IFRS Accounting

Staff paper

Agenda reference: 1

Emerging Economies Group meeting

Date	**October 2023**
Project	**Primary Financial Statements**
Topic	**Introduction to IFRS 18 *Presentation and Disclosure in Financial Statements***
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Project Overview

Project overview

The Primary Financial Statements Project will improve the quality of financial reporting, including digital reporting, through

Presentation of **defined subtotals** in statement of profit or loss to improve **comparability**

Disclosures about **management-defined performance measures** (MPMs) to provide **transparency**

Enhanced requirements for **aggregation and disaggregation** to provide **useful information**

IFRS Accounting

Categories and subtotals

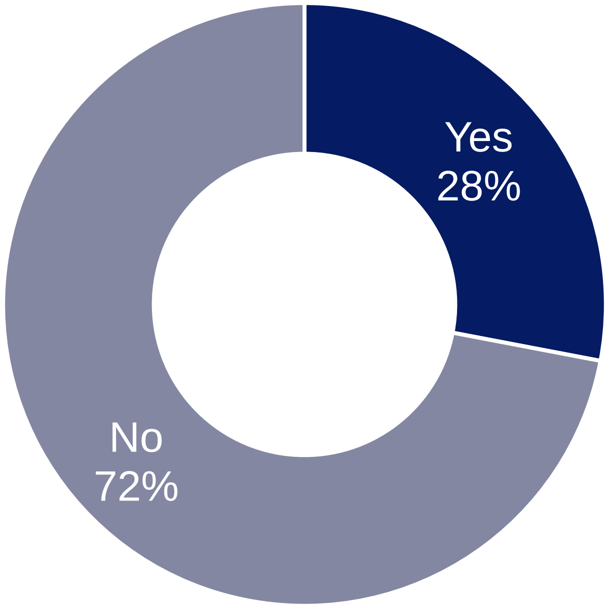
What is the issue?

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

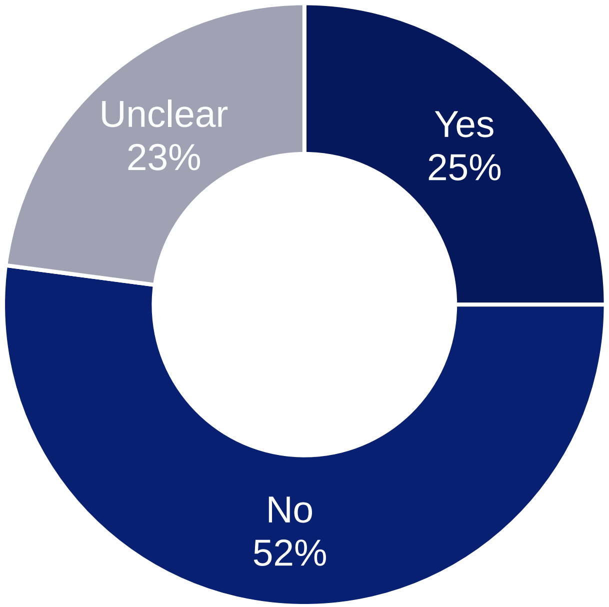
Companies calculate subtotals in different ways

- 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?



Proposed requirements for the statement of profit or loss

Classification

- Items of income and expense shall be **classified** into categories in the statement of profit or loss:
  - operating
  - investing
  - financing
  - income tax, discontinued operations
- Classification differs **in some cases** for entities that provide financing to customers or invest in assets as a main business activity

Presentation

- Entities are required to **present** the subtotals:
  - operating profit or loss
  - profit or loss before financing and income tax*
  - profit or loss
- Subtotals structure the statement of profit or loss into categories, no requirement to present category headings
- Line items listed in IFRS 18 presented unless doing so reduces how effective the statement of profit or loss is in providing a useful structured summary of the entity's income and expenses

** Entities that provide financing to customers as a main business activity and classify all income and expenses from liabilities that involve only the raising of finance in the operating category do not present this subtotal.*

Statement of profit or loss – general corporate

Revenue	Operating
Cost of goods sold	Operating
Gross profit	Operating
Other operating income	Operating
Selling expense	Operating
Research and development expenses	Operating
General and administrative expenses	Operating
Other operating expenses	Operating
Operating profit	
Share of the profit from associates and joint ventures	Investing
Other investment income	Investing
Profit before financing and income tax	
Interest expense on borrowings and lease liabilities	Financing
Interest expense on pension liabilities	Financing
Profit before tax	
Income tax expense	
Profit for the year	

Line items illustrate what is classified in each category and do not necessarily denote line items that a company would present. An entity would present line items that provide a useful structured summary of its income and expenses.

What is in the operating category?

Income and expenses:

- Not classified in other categories
- From a company's operations including from its main business activities
- Also includes volatile and unusual income and expenses

Works for all business models

Provides complete picture of company's operations

What is in the investing category?

Income and expenses from assets that generate a return individually and largely independently of other resources held by an entity

- 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

Income and expenses from subsidiaries, associates and joint ventures

Income and expenses from cash and cash equivalents

What is in the financing category?

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

- Receipt and return of cash or company’s own shares
- Reduction in financial liability
- E.g., bank loans

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

- Lease liabilities
- Defined benefit pension liabilities

How will foreign exchange differences and gain or loss on the net monetary position be classified?

- Foreign exchange differences classified in same category as income or expenses giving rise to the gain or loss, for example:

Items	Classification
Exchange differences on receivables for the sale of goods	Operating category
Exchange differences on cash and cash equivalents	Investing category
Exchange differences on foreign currency denominated debt issued	Financing category
Exchange differences on income taxes	Income tax category

  - For other liabilities, an entity uses its judgement to determine whether the foreign exchange differences relate to the amounts classified in the financing category or the amounts classified in another category.
  - If classifying foreign exchange differences in each category will involve undue cost or effort, they are classified in the operating category.

- Gain or loss on the net monetary position classified in operating category, unless an entity presents the gain or loss on the net monetary item with income and expenses associated with the net monetary position.

How will gains or losses from derivatives and designated hedging instruments be classified?

<table>
<tr><th colspan="2" rowspan="2"></th><th colspan="2">Gains and loss on</th></tr>
<tr><th>Derivatives</th><th>Non-derivative financial instruments</th></tr>
<tr><td rowspan="2">Used to manage particular risks</td><td>Hedging instrument</td><td colspan="2">Same category as the income and expenses affected by the particular risk the company manages, except when it would require the grossing up of gains or losses—then classify in the operating category</td></tr>
<tr><td>Instruments not designated in hedging relationships</td><td>Same category as the income and expenses affected by the particular risks the entity manages, except when it would require the grossing up of gains or losses or involve undue cost or effort—then classify in the operating category</td><td rowspan="2">Category determined by the requirements related to the classification of income and expenses for each asset or liability</td></tr>
<tr><td colspan="2">Not used to manage particular risks</td><td>Financing category if the derivative is a part of a transaction that involves only the raising of finance—otherwise operating category</td></tr>
</table>

Classification of income and expenses on hybrid contracts with host liabilities

Are the host liability and the embedded derivative that is in scope of IFRS 9 required to be separated?

