STAFF PAPER

April 2019

IASB® Meeting

Project	**Primary Financial Statements**
Paper topic	Cover note and summary of the Board's tentative decisions

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Papers for this meeting

1. **Agenda Paper 21A—Amending proposals for management performance measures**: this paper seeks the Board's views on amending the Board's proposals for management performance measures (MPMs). The paper considers the need for amendments to the MPM proposals in the light of feedback we have received on the proposals so far and tentative decisions the Board has made in other project areas.

2. **Agenda Paper 21B—Outstanding issues for financial entities**: this paper addresses outstanding issues related to the project proposals for financial entities. These issues mostly concern the classification of income from cash and cash equivalents and expenses from financing activities in the statement(s) of financial performance.

Next steps

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

   a. project interaction with the IFRS Taxonomy; and

   b. which type of consultative document to publish as next due process document.

4. Depending on the Board's decision on the consultative document, there could be additional topics for the Board to discuss.

5. The Appendix includes a summary of the Board's tentative decisions to date in the project. The items that have been updated since the last meeting are underlined.

Appendix: Summary of the Board's tentative decisions to date in the project (<u>decisions from most recent Board meeting are underlined</u>)

<table>
<tr><th>Topic</th><th>Staff condensed summary of Board's tentative decisions</th></tr>
<tr><td></td><td>A full record of the Board's tentative decisions is available from the December 2016–March 2019 IASB updates.</td></tr>
<tr><td>General</td><td>The Board tentatively decided to focus on targeted improvements to the statement(s) of financial performance and to the statement of cash flows.

In September 2018, the Board decided to move the project to its standard-setting agenda. The Board will decide at a later stage of the project whether to issue a Discussion Paper or an Exposure Draft as the first due process output of the project.</td></tr>
<tr><td>Statement(s) of financial performance—project scope</td><td>The Board tentatively decided to explore the following topics in this project:
a. requiring additional subtotal(s) in the statement(s) of financial performance;
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 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).

The Board tentatively decided to prioritise introducing into the statement(s) of financial performance subtotals that facilitate comparisons between entities, such as profit before financing activities, over introducing a management-performance measure subtotal.</td></tr>
<tr><td>Statement(s) of financial performance—financing activities</td><td>The Board agreed to explore:
a. requiring the presentation of an EBIT-type subtotal in the statement(s) of financial performance; and
b. describing the subtotal as profit before financing and income tax.

The Board tentatively decided that the category below this subtotal should consist of the following separate line items in the statement(s) of financial performance:
a. 'interest income from cash and cash equivalents calculated using the effective interest method';
b. 'other income from cash, cash equivalents and financing activities'; and
c. 'expenses from financing activities'

