STAFF PAPER

January 2014

IFRS Interpretations Committee Meeting

Project	**New items for initial consideration**		
Paper topic	**IAS 1 *Presentation of Financial Statements*—Issues related to the application of IAS 1**		
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Introduction

1. In October 2013, the IFRS Interpretations Committee ('the Interpretations Committee') received a request from the European Securities and Markets Authority (ESMA) ('the submitter') to clarify the application of some of the presentation requirements in IAS 1 *Presentation of Financial Statements*.

2. We performed outreach with the International Forum of Accounting Standard-Setters (IFASS) and securities regulators on this topic in order to find out how widespread the issue raised by the submitter is and to what extent significant diversity in practice exists. The results of this outreach are included as part of our analysis of this issue.

3. The submission is reproduced in full in **Appendix D** to this paper.

Purpose of the paper

4. The purpose of this paper is to:

   (a) provide an analysis of the issues raised in the submission;

(b) provide a summary of the outreach results on the issue raised (refer to **Appendix A**);

(c) make a recommendation not to add this issue to the Interpretations Committee's agenda and provide a draft of a tentative agenda decision (refer to **Appendix B**) for the consideration of the Interpretations Committee members;

(d) present an assessment of the issue against the Interpretations Committee's agenda criteria (refer to **Appendix C**); and

(e) ask the Interpretations Committee whether it agrees with the draft of the tentative agenda decision.

Submission received

5. The submitter points out that IAS 1 gives a lot of flexibility to preparers when preparing their financial statements. In the submitter's opinion such flexibility may impair the comparability and understandability of the financial statements.

6. To illustrate this concern, the submitter has identified a list of areas concerning the application of some of the presentation requirements in IAS 1 that the submitter would like to bring to the attention of the Interpretations Committee, as follows:

(a) **Issue A**. Presentation of expenses by function.

(b) **Issue B**. Presentation of additional lines, headings and subtotals.

(c) **Issue C**. Presentation of additional statements or columns in the primary statements.

(d) **Issue D**. Application of the materiality and aggregation requirements.

7. The submitter also provided some examples that have been identified in practice by securities regulators to illustrate the views raised. We are referring to the examples raised by the submitter regarding the:

(a) presentation of impairment losses (Issue A);

(b) share of the profit or loss of associates and joint ventures and disclosure of impairment losses in the condensed interim statement of profit or loss (Issue B);

(c) presentation of an additional reconciliation of the groups' operating profit to the result attributable to owners (Issue C); and

(d) disclosure of items of income and expense by segment (Issue D)

8. In this paper we have not analysed the examples provided by the submitter, because we have focused our analyses on the underlying concerns raised by the submitter about the presentation and disclosure requirements in IAS 1.

9. In the next section we will provide a brief description of the concerns raised by the submitter as well as our analysis of each issue.

Description of the submission received and staff analysis

Issue A—Presentation of expenses by function

10. The submitter observes that the classification of expenses in the statement of profit or loss by function (based on the guidance in paragraph 97 and paragraphs 103-105 of IAS 1) requires arbitrary allocations and involves considerable judgement, which could lead to a lack of comparability in the financial statements.

11. Paragraph 97 and paragraphs 103-105 of IAS 1 are reproduced below[1] (emphasis added):

> 97 When items of income or expense are material, an entity shall disclose their nature and amount separately.
>
> 103 (…) **At a minimum, an entity discloses its cost of sales under this method separately from other expenses**. This method can provide more relevant information to users than the classification of expenses by nature, **but allocating costs to functions may require**

[1] In some cases we are reproducing only an extract of the applicable paragraph.

arbitrary allocations and involve considerable judgement.

104 **An entity classifying expenses by function shall disclose additional information on the nature of expenses**, including depreciation and amortisation expense and employee benefits expense.

105 The choice between the function of expense method and the nature of expense method depends on historical and industry factors and the nature of the entity. (…) **Because each method of presentation has merit for different types of entities, this Standard requires management to select the presentation that is reliable and more relevant**.

12. The submitter provided some examples of issues that have been identified by securities regulators to illustrate its views. We have summarised those examples in the table below:

Example 1—impairment losses.

