

IFRS® Foundation

Primary Financial Statements

Accounting Standards Advisory Forum meeting

ASAF Agenda Paper 3

March 2022

Purpose of this session

Agenda ref 3

Project status update (slides 5–13)

1. To provide ASAF members with an update on the IASB's redeliberations on the proposals in the Exposure Draft *General Presentation and Disclosures* and seek general advice on way forward.

Disclosure of operating expenses by nature in the notes (slides 14–27)

1. To give ASAF members an overview of:
 - the feedback related to the proposal in the ED requiring entities that report operating expenses by function in the statement of profit or loss to disclose total expenses by nature in the notes; and
 - the current status of redeliberations on this topic.
2. To seek advice from ASAF members to help the IASB develop disclosure requirements with regards to expenses by nature for entities that report operating expenses by function in the statement of profit or loss.

Agenda Paper 3A for this meeting provides the summary of proposals, feedback received and tentative decisions.

Project status update (slides 5–13)

1. Given the IASB's tentative decisions on the proposals to date (slides 9–13), do you have any suggestions in approaching the remaining topics to be redeliberated?

Disclosure of operating expenses by nature in the notes (slides 14–27)

1. In your jurisdiction:
 - a) compared to the proposal in the ED are there particular benefits or costs associated with a partial matrix approach that the IASB should consider; and
 - b) is a particular approach preferable and why?
2. Do you have any additional suggestions with regards to potential standard-setting the IASB could provide to alleviate costs of a partial matrix (slide 27)?

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Project status update and redeliberations to date by topics (slides 5–13)

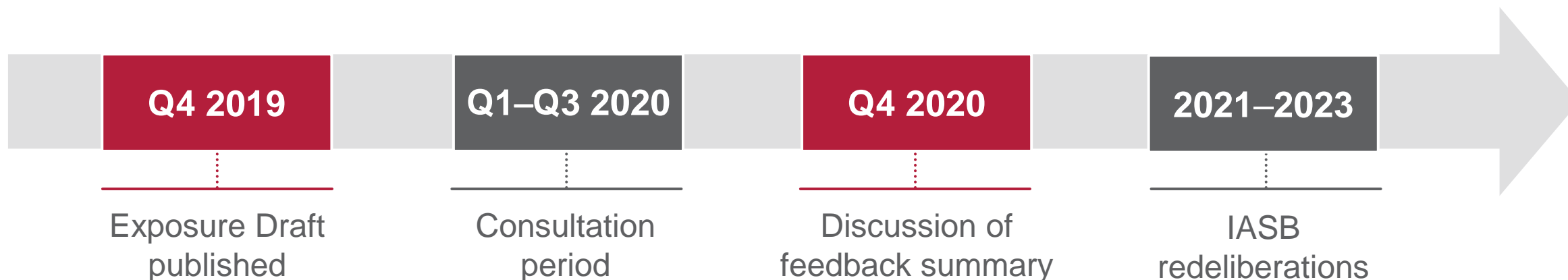
Disclosure of operating expenses by nature in the notes (slides 14–27)



Project status update

Primary Financial Statements

Agenda ref 3



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 Strengthen requirements for **disaggregating information**
- 3 Require disclosures about **management performance measures**

Key factors considered in redeliberations planning

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Project objective and focus

Improve how information is communicated in the financial statements, with a focus on the statement of profit or loss



Linkages between topics

Decisions on one topic may affect approach on another topic



Timeliness

Deliver high quality IFRS Accounting Standard in a timely manner



Efficiency

Use staff and IASB time efficiently

Project status

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| Topic | Proposals redeliberated | Remaining to be discussed |
|---------------------------------|---|--|
| Subtotals | Required subtotals; Classification in categories, general model; Associates and joint ventures | Classification by entities with specified main business activities; tidy up of investing and financing categories |
| Management performance measures | Scope and definition; Disclosure of reconciliation | Disclosure of tax and non-controlling interests Single note, cross-referencing, use of columns, relationship with segments and other |
| Disaggregation and other | Roles of primary financial statements and notes; General principles Direction for unusual income and expenses; Presentation of operating expenses; Direction for disclosure of operating expenses Statement of cash flows | Definition of unusual income and expenses, related disclosures; Disclosure of operating expenses; Proposals relating to 'other' and other small issues left, including relating to the statement of cash flows |



Redeliberations to date by topics

Subtotals and categories

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What is confirmed from the ED?