'Cash and cash equivalents' is used as a proxy for cash and temporary investments of excess cash. The Board also noted that a separate line item for impairment of cash and cash equivalents may be needed, if material.</td></tr>
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The Board tentatively decided to clarify the description of ‘financing activities’ in IAS 7 Statement of Cash Flows by indicating that a financing activity involves:
a. the receipt or use of a resource from a provider of finance (or provision of credit).
b. the expectation that the resource will be returned to the provider of finance.
c. the expectation that the provider of finance will be appropriately compensated through the payment of a finance charge. The finance charge is dependent on both the amount of the credit and its duration.
The Board tentatively decided that ‘interest’ income/expenses on liabilities that do not arise from financing activities (unwinding of a discount) should also be in this category, even though they do not meet the proposed definition of expenses from financing activities.
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<tr><td>Statement(s) of financial performance—investing category and operating profit</td><td>
The Board agreed (by consensus) to explore the introduction of an investing category into the statement(s) of financial performance.
The Board tentatively decided:
a. to label the ‘investing’ category as ‘income/expenses from investments’;
b. to define ‘income/expenses from investments’ using a principle-based approach as ‘income/expenses from assets that generate a return individually and largely independently of other resources held by the entity’; and
c. to provide a list of some items that would typically be treated as ‘investing’ and a list of some items that would typically not be treated as ‘investing’.
The Board tentatively decided that:
a. all entities (including financial entities) should be required to present the results of ‘integral’ associates and joint ventures separately from those of ‘non-integral’ associates and joint ventures below the ‘operating profit’ subtotal; and
b. the project’s first due-process document should:
i. use the Board’s proposed definition of ‘income/expenses from investments’ as the basis for the split between integral and non-integral investments in associates or joint ventures, and include a non-exhaustive list of indicators that could be used in making this distinction;
ii. propose the presentation in the statement(s) of financial performance of the share of profit or loss of integral associates or joint ventures as a line item above the ‘income/expenses from investments’ category;
iii. describe the subtotal above share of profit or loss of integral associates and joint ventures as operating profit;
iv. describe the subtotal that includes share of profit or loss of integral associates and joint ventures as operating profit and share of profit or loss from integral associates and joint ventures; and
v. discuss all of the alternative approaches considered by the Board for presenting the share of the profit or loss of integral associates and joint ventures, both within and outside the ‘income/expenses from investments’ category, and the Board’s reasons for rejecting those approaches.
The Board suggested that—subject to drafting improvements—the following indicators should be included to help preparers decide whether an associate or joint venture is ‘integral’:
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Topic	Staff condensed summary of Board's tentative decisions
	a. the existence of integrated lines of business across the entity and the associate or joint venture that lead to dependency on the associate or joint venture; b. the associate or joint venture's critical supplier or customer status; c. the reporting entity and the associate's or joint venture's sharing of a name or brand; and d. the sharing of capital or borrowing sources, such that the financing for the entity and the associate or joint venture is interrelated. In addition, the Board tentatively decided to: a. state that the proposed list of indicators should not be prioritised in any way; b. state that the classification of an associate or joint venture as integral or non-integral shall be changed only if the relationship between the reporting entity and the associate or joint venture changes; and c. amend the disclosure requirements of IFRS 12 *Disclosure of Interests in Other Entities* to reflect the introduction of the integral and non-integral categorisation of associates and joint ventures by requiring: i. the disclosure in paragraph 20 to be split between 'integral' and 'non-integral' associates and joint ventures; ii. additional disclosure of the factors considered when determining whether associates and joint ventures are 'integral' or 'non-integral'; and iii. additional disclosure where an equity accounted investment has been reclassified in the period, to indicate how its relationship with the reporting entity has changed.
Classification of income and expenses by financial entities	The Board considered the classification of income and expenses in relation to: a. entities that provide financing to customers as a main business activity; and b. entities that, in the course of their main business activities, invest in assets that generate a return individually and largely independently of other resources held by the entity. The Board tentatively decided that: a. an entity of the type described in (a) is required to include in operating profit: i. expenses from financing activities and income from cash and cash equivalents relating to the provision of financing to customers; or ii. all expenses from financing activities and income from cash and cash equivalents. b. an entity of the type described in (a) above shall not present the 'profit before financing and income tax' subtotal if the entity does not present expenses from financing activities or income from cash and cash equivalents below operating profit. This applies even when such an entity presents in the statement(s) of financial performance the unwinding of a discount on liabilities that do not arise from financing activities. c. an entity of the type described in (b) above is required to include in operating profit, income (expenses) from investments made in the course of its main business activities.

Topic	Staff condensed summary of Board's tentative decisions
	d. entities with insurance finance income or expenses should include it in the 'operating profit' subtotal. (Applying the proposal in (c) related investment income and expenses would also be included in that subtotal.)
Statement(s) of financial performance—other comprehensive income (OCI)	The Board tentatively decided to rename the two categories in the OCI section of the statement(s) of financial performance as follows: a. 'remeasurements reported outside profit or loss' (currently 'OCI items that will not be reclassified subsequently to profit or loss'); and b. 'income and expenses to be included in profit or loss in the future' (currently 'OCI items that will be reclassified subsequently to profit or loss') but not to introduce a new subtotal between these two categories called 'income after remeasurements reported outside profit or loss'. The Board tentatively decided: a. the staff should explore whether there is demand to remove the following presentation options in IAS *1 Presentation of Financial Statements* for OCI: i. presenting items of OCI either net of related tax effects, or before related tax effects (paragraph 91 of IAS 1); and ii. presenting reclassification adjustments in the statement(s) of financial performance or in the notes (paragraph 94 of IAS 1); b. not to develop separate guidance or educational material on the presentation of OCI for entities, but to consider both profit or loss and OCI when developing proposals for better aggregation/disaggregation and additional minimum line items; and c. not to develop educational material for investors in the form of case studies that illustrate why it is important for users of financial statements to consider items of OCI in their analysis of companies.
Management performance measure(s)	The Board tentatively decided: a. all entities shall identify a measure (or measures) of profit or comprehensive income that, in the view of management, communicates to users the financial performance of the entity. This measure will: i. often only be a subtotal or total specified by paragraph 81A of IAS 1; and ii. sometimes be identified by management as a measure that is not a subtotal or total specified by paragraph 81A of IAS 1, but would complement those subtotals or totals. Such a measure is a management performance measure. b. the following requirements apply to management performance measures described in paragraph a(ii): i. a reconciliation would be provided in the notes between that measure and the most directly comparable subtotal or total specified by paragraph 81A of IAS 1; ii. that there should be no specific constraints on management performance measures; iii. the measure would be labelled in a clear and understandable way so as not to mislead users; and iv. the following information is required to be disclosed: 1. a statement that the measure provides management's view of the entity's financial performance and is not necessarily comparable with measures provided by other entities; 2. a description of why the management performance measure provides management's view of performance, including an explanation of • how the management performance measure has been calculated and why; and • how the measure provides useful information about an entity's financial performance; and