The following divergent views can be identified in the presentation of impairment losses on capitalised development costs in a statement of profit or loss presented by function.

(a) View 1: present impairment losses on a separate line after the ‘gross profit’ subtotal and outside the ‘cost of sales’, because impairment distorts margin analysis; or

(b) View 2: present impairment losses as part of ‘cost of sales’ because impairment losses are similar in nature to idle costs. Moreover, the cost of inventories should include all costs of conversion including impairment, in according with paragraph 10 of IAS 2 *Inventories*.

Example 2—cost of sales.

The following divergent views have been identified in the presentation of the components of the ‘cost of sales’.

(a) View 1: present the components of the costs of sales separately, because paragraphs 104–105 of IAS 1 require additional information on the nature of the expenses when a classification by function of the expense is used and paragraph 97 of IAS 1 requires material items of income and expense to be disclosed separately

(b) View 2: the disclosure of the components of the cost of sales is not always required and would depend on whether those components are material on the basis of paragraph 29 of IAS 1.

Staff analysis

13. We note that the submitter is concerned that the classification of expenses in the statement of profit or loss by function under the requirements in IAS 1 involves considerable judgement which could sometimes lead to arbitrary allocations or not enough disaggregation of material items.

14. We observe that IAS 1 is a principle-based Standard and consequently the requirements in IAS 1 allow for the use of judgement. We also think that IAS 1 provides the preparer with a degree of flexibility in the presentation of financial statements. In our view both aspects (flexibility and judgement) are an essential feature in IAS 1, because they reflect the fact that IAS 1 recognises that businesses and industries are different and that the preparation of financial statements should be tailored for each business and industry to reflect an entity's particular financial position and financial performance.

15. We observe that the lack of prescriptive guidance in IAS 1 could inevitably lead to some diversity in practice in the application of the presentation requirements in IAS 1. However, in our view these differences are only a reflection of management's judgement on how to best report an entity's specific facts and circumstances.

16. Moreover, we note that paragraph 97 of IAS 1 states that when items of income or expense are material, their nature should be presented separately[2]. Nonetheless, we observe that in IAS 1 the presentation and disaggregation of expenses involves the use of judgement and we understand that some could find this approach too

[2] Paragraph 97 does not specify where material items should be presented but we interpret that this could be either on the face or in the notes to the financial statements.

subjective, because entities may decide not to disaggregate some items because they might not consider them material. If there is an issue here to be addressed we question whether it is about providing more guidance in the application of materiality, which is a topic that it is already on the IASB's agenda (refer to our staff analysis in **Issue D** of this paper).

17. We have identified below some potential alternatives for achieving greater uniformity in the disaggregation of expenses. However, these all have some drawbacks as we explain below:

    (a) *Alternative A.* Require more specific information to be presented on the face of the statement of comprehensive income beyond the current minimum requirements. We think that a drawback of this alternative is that for some entities the required items would not be material and consequently, the required line items would not be presented.

    (b) *Alternative B.* Require the presentation of 'by nature' information for each functional activity. We think that a drawback of this alternative is that there is a risk of disclosure of too much 'irrelevant' information that could distract users of the financial statements from an overall view of an entity's financial position and financial performance. In this respect we refer to the feedback received by the IASB's Financial Statement Presentation (FSP) project as part of its outreach activities, which suggested that the proposal to disaggregate by function and further by nature was:

        (i) too complex, because some pointed out that in some cases, it would be difficult to track down the nature of all the expenses and link them with a specific functional activity; (for example, entities that deal with intercompany transactions in a large scale might find difficult to track down a particular cost); and/or

        (ii) too costly, because disaggregating expenses by function and then by nature would require expensive modifications to accounting systems.

18. We are of the view that none of the solutions as described above are ideal for promoting more disaggregation of income and expense items.

19. We also note that the issues raised are too broad for the Interpretations Committee to analyse. Instead, we think that the IASB's Disclosure Initiative could potentially provide some further clarifications to the disaggregation principle in paragraph 29 of IAS 1 which states that:

> An entity shall present separately each material class of similar items. An entity shall present separately items of a dissimilar nature or function unless they are immaterial.

