IFRS

STAFF PAPER

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IASB® meeting

Project	**Primary Financial Statements**
Paper topic	Additional proposals on minimum line items

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Purpose of the paper

1. This paper discusses whether to require the presentation of additional minimum line items in the primary financial statements.

Summary of staff recommendations in this paper

2. The staff recommend that the Board require presentation of the following line items in the statement of financial position:
   (a) goodwill;
   (b) investments in ‘integral’ associates and joint ventures accounted for using the equity method; and
   (c) investments in ‘non-integral’ associates and joint ventures accounted for using the equity method.
3. The staff also recommend that the Board does not require presentation in the statement(s) of financial performance of:
   (a) amortisation;
   (b) depreciation; and

(c) research and development expenditure.

Structure of paper

4. This paper is structured as follows:

   (a) Background (paragraphs 5–8);

   (b) Assessment of evidence for additional minimum line items (paragraphs 9–13);

   (c) Consideration of additional minimum line items (paragraphs 14–37):

      (i) goodwill (paragraphs 14–20);

      (ii) investments in integral and non-integral associates and joint ventures (paragraphs 21–26);

      (iii) amortisation and depreciation (paragraphs 27–31); and

      (iv) research and development expenditure (paragraphs 32–37);

   (d) Questions for the Board;

   (e) Appendix A: Paragraphs 54 and 82 of IAS 1 *Presentation of Financial Statements*; and

   (f) Appendix B: Summary of tentative Board decisions on aggregation and disaggregation.

Background

5. Paragraph 54 and paragraph 82 of IAS 1 require the presentation of specified line items in the statement of financial position and the statement(s) of financial performance (minimum line items). Appendix A reproduces the requirements of those paragraphs.

6. At its November 2018 meeting[1], the Board discussed clarifying how existing requirements for the presentation of minimum line items in the statement(s) of

[1] For a full discussion of the staff proposals refer to November 2018 (Agenda Paper 21C)

financial performance should be applied in light of the Board's proposals in this project. The Board tentatively decided that minimum line items in the statement(s) of financial performance are required to be presented regardless of the method of analysis of expenses in the operating profit section and may be required to be presented in more than one section of the statement(s). The Board also tentatively decided:

(a) to remove the requirement to present 'finance costs'; and

(b) not to add 'other finance income' and 'other finance expense' to the list of line items required to be presented in the statement(s) of financial performance.

7. The Board discussed potential additional minimum line items at its September 2017 meeting. At that meeting, the staff asked the Board whether there are additional areas the staff could explore to promote more disaggregation of functional or natural line items in the statement(s) of financial performance[2]. The Board commented that any further minimum line items should be identified through evidence that there are line items that are missing in practice or principles should be developed to assist preparers in identifying minimum line items.

8. At its February 2019 meeting the Board discussed principles of aggregation and disaggregation. At that meeting the Board tentatively decided to provide additional guidance describing the process of aggregation and disaggregation including the application of judgement in identifying items to be presented in the primary financial statements and those to be disclosed in the notes. Appendix B reproduces this guidance.

Assessment of evidence for additional minimum line items

9. The staff think that the principles, definitions and guidance for aggregation and disaggregation discussed by the Board in February 2019 will provide preparers with a principle-based approach to identifying line items in the primary financial statements (see paragraph 7). Consequently, we have reviewed stakeholder feedback and other

[2] For a full discussion of the staff proposals refer to September 2017 (Agenda Paper 21B paragraph 62(a)).

evidence to determine whether there is evidence of a need for additional minimum line items.

10. Feedback specific to minimum line items was received as follows:

    (a) at the June 2016 joint Capital Markets Advisory Committee (CMAC) and Global Preparers Forum (GPF) meeting members suggested some minimum required line items and subtotals in the statement(s) of financial performance, such as operating profit, EBIT, cost of goods sold (COGS), and gross profit. Members expressed a preference for principle-based descriptions of these line items and subtotals rather than detailed rules[3].

    (b) at the March 2017 CMAC meeting a few members suggested the Board should require separate line items for depreciation and for amortisation. However, one member disagreed stating that the location of information in the primary financial statements or the notes has become irrelevant because of improvements in digital reporting[4].

    (c) in initial outreach, users suggested that their requirements for comparability would be assisted by more details about the components of the line items and subtotals, primarily in the statement(s) of financial performance. These users stated that this could be achieved via the notes and did not need to be confined to changes in the primary financial statements[5].

    (d) at the November 2018 CMAC meeting it was suggested that investments in 'integral' associates and joint ventures should be presented separately from investments in 'non-integral' associates and joint ventures in the statement of financial position, because this would facilitate the calculation of returns ratios[6].