Topic	Staff condensed summary of Board's tentative decisions
	3. sufficient explanation, if there is a change in how the management performance measure is calculated during the year, to help users understand the reasons for and effect of the change. c. that the reconciliation between the management performance measure and the most directly comparable subtotal or total specified by paragraph 81A of IAS 1 should be provided separately from the operating segment information disclosed in accordance with IFRS 8 *Operating Segmen*ts. However, entities would not be prohibited from also including management performance measures within the operating segment information. Furthermore, the following information would be required to be disclosed: i. an explanation of how the management performance measure differs from the total of the measures of profit or loss for the reportable segments; and ii. if none of the management performance measures fits into the operating segment information, an explanation of why this is the case. For the purposes of these proposals, paragraph 81A of IAS 1 would include the existing subtotals in that paragraph and the proposed new required subtotals developed as part of this project, for example, profit before financing and income tax. The Board tentatively decided to expand the list of subtotals and totals that would not be considered management performance measures to include the following: profit before tax, profit from continuing operations, gross profit, defined as revenue less cost of sales, and operating profit before depreciation and amortisation. The Board members advised caution in drafting to clearly distinguish these subtotals from those that are specifically required to be presented by all entities in paragraph 81A of IAS 1. The Board also asked the staff to clarify in drafting that management performance measures provide additional information that complements the subtotals and totals specified by paragraph 81A of IAS 1, rather than provides a better view of financial performance. The above tentative decisions describe disclosure requirements for management performance measures in the notes only. Consequently, it does not affect the presentation of additional subtotals in the statement(s) of financial performance in accordance with paragraphs 85–85A of IAS 1. The Board tentatively decided to require the reconciliation described in paragraph b(i) to be disclosed in the notes rather than be provided below the statement(s) of financial performance. The Board tentatively decided to prohibit the use of columns to present information about management performance measures in the statement(s) of financial performance.
Adjusted earnings per share (EPS)	The Board tentatively decided that, if an entity identifies a management performance measure, a. it will be required to disclose in the notes the effect of tax and non-controlling interests separately for each of the differences between the management performance measure and the most directly comparable subtotal or total in paragraph 81A in IAS 1; and b. it will not be required to disclose in the notes adjusted EPS calculated consistently with the management performance measure. The Board also tentatively decided that a. an entity would continue to be permitted to disclose adjusted EPS; and b. an entity would be prohibited from presenting adjusted EPS in the statement(s) of financial performance.

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<tr><td>Statement of cash flows—general</td><td>The Board tentatively decided:
a. to eliminate options for the classification of the cash flows from interest and dividends in the statement of cash flows;
b. to require the operating profit subtotal as the starting point for the indirect reconciliation of cash flows from operating activities;
c. not to align the operating section of the statement of cash flows with a corresponding section in the statement(s) of financial performance; and
d. not to make further improvements to the statement of cash flows, besides those mentioned above.</td></tr>
<tr><td>Statement of cash flows—classification</td><td>The Board tentatively decided all entities (including financial entities) shall:
a. classify cash flows from dividends paid as financing cash flows.
b. separately present the investing cash flows of ‘integral’ and ‘non-integral’ associates and joint ventures accounted for using the equity method within the ‘investing activities’ section of the statement of cash flows. The split between ‘integral’ and ‘non-integral’ associates and joint ventures should be the same for the statement of cash flows as for the statement(s) of financial performance.

