
FASB | IASB Joint Education Meeting

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Project **Primary Financial Statements**
Topic **Project Overview**
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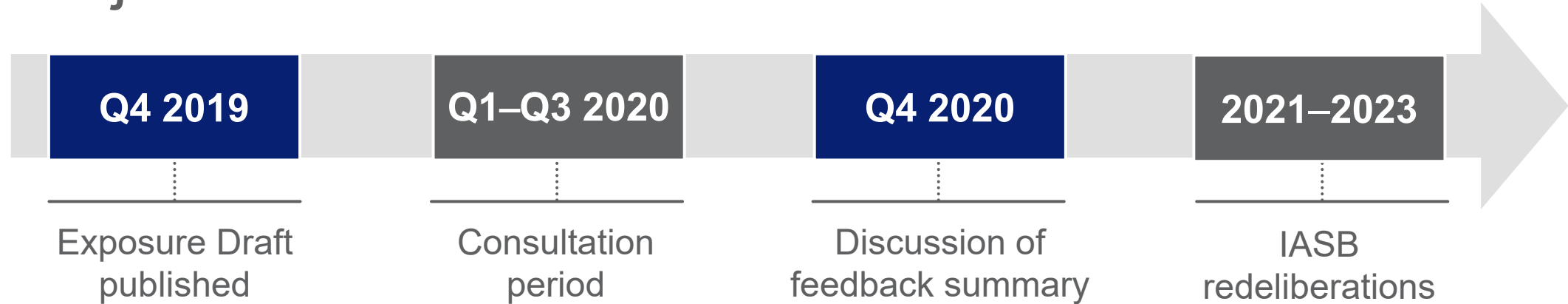
Introduction

In March 2021, the IASB began redeliberating the proposals in response to feedback received on the Exposure Draft *General Presentation and Disclosures*

The IASB has made key decisions in relation to key topics of subtotals and management performance measures and is progressing work on disaggregation

The following slides detail the main proposals in the Exposure Draft updated to reflect the IASB's tentative decisions to July 2022