Yes

No

Does the hybrid liability (with a non-separated embedded derivative) arise from transactions that involve only the raising of finance?

Yes

No

Is the hybrid liability (with a non-separated embedded derivative) a financial liability that is measured at amortised cost?

Yes

No

Host liabilities—classify the income and expenses according to the requirements for classification of income and expenses from liabilities.

Embedded derivatives—classify the income and expenses according to the requirements on standalone derivatives

Classify the income and expenses according to the requirements for income and expenses from liabilities that arise from transactions involving only the raising of finance

Classify all income and expenses arising after initial recognition in the financing category.

Classify the income and expenses according to the requirements for income and expenses from liabilities that do not arise from transactions involving only the raising of finance

Possible effects on the statement of profit or loss

Statement of profit or loss applying IAS 1	
Revenue	X
Cost of goods sold	(X)
Gross profit	X
Other operating income 3	X
Selling expense	(X)
General and administrative expenses 1	(X)
Research and development expense	(X)
Income and expenses from associates and joint ventures accounted for using equity method 2	X
Other operating expenses	(X)
Operating profit or loss	**X**
Finance income 4	X
Finance costs 5	(X)
Profit or loss before tax	**X**
Income tax expense	(X)
Profit or loss	**X**

Statement of profit or loss applying IFRS 18	
Revenue	X
Cost of goods sold	(X)
Gross profit	X
Other operating income	X
Selling expenses	(X)
General and administrative expenses	(X)
Research and development expense	(X)
5 Other operating expenses	(X)
Operating profit or loss	X
2 Share of profit or loss from associates and joint ventures	X
3 4 Other investment income	X
Profit before financing and income taxes	**X**
Interest expense on borrowings and lease liabilities	(X)
1 Interest expense on pension liabilities	(X)
Profit or loss before tax	**X**
Income tax expense	**X**
Profit or loss	**X**

Examples of possible changes in the classification of income and expenses

1. Net interest expense on net defined benefit liabilities will be classified in the financing category
2. Income and expenses from associates and joint ventures accounted for using equity method will be classified in the investing category
3. Gain or loss from the disposal of investment properties will be classified in the investing category
4. Interest income on cash and cash equivalents will be classified in the investing category
5. Foreign exchange differences arising from trade receivables will be classified in the operating category

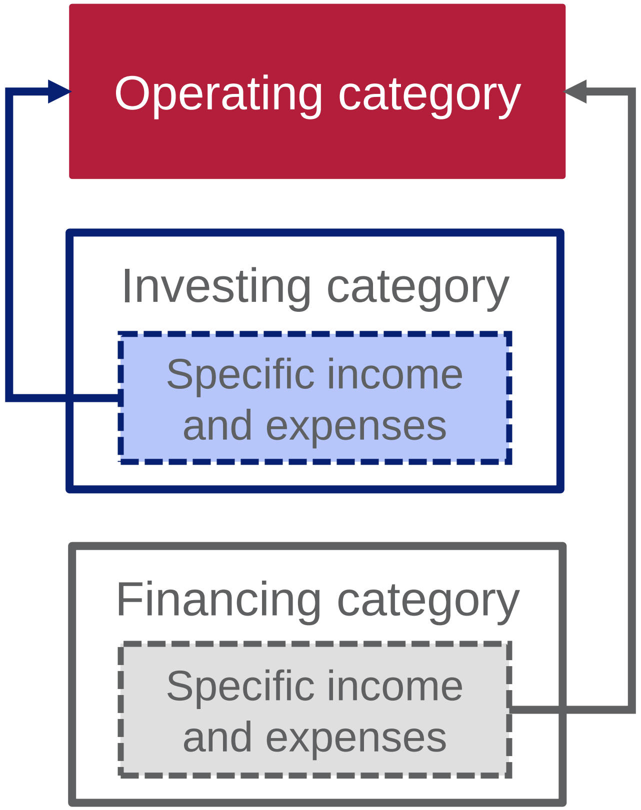
Question for EEG members

How would you expect the statement of profit or loss to change in your jurisdiction?

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

Some entities, such as banks, classify income and expenses in the operating category that would otherwise be classified in the investing or financing categories



Assessing whether an entity has specified main business activities

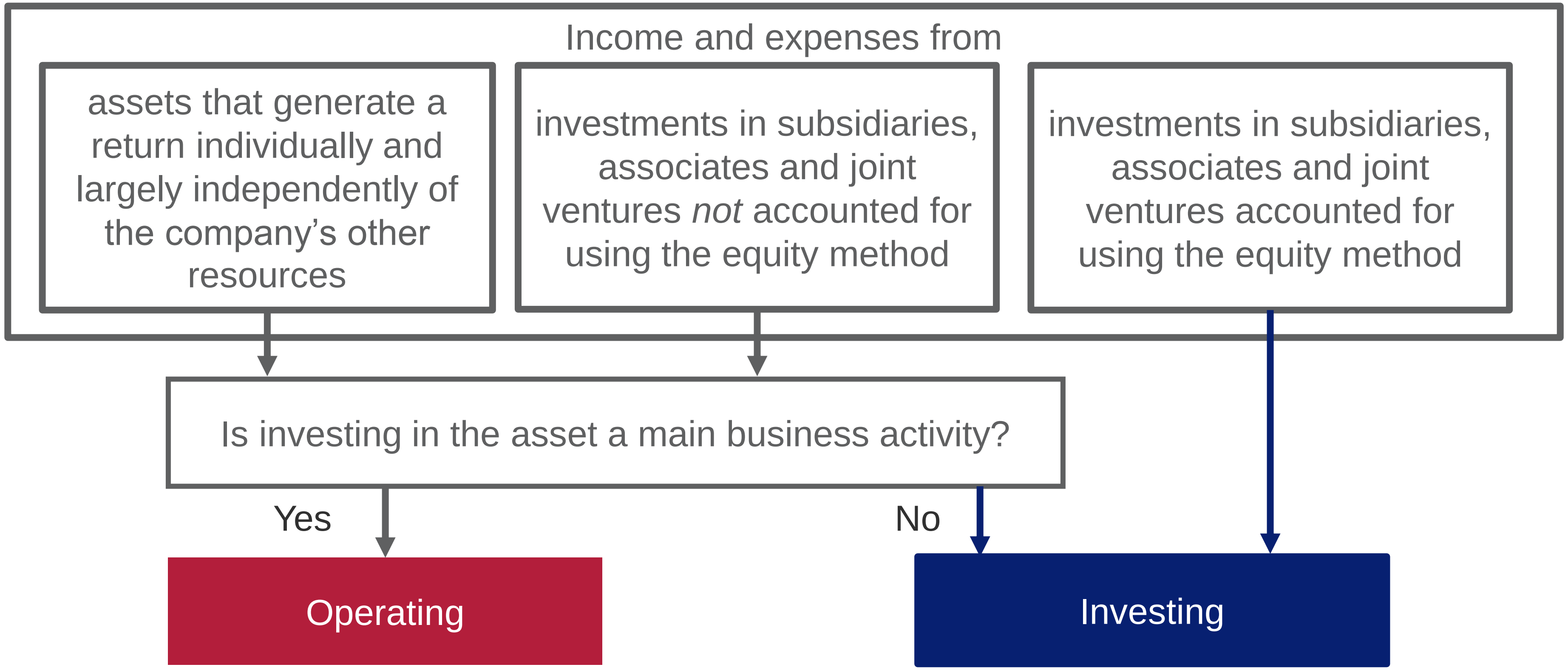
IFRS 18 requires an entity to assess whether it