The Board tentatively decided non-financial entities shall classify:
a. cash flows arising from interest incurred on financing activities as financing cash flows;
b. cash flows arising from interest paid that is capitalised as part of the cost of an asset as financing cash flows; and
c. cash flows arising from interest and dividends received as investing cash flows—the Board tentatively decided to amend the definition of ‘investing activities’ in IAS 7 accordingly.

The Board tentatively decided financial entities (entities that provide financing to customers as a main business activity and/or invest in the course of their main business activities in assets that generate a return individually and largely independently of other resources) shall classify cash flows from dividends received, interest paid and interest received each in a single section of the statement of cash flows. Financial entities shall determine the section in which to classify these cash flows as follows:
a. if the entity presents related income (expenses) in a single section of the statement(s) of financial performance, the entity shall present related cash flows in that section; or
b. if the entity presents related income (expenses) in more than one section of the statement(s) of financial performance, the entity shall make an accounting policy choice regarding the section of the statement of cash flows in which to present related cash flows.</td></tr>
<tr><td>Other topics—project scope</td><td>The Board tentatively decided to explore the following topics:
a. 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; and
b. development of a principle for aggregating and disaggregating items in the primary financial statements.

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.</td></tr>
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	Additionally, the Board tentatively decided that segment reporting and the presentation of discontinued operations should not be part of the scope of the project.
Templates or examples	The Board tentatively decided: a. to develop non-mandatory examples to illustrate the Board's decisions regarding this project. b. to develop illustrative examples of: i. the statement(s) of financial performance for different types of entities; ii. the statement of cash flows for a financial entity and a non-financial entity based on the current illustrative examples in IAS 1; and iii. any notes that are introduced or amended by the project; and c. to include illustrative examples for the statement(s) of financial performance for the following types of entity: i. a non-financial entity (both by function and by nature); ii. an investment property company; iii. an insurer; iv. a traditional bank with no material investing activities; v. a bank engaged in both investing and customer financing activities; vi. a bank-insurer; vii. a manufacturer that conducts investing activities; and viii. a manufacturer that provides financing to customers. The Board noted that this list of entity types may need to be revised following further discussion of the application of the Board's tentative decisions to financial entities.
Principles of aggregation and disaggregation	The Board tentatively decided to include a principle for determining the location of financial information in the primary financial statements or the notes that is based on the role of the primary financial statements and the role of the notes suggested in Discussion Paper *Disclosure Initiative—Principles of Disclosure*. That principle would not override the specific requirements of IAS 1 for the presentation of minimum line items and subtotals in the primary financial statements. An entity should also apply that principle when a Standard allows entities to determine whether to provide financial information in the primary financial statements or in the notes. The Board tentatively decided on the following principles for aggregation and disaggregation: Principle 1: Items that share similar characteristics should be classified and aggregated together; Principle 2: Items that are dissimilar from other items should not be combined with other items and should be separated or disaggregated; and Principle 3: Aggregation and disaggregation in the financial statements should not obscure relevant information or reduce the understandability of the information presented and should also contribute to a faithful representation of the items presented. The Board tentatively decided to define classification, aggregation and disaggregation as follows: a. classification is the sorting of assets, liabilities, equity, income and expenses and cash flows on the basis of shared characteristics; b. aggregation is the adding together of individual items that share characteristics and are classified together; and

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c. disaggregation is the separation of an item or group of items into dissimilar component parts.

The Board tentatively decided to provide guidance on the steps involved in aggregation and disaggregation being as follows:

a. classifying the effects of individual transactions or other events into assets, liabilities, equity, income and expenses;
b. separating assets, liabilities, equity, income and expenses into groups based on their characteristics (for example, their nature, their function, their measurement basis or another characteristic) resulting in the presentation of line items that share at least one characteristic in the primary financial statements; and
c. separating the line items presented in the primary financial statements based on further characteristics resulting in the separate disclosure of items in the notes, if those items are material.

