IFRS

STAFF PAPER

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IASB® Meeting

Project	**Primary Financial Statements**
Paper topic	Cover note

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Purpose of the meeting

1. At this meeting, we will follow up on the discussions at the June 2017 Board meeting about targeted improvements to the statement(s) of financial performance.

Papers for this meeting

2. This Agenda Paper (**Agenda Paper 21**) provides the following background information for the Board:

   (a) planned next steps (paragraph 5);

   (b) Appendix A—summary of tentative decisions to date;

   (c) Appendix B—summary of the June 2017 joint Capital Markets Advisory Committee and Global Preparers Forum meeting on Primary Financial Statements; and

   (d) Appendix C—summary of the July 2017 Accounting Standards Advisory Forum meeting on Primary Financial Statements.

3. **Agenda Paper 21A** sets out the staff's proposals for introducing an investing category and two additional subtotals—'profit before investing, financing and income tax' and 'profit before financing and income tax'—into the statement(s) of financial performance.

4. **Agenda Paper 21B** sets out the staff's proposals for improving the current requirements in IAS 1 *Presentation of Financial Statements* for presenting an analysis of expenses by function or by nature.

Next steps

5. At future Board meetings, we plan to discuss:

    (a) how to develop the proposals for this meeting further to address more complex scenarios, for example entities providing financial services;

    (b) guidance on the use of performance measures including a management performance measure subtotal and alternative earnings per share measures;

    (c) better ways to communicate information about other comprehensive income;

    (d) other principles of aggregation and disaggregation, including considering the need for additional minimum line items;

    (e) development of illustrative examples/templates for the primary financial statements for a few industries; and

    (f) some targeted improvements in the statement of cash flows.

Appendix A—Summary of tentative decisions to date

December 2016 Board meeting

Agenda Paper 21: Scope of the project—cover note

The Board tentatively decided to focus on targeted improvements to the statement(s) of financial performance and to the statement of cash flows. All 11 Board members agreed with this decision.

The Board will decide at a later stage of the project whether it will issue a Discussion Paper or an Exposure Draft as the first due process output of the project. All 11 Board members agreed with this decision.

Agenda Paper 21A: Scope of the project—statement(s) of financial performance

Board members tentatively decided, by consensus, to explore the following topics:

a. requiring additional subtotal(s) in the statement(s) of financial performance—earnings before interest and tax (EBIT) and/or operating profit;
b. removing some of the options for presentation of income and expenses in existing IFRS Standards (eg presentation of net interest cost on the net defined benefit liability);
c. providing guidance on the use of performance measures, including separate presentation of non-recurring, unusual or infrequently occurring items; and
d. better ways to communicate information about other comprehensive income (OCI).

Agenda Paper 21B: Scope of the project—other primary financial statements and segment reporting

The Board tentatively decided to explore the following topics:

a. elimination of options for the classification of the cash effects of interest and dividends in the statement of cash flows. All 11 Board members agreed with this decision.
b. alignment of the operating section across the statement of cash flows and the statement(s) of financial performance. All 11 Board members agreed with this decision.
c. requiring a consistent starting point for the indirect reconciliation of cash flows. All 11 Board members agreed with this decision.
d. development of templates for the statement(s) of financial performance, the statement of cash flows and the statement of financial position for a small number of industries. Eight of 11 Board members agreed and three members disagreed with this decision.
e. development of a principle for aggregating and disaggregating items in the primary financial statements. All 11 Board members agreed with this decision.

The Board tentatively decided not to consider targeted improvements to the statement of financial position unless work on other areas of the primary financial statements identifies possible improvements to that statement. All 11 Board members agreed with this decision.

Additionally, the Board tentatively decided that segment reporting or the presentation of discontinued operations should not be part of the scope of the project. All 11 Board members agreed with this decision.

March 2017 Board meeting

***Earnings before interest and tax* (Agenda Paper 21A)**

The Board agreed (by consensus) that the staff should continue to explore:

a. requiring the presentation of an earnings before interest and tax (EBIT) subtotal in the statement(s) of financial performance;
b. defining EBIT as profit before finance income/expenses and tax; and
c. describing finance income/expenses as income/expenses related to the entity's capital structure.