Project overview



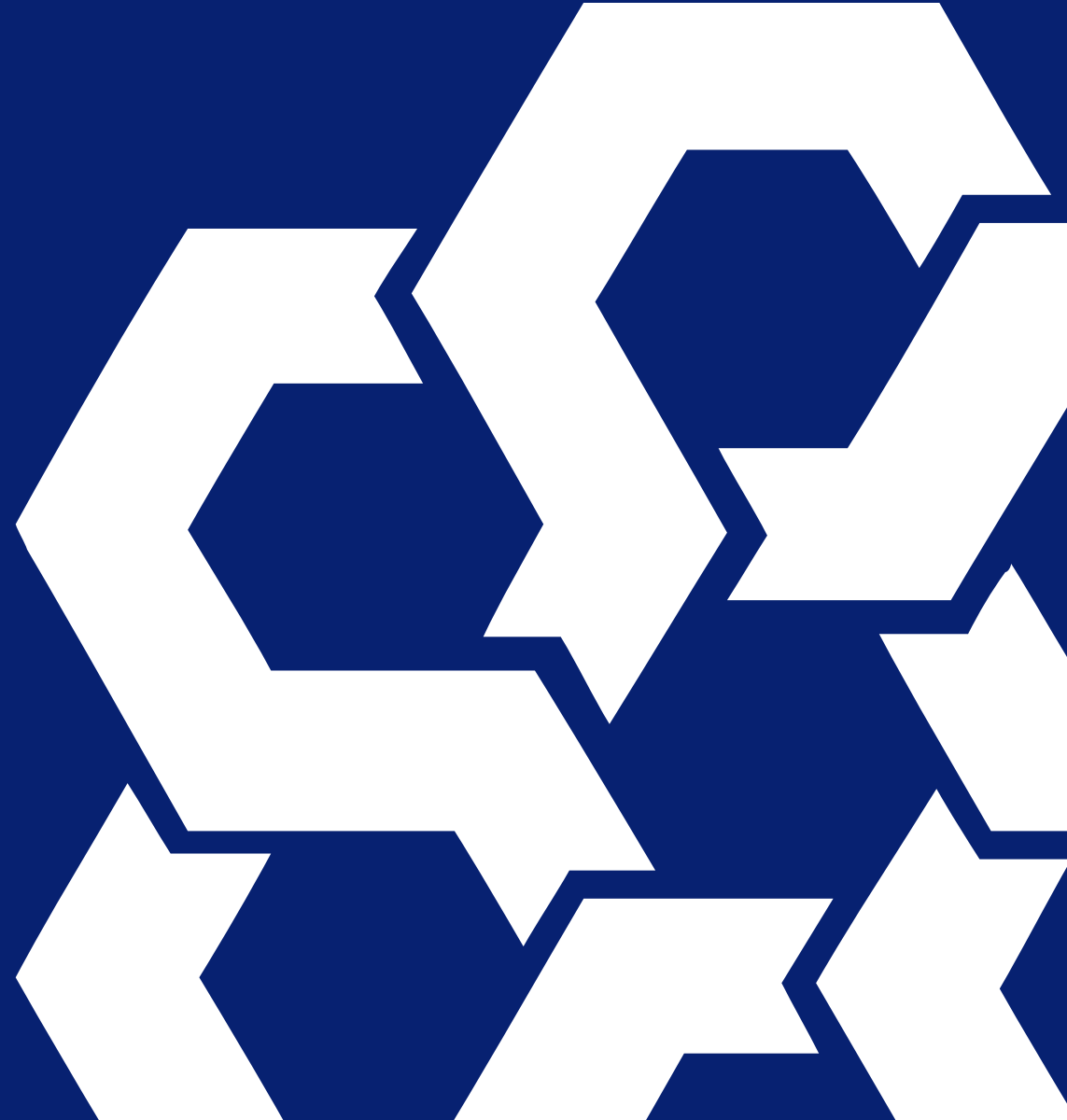
Objective

- Improve communication in financial statements
- Focus on information included in the statement of profit or loss

Main proposals

- 1 Require additional **defined subtotals** in statement of profit or loss
- 2 Require disclosures about **management performance measures**
- 3 Strengthen requirements for **disaggregating information**

Subtotals



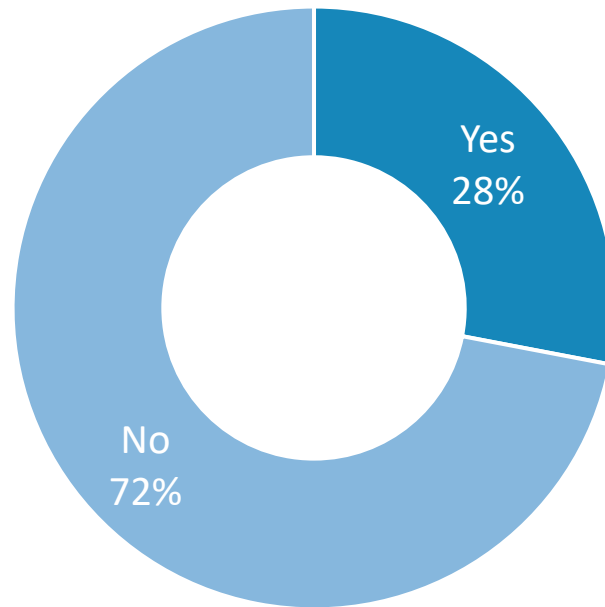
What is the issue?

No subtotals defined by IFRS Accounting Standards between ‘revenue’ and ‘profit or loss’

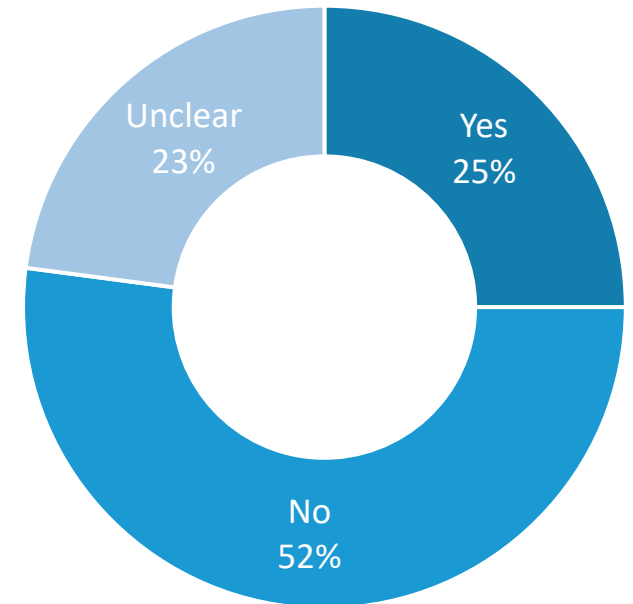
Companies calculate subtotals in different ways

- In a sample of 100 companies, we found that 63 companies reported operating profit in the financial statements, **using at least nine different definitions**

Share of profit or loss of associates and joint ventures included in operating profit?



Interest cost on defined benefit pension liabilities included in operating profit?



What are the new subtotals and categories?

Revenue

Other income

Changes in inventories of finished goods and work in progress

Raw materials used

Employee benefits

Depreciation

Amortisation

Professional fees and other expenses

Operating profit

Income and expenses from associates and joint ventures

Income and expenses from investments

Income and expenses from cash and cash equivalents

Profit before financing and income tax

Income and expenses from liabilities that arise from transactions that involve only the raising of finance

Specified income and expense on other liabilities

Profit before tax

Income tax

Profit for the year

Operating

Investing

Financing

What is in the operating category?