- invests in assets generate a return individually and largely independently of other resources held by an entity as a main business activity?
- provides financing to customers as a main business activity?

Whether an entity has specified main business activities

- Is a matter of fact and not merely an assertion
- Entity uses judgement to assess
- Based on observable evidence to the extent available
- Assessed for the reporting entity as a whole

Entities that invest in assets as a main business activity



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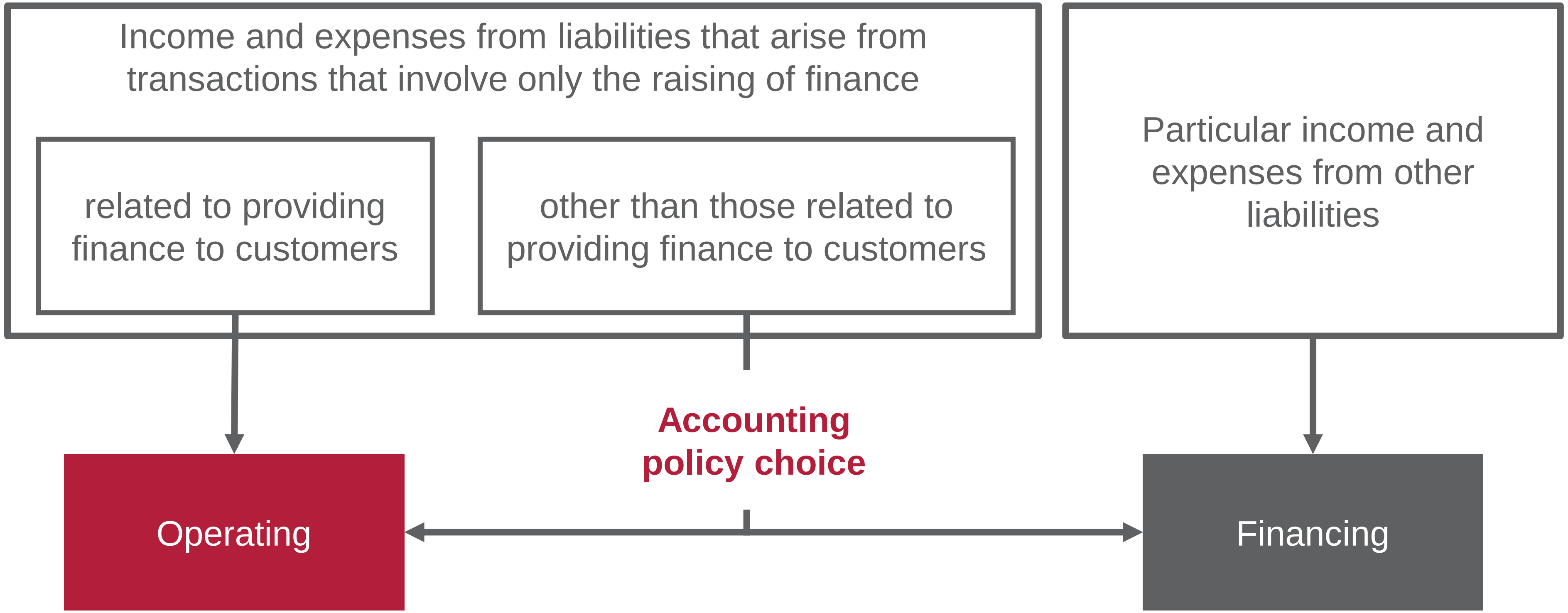
Entities that provide financing to customers as a main business activity



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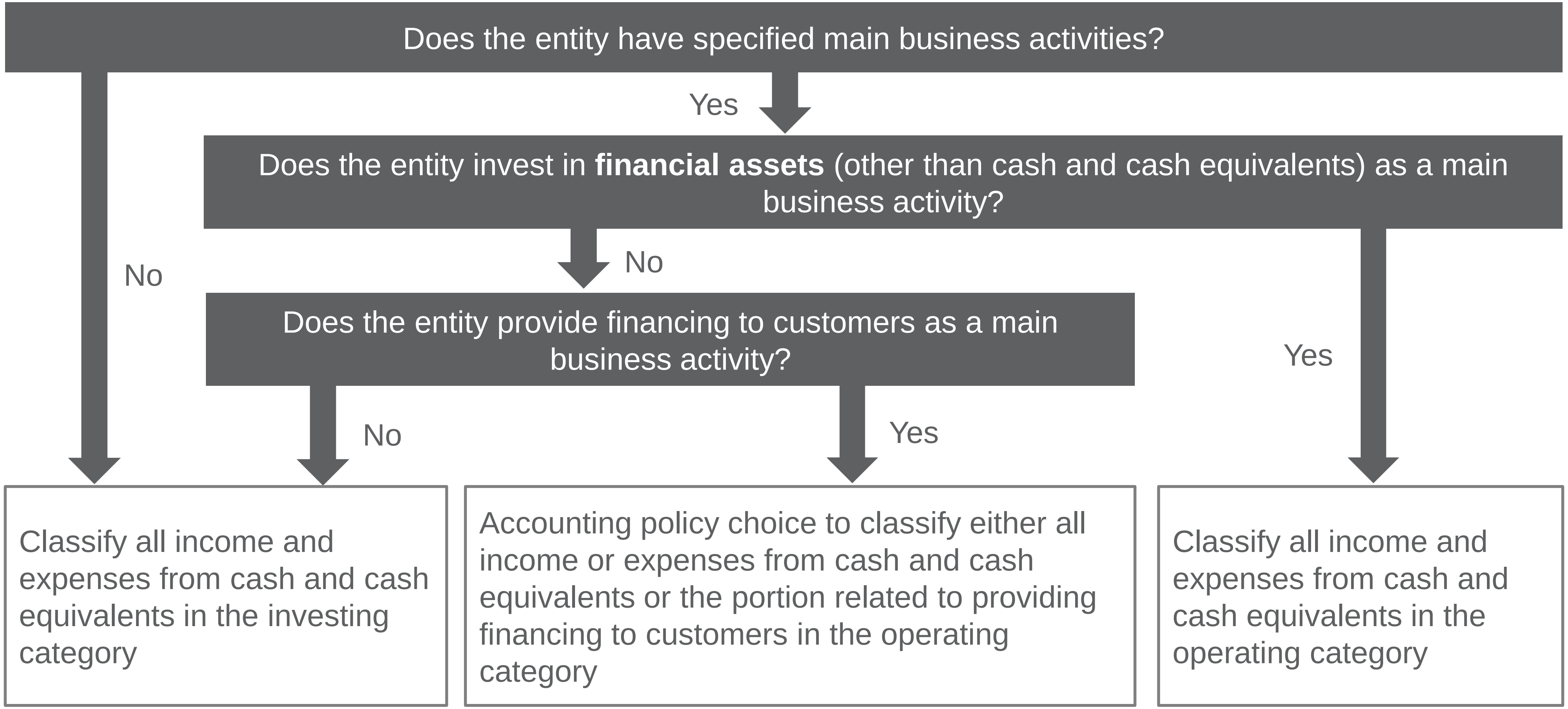
Income and expenses from cash and cash equivalents