- Requirement for operating profit or loss subtotal and profit before financing and income tax subtotal
- Definition of operating profit as a default category, includes, but is not limited to main business activities and includes volatile and unusual items
- Income and expenses to be excluded from operating: investing, financing, income tax and discontinued operations
- Classify in the investing category income and expenses from assets that generate returns individually and largely independently of other resources held by an entity, retain application guidance and label 'investing category'

What has changed?

- Classification of income and expenses from cash and cash equivalents from financing to the investing category
- Approach to classification of items in the financing category
- Default category for gains and losses from derivatives and hedging instruments changed from investing to the operating category
- Undue cost or effort relief for FX classification
- Distinction between integral and non-integral associates and joint ventures removed as well as related subtotal
- Add application guidance for some income and expenses in investing category, include objective in the Basis for Conclusions, and remove definition of 'income and expenses from investments'
- Income and expenses from associates and joint ventures classified in investing category

Remaining topics to be discussed

- Classification by entities with specified main business activities
- Incremental expenses in investing category
- Other issues related to the financing category

What is confirmed from the ED?

- Discussion of roles of primary financial statements and notes
- Principles of disaggregation – with refinements
- Not reinstate para 29 of IAS 1 requiring to separately present dissimilar items unless immaterial
- Nature and function primary characteristics for presentation of operating expenses
- Present goodwill separately from intangible assets
- Present required line items in each affected category in statement of profit or loss

What has changed?

- Include a reference to understandability in the description of the role of financial statements
- Emphasise that single dissimilar characteristic can be enough to disaggregate if it is material
- State the purpose of disaggregation more clearly and strengthen the application of disaggregation
- Provide additional guidance to apply the principles, both in the primary financial statements and the notes
- Removed the proposed prohibition on a mixed presentation approach for operating expenses
- Remove 'limited predictive value' from definition of unusual items and add application guidance
- Revise the general principle for the presentation of line items and add application guidance

Remaining topics to be discussed

- The rest of the definition of unusual income and expenses and related disclosures
- Requirements for disclosure of operating expenses
- Requirements for selecting method of presentation of operating expenses
- Specified and additional subtotals
- Proposals relating to 'other' items

Management performance measures (MPMs)

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What is confirmed from the ED?

- Requirement for disclosure of MPMs in financial statements
- Scope of MPMs would not be beyond the income and expense subtotals
- Reference to management's view of an aspect of an entity's performance in the definition of MPMs
- Requirement for an entity to disclose why an MPM communicates management's view of performance
- Requirement to disclose a reconciliation

What has changed?

- Subtotal of income and expense used in the numerator or denominator of a ratio is MPM
- In the definition, remove the reference to 'complementing'
- Introduce a rebuttable presumption that a subtotal used in public communications represents management's view of an aspect of the entity's financial performance, and add application guidance on rebuttal
- Add application guidance, and refer to general requirement for faithful representation, removing specific requirement
- Application guidance for disclosure of why an MPM communicates management's view of performance
- Disclose, for each reconciling item, amount(s) related to each line item in the statement(s) of financial performance

Remaining topics to be discussed

- Disclosures including tax and non-controlling interests
- Disclosure in single note and cross-referencing
- Disclosures relating to changes in MPMs
- Timing of public communications
- Interaction with other requirements including segments
- Other proposals including use of columns

What is confirmed from the ED?