Questions to the Interpretations Committee (Issue A)
1. Does the Interpretations Committee agree that further work could be done as part of the Disclosure Initiative to clarify the disaggregation principle in paragraph 29 of IAS 1? 2. Does the Interpretations Committee wish the staff to address the presentation of specific line items in the statement of profit or loss? If so, which?

Issue B—Presentation of additional lines, headings and subtotals

20. The submitter observes that paragraphs 85–86 of IAS 1 include a requirement to present additional lines, headings and subtotals when such information is relevant for understanding an entity's financial performance.

21. For instance, paragraph 85 states that:

> An entity **shall present additional line items, headings and subtotals in the statement(s)** presenting profit or loss and other comprehensive income **when such presentation is relevant to an understanding of the entity's financial performance**.

22. The submitter reports that securities regulators have detected the following implications of applying the requirements in paragraphs 85–86 of IAS 1:

(a) there is a lack of consistency on how entities allocate items between the operating and financial results. The submitter claims that this might be due to the fact that some concepts such as ‘results of operating activities’ have not been defined; and

(b) there is a practice of isolating non-recurring transactions, which could be interpreted as a way of presenting ‘extraordinary items’, despite the fact that the presentation of ‘extraordinary items’ is not allowed by paragraph 87 of IAS 1.

23. The submitter further points out that the analysis and understanding of the financial statements becomes more complex if more subtotals and totals are added with the aim of isolating the effects of recurring transactions and non-recurring transactions.

24. The submitter provided an example of an issue identified by securities regulators to illustrate its views. We have summarised this example in the table below:

Example 3—share of the profit or loss of associates and joint ventures.

The following divergent views have been identified in the presentation of the ‘share of the profit or loss of associates and joint ventures’ accounted for using the equity method:

(a) View 1. The ‘share of the results of associates’ should be presented separately from the ‘share of the results in joint ventures’ because according to paragraph 85 of IAS 1 an entity shall present additional lines in the financial statements when such presentation is relevant.

(b) View 2. The ‘share of the profit or loss of associates and joint ventures’ should be presented as part of the entity’s operating results if an entity considers that this result is part of its operating activities.

(c) View 3. The ‘share of the profit or loss of associates and joint ventures’ should be presented outside the entity’s ‘operating results’ because it is not clear what this subtotal should include.

Staff analysis

25. We note that the submitter has raised some concerns regarding the lack of consistency in the presentation of specific items in the financial statements. The submitter has also identified some misuse in the presentation of totals and subtotals.

26. We observe that IAS 1 provides little specific guidance on the presentation of line items in financial statements, such as the level of detail or number of line items that should be presented in the financial statements. Furthermore, IAS 1's objective according to paragraph 1 is to set out "the overall requirements for the presentation of financial statements, guidelines for their structure and minimum requirements for their content". In doing so, IAS 1 sets out minimum levels of required items in the financial statements by requiring certain items to be presented on the face of, or in the notes to, the financial statements and in other required disclosures.

27. We also note that the current requirements in IFRS do not provide a definition of 'gross profit' or 'operating results' or many other common subtotals.

28. We think that the absence of specific requirements arises from the fact that the guidance in paragraphs 15 and 17 and 55 and 85 of IAS 1 relies on management's judgement about which additional line items, headings and subtotals:

    (a) are relevant to an understanding of the entity's financial position/financial performance (paragraphs 55 and 85); and

    (b) should be presented in a manner that provides relevant, reliable comparable and understandable information (paragraphs 15 and 17).

29. We think that providing a common structure for the financial statements with defined categories, subcategories and subtotals is attractive, however we think it might impair management's ability to present the results of the business in the way management thinks they best reflect how management views the entity.

Use of totals / subtotals as part of the Disclosure Initiative

30. We note that some concerns were raised about the use of subtotals/totals during the IASB's Discussion Forum[3] because there was a perception that IFRS prevents the presentation or disclosure of some additional totals and subtotals that are considered to be common. The IASB's Disclosure Initiative project took on the analysis of this topic.

31. During its deliberations as part of the Disclosure Initiative project, the IASB considered that there was no need for IAS 1 to explicitly 'permit' entities to present or disclose additional subtotals or totals of IFRS recognised amounts (such as EBIT or EBITDA, gross margin or operating margin).

