**ACCOUNTING PRONOUNCEMENTS COMMITEE**

**TECHNICAL GUIDANCE OCPC 07**

# Presentation and Disclosures in General Purpose Financial Statements



## Reasons for issuing this Guidance on the preparation of notes to the financial statements

IN1. The volume of information disclosed in general purpose financial statements has raised many questions by market participants about the extent of the material presented. Many market participants have noted the disclosure of irrelevant information concurrently with the absence of relevant information in the financial statements.

IN2. The repetition of information often considered unnecessary would be increasing the cost of preparation and disclosure, which is also the subject of complaints by several market participants, from preparers of financial statements to analysts, and even members of companies' board of directors.

IN3. According to many of these participants, the presentation of financial statements seems to adopt a "checklist approach" in the disclosures required by Pronouncements, Interpretations and Guidance of the Brazilian Accounting Pronouncements Committee (CPC - Comitê de Pronunciamentos Contábeis), and the criteria of *relevance* are often not taken into consideration. The excess of information has been considered as a hindrance to an appropriate decision making by users of financial statements.

IN4. As far as we know, this situation is not typical of Brazil. There has been a strong worldwide movement towards finding ways to disclose in the financial statements only the information that is really of interest to users, guiding their decisions about an entity. Recent discussions and papers about this matter have arisen such as, for example:

- The EFRAG – European Financial Reporting Advisory Group, which recommends to the EU the adoption or not of the International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB) issued in 2012 the document:

*Towards a Disclosure Framework for the Notes*, discussing and gathering opinions specifically about disclosures in the notes. As a conclusion, it proposes the preparation of a specific Conceptual Framework for the presentation of these notes.

- The ASAF – Accounting Standards Advisory Forum, from IASB, in its September 2013 meeting, discussed intensively this matter and decided to propose to the IASB board actions to discipline the general guidelines on disclosures and notes.
- The IASB – International Accounting Standards Board issued the document *Discussion Forum – Financial Reporting Disclosure*, in May 2013, reporting several opinions of users, preparers and auditors on the difficulties faced in respect of the quality of the notes and it has recently created a group to discuss specifically the Disclosure Initiative.
- The FASB – Financial Accounting Standards Board, in a concrete action in March 2014, issued, for discussion, the *Proposed Statement of Financial Accounting Concepts* named *Conceptual Framework for Financial Reporting*, *Chapter 8: Notes to Financial Statements* (41 pages), as conceptual framework for issuance of notes to financial statements.
- The IASB, also in a concrete action in March 2014, issued the staff paper on the project *Disclosure Initiative* on *Materiality*, and the exposure draft *ED/2014/1 Disclosure Initiative – proposed amendments to IAS 1*, in order to introduce amendments to IAS 1, Technical Pronouncement CPC 26 – Presentation of Financial Statements, as a result of a series of short- and medium-term projects to improve the presentation and disclosure principles through the use of judgment and the concept of materiality by the entities.

IN5. The CPC decided, then, to conduct some surveys and concluded that there are already guidelines on disclosure, especially in the notes to financial statements, in several Pronouncements, Interpretations and Guidance, mainly in the Basic Conceptual Pronouncement - Conceptual Framework for Preparation and Disclosure of Financial Statements and in Technical Pronouncement CPC 26 – Presentation of Financial Statements, as well as in the Brazilian Corporate Law (6,404/76), and in documents issued by several regulatory agencies.

IN6. The CPC concluded also that it is possible to issue some guidelines on such disclosure.

IN7. After analyzing this situation and considering that it may take a long time until IASB completes the current projects related to this matter, the CPC decided to issue this Guidance in order to clarify and highlight that, in the financial statements and in the notes to the financial statements, relevant information (and only relevant information) which actually helps users of financial statements shall be disclosed, considering the standards already in effect, not failing to meet the minimum requirements of each Accounting Pronouncement issued by the CPC.

## Objective

1. The objective of this Guidance is to address the minimum preparation and disclosure requirements to be met in the presentation of general purpose financial statements.

2. This Guidance addresses specifically the disclosure of information from the annual and interim financial statements, especially the information contained in the notes to the financial statements.

**Scope**

3. This Guidance addresses basically disclosure issues, not covering recognition and measurement issues.

4. This guidance consolidates the requirements already existing in Pronouncements, Interpretations and other Guidance of this Committee, as well as in the Law, without changing such requirements.

5. For purposes of this Guidance, the word *relevance* is always used, reminding you that this concept covers the words *materiality* and *significant* and uses the expression *accounting policies*, which covers also *accounting practices and criteria.*

**Disclosures already regulated**

**Main general guidelines in the Basic Conceptual Framework**

6. The objective of the general purpose financial statements, as already established in item OB2 of the Basic Conceptual Pronouncement – Conceptual Framework for the Preparation and Disclosure of Financial Statements is "*to provide financial information about a reporting entity <u>that helps users of such information, including existing and potential investors and other creditors, make decisions about supplying resources to the entity</u>.*" (underlining added, in abbreviated form: u.a.)