- Requirement of operating profit or loss subtotal as the starting point for the indirect method of reporting cash flows from operating activities
- Interest and dividends paid classified as financing activities, and dividends received classified as investing activities in the statement of cash flows

What has changed?

- Amend the specified subtotal 'operating profit or loss before depreciation and amortisation' to exclude impairments of assets within the scope of IAS 36

Remaining topics to be discussed

- Classification of interest received in the statement of cash flows
- Proposals for labelling of items of other comprehensive income
- Requirements carried over from IAS 1
- Amendments to other IFRS Accounting Standards; IFRS 12 *Disclosure of Interests in Other Entities*, IAS 33 *Earnings Per Share* and IAS 34 *Interim Financial Reporting*
- Transition provisions and effective date

The background of the slide features a stylized world map in shades of gray. Overlaid on the map are several curved, concentric lines and dotted lines, creating a sense of global connectivity and data flow.

Disclosure of operating expenses by nature in the notes for entities that report by function

A grayscale world map is the background, showing continents and a grid of dotted lines. Overlaid on the left side are several thick, curved, light-gray lines that sweep across the map from the bottom left towards the top right.

Background and status of redeliberations

Proposal—Entities reporting by function shall disclose total operating expenses by nature in the notes

Agenda ref 3

| Statement of profit or loss | 20X2 | 20X1 |
|-------------------------------------|-------------|------|
| Revenue | 3000 | ... |
| Cost of goods sold | (600) | ... |
| Gross profit | 2400 | ... |
| Selling expenses | (500) | ... |
| General and administrative expenses | (100) | ... |
| Research and development expenses | (300) | ... |
| Other income | 300 | ... |
| Operating profit or loss | 1800 | ... |

| Disclosure in a single note | 20X2 | 20X1 |
|---|---------------|------|
| Changes in inventories of finished goods and work in progress | 300 | ... |
| Materials | (700) | ... |
| Depreciation, Amortisation (bundled for simplification) | (300) | ... |
| Employee benefits | (300) | ... |
| Impairment | (200) | ... |
| Other | (300) | ... |
| Operating expenses total | (1500) | ... |

- 1) Likely that disclosing cost rather than expense would be a more operational approach for entities in complying with the specific disclosure requirement in the ED (as applied by entities reporting expenses by nature in the statement of profit or loss for simplicity purposes)

Summary of feedback received on proposal

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- Comment letter respondents have expressed mixed views on the proposal:
 - many respondents, mainly preparers, said that the costs of the proposal would be too high (as it would require changes to systems and reporting processes)
 - many respondents, mainly users, said that the proposal would provide users with useful information
 - feedback from a few respondents (mainly preparers and users) indicated that limited disaggregation of (some) functions into expenses by nature (a partial matrix) would be less costly for preparers and more useful for users than disclosing only totals of expenses by nature (see slide 18 for more detail)
- Feedback from fieldwork participants and the Global Preparers Forum (GPF) amplifies concerns with regards to costs of the proposal:
 - most fieldwork participants that report expenses by function were either unable, or required significant estimates, to disclose expenses by nature using existing systems (23 out of 29 entities)
 - feedback from November 2021 GPF meeting indicates that the proposal is too costly for preparers as it would require changes to systems and reporting processes

Feedback relevant to a partial matrix approach

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- IASB did not ask for feedback on partial matrix approach
- However, as mentioned on slide 17, a few comment letter respondents indicated that limited disaggregation of (some) functions into expenses by nature (a partial matrix) would be less costly for preparers and more useful for users than disclosing only totals of expenses by nature, in particular:
 - preparers suggested an allocation of depreciation, amortisation and employee benefit expense to functions
 - users highlighted that:
 - employee costs should be shown by function as they are often the largest expense for services and technology companies;
 - depreciation and amortisation expenses should be shown by function, as users need to remove depreciation and amortisation from R&D in order to capitalise R&D themselves; and
 - a rough approximation of expenses by function may already be of significant value to users