The Board asked the staff to consider:

a. how to define an entity's capital structure; and
b. whether additional guidance would be needed on the treatment of particular items of income and expense (for example, the net interest on net defined benefit liabilities and income/expenses from investments).

***Management operating performance measure* (Agenda Paper 21B)**

The Board agreed (by consensus) that the staff should continue to explore:

a. requiring the presentation of a management operating performance measure, rather than seeking to define operating profit, in the statement(s) of financial performance;
b. allowing items to be excluded from the management operating performance measure as long as the subtotal meets the requirements in existing paragraphs 85, 85A and 85B of IAS 1 *Presentation of Financial Statements*; and
c. requiring additional disclosures to provide transparency around presentation of the management operating performance measure.

***General guidance on classification, aggregation and disaggregation* (Agenda Paper 21C)**

The Board tentatively decided to develop, along the lines suggested in Agenda Paper 21C:

a. principles for aggregation and disaggregation in the financial statements;
b. definitions of the notions 'classification', 'aggregation' and 'disaggregation; and
c. guidance on the steps involved in applying 'classification', 'aggregation' and 'disaggregation' when preparing financial statements.

Ten Board members agreed and two disagreed with this decision.

The Board tentatively decided to explore providing more guidance on aggregation characteristics. Eleven Board members agreed and one disagreed.

June 2017 Board meeting

The Board continued its discussion from the March 2017 Board meeting about introducing two subtotals in the statement(s) of financial performance—earnings before finance income/expenses and tax (EBIT) and a management performance measure. No decisions were made at this meeting.

Appendix B—Summary of the joint CMAC and GPF meeting on Primary Financial Statements (June 2017)

A1. The purpose of this session was to seek the views of CMAC and GPF members on staff proposals to introduce two subtotals in the statement(s) of financial performance:

(a) earnings before finance income/expenses and tax (EBIT); and

(b) a management performance measure.

A2. Many CMAC and GPF members supported the general direction of the staff proposals.

Earnings before finance income/expenses and tax (EBIT)

A3. Many CMAC and GPF members supported requiring an EBIT subtotal in the statement(s) of financial performance and agreed that its objective should be to provide a comparable starting point for users' analysis. Many members also agreed that a principle-based approach to defining finance income/expenses (ie the 'I' in EBIT) in terms of an entity's capital structure would be appropriate. However, many members observed that introducing a comparable EBIT subtotal was a difficult undertaking for the Board and some had reservations about whether it would be successful, particularly across different industries.

A4. CMAC and GPF members commented on the staff proposal to define capital structure as 'equity, assets and liabilities arising from financing activities, and cash and cash equivalents':

(a) CMAC and GPF members debated whether decommissioning liabilities and net defined benefit liabilities are part of an entity's capital structure:

(i) some members argued that, unlike decommissioning liabilities, net defined benefit liabilities result from an explicit 'financing choice' made by the entity—ie the entity decided not to transfer the liability to an insurer or fully fund the plan—and are therefore part of an entity's capital structure.

(ii) in contrast, a GPF member argued that in the mining industry, decommissioning liabilities are considered a more important source of financing than net defined benefit liabilities. This member said that entities often do have a 'financing choice' for decommissioning liabilities because they often have some flexibility to decide when to start restoration and hence when the cash outflows will occur.

(b) Some CMAC and GPF members said that using cash and cash equivalents as a proxy for cash and temporary investments of excess cash in the definition of capital structure was too narrow. For example, some CMAC and GPF members observed that other assets are held for the specific purpose of settling liabilities. One GPF member commented that when they issue loans, they invest a specific amount of cash in financial assets as a liquidity reserve. In this member's view, the income and expenses related to these financial assets should be presented as finance income and expenses.

A5. One break-out group explicitly supported the staff proposal to exclude all interest expenses from EBIT, even when the interest expense does not relate to the entity's capital structure. One GPF member said that we should just use interest on long-term liabilities as the 'I' in EBIT.