11. This feedback is consistent with the responses received to the disaggregation principle proposed in the October 2008 Discussion Paper on Financial Statements Presentation. Although there was wide support in the responses for a principle of further

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[3] See minutes of the joint meeting of GPF-CMAC in June 2016

[4] See minutes of meeting of CMAC in March 2017

[5] Result of outreach on scope of project November 2016 Agenda paper 21D

[6] See minutes of meeting of CMAC in November 2018

disaggregation, of the 55 comments received relating to the principle of disaggregation 45 raised concerns that it would lead to too many line items in the statement(s) of financial performance reducing usefulness. Many of these respondents preferred further disaggregation to be provided in the notes. No respondents identified specific line items to be included in the primary financial statements.

12. Based on the stakeholder feedback there appears to be a greater demand for principle-based guidance on disaggregation than additional minimum line items. However, stakeholders have suggested:

    (a) requiring the presentation of amortisation and depreciation in the statement(s) of financial performance (see paragraphs 27–31); and

    (b) requiring investments in 'integral' associates and joint ventures accounted for using the equity method to be presented separately from 'non-integral' associates and joint ventures accounted for using the equity method in the statement of financial position (see paragraphs 21–26).

13. We also reviewed other evidence of the need for minimum line items and noted the following:

    (a) recent academic research suggests that the value relevance of some financial statement items have increased over time[7]. Research and development expenditure was identified as one such item. The usefulness to users of information about research and development expenditure has also been highlighted by recent debate on the capitalisation of intangible assets such as in the UK FRC's recent discussion paper[8]. We discuss research and development expenditure in paragraphs 32–37.

    (b) there is evidence that goodwill balances are increasing. For example, a 2016 EFRAG study[9] of goodwill and impairment analysing goodwill balances

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[7] Mary E. Barth, Ken Li, Charles G. McClure, 'Evolution in Value Relevance of Accounting Information', September 2018, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2933197

[8] UK Financial Reporting Council 'Business Reporting of Intangibles: Realistic proposals' February 2019, https://www.frc.org.uk/consultation-list/2019/discussion-paper-business-reporting-of-intangibl

[9] EFRAG 'What do we really know about goodwill and impairment? A quantitative study' September 2016, http://efrag.org/Assets/Download?assetUrl=%2Fsites%2Fwebpublishing%2FSiteAssets%2FEFRAG%2520Quantitative%2520Study%2520Goodwill%25202016.pdf

from 2005 to 2014 noted that across a sample of European companies recognised goodwill increased from 935 billion euros to 1,341 billion euros. Increases over that time period were also noted in samples from the US, Japan and Australia. We discuss goodwill in paragraphs 14–20.

Consideration of additional minimum line items

Goodwill

14. The staff have analysed the financial statements of a sample of 85 entities and found that 74 carried a material goodwill balance. Of the 74 entities 25 or 34% did not present goodwill as a line item in the statement of financial position. These entities disclosed goodwill in the notes as a component of intangible assets.

15. The items required to be presented in the statement of financial position are included in paragraph 54 of IAS 1 and include intangible assets but not goodwill. Paragraph 57 explains that the items listed in paragraph 54 are considered sufficiently different in nature or function to warrant separate presentation in the statement of financial position.

16. Although goodwill and intangible assets share the characteristic of not having a physical substance, they differ in their identifiability and measurement.

17. Paragraph 8 of IAS 38 *Intangible Assets* defines an intangible asset as an identifiable non-monetary asset without physical substance. Goodwill is not an identifiable asset, being defined in Appendix A of IFRS 3 *Business Combinations* as an asset representing the future economic benefits arising from other assets in a business combination that are not individually identified and separately recognised.

18. As identifiable assets, intangible assets are measured directly. Paragraph BC328 of the Basis for Conclusions on IFRS 3 clarifies that goodwill is required to be measured as the excess of one amount over another. Therefore, goodwill is measured as a residual and it is not possible to directly measure it.

19. The staff think that despite the shared characteristic of lacking physical substance the differences in identifiability and measurement between goodwill and intangible assets are significant and warrant separate presentation in the statement of financial position.

Staff recommendation

20. The staff recommend that the Board add goodwill to the list of line items in paragraph 54 of IAS 1 requiring presentation in the statement of financial position.

Investments in 'integral' and 'non-integral' associates and joint ventures

21. Paragraph 54(e) of IAS 1 requires the presentation of investments accounted for using the equity method in the statement of financial position.