Current status of redeliberations on proposal

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- The IASB has tentatively decided to require a narrative disclosure of the composition of functions (see IASB tentative decision in October 2021 [Agenda Paper 21B](#))
- The IASB has asked the staff to develop a better understanding of whether a ‘partial matrix’ could achieve a better cost-benefit balance than the proposal in the ED (October 2021 [Agenda Paper 21C](#))
- So far, there was no structured outreach on the topic, feedback from the November 2021 GPF meeting and discussion with preparers suggests that a partial matrix could be equally or more costly than the proposal (eg that disaggregation of cost of sales would be very challenging for entities using standard costing systems*)
- Discussion with CMAC planned for March 2022 to explore benefits of different approaches for investors
- Further outreach with preparers necessary to determine whether a partial matrix would be a feasible solution to the cost concerns expressed with regards to the proposal in the ED

* Standard costing is a technique for measuring the cost of inventories that may be used for convenience if the results approximate cost. Standard costs take into account normal levels of materials and supplies, labour, efficiency and capacity utilisation. They are regularly reviewed and, if necessary, revised in light of current conditions.



What could a partial matrix
look like?

What is a partial matrix?

- Prior to finalising the ED, the IASB considered to require that entities disclose a full matrix (that is: a disaggregation of functions into expenses by nature based on materiality). However, the IASB concluded that a full matrix would be significantly more complex and costly to apply than the proposal in the ED (that is, to require that entities disclose an analysis of total operating expenses by nature) (see paragraph BC112 of the Basis for Conclusions on the Exposure Draft)
- A full matrix:
 - would give entity-specific material information; but
 - would not solve the cost problem for entities
- A partial matrix, on the other hand, is likely to result in some material information not being disclosed as it would require that either:
 - all functions be disaggregated into specified expenses by nature; or
 - specified functions be disaggregated into expenses by nature

Partial matrix 1—IASB specifies which expenses* by nature to be disaggregated by function

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| Statement of profit or loss | 20X2 | 20X1 |
|-------------------------------------|-------------|------|
| Revenue | 3000 | ... |
| Cost of goods sold | (600) | ... |
| Gross profit | 2400 | ... |
| Selling expenses | (500) | ... |
| General and administrative expenses | (100) | ... |
| Research and development expenses | (300) | ... |
| Other income | 300 | ... |
| Operating profit or loss | 1800 | ... |

| Disclosure in a single note | 20X2 | 20X1 |
|---|------------|------|
| 1) Depreciation, Amortisation (bundled for simplification) | 400 | ... |
| Cost of goods sold | 250 | ... |
| Selling expenses | 50 | ... |
| General and administrative expenses | 50 | ... |
| Research and development expenses | 25 | ... |
| Delta | 25 | ... |
| 2) Employee benefits | 400 | ... |
| Cost of goods sold | 150 | ... |
| Selling expenses | 100 | ... |
| General and administrative expenses | 50 | ... |
| Research and development expenses | 50 | ... |
| Delta | 50 | ... |

- 1) Material information perhaps not disclosed as entities would only disclose quantitative information on specific expenses by nature
- 2) Totals** of specified expenses by nature determinable

* See slide 27 on a cost approach (rather than an expense approach)

** Totals mentioned in paragraph 104 of IAS 1 *Presentation of Financial Statements* would be given regardless of which version of a partial matrix would be required (depreciation, amortisation and employee benefits)