Statement of profit or loss - financing and investing as main business activities

Interest revenue

Interest expense

Net interest income

Fee and commission income

Fee and commission expenses

Net fee and commission income

Net trading income

Net investment income

Credit impairment losses

Employee benefits

Depreciation and amortisation expenses

Operating profit

Share of profit or loss of associates and joint ventures

Operating profit and income and expenses from equity method investments

Interest expense on pension and lease liabilities

Profit before tax

Income tax expense

Profit for the year

Operating

Non-main Investing and financing

Line items illustrate what is classified in each category and do not necessarily denote line items that a company would present. An entity would present line items that provide a useful structured summary of its income and expenses.

Statement of profit of loss - insurance as a main business activity

Insurance revenue	Operating
Insurance service expenses	
Insurance service results	
Interest revenue	
Other investment revenue	
Credit impairment losses	
Insurance finance expenses	
Net financial result	
Other operating expenses	
Operating profit	
Share of profit or loss of associates and joint ventures	Investing
Operating profit and income and expenses from associates and joint ventures / Profit before financing and income tax	
Interest expense on borrowings and pension liabilities	Financing
Profit before tax	
Income tax	
Profit for the year	

Line items illustrate what is classified in each category and do not necessarily denote line items that a company would present. An entity would present line items that provide a useful structured summary of its income and expenses.

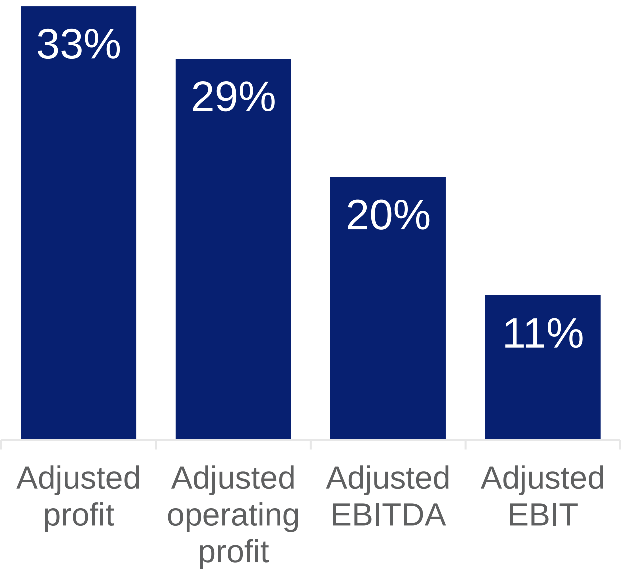
IFRS Accounting

Management-defined performance measures

What is the issue?

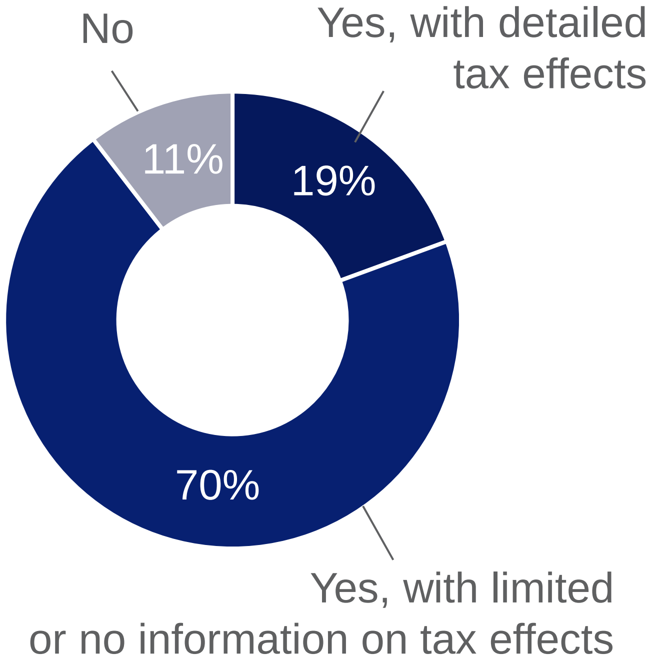
- Many companies provide performance measures defined by management in communications with investors
- Investors have said such measures can provide useful information, but should be used in a more transparent and disciplined way

Common management-defined performance measures



% of companies using measure in annual report

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



What are management-defined performance measures?