Includes, **but is not limited to**, income and expenses from an entity's main business activities

Defined as a default—includes income and expenses not classified in other categories

- Works for **different business models**
- A direct definition would require **significant judgement** which may result in operating profit not being comparable
- Avoids creation of a '**non-operating**' **category** that is neither operating, investing or financing, which may be used opportunistically

Includes volatile and unusual income and expenses arising from an entity's operations

- The category is intended to provide a **complete** picture of the entity's operations for the period

What is in the investing category?

- Income and expenses from associates and joint ventures accounted for using the equity method
- Income and expenses from assets that generate a return individually and largely independently of other resources held by an entity, including cash and cash equivalents

Examples (classified in the operating category when investing as a main business activity)

- rental income and remeasurements of investment property
- interest income and fair value changes on financial assets
- dividends and fair value changes on non-consolidated equity investments

★ Proposal related to classification of incremental expenses in the investing category to be redeliberated in September IASB meeting (see [Agenda Paper 21D](#))

What is in the financing category?

All income and expenses from liabilities that involve only the raising of finance

A transaction that involves only the raising of finance is a transaction that involves:

- The receipt by the entity of cash, an entity's own equity instruments or a reduction in a financial liability; and
- The return by the entity of cash or an entity's own equity instruments

For example, typical loan contract involves only the receipt of cash and the return of cash

Interest expense and the effects of changes in interest rates from other liabilities

For other liabilities, including lease liabilities, **interest expense and the effect of changes in interest rates** are classified in the financing category when such amounts are identified applying the requirements of IFRS Accounting Standards (eg IAS 19 or IAS 37)

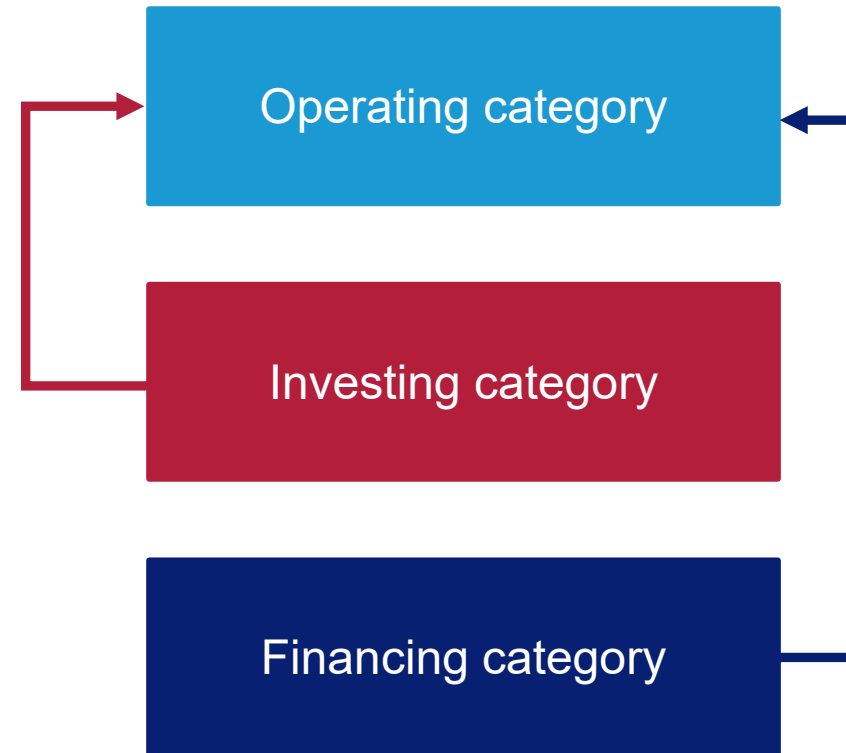
For example, a lease liability involves the receipt of a right-of-use asset and the return of cash

