IFRS Accounting

Staff paper

Agenda Paper 2

Capital Markets Advisory Committee

Date	**October 2022**
Project	**Primary Financial Statements**
Topic	**Targeted feedback**
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Purpose of this session

The purpose of this session is to obtain feedback from CMAC members on whether the tentative decisions on the following selected topics will achieve the related objectives and the intended balance of costs and benefits:

1. Classification of income and expenses in the financing category
2. Aspects of the disclosure requirements for management performance measures
3. Disclosure of operating expenses by nature in the notes when an entity presents operating expenses by function in the statement of profit or loss

We will also provide an update on unusual income and expenses

Classification of income and expenses in the financing category

Financing category proposed in the Exposure Draft

The Exposure Draft proposed a financing category to facilitate an analysis of an entity's performance independently of how it is financed

The financing category was proposed to include:

1. income and expenses on liabilities from 'financing activities'—defined as the receipt or use of a resource from a provider of finance with the expectation the resource will be returned and the provider of finance compensated through payment of a finance charge dependent on amount of credit and duration; and
2. interest expenses on other liabilities

The Exposure Draft also proposed that an entity classify income and expenses from cash and cash equivalents in the financing category. In the redeliberations, the IASB has tentatively decided that an entity classify income and expenses from cash and cash equivalents in the investing category

Exposure Draft Feedback

Respondents raised questions to clarify the definition of ‘financing activities’ such as:

- Who qualifies as a provider of financing and what compensation qualifies as a finance charge?
- Does the resource returned need to be the same as the resource received?

In response to the questions raised and to make the proposals easier to apply, the IASB tentatively decided to revise the approach to classifying income and expenses in the financing category

The new approach is not expected to result in a change in the income and expenses that would be classified in the financing category

Interest expenses on lease liabilities and amounts payable for goods and services received were captured by 'income and expenses on liabilities arising from financing activities' in the Exposure Draft but are now captured by 'specified income and expenses from other liabilities’

Revised proposal for the financing category

Applying the revised proposal the financing category will include:

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, a typical loan contract that 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 is an 'other liability' because it involves the receipt of a right-of-use asset and the return of cash. Only interest expense (and the effects of changes in interest rates) identified by IFRS 16 is included in the financing category

Statement of profit or loss applying revised proposals

Revenue	Operating
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	Investing
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	Financing
Specified income and expense on other liabilities	
Profit before tax	
Income tax	
Profit for the year	

Entities with specified main business activities

Operating profit is intended to include key metrics of operating performance

Entities with specified main business activities include banks, insurers and investment property companies

These entities have subtotals similar to gross profit, such as net interest income, net financial result and net rental income

In order for these entities to present their key performance metrics in the operating category, the Exposure Draft proposed requirements for them to classify income and expenses in the operating category that would otherwise be classified in the investing or financing categories

Under the revised proposal, an entity with financing as a main business activity, such as a bank, would reclassify income and expenses from liabilities that involve only the raising of finance to the operating category

Interest expense and the effects of changes in interest rates from other liabilities would not be reclassified to the financing category. For example, interest from lease liabilities would be classified in the financing category for all entities, including banks

Questions for CMAC Members

1. In your experience, are there any transactions that you think should be captured in the financing category that would not be captured by the revised proposal (see slide 6)?
2. Are you aware of any issues that may arise from the expected change in outcome from the Exposure Draft for lease liabilities and amounts payable for goods and services received?

Aspects of the disclosure requirements for management performance measures

Management performance measures (MPM) definition

The Exposure Draft proposed disclosure requirements for management performance measures which it defined as subtotals of income and expenses that:

1. are used in public communications outside financial statements;
2. complement totals or subtotals specified by IFRS Accounting Standards; and
3. communicate to users of financial statements management's view of an aspect of an entity's financial performance

Rebuttable presumption to address feedback

Some respondents said that the requirement that a management performance measure communicate management’s view of an aspect of an entity’s financial performance may be too subjective to capture all of the measures intended by the proposals

Other respondents were concerned that not all measures used in public communications outside financial statements reflect management’s view. For example, some participants asked whether a subtotal required by local Accounting Standards would be a management performance measure

In response, the IASB tentatively decided to establish a rebuttable presumption* that a subtotal of income and expenses included in public communications outside financial statements represents management’s view of an aspect of the entity’s financial performance

The rebuttable presumption could be rebutted with reasonable and supportable evidence that a subtotal does not represent management’s view of an aspect of financial performance

* The IASB uses rebuttable presumptions to establish a general rule that is assumed to be true in most cases.
In the case that the assumption is not true an entity may ‘rebut’ the presumption with appropriate evidence.
The rebuttable presumption requires an entity to provide evidence why the general rule does not apply in the entity’s specific circumstances

How the rebuttable presumption would work

A subtotal of income and expenses published outside the financial statements would be assumed to be a management performance measure and be required to be disclosed in the financial statements (unless the presumption were rebutted)

The rebuttable presumption assumes that if an entity publishes a subtotal of income and expenses outside of financial statements, it does so to communicate management's view of an aspect of the entity's financial performance