The Board tentatively decided to provide the following additional guidance for material balances comprised of immaterial items:

Items presented in the primary financial statements or disclosed in the notes shall be described in a way that faithfully represents the items they aggregate. Faithful representation could be achieved by using item labels that describe the shared characteristics that form the basis of the aggregation. In producing financial statements, an entity may identify items that do not appear to share characteristics with other items and are not material but that when aggregated would result in a material balance. Labelling these items with a non-descriptive label such as ‘other’ would not faithfully represent these items without additional information. In order to faithfully represent these items, an entity shall:
a. reconsider whether the immaterial item(s) share similar characteristics with other immaterial item(s) and can be aggregated to create a material item that can be described in a manner that faithfully represents the aggregated items;
b. consider whether the aggregated items may be described in a way that faithfully represents the dissimilar items without changing the level of aggregation; and
c. if (a) and (b) are impractical, disclose information in the notes about the composition of the aggregated item, for example, ‘the balance consists of several unrelated immaterial amounts, the largest balance of which is CU10 of property maintenance expenses’.
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<tr><td>Disaggregation—analysis of operating expenses</td><td>
The Board tentatively decided to:

a. describe the ‘nature of expense’ method and the ‘function of expense’ method used to analyse expenses required by paragraph 99 of IAS 1.
b. continue to require an entity to provide an analysis of expenses using the methodology, either by-function or by-nature, that provides the most useful information to users.
c. describe factors that entities would consider to determine whether a by-function or by-nature methodology provides the most useful information to users. These are:
i. which method provides the best information about the key components or drivers of profitability;
ii. which method most closely matches how management reports internally to the board or key decision makers and the way the business is run;
iii. peer industry practice; and
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<tr><td></td><td>iv. whether the allocation of expenses to functions would be so arbitrary that it would not provide a sufficiently faithful representation of the composition of an entity’s functions. In such cases, a ‘by nature’ method should be used.
d. provide no requirement for entities that use the ‘nature of expense’ method to provide additional information using the ‘function of expense’ method.
e. require an entity to:
i. present its primary analysis of expenses in the statement(s) of financial performance.
ii. when an entity provides primary analysis of expenses using a by-function methodology, require the entity to disclose in a single note additional information on the nature of the expense. This information would be provided at an entity level, not as a breakdown of each functional line presented.</td></tr>
<tr><td>Disaggregation — separate disclosure of unusual items</td><td>The Board tentatively decided to:
a. require separate disclosure of information about unusual items regardless of whether an entity chooses to disclose a management performance measure;
b. require separate disclosure of unusual items in the notes to the financial statements and require that those items be attributed to line items in the statement(s) of financial performance;
a. <u>define unusual items along the following lines:</u>
<u>‘Unusual items are income or expenses with limited predictive value because it is reasonable to expect that similar items will not arise for several future annual reporting periods. Similar items are income or expenses that are similar in type and amount.’</u>
b. <u>state that gains and losses arising from the remeasurement of items required to be measured at current value (including fair value) generally should not be classified as unusual items.</u>
c. <u>require entities to attribute unusual expenses to categories of expense by nature, regardless of their method of analysis of expenses in the statement(s) of financial performance.</u>
d. <u>require entities to provide a narrative description of the transactions or other events that give rise to unusual items; and</u>
e. <u>not require entities to provide information about income or expenses related to unusual income or expenses (unless those income or expenses themselves meet the definition of unusual items).</u>

<u>The Board tentatively decided not to provide guidance stating that:</u>
a. <u>information provided about unusual items should be neutral, noting that information in financial statements is expected to be neutral; and</u>
b. <u>entities may consider the past occurrence of similar items to assess whether it is reasonable to expect that similar items will arise in the future.</u></td></tr>
<tr><td>Minimum line items</td><td>The Board tentatively decided:
a. to clarify that the line items that are required to be presented in the statement(s) of financial performance may need to be presented in more than one section of that statement;
b. to remove the requirement in paragraph 82(b) of IAS 1 to present ‘finance costs’ in the statement(s) of financial performance; and
c. to clarify that when line items are required to be presented in the statement(s) of financial performance, that requirement necessitates separate presentation, regardless of the method of analysis of expenses within operating profit.</td></tr>
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	d. to require entities to present in the statement of financial position: i. goodwill; ii. investments in 'integral' associates and joint ventures accounted for using the equity method; and iii. investments in 'non-integral' associates and joint ventures accounted for using the equity method. e. not to add amortisation, depreciation or research and development expenditure to the list of line items in paragraph 82 of IAS 1 required to be presented in the statement(s) of financial performance.