Performance measures

Financial performance measures

Subtotals of income & expenses

MPMs

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

IFRS-Specified

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

Other measures that are not subtotals of income and expenses

- Free cash flow
- Return on equity
- Net debt

Non-financial performance measures

- Number of subscribers
- Customer satisfaction score
- Store surface

Definition of management-defined performance measures

Subtotals of income and expenses not specified by IFRS Accounting Standards

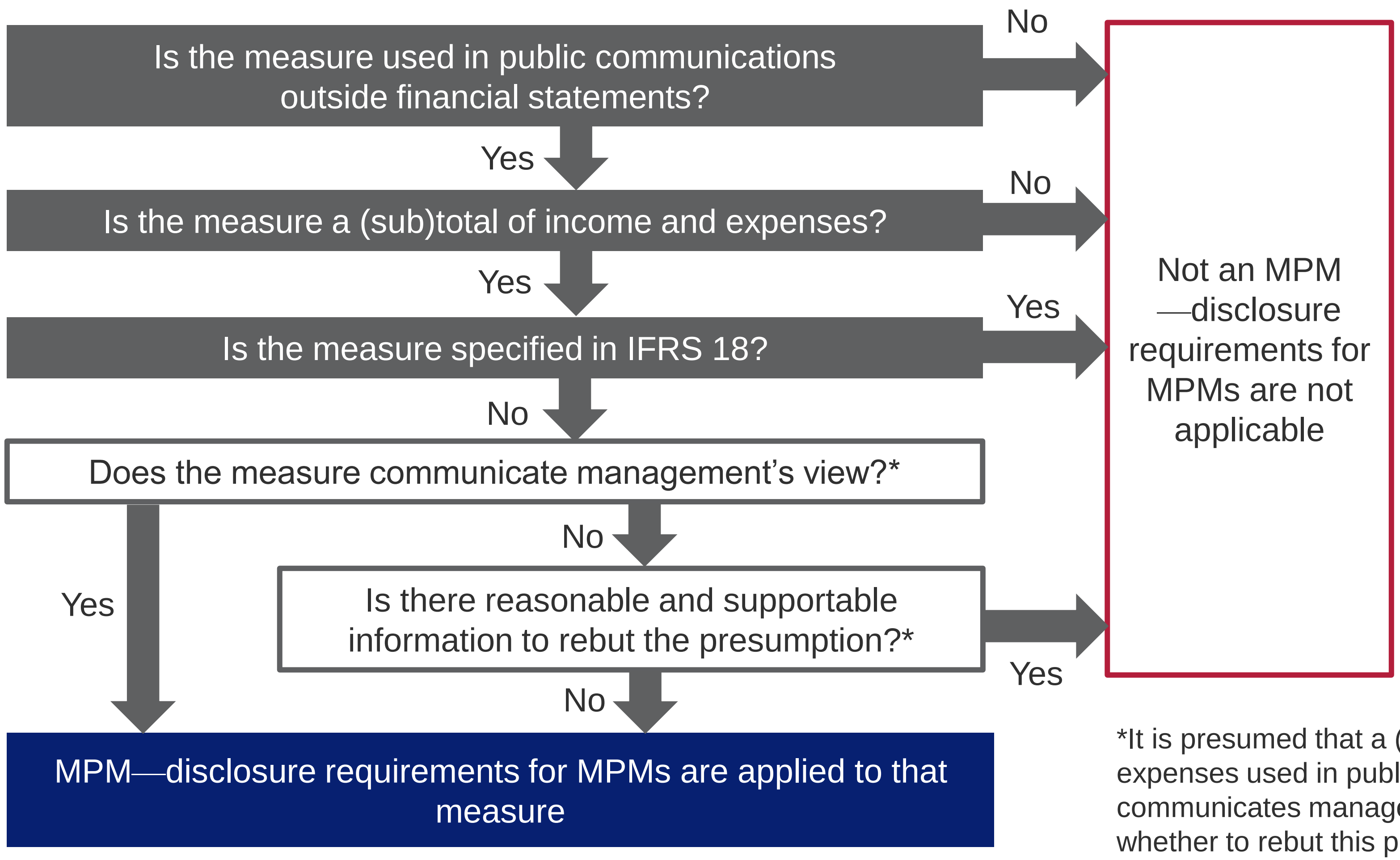
Used in public communications outside financial statements

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

Presumed that a subtotal used in public communications represents management's view of an aspect of an entity's financial performance.

The presumption can be rebutted with reasonable and supportable information.

Management performance measures



*It is presumed that a (sub)total of income and expenses used in public communications communicates management's view, assessing whether to rebut this presumption is optional.

Disclosures for management-defined performance measures

Disclosed in a single note

Reconciliation to the most directly comparable specified subtotal/total	Explanation of MPM calculation and how it provides useful information
Statement that MPM provides management's view and not comparable to MPM of other entities	Explanation of and reasons for changes to MPMs

What might a reconciliation look like?

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

Most directly comparable subtotal/total specified by IFRS Accounting Standards:

- 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
- operating profit and income and expense from investments accounted for using the equity method
- operating profit and income and expenses in the investing category (specific entities only)

Calculating the income tax effects – three possible methods

Using the statutory tax rate(s) applicable to the underlying transaction(s) in the relevant jurisdiction(s)	Based on a reasonable pro rata allocation of the entity's current and deferred tax in the relevant jurisdiction(s)	By another method that achieves a more appropriate allocation in the circumstances

Disclose how income tax effects are calculated — required for each reconciling item if more than one method is used.

How does EBITDA fit in the proposals?

The IASB has specified '**operating profit before depreciation, amortisation and specified impairments within the scope of IAS 36' (OPDAI)** as a subtotal that is not an MPM.

- If an entity uses OPDAI in its public communications, no MPM disclosures would be required.
- If an entity uses an EBITDA that is calculated differently to OPDAI in its public communications, such a measure is an MPM and MPM disclosure would be required.
- The IASB does not explicitly prohibit 'EBITDA' as a label for OPDAI, but such a label would rarely be an accurate description of it.

Illustration for requirements in IFRS 18 for OPDAI and an MPM of Adjusted EBITDA

		20X1	Tax effect	Effect on non-controlling interests
			Tax effect and effect on non-controlling interests	
MPM	**Adjusted EBITDA**	**XX**		
	Restructuring cost in Country X	(XX)	XX	(XX)
	Revenue adjustment	(XX)	XX	–
Specified subtotal <u>not</u> presented in PL	**Operating profit or loss before depreciation, amortisation and specified impairments**	**XX**		
	Depreciation	XX	(Not required to provide tax effect and effect on non-controlling interests)	
	Amortisation	XX		
	Impairment losses	XX		
Subtotal presented in PL	**Operating profit**	**XX**		

Reconciliation not required if specified subtotal is presented in statement of profit or loss

Aggregation and disaggregation

Grouping – aggregation and disaggregation – of information

Investors’ concerns

- Some companies don’t provide enough detailed information
- Important information is obscured

IFRS 18 introduces

- Enhanced requirements for grouping of information
- Guidance on whether information should be in the primary financial statements or the notes
- Disclosures about items labelled as ‘other’

Aggregation and disaggregation requirements

General requirements	Roles of the primary financial statements and the notes	Principles for aggregation and disaggregation
	Requirements for line items, including goodwill in the statement of financial position	Aggregating items and using meaningful labels
Specific requirements	Disclosure of specified expenses by nature	Present operating expenses by nature or by function (mixed presentation permitted)