Entities with specified main business activities

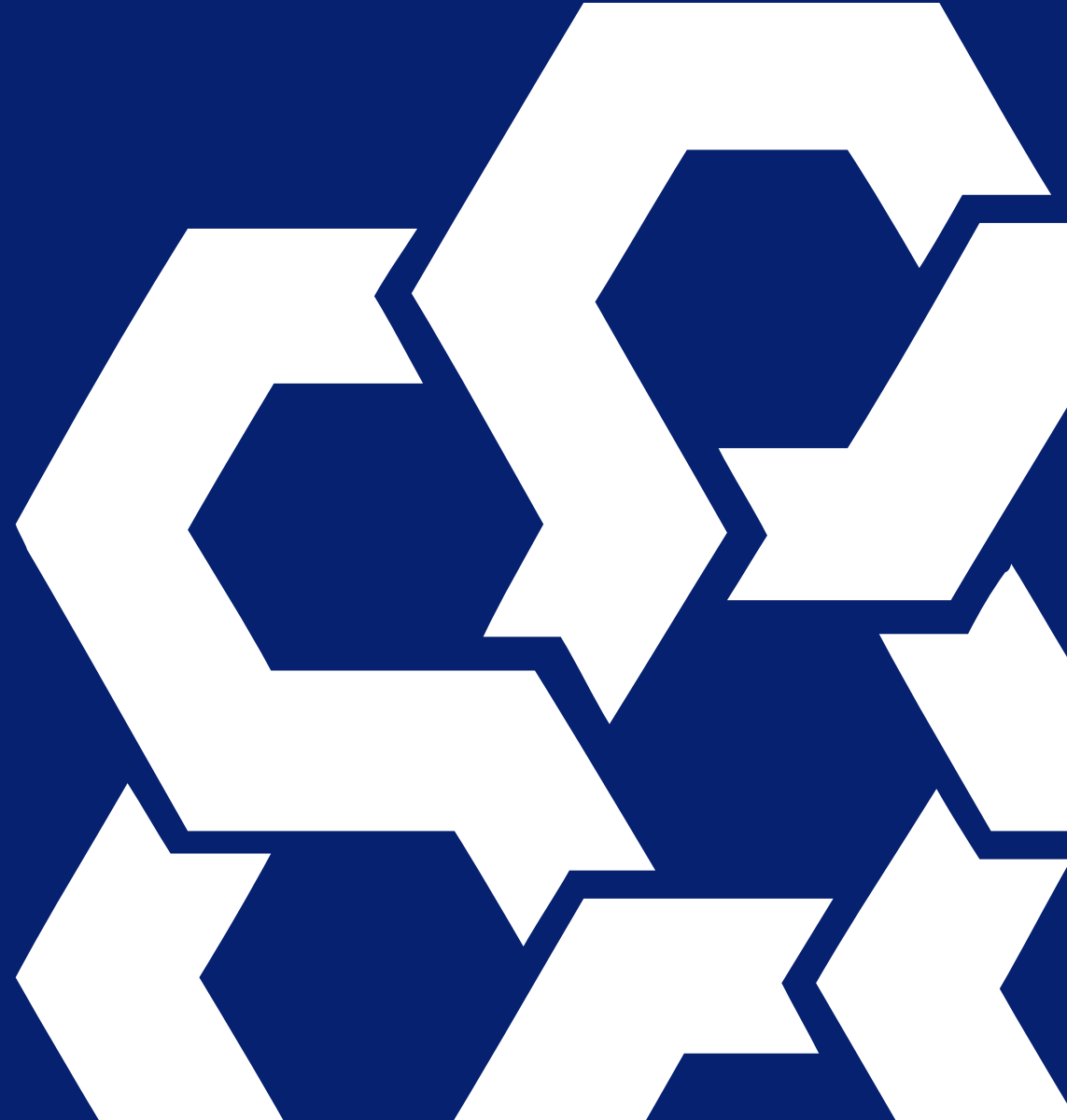
Operating profit is intended to include, but is not limited to, income and expenses from an entity's main business activities



The IASB proposes requirements for some entities, such as banks, to classify income and expenses in the operating category that would otherwise be classified in the investing or financing categories



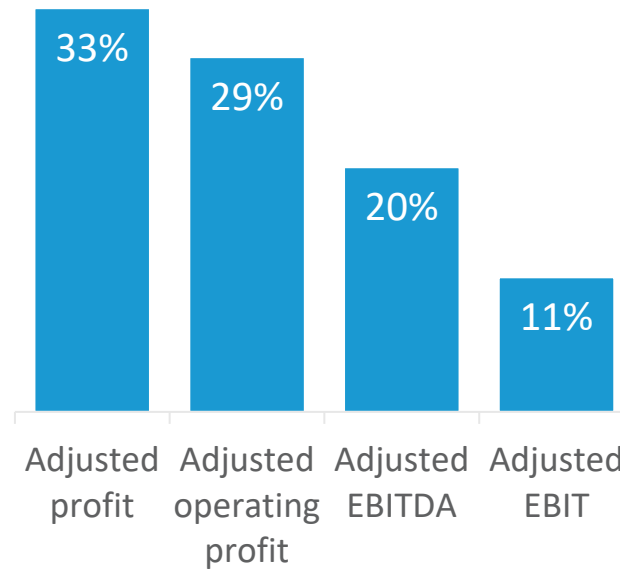
Management performance measures



What is the issue?