A6. A few GPF members questioned whether the benefits of an EBIT subtotal would outweigh the costs preparers would incur in changing their reporting systems.

A7. Some CMAC and GPF members highlighted issues that the Board would have to address when defining EBIT:

(a) the presentation of EBIT for financial institutions and groups that have captive finance subsidiaries (this issue was not addressed in the June 2017 Board papers however, the staff intend to address the issue at a later Board meeting); and

(b) the presentation of the share of the profit or loss of associates and joint ventures (this issue was not presented at the CMAC/GPF meeting but was discussed at the June 2017 Board meeting). Some CMAC members supported presentation of the share of the profit or loss of associates and joint ventures outside of EBIT, because investors value investments in associates and joint ventures separately from other operations. However, some CMAC and GPF members said the Board should consider including in EBIT the results of associates and joint ventures that are integral to the entity's strategy.

Management performance measure

A8. Three of the four break-out groups supported the proposal to present a management performance measure in the statement(s) of financial performance. CMAC and GPF members from those groups supported the discipline (including bringing the measure within the scope of the audit), transparency, consistency over time and additional disclosures (eg the proposed historical summary of infrequent items) that would be required for management performance measures under the staff proposal. One GPF member added that the relevance of IFRS financial statements would be enhanced by including management performance measures.

A9. However, CMAC and GPF members from one break-out group opposed the presentation of a management performance measure in the statement(s) of financial performance. They argued that management-defined (non-IFRS) measures do not belong in IFRS financial statements and that the Board should not try to regulate these measures. This group supported more disaggregation above EBIT in the statement(s) of financial performance, including separate presentation of infrequent items and better disaggregation by nature of expenses.

A10. Many of the CMAC and GPF members who supported the presentation of a management performance measure in the statement(s) of financial performance agreed with staff suggestions that the Board should not place too many constraints on what can be excluded from the management performance measure —rather the management performance measure should be 'self-constrained' by requiring entities to:

(a) define their management performance measure in the financial statements; and

(b) apply this definition consistently over time.

A11. Some CMAC and GPF members were concerned that the term 'infrequent' could be interpreted too narrowly as 'one-off' items. In their view, volatile or 'lumpy' items should also be separately presented, to help investors make better forecasts. One CMAC member noted that in one country a recurring operating profit subtotal (with a limited number of non-recurring items below it) was presented by a significant number of companies and well understood by users.

Next steps

A12. The staff reported the feedback received from CMAC and GPF members at the June 2017 Board meeting, when the Board discussed the staff proposals to introduce EBIT and management performance measure subtotals.

Appendix C—Summary of the ASAF meeting on Primary Financial Statements (July 2017)

B1. The purpose of this session was to seek ASAF members' views on staff proposals for addressing the competing needs for comparability and flexibility in reporting financial performance. The package of staff proposals consisted of proposals for the presentation in the statement(s) of financial performance of:

(a) earnings before finance income/expenses and tax (EBIT);

(b) a management performance measure and adjusted earnings per share; and

(c) the share of profit or loss of associates and joint ventures.

B2. The staff provided a summary of the June 2017 Board discussions on these proposals.

Earnings before finance income/expenses and tax (EBIT)

B3. Many ASAF members supported the presentation of an EBIT subtotal in the statement(s) of financial performance, but some acknowledged that defining EBIT would be a challenging undertaking for the Board.

B4. Some members challenged the proposed definition for EBIT, raising specific operational issues:

(a) the FASB representative queried whether:

(i) right-of-use assets under a lease contract and derivatives in an asset position—including those not qualifying for hedge accounting but used as an economic hedge—would meet the definition of 'assets arising from financing activities';

(ii) some interest would be excluded from EBIT—for example on zero coupon bonds; and

(iii) EBIT would exclude capitalised interest—for example, interest capitalised in inventories and included in profit or loss as part of the cost of goods sold.