Partial matrix 2—IASB specifies the functions to be disaggregated by nature

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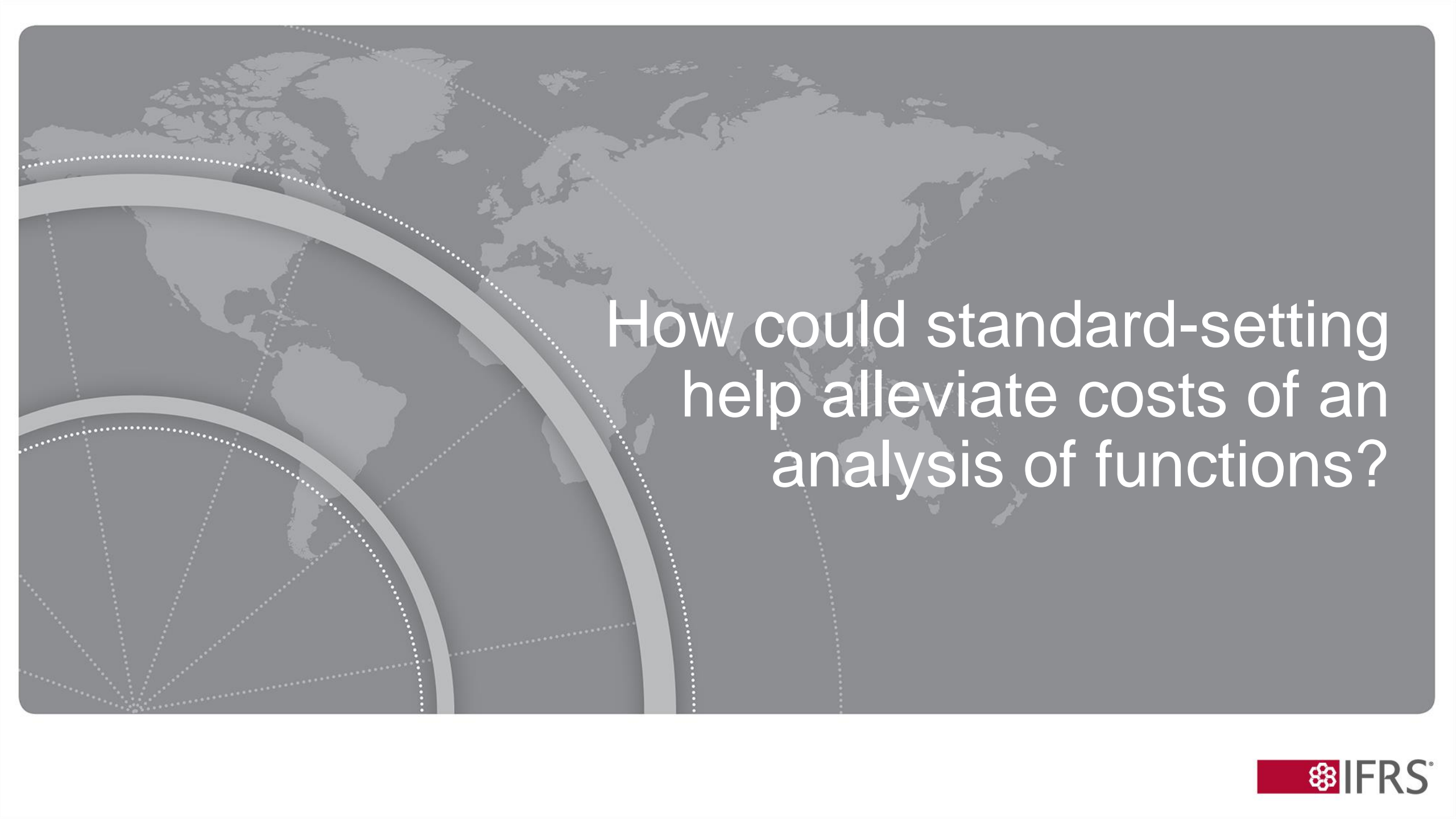
| Statement of profit or loss | 20X2 | 20X1 |
|-------------------------------------|-------------|------|
| Revenue | 3000 | ... |
| Cost of goods sold | (600) | ... |
| Gross profit | 2400 | ... |
| Selling expenses | (500) | ... |
| General and administrative expenses | (100) | ... |
| Research and development expenses | (300) | ... |
| Other income | 300 | ... |
| Operating profit or loss | 1800 | ... |