To rebut the presumption there must be reasonable and supportable evidence to explain why the subtotal was published even though it does not represent management's view

For example, the entity may be required by a regulator to publish a subtotal that does not reflect management's view

Objective of the rebuttable presumption

The rebuttable presumption is intended to:

a) reduce the subjectivity involved in identifying the subtotals of income and expense that represent management’s view by requiring a publicly disclosed subtotal of income and expense to be a management performance measure unless there is reasonable and supportable evidence that the subtotal does not represent management’s view; and

b) avoid requiring entities to include as management performance measures, subtotals of income and expenses that do not represent management’s view of an aspect of the entity’s performance but which they are required to publicly disclose for other reasons. For example, when disclosure of a subtotal is required by a regulator

Questions for CMAC Members

1. Do you agree that measures that do not represent management’s view (eg required by local GAAP or regulation) should not be disclosed as management performance measures in the notes to the financial statements?
2. Do you think establishing the rebuttable presumption will reduce subjectivity over which measures are not disclosed as management performance measures? If not, what alternative approach would you suggest and why?

Proposed calculation of tax on reconciling items

The Exposure Draft proposed an entity be required to reconcile each management performance measure to the most directly comparable subtotal or total specified in IFRS Accounting Standards

It also proposed an entity be required to disclose the tax effect and the effect on non-controlling interests for each item disclosed in the reconciliation

The tax effect was proposed to be determined on the basis of a reasonable pro rata allocation of the current and deferred tax of the entity in the tax jurisdiction(s) concerned or by another method that achieves a more appropriate allocation in the circumstances

Example of a reconciliation

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**		

Simplified approach to calculating the tax effect

Feedback on calculating tax on reconciling items

Some respondents (mainly preparers) said that it may be complex and therefore costly to calculate the tax effects of individual reconciling items using the method proposed in the Exposure Draft

However, other respondents (mainly users) said that information about the tax effects was important to help users to analyse management performance measures

User feedback was that effects of reconciling items were important to understanding the measures because the tax effects can be materially different from those using the effective tax rate and the information was necessary for analysing the measures on a per share basis

Feedback from users was also that high-level information about the tax effects of reconciling items would meet their needs

Revised calculation of tax on reconciling items

In response the IASB tentatively decided to revise the requirement specifying how to calculate the income tax effect. The revised requirement allows an entity to either:

a) calculate the tax effects of the underlying transaction(s) at the statutory tax rate(s) applicable to the transaction(s) in the relevant jurisdiction(s); or

b) calculate the tax effects as described in a) and allocate any other tax effects related to the underlying transaction(s) based on a reasonable pro rata allocation of the current and deferred tax of the entity in the jurisdictions concerned, or other method that achieves a more appropriate allocation

The revised requirement is intended to reduce the complexity of the proposal in the Exposure Draft by specifying a simplified calculation of the tax effects of reconciling items that an entity can choose when a full calculation would be too complex

As a simplified calculation, the information provided may be less than would be provided by a full calculation but is intended to respond to user feedback that high-level information on these tax effects would meet their needs. For example, the effect when the transaction(s) occur in a jurisdiction with a tax rate materially different to the effective tax rate for the consolidated entity

Question for CMAC Members

1. Does the IASB’s tentative decision to revise the method used to calculate the tax effect in slide 19 provide sufficient information for users to understand the tax effects of individual reconciling items?

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 profit or loss to disclose in a single note an analysis of total operating expenses using the nature of expense method

The IASB received feedback that the proposed approach would be costly to apply, to the extent it would require an entity to provide additional information about expenses by nature that it is not currently disclosing

The evidence from practice suggests that while some entities already provide disclosure of all operating expenses by nature, many only provide those disclosures by nature specifically required by IFRS Accounting Standards (including depreciation, amortisation and employee benefits) and would have to incur significant costs to implement the proposals

Revised proposal

In response to the feedback the IASB has tentatively decided to withdraw the proposal to specifically require disclosure of all operating expenses by nature in the notes, for those that report by function

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

An illustration comparing the original proposal in the Exposure Draft to how the revised proposal might be applied is included in slide 24

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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)**
Cost of goods sold	*(250)*
Selling expenses	*(150)*
Research and development expenses	*(50)*
General and administrative expenses	*(50)*
Employee benefits	**(400)**
Cost of goods sold	*(200)*
Selling expenses	*(100)*
Research and development expenses	*(50)*
General and administrative expenses	*(50)*

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

Exploring further changes to the revised proposal

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

In response the IASB is exploring:

a) whether the revised proposal in slide 23 should include impairments and write-downs of inventory in addition to depreciation, amortisation, and employee benefits; and

b) 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

Question for CMAC Members

1. Does disclosing the amounts of depreciation, amortisation and employee benefits included in each line item in the statement of profit or loss provide sufficient information about the nature of expenses considering the cost concerns of some stakeholders?
2. Do you think the list of line items included in question 1 should also include impairments and write-downs of inventories? Why or why not?
3. Would the approach in question 1 provide similar, or better, information if applied to all other operating expenses disclosed in the notes, subject to an undue cost constraint?