22. In the statement(s) of financial performance, paragraph 82(c) requires the presentation of the share of profit or loss of associates and joint ventures accounted for using the equity method. The Board has tentatively decided to require presentation of the share of results of 'integral' associates and joint ventures separately from those of 'non-integral' associates and joint ventures.

23. In making this decision the Board considered feedback that some users evaluate how closely aligned an associate or joint venture is to an entity's activities in determining how its results should be included in the entity valuation. These investors make a distinction between the functions of these assets in the entity suggesting that disclosing them separately would provide useful information. Separate disclosure of the carrying amount of the assets would further allow these investors to better evaluate the returns on the related assets as suggested in the comment raised in the CMAC meeting (see paragraph 10(d)).

24. The Board also tentatively decided:

    (a) to require separate presentation of the cash flows of 'integral' associates and joint ventures and 'non-integral' associates and joint ventures in the investing section of the statement of cash flows; and

    (b) to update the disclosure requirements of IFRS 12 *Disclosure of Interests in Other Entities* to reflect the introduction of 'integral' associates and joint ventures and 'non-integral' associates and joint ventures.

25. Requiring investments in 'integral' associates and joint ventures to be presented separately from 'non-integral' associates and joint ventures in the statement of financial position would be consistent with the Board's tentative decisions with

respect to the statement(s) of financial performance, the statement of cash flows and the disclosures required by IFRS 12.

Staff recommendation

26. The staff recommend that the Board require ‘integral’ associates and joint ventures to be presented separately from ‘non-integral’ associates and joint ventures in the statement of financial position.

Amortisation and depreciation

27. Paragraph 73(vii) of IAS 16 *Property, Plant and Equipment* requires the disclosure of the amount of depreciation for each class of property, plant and equipment and paragraph 118(vi) of IAS 38 *Intangible Assets* requires disclosure of the amortisation recognised in the period by class of intangible asset.

28. The users that suggested amortisation and depreciation be required to be presented in the statement(s) of financial performance argue that presenting these items would increase comparability and facilitate large-sample screening of investment opportunities. These users thought that the primary financial statements should provide an easily accessible high-level overview of an entity’s performance.

29. Depreciation and amortisation are both natural, rather than functional, line items. As a result, requiring their presentation in the statement(s) of financial performance would result in a mixed presentation of function and nature within the operating section for entities that present their analysis of expenses by function. Depreciation and amortisation would however be required to be disclosed in the notes.

30. When an entity presents an analysis of expenses by nature it is expected that application of the principles of aggregation and disaggregation tentatively decided by the Board would usually lead to a conclusion that depreciation and amortisation should be presented separately.

Staff recommendation

31. The staff do not recommend requiring the presentation of amortisation and depreciation expense in the statement(s) of financial performance. The staff think that the increase in prominence that would be achieved is outweighed by the disadvantage of requiring entities that present expenses by function to present these natural items. To encourage best practice, amortisation and depreciation expense could be included in the illustrative examples that the Board has tentatively decided to develop for the statement(s) of financial performance when an analysis of expenses is presented by nature.

Research and development expenditure

32. Paragraph 126 of IAS 38 requires disclosure of the aggregate amount of research and development expenditure recognised as an expense in the period. Paragraph 127 of IAS 38 further clarifies that research and development expenditure comprises all expenditure that is directly attributable to research and development activities including costs of materials, employee benefits, fees, and amortisation of patents and licences.

33. There is currently debate regarding the extent to which financial reporting should capture information regarding intangible assets as they become greater drivers of economic activity. For example, Deloitte and the ACCA jointly issued a study on the capitalisation of intangibles[10]. Although much of the discussion relates to when it might be appropriate to capitalise these expenses, many of the proposed solutions relate to improved disclosure, and highlight the importance to users, of information about research and development expenditure.

34. Requiring the presentation of research and development expenditure in the statement(s) of financial performance would not respond to these broader concerns but would have the benefit of increasing the prominence of research and development expenditure in the financial statements.

[10] ACCA and Deloitte 'The capitalisation debate: R&D expenditure, disclosure content and quantity, and stakeholder views, February 2019, https://secure.accaglobal.com/content/dam/ACCA_Global/professional-insights/Intangibles/pi-intangibles-R%26D.pdf

35. However, the need to allocate expenses attributable to the activity of research and development makes it a functional, rather than a natural line item. As a result, requiring its presentation in the statement(s) of financial performance would result in a mixed presentation of function and nature within the operating section for entities which present their analysis of expenses by nature.

36. It is expected that when an entity presents an analysis of expenses by function, application of the principles of aggregation and disaggregation tentatively decided by the Board would lead to a conclusion that research and development would be disaggregated based on its unique function.