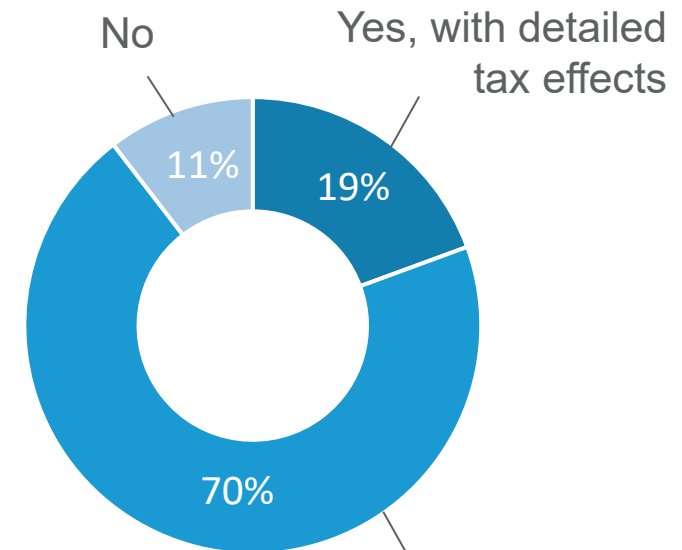
- Many companies provide performance measures defined by management in communications with investors
- Investors have said such measures can provide useful information, but should be used in a more transparent and disciplined way

Common management-defined performance measures



% of companies using measure in annual report

Is a reconciliation provided to a measure specified by IFRS Accounting Standards?



Yes, with limited or no information on tax effects

What are MPMs? (2/2)

Performance measures

Non-Financial performance measures

For Example:

- Number of subscribers
- Customer satisfaction score
- Store surface

Financial performance measures

(Sub)totals of income and expenses

IFRS-Specified

For example:

- Operating profit
- Operating profit before depreciation amortisation and specified impairments

MPMs

For example:

- Adjusted profit or loss
- Adjusted operating profit
- Adjusted EBITDA

Other measures that are not subtotals of income/expenses

For example:

- Free cash flow
- Return on equity
- Net debt
- Same-store sales

How will MPMs be defined?

Subtotals of income and expenses not specified by IFRS Accounting Standards that:

Are used in public communications outside financial statements (excluding oral communications, transcripts and social media posts)



Communicate management's view of an aspect of an entity's financial performance

Rebuttable presumption that a subtotal used in public communications represents management's view of an aspect of an entity's financial performance—rebutted with reasonable and supportable evidence

What disclosures will be required for MPMs?

Reconciliation



Reconciliation between MPM and the most directly comparable subtotal or total specified by IFRS Accounting Standards, including the income tax effect and effect on non-controlling interests ★

Why an MPM communicates management's view



Includes an explanation of how the MPM is calculated and how the measure provides useful information about the entity's performance. Explanation should refer to individual reconciling items where necessary

Not necessarily comparable with other entities



A statement that MPM provides management's view of an aspect of the entity's financial performance and is not necessarily comparable with measures provided by other entities

Changes in calculation



Explanation of any changes in how the entity calculates its MPMs or which MPMs it provides ★



Aspects of proposal to be redeliberated in a future IASB meeting

What will a reconciliation look like?

Adjusted operating profit (MPM)	52,870	Tax	NCI
Restructuring in Country X (incl. in employee benefits)	(5,400)	900	(1,020)
Revenue adjustment (incl. in revenue)	(6,200)	1,550	-
Operating profit (IFRS-specified)	41,270		



Most directly comparable subtotal/total specified by IFRS Accounting Standards—can be: ★

- operating profit, profit before financing and income tax;
- gross profit and subtotals similar to gross profit;
- profit before tax, profit from continuing operations, profit or loss;
- total other comprehensive income, comprehensive income;
- operating profit before depreciation, amortisation and specified impairments

Simplified approach to calculating the tax effect ★

★ Specified subtotals to be redeliberated in September IASB meeting (see [Agenda Paper 21E](#))
 Aspects of proposal related to tax calculation to be redeliberated in a future IASB meeting