32. This is because during the IASB's deliberations it was argued that the provisions of IAS 1 were sufficient to require an entity to disclose additional subtotals or totals in cases in which the entity determines that the subtotal or total provides relevant information and if the manner of its presentation or disclosure is a fair presentation of what it represents. For example, 'operating profit', 'gross margin' and 'net debt' are subtotals that are commonly presented on the face of primary financial statements or disclosed in the notes.

33. However, some of the feedback received during the Disclosure Forum suggested that some preparers were being discouraged by their auditors from presenting some subtotals/totals because there was a perception that the subtotal or total was somewhat misleading, confusing or otherwise difficult to understand, or was presented with more prominence than the specific subtotals referred to in IAS 1.

34. The IASB is addressing this issue as part of the Disclosure Initiative project and proposes to add guidance to paragraphs 55 and 85 of IAS 1 to clarify the factors that an entity should consider when aggregating IFRS-recognised amounts into

[3] These and other concerns were summarised in the following document: [Discussion Forum: Financial Reporting Disclosure Feedback Statement] (the 'Feedback Statement') published in May 2013.

subtotals and totals. A draft of this proposed additional guidance to IAS 1 is reproduced below (emphasis added) [4]:

> **When an entity presents or discloses aggregated items in subtotals and totals, those subtotals or totals must be fairly presented**. Specifically, the totals and subtotals should:
>
> **(a) be made up of items recognised or otherwise disclosed in compliance with IFRS;**
>
> **(b) reference line items and/or other amounts disclosed in the financial statements so that what constitutes the total or subtotal is understandable;**
>
> (c) should be calculated on a consistent basis from period to period;
>
> (d) be labelled to reflect how they have been calculated; and
>
> **(e) not be displayed with more prominence than the specific subtotals referred to in this Standard.** [proposed paragraph 31B]

35. It is our view that the amendments to IAS 1, as proposed by the Disclosure Initiative, could assist in addressing some of the concerns raised, mainly the lack of consistency in the presentation of totals and subtotals.

36. These amendments could also potentially prevent the practice that some respondents to our outreach request have reported, of entities isolating groups of transactions (ie recurring or non-recurring transactions) through the use of totals and subtotals (refer to our summary of outreach conducted in Appendix A of this paper). This is because we think that these proposed amendments reinforce the current requirements in IAS 1 regarding the presentation of fair and

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[4] We are reproducing the proposed guidance recommended by the staff of the Disclosure Initiative to the IASB (refer to Agenda Paper 8B of October 2013). This wording is not final and is currently being revised.

understandable information and prevent entities from displaying totals and subtotals with more prominence than the specific subtotals required in IAS 1.

37. We also think that the proposed amendments are in line with the core principle in IAS 1 of allowing flexibility to the preparer of the financial statements for presenting information in the financial statements.

38. We observe, however, that the Disclosure Initiative could provide some further general guidance to ensure that entities do not disclose ‘unusual’ or ‘exceptional’ items, because despite of the fact that paragraph 87 of IAS 1 prohibits the disclosure of ‘extraordinary items’ in the statement of profit or loss, the results of our outreach request indicated that some entities commonly disclose such items. Consequently, we think that this could be a potential area in which the Disclosure Initiative could do some further work.

Question to the Interpretations Committee (Issue B)
3. Does the Interpretations Committee agree that further work could be done as part of the Disclosure Initiative to ensure that entities do not disclose ‘unusual’ or ‘exceptional’ items, because they are prohibited under IAS 1?

Additional lines in the condensed interim financial statements

39. The submitter points out that some difficulties have been encountered in the application of the requirement in paragraph 10 of IAS 34, which requires an entity to include additional lines in the condensed interim financial statements on the basis of the headings and subtotals included in the annual financial statements and that this situation has led to diversity in practice.

