Primary Financial Statements

Nick Anderson
Nick Barlow
Roanne Hasegawa
Juliane-Rebecca Upmeier

#WSS2022
Presenters

Nick Anderson  
IASB Member

Nick Barlow  
IASB Technical Staff

Roanne Hasegawa  
IASB Technical Staff

Juliane-Rebecca Upmeier  
IASB Technical Staff
Project overview
Project overview

**Objective**

- Improve communication in financial statements
- Focus on information included in the statement of profit or loss

**Main proposals**

1. Require additional **defined subtotals** in statement of profit or loss
2. Require disclosures about **management performance measures**
3. Strengthen requirements for **disaggregating information**

---

- **Q4 2019**: Exposure Draft published
- **Q1–Q3 2020**: Consultation period
- **Q4 2020**: Discussion of feedback summary
- **2021–2023**: IASB redeliberations
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.

<table>
<thead>
<tr>
<th>Share of profit or loss of associates and joint ventures included in operating profit?</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Yes</strong></td>
</tr>
<tr>
<td><strong>28%</strong></td>
</tr>
<tr>
<td><strong>No</strong></td>
</tr>
<tr>
<td><strong>72%</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Interest cost on defined benefit pension liabilities included in operating profit?</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Yes</strong></td>
</tr>
<tr>
<td><strong>25%</strong></td>
</tr>
<tr>
<td><strong>Unclear</strong></td>
</tr>
<tr>
<td><strong>23%</strong></td>
</tr>
<tr>
<td><strong>No</strong></td>
</tr>
<tr>
<td><strong>52%</strong></td>
</tr>
</tbody>
</table>
## What are the new subtotals and categories?

<table>
<thead>
<tr>
<th>Category</th>
<th>Line Items</th>
<th>Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Revenue</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other income</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Changes in inventories of finished goods and work in progress</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Raw materials used</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Employee benefits</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Depreciation</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Amortisation</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Professional fees and other expenses</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Operating profit</strong></td>
<td>Income and expenses from associates and joint ventures</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Income and expenses from investments</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Income and expenses from cash and cash equivalents</td>
<td></td>
</tr>
<tr>
<td><strong>Profit before financing and income tax</strong></td>
<td>Income and expenses from liabilities that arise from transactions that involve only raising of financing</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Unwinding of the discount on provisions</td>
<td></td>
</tr>
<tr>
<td><strong>Profit before tax</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income tax</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Profit for the year</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*Line Items illustrate what is included in each category and do not necessarily denote specified line items.*
What is in the operating category?

Includes, **but is not limited to**, income and expenses from an entity’s main business activities

- Defined as a default—includes income and expenses not classified in other categories
- Works for **different business models**.
- A direct definition would require **significant judgement** which may result in operating profit not being comparable.
- Avoids creation of a ‘**non-operating**’ category that is neither operating, investing or financing, which may be used opportunistically.

Includes volatile and unusual income and expenses arising from an entity’s operations

- The category is intended to provide a **complete** picture of the entity’s operations for the period.
What is in the investing category?

Income and expenses from associates and joint ventures accounted for using the equity method.

Income and expenses from assets that generate a return individually and largely independently of other resources held by an entity, including cash and cash equivalents.

Examples (classified in the operating category when invest as a main business activity):

- 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
What is in the financing category?

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

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

Specified income and expenses from other liabilities

For other liabilities, including lease liabilities, classify interest expense and the effect of changes in interest rates in the financing category when such amounts are identified applying the requirements of IFRS Accounting Standards

⭐️ Change in classification of income and expenses within the financing category included in targeted outreach topics
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.