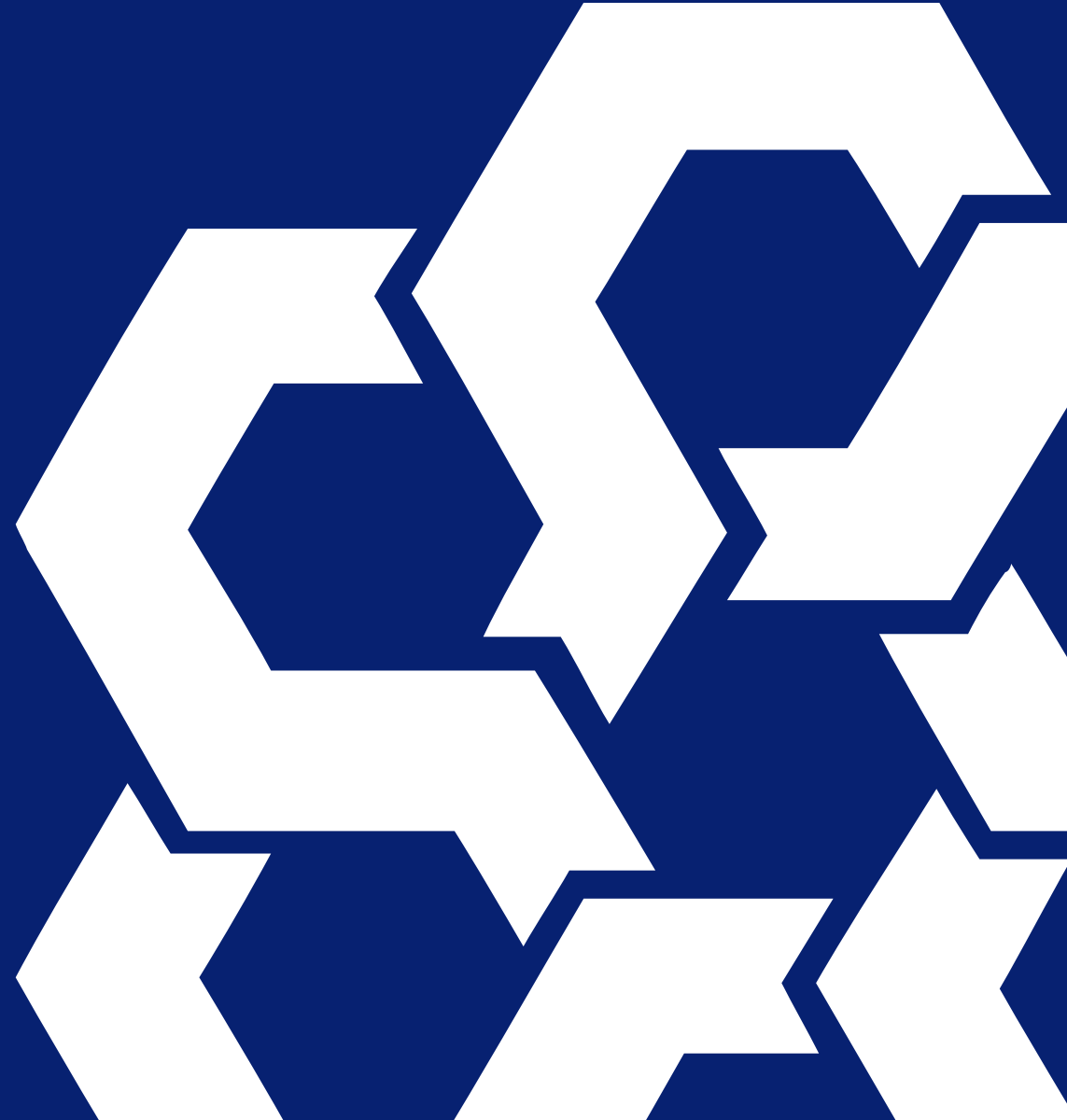
How does EBITDA fit in the proposals?

The IASB is proposing to define

‘operating profit before depreciation, amortisation and specified impairments’

- Would be allowed but not required to be reported
 - If used, no MPM disclosures would be required for this measure
 - The IASB will not explicitly prohibit ‘EBITDA’ as a label for ‘operating profit before depreciation, amortisation and specified impairments’, but will explain in the Basis for Conclusions that such a label would rarely be a faithful representation of it
-

Disaggregation overview



What will be the disaggregation requirements?

General requirements and specified line items	Roles of the primary financial statements (PFS) and the notes	Principles for aggregation and disaggregation ★
	Specified line items	Grouping dissimilar immaterial items, avoiding 'other' labels ★
Specific requirements	Present operating expenses by nature and by function ★ Disclosure of amounts included in each line item of profit or loss for depreciation, amortisation and employee benefits ★	Disclosure of unusual income and expenses ★

★ Presentation of operating expenses (see [Agenda Paper 21F](#)) and unusual income and expenses (see [Agenda Paper 21A](#)) to be redeliberated in September IASB meeting. Other aspects of proposal to be redeliberated in a future IASB meeting

What would be the general requirements?