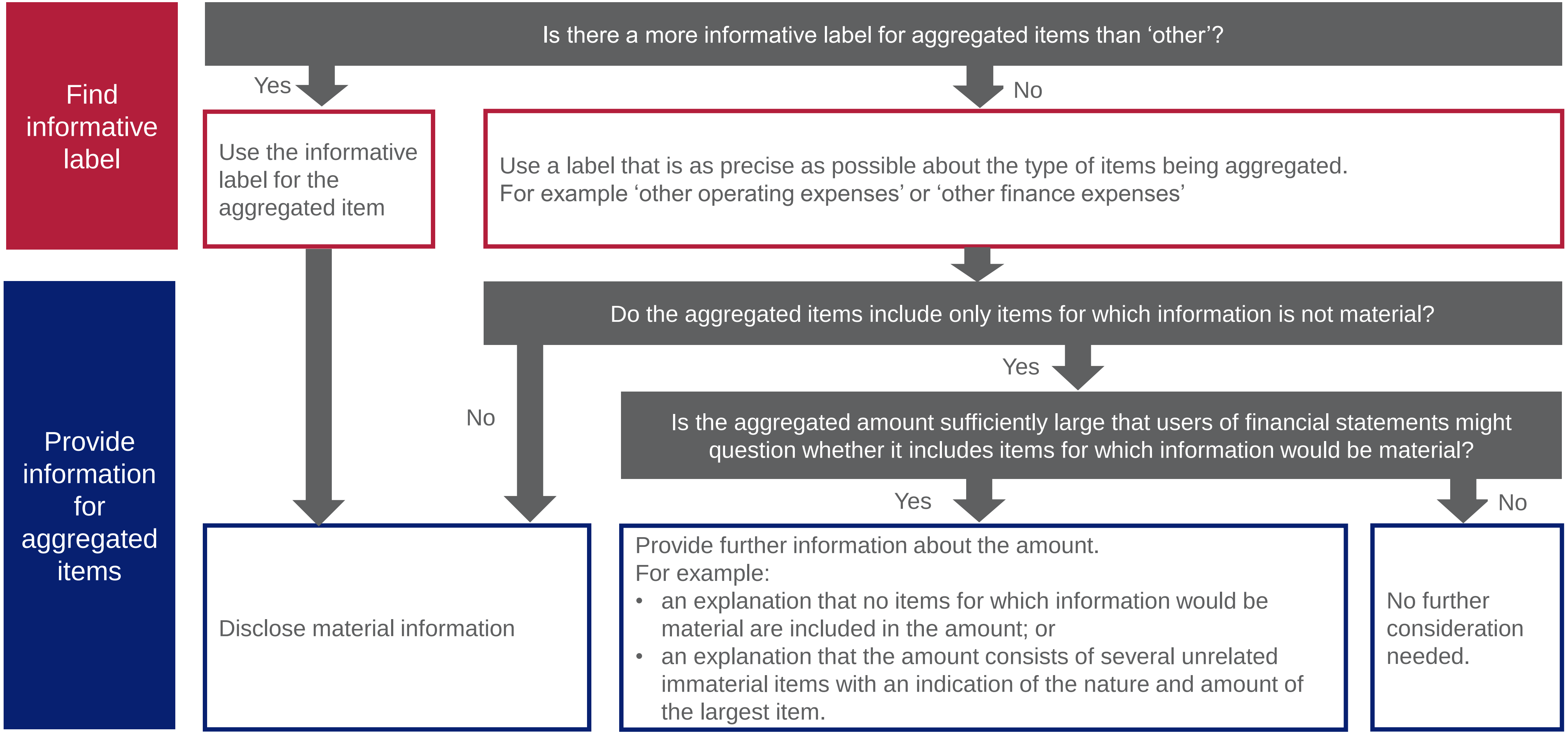
Roles of the primary financial statements and the notes

Role of primary financial statements	Role of the notes
Provide a **useful structured summary** for: • **obtaining an understandable overview** of the entity's assets, liabilities, equity, income, expenses and cash flows • **making comparisons** between entities and reporting periods • **identifying items or areas** about which users may wish to seek additional information in the notes	**Provide further information** necessary to understand items included in primary financial statements **Supplement the primary financial statements** with other information to meet the objectives of financial statements

Aggregation and disaggregation

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 primary financial statements would result in a **useful structured summary** • in the notes would result in **material information**
Aggregating items and using meaningful labels	Use meaningful labels • use the label ‘other’ only when unable to find a more informative label • label as precisely as possible (eg ‘other operating expenses’) Additional disclosures required if aggregated amounts of immaterial items are sufficiently large that users might question whether the amount includes material items

How will an entity apply the guidance to describe items?



Disclosure of specified expenses by nature

Disclose the amounts included in each line item in the statement of profit or loss for

Depreciation	Amortisation	Employee benefits	Specified impairments	Write-down of inventories

Amount disclosed are not required to be expense amounts
— qualitative explanation required if part of the amount disclosed has been included in the carrying amount of assets

Extract from statement of profit or loss – general corporate

Revenue	367,000	Operating
Cost of goods sold	(237,100)	
Gross profit	**129,900**	
Other operating income	12,200	
Selling expense	(28,900)	
Research and development expenses	(25,100)	
General and administrative expenses	(20,900)	
Goodwill impairment loss	(4,500)	
Other operating expenses	(1,200)	
Operating profit	**61,500**	