The IASB proposes requirements for some entities, such as banks, to classify income and expenses in the operating category that would otherwise be classified in the investing or financing categories.
Entities that provide financing to customers as a main business activity

- Operating
  - Income and expenses from transactions that involve only the raising of finance
    - Classified in the operating category by entities that provide financing to customers as a main business activity, such as banks and entities that provide financing to customers to purchase the entity’s products
    - Accounting policy choice whether to classify in the operating category *all* such income and expenses or *only* those related to providing financing to customers

- Financing
  - Specified income and expenses from other liabilities classified in the financing category (same approach for all entities)
Entities that invest as a main business activity

**Operating**

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

- Classified in the operating category by entities that invest in those assets as a main business activity, such as insurers, investment entities and investment property companies
- Applies to cash and cash equivalents if invest in financial assets as a main business activity

**Investing**

Income and expenses from associates and joint ventures accounted for using the equity method classified in the investing category (same approach for all entities)

Withdrawal of the proposal in the Exposure Draft for entities that provide financing to customers as a main business to be explored in targeted outreach
Questions
Management performance measures
What is the issue?

Common management-defined performance measures

- Adjusted profit: 33%
- Adjusted operating profit: 29%
- Adjusted EBITDA: 20%
- Adjusted EBIT: 11%

% of companies using measure in annual report

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

- 70% No
- 19% Yes, with detailed tax effects
- 11% Yes, with limited or no information on tax effects

• 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
What are MPMs?

Performance measures

Non-financial performance measures
- For example:
  - Number of subscribers
  - Customer satisfaction score
  - Store surface

Financial performance measures
- (Sub)totals of income and expenses
- IFRS-specified
  - For example:
    - Operating profit
    - Operating profit before depreciation, amortisation and specified impairments
- MPMs
  - For example:
    - Adjusted profit or loss
    - Adjusted operating profit
    - Adjusted EBITDA
- Other measures that are not subtotals of income/expenses
  - For example:
    - Free cash flow
    - Return on equity
    - Net debt
    - Same-store sales
How will MPMs be defined?

Subtotals of income and expenses not specified by IFRS Accounting Standards that:

- are used in public communications outside financial statements (excluding oral communications, transcripts and social media posts)

  communicate management’s view of an aspect of an entity’s financial performance

Rebuttable presumption that a subtotal used in public communications represents management’s view of an aspect of an entity’s financial performance – rebutted with reasonable and supportable evidence

Included in targeted outreach topics
What disclosures will be required for MPMs?

<table>
<thead>
<tr>
<th>Reconciliation</th>
<th>Reconciliation between MPM and the most directly comparable subtotal or total specified by IFRS Accounting Standards, including the income tax effect and effect on non-controlling interests. ★★★</th>
</tr>
</thead>
<tbody>
<tr>
<td>Why an MPM communicates management’s view</td>
<td>Includes an explanation of how the MPM is calculated and how the measure provides useful information about the entity’s performance. Explanation should refer to individual reconciling items where necessary.</td>
</tr>
<tr>
<td>Not necessarily comparable with other entities</td>
<td>A statement that MPM provides management’s view of an aspect of the entity’s financial performance and is not necessarily comparable with measures provided by other entities.</td>
</tr>
<tr>
<td>Changes in calculation</td>
<td>Explanation of any changes in how the entity calculates its MPMs or which MPMs it provides.★</td>
</tr>
</tbody>
</table>

★ Aspects of proposal to be redeliberated in a future IASB meeting
★★ Tax calculation included in targeted outreach topics
## What might a reconciliation look like?

<table>
<thead>
<tr>
<th>Description</th>
<th>Adjusted operating profit (MPM)</th>
<th>Tax</th>
<th>NCI</th>
</tr>
</thead>
<tbody>
<tr>
<td>Restructuring in Country X (incl. in employee benefits)</td>
<td>(5,400)</td>
<td>900</td>
<td>(1,020)</td>
</tr>
<tr>
<td>Revenue adjustment (incl. in revenue)</td>
<td>(6,200)</td>
<td>1,550</td>
<td>-</td>
</tr>
<tr>
<td><strong>Operating profit (IFRS-specified)</strong></td>
<td><strong>41,270</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### 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; and
- operating profit and income and expenses from investments accounted for using the equity method

---

**Simplified approach to calculating the tax effect**

- Aspects of proposal to be redeliberated in a future IASB meeting
- Included in targeted outreach topics
How does EBITDA fit in the proposals?