40. Paragraph 10 states the following (emphasis added):

> If an entity publishes a set of condensed financial statements in its interim financial report, **those condensed statements shall include, at a minimum, each of the headings and subtotals that were included in its most recent annual financial statements and the selected**

> **explanatory notes as required by this Standard**. Additional line items or notes shall be included if their omission would make the condensed interim financial statements misleading

41. The submitter provided an example of an issue identified by securities regulators to illustrate its views. We have summarised this example in the table below:

Example 4—disclosure of impairment losses in the condensed interim statement of profit or loss.
In the interim condensed statement of profit or loss, an entity recognised impairment losses on a research and development project. The entity separately disclosed the amount for the impairment losses in the management's report reported as part of its interim report.
In its most recent annual statement of profit or loss the amount of impairment losses was presented together with the amortisation of other intangible assets and no additional disclosures were included in the notes
The following divergent different views have been identified in the presentation of impairment losses in the condensed interim statement of profit or loss:
(a) <u>View A.</u> The amount for impairment losses is not disclosed separately in the condensed interim statement of profit or loss on the basis that:
(i) an amount for an impairment loss was not separately disclosed in the most recent annual statement of profit or loss;
(ii) paragraph 10 of IAS 34 states that condensed statements shall include at a minimum, each of the headings and subtotals included in the most recent annual financial statements; and
(iii) IAS 34 does not have a requirement similar to paragraphs 85 and 86 of IAS 1 to explain the elements of financial performance arising from non-recurring events when such presentation is relevant and necessary.
(b) <u>View B</u>. Present the amount for impairment losses separately in the condensed interim statement of profit or loss on the basis that:
(i) an amount for impairment losses is expected to be disclosed in a future annual statement of profit or loss; and
(ii) paragraph 16A(c) in IAS 34 requires the disclosure of items that are unusual because of their nature, size and incidence.

Staff comment

42. We have provided a separate analysis on the application of paragraph 10 of IAS 34 in Agenda Paper 21 of January 2014. Consequently we will not analyse in this paper the difficulties encountered about the content and presentation of condensed interim financial statements.

Issue C—Presentation of additional statements or columns in the primary financial statements

43. The submitter observed that some preparers provide information that is not specifically required in IAS 1 in addition to the information required as part of a complete set of financial statements (as described in paragraph 10 of IAS 1). Some examples of the additional information provided by preparers are:

    (a) pro forma information as an extra column;

    (b) reconciliations of pro forma information with the information presented in the primary financial statements; or

    (c) extra columns in the primary financial statements, for example to present information on non-recurring items and remeasurements.

44. The submitter claims that some justify the practice of providing additional information to that required in paragraph 10 of IAS 1 by citing the guidance in paragraphs 85 and 86 of IAS 1, which require entities to present additional lines, headings and subtotals if they are relevant to the understanding of the financial statements. Paragraph 10 of IAS 1 states the following (emphasis added):

> **A complete set of financial statements** comprises:
>
> (a) **a statement of financial position** as at the end of the period;
>
> (b) **a statement of profit or loss and other comprehensive income** for the period;
>
> (c) **a statement of changes in equity** for the period; (d) a statement of cash flows for the period;

(e) **notes,** comprising a summary of significant accounting policies and other explanatory information;

(ea) **comparative information** in respect of the preceding period as specified in paragraphs 38 and 38A; and

(f) **a statement of financial position as at the beginning of the preceding period** when an entity applies an accounting policy retrospectively or makes a retrospective restatement of items in its financial statements, or when it reclassifies items in its financial statements in accordance with paragraphs 40A–40D.

45. The submitter provided an example of an issue identified by securities regulators to illustrate its views. We have summarised this example in the table below:

Example 5—presentation of an additional reconciliation. An entity provided a reconciliation of the group's operating profit to the result attributable to owners on the same page as the statement of profit or loss. The basis for such presentation is that this information is useful to understand how the business is managed. The following divergent views have been identified regarding the presentation of such reconciliation: (a) <u>View A.</u> The reconciliation should not be presented together with the primary statement on the basis that only the primary statements described in paragraph 10 of IAS 1 should be presented. The reconciliation should be disclosed in the notes as non-GAAP information or in the management report. (b) <u>View B.</u> Additional information or additional statements can be provided on the face of the primary statements because there is no prohibition in IAS 1 from doing so. Such information could be viewed as a footnote to the statement of profit or loss.

Staff analysis

46. We note that the submitter raises some concerns about the presentation of additional statements or columns in the primary financial statements that are not specifically required in IAS 1.