(b) the SAFRC representative:

(i) asked whether all income and expenses representing time value of money—eg interest on a significant financing component under IFRS 15 Revenue from Contracts with Customers—would be excluded from EBIT;

(ii) said the current diversity in practice in the presentation of foreign exchange differences and fair value gains and losses on derivatives should be addressed; and

(iii) queried whether it is appropriate to require a different presentation for income and expenses on interest-bearing investments than for income and expenses on non-interest bearing investments.

B5. Other ASAF members expressed more general concerns about defining and requiring an EBIT subtotal:

(a) the DRSC representative argued that, because users are likely to continue adjusting any subtotal the Board defines and because no consensus exists around the definition of EBIT, the Board should focus on improving disaggregation, rather than on defining EBIT. A Board member said that, nevertheless, many users support introducing a comparable EBIT subtotal as a starting point for their analysis.

(b) the GLASS representative expressed the view that the Board should not encourage users to use EBIT as a starting point for discounted cash flows (DCF) analysis, because EBIT is not a good proxy for free cash flows. However, a Board member said that EBIT is a common and legitimate starting point for DCF analysis. He added that users adjust EBIT in their model to correct for any cash-accruals differences.

(c) the ASBJ and GLASS representatives said presenting an EBIT subtotal is inappropriate in some industries, such as financial services. The ASBJ and AOSSG representatives said the presentation of an EBIT subtotal should be optional, rather than mandatory.

B6. The FASB representative encouraged the Board to consider different terminology going forward. The FASB representative said the label 'earnings before interest and tax' is inappropriate, because the staff proposes to exclude more than just interest (eg foreign exchange differences) and to exclude only income taxes (eg not revenue-based taxes) from the subtotal.

B7. In written comments submitted before the meeting, the CASC requested that the Board consider another term for 'capital structure', as it is already widely used in some jurisdictions with different meanings, so using that term might lead to confusion.

B8. The EFRAG representative suggested the staff should investigate how entities define capital structure in practice by reviewing the disclosures required by IAS 1 paragraphs 134–136.

B9. Other suggestions included:

(a) some ASAF members said the Board should introduce an investing category and/or have three parts to the statement(s) of financial performance (operating, investing, and financing); and

(b) the AOSSG and ASBJ representatives supported the Board considering a broadly-defined operating profit subtotal.

Management performance measures and adjusted earnings per share

B10. ASAF members had some concerns about the staff proposals for introducing a management performance measure in the statement(s) of financial performance. Few comments were made about the staff proposals for an adjusted earnings per share in the statement(s) of financial performance.

B11. Some ASAF members had concerns about allowing too much flexibility in presenting the management performance measure and said there was a need to develop strict guidance about the measure. However, other ASAF members cautioned that the management performance measure might not represent management's view of performance if it is subject to restrictions—for example if some items, such as the share of profit or loss of associates and joint ventures, are required to be presented below EBIT. The AASB/NZASB representative said that the existing guidance in IAS 1, combined with the suggested principles in the Principles of Disclosure Discussion Paper might be sufficient to ensure fair presentation of such measures. The AcSB representative encouraged the Board to engage with securities regulators about the management performance measure, given the regulatory guidance on non-GAAP measures.

B12. The AASB/NZASB representative encouraged the Board to focus on the predictive value of income and expenses, rather than considering a distinction between frequent and infrequent items.

Share of the profit or loss of associates and joint ventures

B13. The AcSB and ASBJ representatives expressed support for a single location for the presentation of the share of profit or loss of all associates and all joint ventures. In contrast, most other ASAF members expressed support for the Board considering whether the location should depend on whether the associate or joint venture is integral to the entity's operations. The AASB/NZASB representative cautioned that—for determining the presentation of associates and joint ventures, but also more generally—the Board should not confuse comparability with uniformity, ie it should not 'make unlike things look alike', referring to paragraph QC23 of the Conceptual Framework for Financial Reporting (Conceptual Framework).

B14. The AOSSG and SAFRC expressed the view that the presentation of the share of profit or loss of associates and joint ventures should be treated similarly to the presentation of the fair value changes in other investments the entity has no control over.