The IASB is proposing to define ‘operating profit before depreciation, amortisation and specified impairments’

• If used, no MPM disclosures would be required for this measure.
• The IASB will not explicitly prohibit ‘EBITDA’ as a label for ‘operating profit before depreciation, amortisation and specified impairments’, but will explain in the Basis for Conclusions that such a label would rarely be a faithful representation of it.
Questions
Disaggregation
and other topics
What is the issue?

Entities sometimes provide information that is too aggregated or incomplete so investors don’t get the information they need for their analysis.
**What will be the disaggregation requirements?**

<table>
<thead>
<tr>
<th>General requirements and specified line items</th>
<th>Specific requirements</th>
</tr>
</thead>
<tbody>
<tr>
<td>Roles of primary financial statements (PFS) and notes</td>
<td>Present operating expenses by nature and by function (mixed approach permitted) Disclosure of amounts included in each line item of profit or loss for depreciation, amortisation and employee benefits</td>
</tr>
<tr>
<td>Specified line items</td>
<td>Disclosure of unusual income and expenses <em>(proposal withdrawn)</em></td>
</tr>
<tr>
<td>Principles for aggregation and disaggregation</td>
<td>Grouping dissimilar immaterial items, avoiding ‘other’ labels</td>
</tr>
</tbody>
</table>

- To be redeliberated in a future IASB meeting
- Included in targeted outreach topics
## What would be the general requirements?

<table>
<thead>
<tr>
<th>Roles of PFS and the notes</th>
<th>• Describe the roles of PFS and the notes and refer to understandability in the description of the role of PFS</th>
</tr>
</thead>
</table>
| 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 notes would result in material information and when disaggregation in the PFS would result in a more understandable overview |
| Specified line items | • New specified line items, including goodwill in the statement of financial position |
| Grouping dissimilar immaterial items, avoiding ‘other’ labels | • Use meaningful labels for groups of immaterial items, avoiding line items such as ‘other expenses’  
• If that is not possible, entities required to provide information in the notes about the content of such groups of items |

*Proposals to be discussed at future IASB meetings*
Disclosure of operating expenses by nature in the notes

ED proposed that an entity that reports expenses by function in the statement of profit or loss discloses in the notes an analysis of its total operating expenses by nature.

Some respondents (users, standard-setters and accountancy bodies) agreed. Some respondents (preparers and their representative bodies) disagreed.

To achieve a more balanced outcome between costs for preparers and benefits for users the IASB has tentatively decided to:

- require an entity to disclose the amounts of depreciation, amortisation and employee benefits included in each line item in the statement of profit or loss; and
- explore in targeted outreach an approach that would require an entity to disclose, for all operating expenses disclosed in the notes, the amounts included in each line item in the statement of profit or loss (‘a general requirement’).

To be redeliberated in a future IASB meeting

Included in targeted outreach topics
Unusual income and expenses

ED proposed a definition of unusual income and expenses and disclosure requirements (for example, an entity would disclose the line item(s) in the statement of financial performance in which unusual income and expenses are included and narrative information)

Most agreed with the IASB developing a definition, but also said the definition was too subjective, that it included income and expenses that some did not view as unusual, and that more application guidance was required

• IASB has been working on a revised definition of unusual items – focusing on reducing the subjectivity and limiting the population of items captured by the definition
• Discussions with stakeholders and IASB members over the last nine months have not led to a consensus on what the population of unusual income and expenses should be

IASB tentatively decided not to proceed with specific requirements for unusual income and expenses as part of this project
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>
<thead>
<tr>
<th>Description</th>
<th>Category</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dividends received</td>
<td>Investing category</td>
</tr>
<tr>
<td>Dividends paid</td>
<td>Financing category</td>
</tr>
<tr>
<td>Interest paid</td>
<td>Financing category</td>
</tr>
<tr>
<td>Interest received</td>
<td>To be discussed at a future IASB meeting</td>
</tr>
</tbody>
</table>

Classification of dividends and interest paid and received by entities with specified main business activities to be discussed at a future IASB meeting
Questions