1) Material information perhaps not disclosed as entities would only disclose quantitative information on specific functions (however: users would be provided with a narrative disclosure of the composition of functions; see IASB tentative decision in October 2021 [Agenda Paper 21B](#))

2) Totals* of some expenses by nature perhaps not determinable if a portion of the total expense is included in a function for which disaggregation is not required

| Disclosure in a single note | 20X2 | 20X1 |
|---|------------|------|
| Cost of goods sold | 600 | ... |
| Depreciation, Amortisation (bundled for simplification) | 250 | ... |
| Employee benefits | 150 | ... |
| Materials | 150 | ... |
| Impairment | 25 | ... |
| Other | 25 | ... |
| Selling expenses | 500 | ... |
| Depreciation, Amortisation (bundled for simplification) | 100 | ... |
| Employee benefits | 150 | ... |
| Materials | 200 | ... |
| Other | 50 | ... |

* Totals mentioned in paragraph 104 of IAS 1 *Presentation of Financial Statements* would be given regardless of which version of a partial matrix would be required (depreciation, amortisation and employee benefits)

A grayscale world map is the background, showing continents and a grid of dotted lines. Overlaid on the left side are several thick, curved, light-gray lines that sweep across the map, suggesting a global or regional focus.

How could standard-setting help alleviate costs of an analysis of functions?

Main costs of an analysis of functions

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- For an entity with inventory management systems and no consolidation:
 - disaggregation of cost of sales would require unbundling of standard costing system
 - some entities have information about production costs (that is, inputs used) but cannot differentiate between costs incurred and what was expensed in the period (process and system changes necessary)
 - costs are initially charged to cost centres (linked to specific functions) and subsequently recharged to other functions (eg IT, Finance, HR), resulting in a loss of information on the nature of the recharged cost (process and system changes necessary)
- For an entity with consolidation, but no intercompany transactions, additional to above:
 - cost centre information is tracked at subsidiary level but not tracked on a group level as subsidiary only reports by functions to group (process and system changes necessary)
- For an entity with consolidation, and with intercompany transactions, additional to above:
 - consolidation/elimination of intercompany transactions (eg sale/purchase of assets) currently only by function (obtaining information would require additional consolidation by nature)

Could costs of an analysis of functions be alleviated?

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- Expect that some process and systems changes would be necessary for most entities reporting expenses by function in the statement of profit or loss, but that extent of necessary changes varies among entities
- Analysis of the main costs of a partial matrix shows that the IASB could alleviate costs for entities in fulfilling specific disclosure requirement to some extent by standard-setting

How could costs be alleviated by standard-setting?

Agenda ref 3

| | Main costs for entities | | | |
|--|---|--|--|---|
| | Determining expense in the period | Unbundling of standard costs | Collection of cost centre information at reporting entity level | Identification of nature of recharged cost |
| Proposal in the ED (totals of expenses by nature) | Yes | No, information expected to be generated from other systems (e.g., purchase and payroll systems) | Limited to collection of information (no tracking of allocation to functions required) | Yes |
| Partial matrix 1 (IASB specifies which expenses by nature to be disaggregated by function; slide 22) | Yes | Yes, some unbundling would be required (e.g., employee benefits) | Yes, for functions in which specified expenses are included | Yes |
| Partial matrix 2 (IASB specifies the functions to be disaggregated by nature; slide 23) | Yes | Yes, because cost of sales is expected to be a specified function | Yes, for functions specified | Yes |
| | Clarify that disclosure would be by cost rather than expense (as for entities reporting by nature in the statement of profit or loss) | Extend relief in paragraph 21 of IAS 2 <i>Inventories</i> so that entities can use standard costing assumptions for disclosure | Nothing identified | Clarify the level at which nature of expense and function are assessed for disclosure |
| How standard-setting could alleviate costs for entities | | | | |

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