7. Useful information is that with qualitative characteristics, fundamental to the financial statements. These characteristics, according to the same Basic Conceptual Pronouncement, item QC5, are *<u>relevance</u>* and *<u>faithful representation</u>*. (u.a.)

8. Item QC6 of this Conceptual Framework defines: *"<u>Relevant</u>* information is *the information that is <u>capable of making a difference in the decisions</u> made by users."* (u.a.)

9. And QC11 emphasizes: *"Information is <u>relevant</u> <u>if its omission or misstatement can influence the decisions</u> that users make on the basis of the financial statements.* (u.a.)

10. From the above it may be concluded that *all* information of the financial statements known by the entity that can influence investors and creditors, and *only that*, shall be disclosed. The disclosure of irrelevant information usually has the bad effect of distracting the user's attention, which is fully contrary to the objective of reliable representation.

11. Item QC12 states, addressing the financial statements (which include the notes): *"for a <u>reliable</u> representation, the information needs to have three characteristics. It has to be <u>complete</u>, <u>neutral</u> and <u>free from error</u>"*. (u.a.)

12. This item evidences the responsibility of the preparer regarding the completeness of the information, the requirement that the information and the related comments be neutral, and the care for the inexistence of errors.

13. QC4 states: *"If the financial information is to be useful, it needs to be <u>relevant</u> and represent <u>reliably</u> what it purports to represent. The usefulness of the financial information is improved if it is <u>comparable</u>, <u>verifiable</u>, <u>timely</u> and <u>comprehensible</u>."* (u.a.)

14. In this item QC4, the item *comprehensibility* calls attention since it includes the *nomenclature* of the accounts in the statements and the *wording* used in the notes to the financial statements. The minimum knowledge required from the user of financial statements

does not necessarily cover the same knowledge of specialists or even the terminologies specific to the entity or to the economic segment to which the entity belongs. Thus, only when absolutely unavoidable, the technical terminology specific to the entity or to the segment shall be used. It is convenient to consider, in this case, the presentation of a complete and concise glossary with the financial statements;

15. The *relevance*, according to the Conceptual Framework, is based on the *nature* or *size* of the information, or a combination of both. Consequently, it is not possible *a priori* to specify a uniform quantitative limit to relevance or predetermine what would be judged as relevant in a particular situation. Consequently, the judgment on the relevance of the information will be on a case by case basis. Item QC11 states: "*materiality is an aspect of relevance specific to the entity based on the nature or size, or a combination of both, of the items to which the information is related in the context of the financial statements of a particular entity*". (u.a.)

16. Therefore, usually the significant numbers for the size of the entity are material/relevant for their potential influence on the decisions made by users, but certain values, *even if small* in absolute or percentage terms, can be *relevant* due to their *nature*, not due to their *size*. This means that it can be of interest for users' decision due to the importance of the information in terms of governability, potential future impact, social information, etc.

17. In summary, the Conceptual Framework determines that all information is *relevant* and shall be disclosed if its omission or misstatement can influence decisions made by users on the basis of the general purpose financial statements of the specific reporting entity. Accordingly, if the information does not have this characteristic it is not relevant and shall not be disclosed. Moreover, when the information is relevant it must be complete, neutral and free from error, comparable, verifiable, timely and comprehensible.

18. This set of characteristics mentioned in the previous items evidences that the focus to be considered in the preparation and analysis of the financial statements is of the *relevance* of the information necessary for the decisions made by investors and creditors.

19. Consequently, relevant information known by the entity shall be disclosed in the financial statements and irrelevant information shall not.

**Main general guidelines in the Technical Pronouncement CPC 26**

20. Technical Pronouncement CPC 26 – Presentation of Financial Statements, defines, in items 29 to 31, that:

> 29. "*An entity shall present separately each material class of similar items. An entity shall present separately items of a dissimilar nature or function unless they are immaterial.*" (u.a.)
>
> 30. "*If a line item is not individually material, it is aggregated with other items either in those statements or in the notes.* However, it states that "*An item that is not sufficiently material to warrant separate presentation in those statements may warrant separate presentation in the notes.*"
>
> 31. "*The entity does not need to provide a specific disclosure required by a Technical Pronouncement, Interpretation or Guidance from CPC if the information is not relevant.*" (u.a.)

21. These three items, in summary, lead to the conclusion that the disclosure, both in the financial statements and in the notes, shall comprise information related to items grouped by similar

(not equal) nature and function. *However, if irrelevant, it can be included in other groups for presentation purposes.*

22. And another fundamental conclusion: *any specific information required by any Pronouncement, Interpretation or Guidance that is not relevant shall not be disclosed,* even in order to avoid distracting the user's attention, except for the disclosure expressly required by a regulatory agency.

23. Item 113 of the same Pronouncement defines that "*an entity shall, as far as practicable, present notes in a systematic manner. An entity shall cross-reference each item in the financial statements to any related information in the notes.*"

24. Item 114, in turn, states that "*the notes are normally presented*" in a certain order (statement of compliance, summary of significant accounting policies, supporting information, etc.), <u>but does not require the use of such order</u>.