47. We observe that IAS 1 sets requirements in paragraphs 10 and 11 of what constitutes a complete set of financial statements. In particular, we observe that when describing a "complete set of financial statements" this notion refers to the "primary financial statements" and the notes. In this respect we think that information that is required by IFRS must be part of the "primary financial statements" and the notes.

48. Furthermore, according to paragraph 14 of IAS 1, information that is presented outside the financial statements (eg environmental reports, value added statements, financial review by management) is outside the scope of IAS 1.

49. We infer from the application of paragraph 10 and paragraph 14 (as described above) that pro forma information or additional reconciliations that are not required in IFRS, is information that is not part of the "primary financial statements" or the notes and consequently, we think that it should be presented outside the "primary" financial statements and the notes. We also think that this information is not required to understand the entity's financial performance, as prescribed by paragraphs 85 and 86 of IAS 1.

50. We think it is helpful to note that the only instance in which IFRS refers to the presentation of non-GAAP information along with information prepared under IFRS, is for comparative purposes when first-time adopters present information in accordance with IFRS for the first period[5], this is, in accordance with paragraph 22 of IFRS 1 *First-time Adoption of International Financial Standards*.

51. We, acknowledge, however, that some entities could misinterpret the guidance in IAS 1 (ie paragraphs 10 and 14 and the guidance in paragraphs 85 and 86) and present proforma information or additional reconciliations that are not required by IFRS as part of the primary financial statements and the notes. However, we think that this should not be the case because paragraph 85-86 requires the presentation of additional line items in the statement of profit or loss and other comprehensive income (and not of proforma information or additional

[5] It is worth noting that paragraph 38C of IAS 1 allows the presentation of additional comparative information in addition to the minimum comparative financial statements required by IFRS, as long as that information is prepared in accordance with IFRS.

reconciliations not required in IFRS) when an entity needs this information in order to explain the elements of financial performance.

52. We think, however, that the Disclosure Initiative could potentially do some further work on providing further guidance or principles in IAS 1 to prevent the presentation of additional statements or of additional information that is not required by IFRS.

The format of the financial statements

53. We observe that IAS 1 does not prescribe any particular format for the financial statements and the notes. For instance, an extract from paragraph 57 states that (emphasis added):

> 57 **This Standard does not prescribe the order or format in which an entity presents items.** Paragraph 54 simply lists items that are sufficiently different in nature of function to warrant separate presentation in the statement of financial position

54. However, paragraph 51 of IAS 1 requires each financial statement and the notes to be clearly identified. To comply with this paragraph, paragraph 52 of IAS 1 states the following (emphasis added):

> An entity meets the requirements in paragraph 51 by presenting appropriate headings for pages, statements, notes, columns and the like. **Judgement is required in determining the best way of presenting such information**. **For example, when an entity presents the financial statements electronically, separate pages are not always used; an entity then presents the above items to ensure that the information included in the financial statements can be understood.**

55. On the basis of the guidance noted above, we think that management can employ its judgement to present the information in the financial statements in the format that management considers most understandable for users of the financial statements.

56. On the basis of the guidance above, we do not think that further guidance should be added to IAS 1.

Question to the Interpretations Committee (Issue C)
4. Does the Interpretations Committee agree that IAS 1 prohibits the presentation of additional information that is not required in IFRS as part of a complete set of financial statements? 5. Does the Interpretations Committee think that further work could be done as part of the Disclosure Initiative to provide additional guidance or principles in IAS 1 to prevent the presentation of additional statements or of additional information that is not required by IFRS?

Issue D—Application of the materiality and aggregation requirements

57. The submitter observes that the requirements in IAS 1 (paragraphs 29-30 and 97-98 of IAS 1) may lead some preparers to disclose *material items* separately or *material classes of similar items* (in other words, when a line item that is not individually material is aggregated with other items either on the face of the financial statements or in the notes. These paragraphs are reproduced below[6] (emphasis added):

> 29 An entity **shall present separately each material class of similar items**. An entity **shall present separately items of a dissimilar nature** or function unless they are immaterial.
>
> 30 (…) **If a line item is not individually material, it is aggregated** with other items either in those statements or in the notes.
>
> 97 **When items of income or expense are material,** an entity shall disclose their nature and amount **separately**.