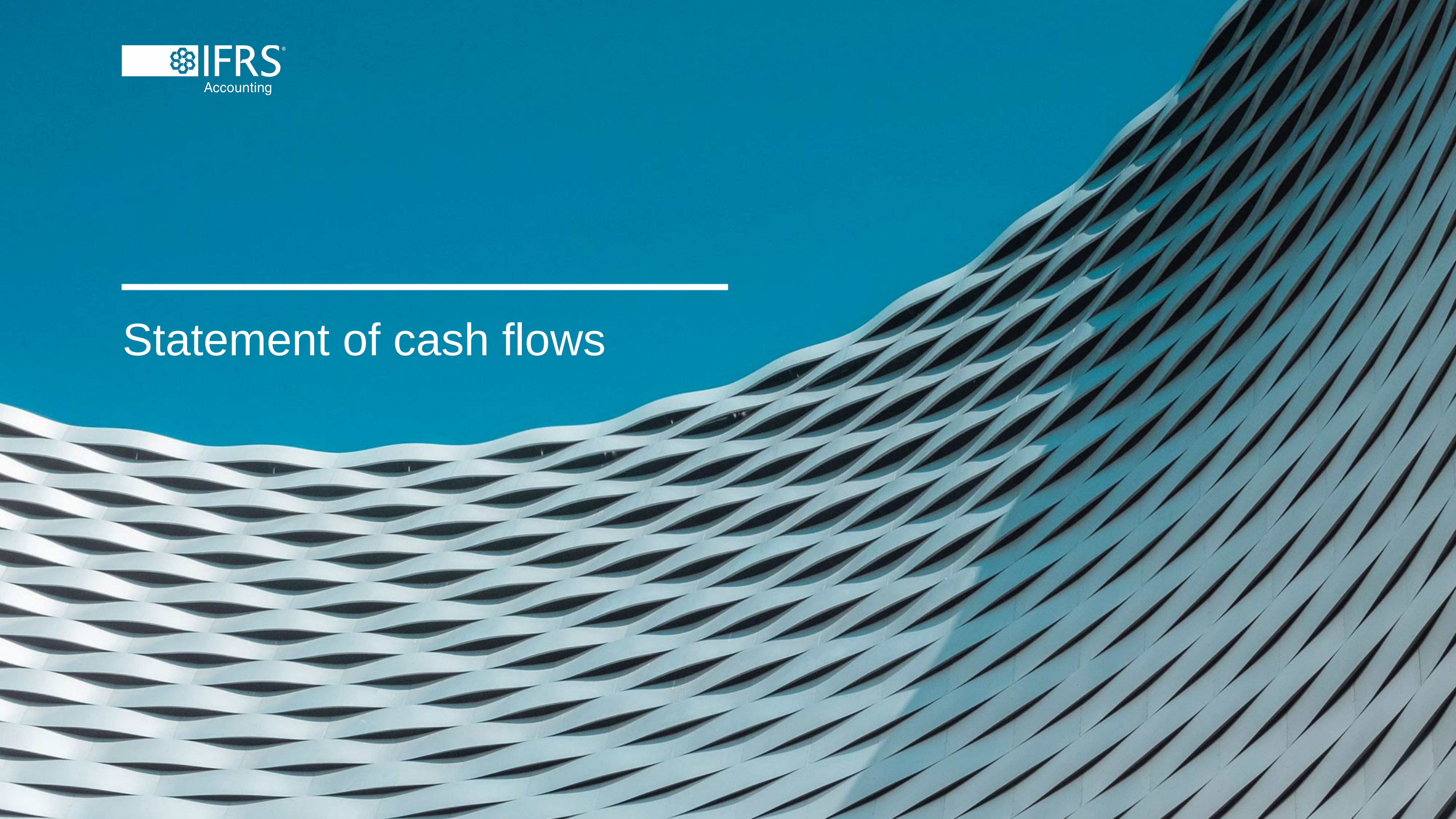
Line items illustrate what is classified in the operating category and do not necessarily denote line items that a company would present. An entity would present line items that provide a useful structured summary of its income and expenses.

Specified expenses by nature note

(in currency units)	20X2	20X1
Cost of goods sold	23,710	21,990
Research and development expenses	2,518	2,596
General and administrative expenses	4,975	4,975
Total depreciation	**31,203**	**29,561**
Research and development expenses	13,842	12,693
Total amortisation	**13,842**	**12,693**
Cost of goods sold	61,646	57,174
Selling expenses	7,514	7,111
Research and development expenses	6,547	6,750
General and administrative expenses	5,421	5,824
Total employee benefits	**81,128**	**76,859**
Research and development expenses	1,600	1,500
Goodwill impairment loss	4,500	–
Total impairment loss	**6,100**	**1,500**
Cost of goods sold	2,775	2,625
Other operating expenses	–	4,900
Total write-down of inventories	**2,775**	**7,525**

This table shows the amount of depreciation, amortisation, employee benefits, impairment losses and write-down of inventories included in each line item in the statement of profit or loss.

Each amount disclosed for depreciation and employee benefits includes both amounts that have been recognised as an expense in the reporting period and amounts that have been included in the carrying amount of inventory and property, plant and equipment.



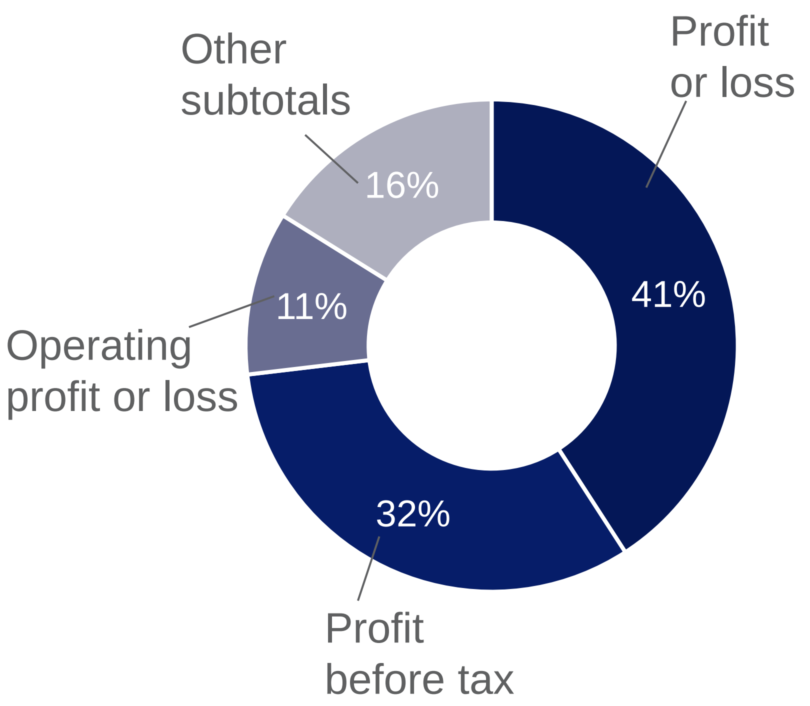
IFRS Accounting

Statement of cash flows

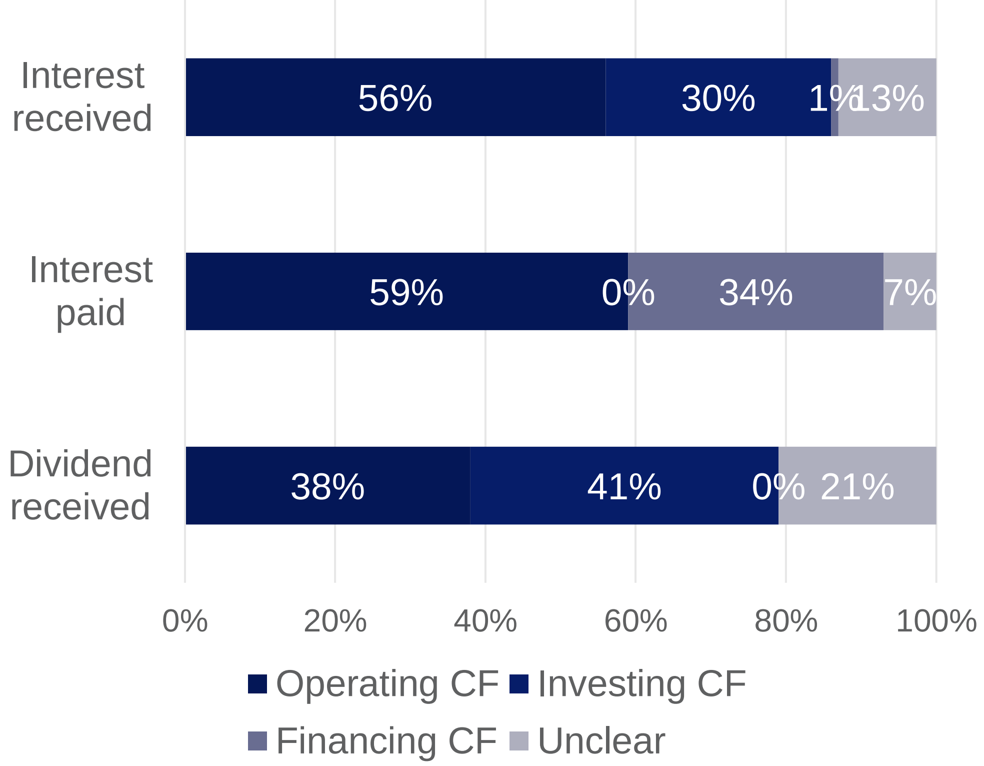
What is the issue?