Roles of PFS and the notes



- Describe the roles of PFS and the notes and refer to understandability in the description of the role of PFS


Principles for aggregation and disaggregation



- Single dissimilar characteristic can be enough to disaggregate if resulting information is material
- Application guidance on when disaggregation in the notes would result in material information and when disaggregation in the PFS would result in a more understandable overview

Specified line items



- New specified line items, including goodwill in the statement of financial position 

Grouping dissimilar immaterial items, avoiding 'other' labels



- Use meaningful labels for groups of immaterial items, avoiding line items such as 'other expenses'
- If that is not possible, entities required to provide information in the notes about the content of such groups of items



Understandable overview and specified line items

The IASB has tentatively decided to provide guidance explaining when disaggregation in the notes would result in material information and when disaggregation in the primary financial statements would result in a more understandable overview of the entity's income and expenses or assets, liabilities and equity

- An entity presents specified line items in the primary financial statements when the resulting presentation does not detract from the primary financial statements providing an understandable overview
 - Specified line items not presented in the primary financial statements would be disclosed in the notes when material
-

Disclosure of operating expenses by nature



Proposal to disclose operating expenses by nature

The Exposure Draft proposed requiring an entity that reports expenses by function in the statement of financial performance to disclose in a single note an analysis of total operating expenses using the nature of expense method

The IASB received mixed feedback on the proposal, in particular:

- many respondents (mainly users, standard-setters and accountancy bodies) agreed with the proposal because it would:
 - enable a comparison with information provided in the statement of cash flows; and
 - help forecast future operating expenses and cash flows (amounts reported by functions can make it difficult for users to forecast future operating expenses because functions combine expense items with different natures that respond differently to changes in the economic environment); and
- many respondents (mainly preparers and their representative bodies) disagreed with the proposal because providing such information would require costly changes to systems and reporting processes

The IASB also received feedback that information that helps users to understand how information about operating expenses already disclosed in the notes relate to the line items presented in the statement of profit or loss would provide more useful information than the disclosure requirement in the Exposure Draft, and would be less costly to provide

Alternative proposal

The IASB discussed alternatives to the proposal

Specifically, the IASB explored whether a better balance of costs and benefits could be achieved by requiring entities to disclose, for specified expense items, the amounts included in each line item(s) in the statement of profit or loss

The feedback received from limited outreach with users and preparers indicates that:

- having a better understanding of the composition of functions would provide useful information, possibly providing more benefits than the proposal in the Exposure Draft; and
- disclosing, for a limited number of expense items, the amounts included in each line item(s) in the statement of profit or loss is likely to be more feasible for preparers than the proposal in the Exposure Draft.

The IASB has proposed to require an entity to disclose the amounts included in each line item in the statement of profit or loss for depreciation, amortisation, and employee benefits

Exploring further changes to the alternative proposal

The IASB is also continuing to explore:

- whether the revised proposal to disclose the amounts included in each line item in the statement of profit or loss should also include impairments and write-downs of inventory in addition to depreciation, amortisation, and employee benefits; and
- whether an entity should also be required to disclose, for all other operating expenses disclosed in the notes, the amounts included in each line item in the statement of profit or loss unless doing so would require undue cost or effort*

* Entities would not be required to provide disclosure for other operating expenses if this would give rise to undue costs

Comparison of Exposure Draft and revised proposal

Statement of profit or loss	202X ¹
Revenue	3000
Cost of goods sold	(600)
Gross profit	2400
Other income	500
Selling expenses	(400)
Research and development expenses	(300)
General and administrative expenses	(200)
Impairment losses on trade receivables	(100)
Operating profit (loss)	1900