25. Contrarily, item 115 states: *"In some circumstances, it may be necessary or desirable <u>to vary the order</u> of specific items within the notes. For example, an entity may combine information on changes in fair value recognized in profit or loss with information on maturities of financial instruments, although the former disclosures relate to the statement of profit or loss and the latter relate to the statement of financial position. Nevertheless, an entity retains a systematic structure for the notes as far as practicable"* (u.a.). Thus, the order may be the one that the entity's management considers the most appropriate; however, it is recommendable to maintain consistency in the form of presentation of the information in the notes in relation to preceding periods for purposes of comparability between the financial statements of a period with the prior periods.

26. Item 117 of the same Pronouncement defines that "an entity shall disclose in the summary of <u>significant</u> accounting policies:

    *(a) "the measurement basis (or bases) used in preparing the financial statements, and*

    *(b) the other accounting policies used that are <u>relevant</u> to an <u>understanding</u> of the financial statements."*

27. Item 116 clarifies: *"An entity may present notes providing information about the <u>basis of preparation</u> of the financial statements and <u>specific accounting policies</u> as a <u>separate section</u> of the financial statements."* (u.a.)

28. It may be concluded from the prior items that the entity shall only disclose the *basis of preparation* of the financial statements and its particular *specific accounting policies*. Therefore, the accounting policies that are not applicable to the entity do not require disclosure, as well as the accounting policies based on standards that do not present any alternative. This covers both documents in effect and those that will be in effect in the future.

**Main general guidelines in the Brazilian Corporation Law**

29. Brazilian Corporation Law (6,404/76) expressly requires notes that clarify the financial position and results of operations, and mentions the obligation of presenting accounting practices that are specific and apply to significant businesses and events. Its Art. 176 defines:

    *"§ 5 The notes shall:*
    *I – present information on the basis of preparation of the financial statements and <u>specific</u> accounting policies selected and applied to <u>significant</u> businesses and events;*

....
*IV – indicate:*
*a) the main criteria for valuation of assets and liabilities..."* (u.a.)

30. That is, the Brazilian Corporation Law followed the same line of requiring notes on the basis of preparation and accounting policies that are specific to the reporting entity and that are related to relevant items. Any mention to the bases and policies not specific to the entity and related to irrelevant items can also distract the user's attention.

**Summary of the main general guidelines contained in the texts mentioned**

The CPC, then, points out that these documents already specify that:

A. All information disclosed shall be *relevant* to external users and it is relevant only if it *influences the decisions made by investors and creditors*. Consequently, irrelevant information shall not be disclosed.

B. The relevance, in turn, covers the concepts of *size* and *nature* of the information, from the viewpoint of users.

C. Only information *relevant* and *specific* to the entity shall be disclosed, both regarding the accounting policies and all other notes, including those related to the probable effects of accounting policies to be adopted in the future.

D. Any mention in Pronouncements, Interpretations and Guidance of the CPC and in the Law of disclosure requirements shall always be interpreted in the light of the *relevance* of the information to be disclosed, even if there are expressions such as "minimum disclosure", "at a minimum" or similar.

E. On the other hand, no *relevant* information that can influence the user of the entity's financial statements can be failed to be disclosed, even if there is no express mentioning to it in the Law or in a document of the CPC.

F. The simple compliance with the checklist does not absolutely meet the requirement for the achievement of the objectives of the general purpose financial statements.

**Additional guidelines**

31. Although not specifically mentioned in such documents, in the set of Pronouncements, Interpretations and Guidance of the CPC there is always emphasis on the information related to all matters that can represent *risks* to the entity. For example, in Technical Pronouncement CPC 26 this can be seen explicitly in items 114, 125, 126 and 128. Consequently, the CPC understands that within the concept of relevance this characteristic shall always be considered.

32. In the notes on the basis of preparation of the financial statements and the accounting policies specific to the entity, the texts of normative acts shall not be repeated but only the main relevant aspects applicable to the entity shall be summarized.

33. Mention shall be made only to the numbers and names of the documents of this CPC and a summary of the main *relevant* aspects *specifically* applicable to the entity.

34. When there is a choice between two or more accounting policies permitted to the entity and there is a change in accounting policy, the note shall clarify in detail about these facts, reasons for the choice or change, and consequences with the financial statements.

35. The notes on accounting policies shall be included together with the notes on items contained in the financial statements to which they refer.

36. The order of presentation of the notes, after those related to the operational context and the statement of conformity, can follow the order of relevance of the matters addressed, always following the requirement of cross reference between the notes and the items of the financial statements or the notes to which they refer.

37. In the wording of the notes there shall not be, as practicable, repetition of facts, policies and information in order to avoid distracting the user's attention.

38. The entity's management shall, in the note on the statement of compliance, state that all relevant information of the financial statements, and only relevant information and that corresponds to that used in their management, is being disclosed.

39. In the assessment of relevance, the information from the individual financial statements and from the consolidated financial statements shall be considered separately since certain information can be relevant for a case and irrelevant for another.