Classification and presentation options in the statement of cash flows make it difficult to compare companies' cash flows

Starting point for the indirect method



Classification of interest and dividends



Changes to the statement of cash flows

Operating profit or loss subtotal to be the starting point for the indirect method of reporting cash flows from operating activities

<table>
<tr><th>Cash flows</th><th>Entities without specified main business activities</th><th>Entities with specified main business activities</th></tr>
<tr><td>Interest received</td><td>Investing activities</td><td rowspan="3">Single category (either operating, investing or financing activities)</td></tr>
<tr><td>Interest paid</td><td>Financing activities</td></tr>
<tr><td>Dividends received</td><td>Investing activities</td></tr>
<tr><td>Dividends paid</td><td>Financing activities</td><td>Financing activities</td></tr>
</table>

Changes to the statement of cash flows

Statement of cash flows
Cash flows from operating activities
Operating profit
Adjustment for:
…
Net cash from operating activities
Cash flows from investing activities
…
Interest received
Dividends received
Net cash used in investing activities
Cash flows from financing activities
…
Interest paid
Dividends paid
Net cash used from financing activities
Net increase in cash and cash equivalents
Cash and cash equivalents at beginning of period
Cash and cash equivalents at end of period

Operating profit or loss subtotal to be the starting point for the indirect method of reporting cash flows from operating activities

Removal of the presentation alternatives for cash flows from interest and dividends paid and received for entities **without** specified main business activities.

Entities **with** specified main business activities classify interest received, interest paid and dividend received each in a single category (either operating, investing or financing activities)

Digital reporting

What is the issue?

Investors require digital data that is:

- comparable between companies and periods;
- company-specific;
- available in an easily usable format;
- consistently available; and
- free from errors.

However, reported digital data does not always meet these requirements.

- Few investors use digital data that comes directly from companies.
- Many investors instead rely on paid services from information intermediaries, such as data aggregators, for data that is cleansed, standardised and aggregated.

Improving digital reporting

Investor needs	Current practice	Likely effects of IFRS 18
Comparable across companies and periods	Diversity in tagging data	Reduced diversity in reporting practices will in turn reduce diversity in tagging data
Company-specific	Company-specific information tagged using extensions or not tagged at all	MPMs in a single note are more likely to be tagged New elements will reduce need for company-specific extensions
Availability in an easily usable format	Use of intermediaries, XBRL calculations and manual adjustments to normalise subtotals	Enhanced comparability across companies Easier extraction of information about MPMs
Consistently available	Diversity in reporting practice	Defined subtotals consistently available for all companies
Free from errors	Tagged information is not free from errors	No significant effect on the number of errors

Transition, effective date and due process

Transition period and effective date

H1/2024

New IFRS Accounting Standard issued

Transition Period

1/1/2027

Effective date

Prepare financial statements

Financial statements issued

- ✓ **All** requirements applied at the **same time** by all entities from the effective date, unless an entity elects to apply the requirements **earlier**
- ✓ Comparative periods in interim and annual financial statements restated
- ✓ Reconciliation of the statement of profit or loss required for the immediately preceding comparative period
- ✓ An entity eligible to apply paragraph 18 of IAS 28 *Investments in Associates and Joint Ventures* is permitted to change its selection for measuring an investment in an associate or joint venture from the equity method to fair value through profit or loss

Overview of the IASB's due process

Completion of deliberations

IASB has reached general agreement on technical matters in the project and considered the likely effects of the new IFRS Accounting Standard.

IASB considers the due process requirements

Technical staff present a paper to the IASB summarising the steps the IASB has taken in developing the Accounting Standard and assessing whether the proposals can be finalised or whether they should be re-exposed (see slide 7). The IASB will follow the steps in the Due Process Handbook if re-exposure is deemed necessary.

IFRS Accounting Standard is prepared for balloting (see slide 52)

IASB informs the DPOC of its decision on whether or not to proceed to ballot stage

The IASB explains to the Due Process Oversight Committee (DPOC) whether or not re-exposure is necessary and why, before the IFRS Accounting Standard is issued

Oct 2023

Additional consultation

The IASB may also consult the IFRS Advisory Council or any consultative groups to seek advice on steps after publication to support implementation

Oct-Dec 2023

Publication of IFRS Accounting Standard

Including Basis for Conclusions, Illustrative Examples and Effects Analysis. Requires a supermajority of IASB members

Q2 2024

Materials accompanying an IFRS Accounting Standard

Other materials will also be published, for example project summary and feedback statement

Overview of the balloting process

A drafting, review and approval process to ensure an IFRS Accounting Standard is well written and accurately reflects IASB decisions

Ballot drafts

Pre-ballot draft

- An early draft reviewed by IASB members to ensure the technical decisions taken by the IASB are captured correctly and that the document is clearly written.
- There may be more than one pre-ballot draft.

Ballot draft

- Circulated for IASB members to approve once feedback from the IASB members on the pre-ballot draft has been considered.
- IASB members confirm that they are satisfied the document is consistent with the decisions taken during public IASB meetings and that they are happy to put their name to it.
- If an IASB member dissents from the publication of the document, the reasons will be explained within the document when published.

Additional reviews

- Editorial, translations and digital reporting teams also review the draft to make sure the document is understandable, can be translated into other languages and incorporated into the IFRS Foundation’s taxonomies to enable digital reporting.
- The process may also include reviews by external stakeholders.

Sweep issues

- Sometimes the balloting process may reveal new issues or inconsistencies between sections of an IFRS Accounting Standard.
- If that happens, the questions—called ‘sweep issues’—will be brought back to the IASB to discuss and resolve at a public IASB meeting prior to finalising the document for publication.

Questions for EEG members

1) **What challenges do see in the implementation and endorsement process in the EEG jurisdictions?**
2) **How the implementation will be supported in the EEG jurisdictions?**
3) **How can the Foundation help you during IFRS Standard implementation?**

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