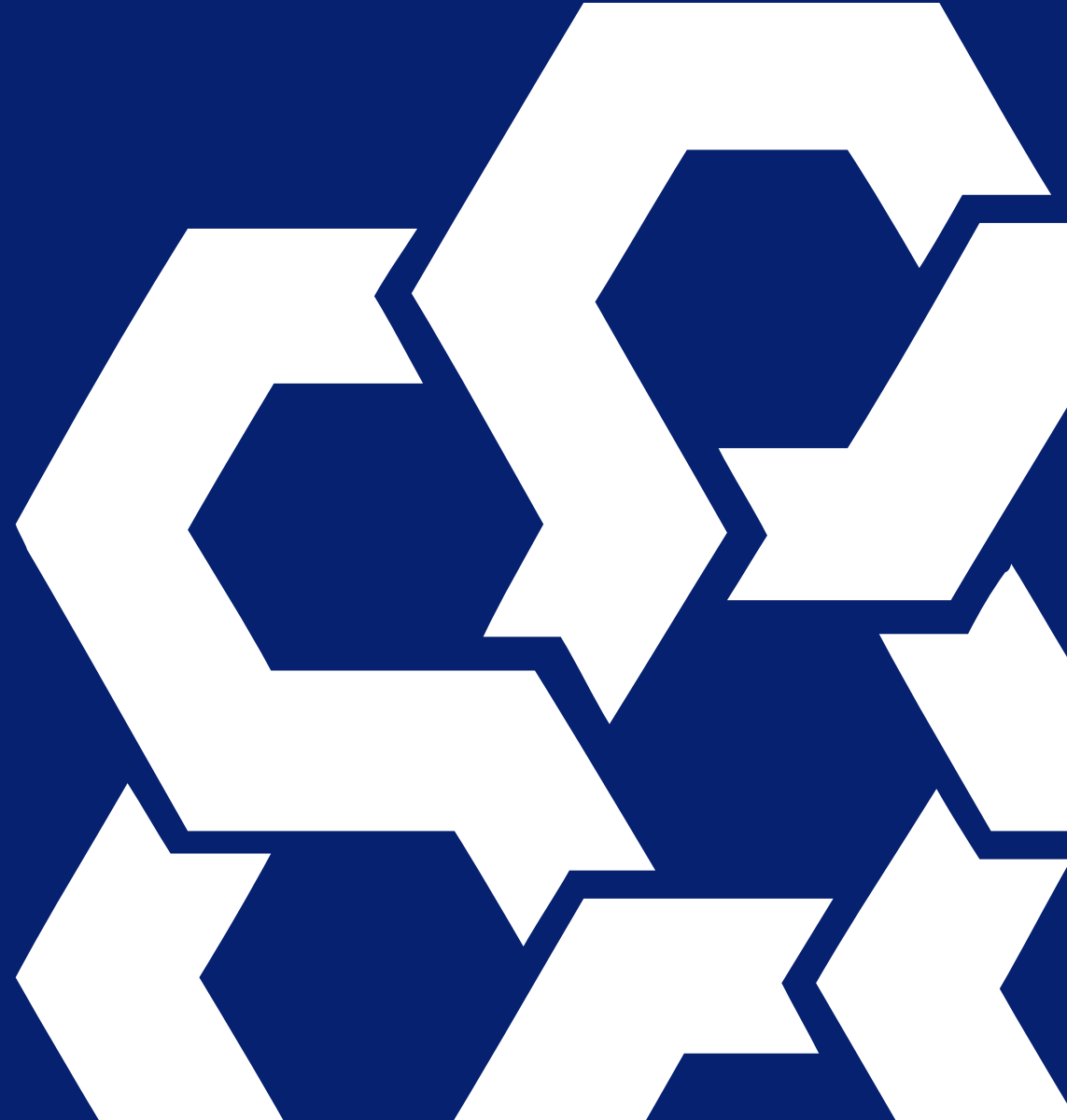
¹ Comparative reporting period not depicted in example for simplification purposes

Exposure Draft proposal	202X ¹
Changes in inventories of finished goods and work in progress	200
Raw material used	(400)
Reversal of inventory write-downs	50
Depreciation	(500)
Employee benefits	(400)
Amortisation	(100)
Impairment of property, plant and equipment	(100)
Impairment losses on trade receivables	(100)
Property taxes	(25)
Litigation expenses	(100)
Gains (losses) on derivatives	(25)
Other miscellaneous expenses	(100)
Operating expenses total	(1600)


Revised proposal (illustrating depreciation and employee benefits) ²	202X ¹
Depreciation	(500)
<i>Cost of goods sold</i>	<i>(250)</i>
<i>Selling expenses</i>	<i>(150)</i>
<i>Research and development expenses</i>	<i>(50)</i>
<i>General and administrative expenses</i>	<i>(50)</i>
Employee benefits	(400)
<i>Cost of goods sold</i>	<i>(200)</i>
<i>Selling expenses</i>	<i>(100)</i>
<i>Research and development expenses</i>	<i>(50)</i>
<i>General and administrative expenses</i>	<i>(50)</i>

² Amortisation not illustrated. Additional specified nature expenses may be required in the final proposal

Unusual income and expenses



Exposure Draft—unusual income and expenses

<p>Definition</p> 	<p>Income and expenses with limited predictive value. Income and expenses have limited predictive value when it is reasonable to expect that income or expenses that are similar in type and amount will not arise for several future annual reporting periods.</p> <p style="border: 1px solid red; padding: 5px;">Income and expenses from the recurring remeasurement of items measured at a current value would not normally be classified as unusual</p>	
<p>Disclosures</p>	<p>Amount & narrative description</p>	<p>Amount disaggregated by:</p> <ul style="list-style-type: none"> • line items presented in statement of profit or loss; and • line items disclosed in analysis of operating expenses by nature, if the entity analyses expenses by function in the statement of profit or loss

Feedback on defining unusual income and expenses

Feedback on the proposals on unusual income and expenses in the Exposure Draft and on the IASB's redeliberations has been consistently mixed. There is strong support for the IASB to develop a definition, but no consensus on what that definition should be

Many respondents, including users, agreed the IASB should define unusual income and expenses

- users want to identify recurring or normalised earnings but currently have to rely on voluntary disclosures by an entity to do so
- definition would provide discipline and reduce opportunistic classification of items as unusual

Some respondents, including a few users, did not agree

- any definition would be too restrictive, better to rely on strengthened principles of disaggregation
- any definition would be too subjective, better to rely on requirements for management performance measures (MPMs)

★ Proposal to be redeliberated at the September IASB meeting (see [Agenda Paper 21A](#))

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