[6] We are not reproducing paragraph 98 because it only provides examples of circumstances that would give rise to the separate disclosure of items of income and expense.

58. The submitter raised some concerns that in IFRS there are requirements to disclose "material items" but not "material classes" of items.

59. More specifically, the submitter refers to the case of paragraph 23(f) of IFRS 8 *Operating Segments*, which refers to the disclosure of "material **items** of income and expense" and not to the disclosure of "material **classes** of similar items". An extract of this paragraph is presented below (emphasis added):

> **An entity shall report a measure of profit or loss for each reportable segment.** An entity shall report a measure of total assets and liabilities for each reportable segment if such amounts are regularly provided to the chief operating decision maker. **An entity shall also disclose the following about each reportable segment if the specified amounts are included in the measure of segment profit or loss reviewed by the chief operating decision maker, or are otherwise regularly provided to the chief operating decision maker**, even if not included in that measure of segment profit or loss:
>
> (a) …
>
> (f) **material items of income and expense disclosed in accordance with paragraph 97 of IAS 1 Presentation of Financial Statements (as revised in 2007)**;

60. The submitter asserts that in the case of paragraph 23(f) of IFRS 8 only material "items" of income and expense would be disclosed within the information reported by segments, and not material "classes" of items.

61. To illustrate its views the submitter provided an example identified by securities regulators on the application of paragraph 23(f) of IFRS 8. We have summarised this example in the table below:

Example 6—disclosure of items of income and expense by segment. An entity's management reporting is based upon four operating segments. Management assesses the performance of operating segments based on revenue and earnings before interest and taxes (EBITDA). Research and development expenses are presented as a separate line item on the face of the statement of profit or loss but they are not disclosed separately within the entity's operating segment information. The following divergent views have been identified in reporting research and development expenses for each reportable segment:

(a) View A. Research and development expenses represent a class of items, not an individual material item of income and expense, and consequently, according to paragraph 23(f) of IFRS 8 this class of items should not be disclosed.

(b) View B. Research and development expenses represent a class of items that should be disclosed for each reportable segment in accordance with paragraph 23(f) of IFRS 8 because this class of items is regularly reviewed and provided to the chief operating decision maker (CODM).

Staff analysis

62. We note that the submitter raised some concerns regarding the application of paragraph 23(f) of IFRS 8. The submitter refers that such an example refers to a requirement to disclose material *items* but not necessarily material *classes* of items.

63. We observe that paragraph 23(f) of IFRS 8 explicitly requires the disclosure of "material *items* of income and expense" and not "material *classes* of items of income and expense should be disclosed" and we think that this was the intent of the IASB because this disclosure is specifically linked to paragraph 97 of IAS 1[7].

[7] As part of our research we looked at the guidance in USGAAP to see if a similar disclosure was required in the information provided by segments. We found that Topic 280 *Segment Reporting* in the US Financial Accounting Standards Board (FASB)'s Accounting Standards Codification ®, Topic 280-10-50-22 requires, instead, the disclosure of "Unusual items" defined in Topic 225-20-45-16. Paragraph 87 of IAS 1 prohibits the disclosure of 'extraordinary items'.

Consideration of the materiality concept as part of the Disclosure Initiative

64. As a further note, we observe that the concept of materiality and the lack of its appropriate application was one of the other topics that were analysed as part of the Disclosure Initiative because some concerns were identified about the fact that:

    (a) too much irrelevant information is being disclosed in financial statements, ie 'disclosure overload'; and

    (b) not enough relevant information is disclosed.

65. The IASB's Disclosure Initiative project took on the analysis of these topics and proposed adding:

    (a) some amendments to the materiality section of IAS 1 to clarify that the concept of materiality should be applied to the specific disclosure requirements set forth in a Standard or Interpretation and to clarify that materiality should be assessed both for primary financial statements and for the notes to the financial statements;

    (b) additional guidance to the 'materiality' section in IAS 1 to highlight that disclosing immaterial information could obscure useful information; and

    (c) some amendments to paragraphs 54 and 82 dealing with the presentation of the statement of financial position and the disaggregation of line items in the statement of profit or loss.