Staff recommendation

37. The staff do not recommend requiring the presentation of research and development expenditure in the statement(s) of financial performance. The staff think that the increase in prominence that would be achieved is outweighed by the disadvantage of requiring entities that present expenses by nature to include this functional item in the statement(s) of financial performance. To encourage best practice, research and development expenditure could be included in the illustrative examples that the Board has tentatively decided to develop for the statement(s) of financial performance when an analysis of expenses is presented by function.

Questions for the Board

Question 1
Does the Board agree with the staff's recommendation to require presentation in the statement of financial position of: (a) goodwill; (b) investments in 'integral' associates and joint ventures accounted for using the equity method; and (c) investments in 'non-integral' associates and joint ventures accounted for using the equity method.

Question 2

Does the Board agree with the staff's recommendation not to require presentation in the statement(s) of financial performance of:

(a) amortisation;

(b) depreciation; and

(c) research and development expenditure.

Appendix A: Paragraphs 54 and 82 of IAS 1 *Presentation of Financial Statements*

54. The statement of financial position shall include line items that present the following amounts:

(a) property, plant and equipment;

(b) investment property;

(c) intangible assets;

(d) financial assets (excluding amounts shown under (e), (h) and (i));

(da) groups of contracts within the scope of IFRS 17 that are assets, disaggregated as required by paragraph 78 of IFRS 17;

(e) investments accounted for using the equity method;

(f) biological assets within the scope of IAS 41 *Agriculture*;

(g) inventories;

(h) trade and other receivables;

(i) cash and cash equivalents;

(j) the total of assets classified as held for sale and assets included in disposal groups classified as held for sale in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*;

(k) trade and other payables;

(l) provisions;

(m) financial liabilities (excluding amounts shown under (k) and (l));

(ma) groups of contracts within the scope of IFRS 17 that are liabilities, disaggregated as required by paragraph 78 of IFRS 17;

(n) liabilities and assets for current tax, as defined in IAS 12 *Income Taxes*;

(o) deferred tax liabilities and deferred tax assets, as defined in IAS 12;

(p) liabilities included in disposal groups classified as held for sale in accordance with IFRS 5;

(q) non-controlling interests, presented within equity; and

(r) issued capital and reserves attributable to owners of the parent.

82. In addition to items required by other IFRSs, the profit or loss section or the statement of profit or loss shall include line items that present the following amounts for the period:

(a) revenue, presenting separately:

(i) interest revenue calculated using the effective interest method; and

(ii) insurance revenue (see IFRS 17);

(aa) gains and losses arising from the derecognition of financial assets measured at amortised cost;

(ab) insurance service expenses from contracts issued within the scope of IFRS 17 (see IFRS 17);

(ac) income or expenses from reinsurance contracts held (see IFRS 17);

(b) finance costs;

(ba) impairment losses (including reversals of impairment losses or impairment gains) determined in accordance with Section 5.5 of IFRS 9;

(bb) insurance finance income or expenses from contracts issued within the scope of IFRS 17 (see IFRS 17);

(bc) finance income or expenses from reinsurance contracts held (see IFRS 17);

(c) share of the profit or loss of associates and joint ventures accounted for using the equity method;

(ca) if a financial asset is reclassified out of the amortised cost measurement category so that it is measured at fair value through profit or loss, any gain or loss arising from a difference between the previous amortised cost of the financial asset and its fair value at the reclassification date (as defined in IFRS 9);

(cb) if a financial asset is reclassified out of the fair value through other comprehensive income measurement category so that it is measured at fair value through profit or loss, any cumulative gain or loss previously recognised in other comprehensive income that is reclassified to profit or loss;

(d) tax expense;

(e) [deleted]

(ea) a single amount for the total of discontinued operations (see IFRS 5).

(f)-(i) [deleted]

Appendix B: Summary of tentative Board decisions on aggregation and disaggregation

B1. The Board tentatively decided to develop principles, definitions and guidance on aggregation and disaggregation. The following paragraphs summarise those principles, definitions and guidance.

B2. 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'.
>
> 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'.

B3. The Board tentatively decided to define classification, aggregation and disaggregation as follows:

> Classification is the sorting of assets, liabilities, equity, income and expenses and cash flows on the basis of shared characteristics.
>
> Aggregation is the adding together of individual items that share characteristics and are classified together.
>
> Disaggregation is the separation of an item or group of items into dissimilar component parts.

B4. The Board tentatively decided to provide the following guidance on the steps involved in aggregation and disaggregation:

> Aggregation and disaggregation involve:
>
> (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 also tentatively decided to provide additional supporting guidance.