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23 This issue will be addressed as part of the project phase on presentation and disclosure (Phase E of the draft project plan discussed by the Boards in February).
Issue OB.4: What is (or should be) the interaction between financial reporting and management’s perspective?

61. The discussion above comments on three aspects of this issue:

(a) the staff observes that management’s primary role in external financial reporting is communicating information to others

(b) the question of whether standard-setters are consistent in their views about the role of management’s perspective, in particular, whether it should influence or be reflected in the information that is presented in the financial reports, will be addressed later in the project

(c) the question of what the boundaries of financial reporting should be, in particular, whether financial reporting should include management commentary, will be addressed later in the project.

Issue OB.5: Should the individual financial statements provide information to assist users to assess solvency?

62. The staff observes that assisting users in assessing an entity’s liquidity and solvency is one—but not the only—objective of the information provided in the individual financial statements. Furthermore, that objective should be consistent with the overall objective of providing information that is useful to a wide range of users in making economic decisions (assuming that the Boards confirm that overall objective). Hence, the information provided in the individual financial statements should not be focused on meeting the information needs of particular users (eg lending institutions or bank regulators). Do the Boards agree?

Issue OB.6: Should financial reporting continue to be general purpose?

63. Do the Boards agree that the concept of general purpose financial reports should be retained, and hence the objectives (and the framework) should continue to relate to general purpose financial reports?

Issue OB.7: Should financial reporting include environmental and social information?

64. This issue relates to the boundaries of financial reporting, a topic to be addressed later in the project.