Unusual income and expenses

Exposure Draft—unusual income and expenses

Definition	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 Income and expenses from the recurring remeasurement of items measured at a current value would not normally be classified as unusual

Disclosures	Amount & narrative description	Amount disaggregated by: • 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

Update from September IASB meeting

Continued discussions with stakeholders and the IASB have indicated that rather than defining unusual income and expenses solely in terms of recurrence, a definition should focus on whether income or expenses have another characteristic that make them ‘unusual’. However, developing such a definition, which is different to that proposed in the Exposure Draft, is unlikely to be successful on a timely basis

Given the feedback from stakeholders that other aspects of this project should be finalised as quickly as possible, the IASB has tentatively decided not proceed with any specific requirements for unusual income and expenses as part of this project

Not proceeding with the proposals on unusual income and expenses will result in the loss of some information compared to the outcome of the proposals in the Exposure Draft, had a consensus on the definition emerged

However, requirements for disclosures relating to management performance measures and the general requirement to disaggregate amounts when information about the disaggregated amounts is material will result in improvements in current practice for the disclosure of unusual income and expenses and provide some of the information intended to be provided by the proposals in the Exposure Draft

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)

Disclosures required by MPM proposals

Information about unusual income and expenses will often be required as part of the management performance measure disclosures—if an entity excludes income or expenses that it has identified as unusual from a management performance measure

Application guidance tentatively decided in redeliberations would require an entity to:

a) be transparent about the meaning of the terms used and the methods applied;

b) refer to the individual line items in the reconciliation when necessary for a user to understand why a management performance measure communicates management's view of performance; and

c) require an entity to disclose, for each reconciling item, the amount(s) related to each line item(s) in the statement(s) of financial performance

As a result, we expect that if an entity excludes unusual income or expenses from a management performance measure, it would disclose how it applies the term 'unusual' and disclose where the amounts so described are included in the line items in the statement of profit or loss

In addition, there is a general requirement to disaggregate amounts when information about the disaggregated amounts is material

Question for CMAC Members

1. Do CMAC Members have any comments on IASB tentative decision to withdraw the proposals for unusual income and expenses?

Appendix—Previous CMAC feedback on unusual income and expenses

March 2022 CMAC meeting (1/2)

At the CMAC meeting in March 2022, the staff asked CMAC members for their views on the proposed definition of unusual income and expenses, in particular whether the IASB should focus on:

a) ensuring all ‘unusual’ income and expenses are identified; or

b) preventing recurring items from being portrayed as ‘unusual’

Some members preferred a broad definition that would capture a wide range of non-recurring items. They wanted information about many such items, not just a narrow set of highly exceptional items. Users are also looking for information about varied items, depending on their needs. A broad definition would enable users to choose which items they would exclude from an ongoing earnings calculation.

However, a few members would prefer the definition to focus on preventing recurring items from being portrayed as ‘unusual’.

March 2022 CMAC Meeting (2/2)

At the CMAC meeting in March 2022 the staff also specifically asked whether:

a) the definition should include income and expenses that have occurred in the past (as proposed in the Exposure Draft). Some said the definition should include such income and expenses. A member gave an example of natural disasters that might have occurred in a recent annual financial reporting period, but should still be deemed to be unusual if they occurred again in the current period

b) the definition should include income and expenses that are expected to occur in a few annual periods (rather than not recurring at all in the future, as proposed in the Exposure Draft). Most members said the definition should include such income and expenses. Some members said information about when such items had occurred in the past and for how long they were expected to continue in the future would be important

June 2022 joint CMAC-GPF meeting (1/2)

At the June 2022 joint CMAC-GPF meeting the staff set out a working definition of items with limited recurrence (unusual items) based on the IASB's tentative decisions in May and provided three examples for CMAC and GPF members to consider:

a) a one-off restructuring that was expected to give rise to expenses in three annual periods;

b) revenue and expenses from a product line that was expected to be discontinued in the next year; and

c) revenue and expenses that were expected to increase in the next few years because of expected internal growth or an expected acquisition

June 2022 joint CMAC-GPF meeting (2/2)

CMAC and GPF members all agreed that the definition of unusual income and expenses should capture only items such as the first example and not items such as the second or third examples. They said that information about the second and third examples is a matter of capital market communication beyond the financial statements. For items such as the first example, some emphasised that the definition should include income and expenses that are unusual because of their amount as well as items that are unusual because of their type.

Some CMAC members said the IASB should establish a definition of unusual income and expenses. Without such a definition, the information provided about unusual income and expenses could be incomplete. They agreed that what is unusual will vary from entity to entity. These members said that they can use their judgement to assess how to treat the different items disclosed, but can only assess what has been disclosed.

Some CMAC and GPF members suggested the IASB establish a list of income and expenses that should be regarded as unusual, for example restructuring expenses, impairments, and litigation expenses.

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Thank you