66. In this respect we note that the IASB has tentatively proposed that the following guidance could be added to the materiality section in IAS 1 (emphasis added)[8]:

> An entity shall decide, in the light of its circumstances, how much detail it provides to satisfy the information needs of users, how much emphasis it places on different aspects of the requirements and how it aggregates the information.

[8] We are reproducing the proposed guidance recommended by the staff of the Disclosure Initiative to the IASB (refer to Agenda paper 8B of September 2013. This wording is not final and is currently being revised.

> **An entity shall aggregate or disaggregate disclosures so that useful information is not obscured by either the inclusion of a large amount of immaterial detail or the aggregation of items that have different characteristics**. [proposed par. 30A]

67. We think that the proposals to amend the materiality section of IAS 1 as part of the Disclosure Initiative increase awareness of how disclosing immaterial information could obscure useful information; it will also increase awareness on how omitting relevant information would fail to provide useful information. We consequently do not think that further work should be done in this respect by the Interpretations Committee.

Question to the Interpretations Committee (Issue D)
6. Does the Interpretations Committee agree that no specific guidance should be added to paragraph 23(f) in IFRS 8 to address the submitter's concern that this paragraph requires the disclosure of material items of income and expense for each reportable segment?

Could standardisation be the way forward?

68. We have observed that prevalent concern by the submitter is that IAS 1 provides flexibility when preparing and presenting an entity's financial statements. In this respect a question arises on whether standardisation of the financial statements could be the way forward to address the submitter's concerns.

69. We observe that standardisation was one of the main goals of the joint project that the IASB undertook with the FASB on FSP. This is because the IASB and the FASB had noted that the existing presentation requirements permitted a wide spectrum of presentation formats that varied in detail and comparability. The IASB and FASB had also observed that users' primary criticisms were that information was not presented consistently and nor was it sufficiently disaggregated (refer to paragraph 1.9 of the DP).

70. The FSP project resulted in the issue of a Discussion Paper (DP) Preliminary Views on Financial Statement Presentation, in October 2008 and subsequently, the issue of a Staff Draft in 2010. A primary objective was to set out some principles for presenting financial statements, along with establishing a common structure for the financial statements in the form of required sections, categories or subcategories and related subtotals.

71. We, however think that providing a standard model for the presentation of the financial statements (for example, by providing definitions of sections or categories or of total/subtotals in the financial statements in a similar way to what the FSP project proposed) is not an ideal solution. This is because we think that standardising the information presented in the financial statements:

    (a) imposes limits on an entity's flexibility to select from a range of ways to present information and consequently, may be detrimental to the effective communication of the entity's particular circumstances, events and transactions; and

    (b) could force the inappropriate presentation of some of the line items in the financial statements.

72. Consequently, we support the flexibility inherent in IAS 1 and the use of judgement in preparing and presenting financial statements and we do not think that these aspects should be questioned or removed from this Standard.

Staff recommendation

73. Based on our analysis above and our assessment against the Interpretations Committee agenda criteria (refer to **Appendix C** of this Agenda Paper) we think that the Interpretations Committee should *not* add the issues raised by the submitter to its agenda.

74. As we have pointed out in previous paragraphs we think that the Disclosure Initiative could:

(a) potentially clarify the disaggregation principle in paragraph 29 of IAS 1.

(b) do some further work on providing additional guidance or a principle in IAS 1 to prevent the:

(i) disclosure of ‘infrequent, ‘unusual’ or ‘exceptional’ items; and

(ii) presentation of additional statements or of additional information that is not required by IFRS.

75. Furthermore, we have also noted that some related topics raised by the submitter (ie the presentation of subtotals/totals and the application of the materiality concept) have been brought to the attention of the IASB during the agenda consultation and during the IASB’s Discussion Forum and have been discussed as part of the IASB’s Disclosure Initiative. Because these specific topics have therefore been brought up by others for discussion by the IASB, we do not think that further work is needed from the Interpretations Committee.

76. We have asked the Interpretations Committee if the presentation of any particular items should be further analysed by the staff. If so, we will bring back a paper with our analysis at a future meeting.

Final questions to the Interpretations Committee
7. Does the Interpretations Committee agree with the staff’s recommendation that this issue should not be added to its agenda? 8. If the Interpretations Committee agrees with the staff recommendation, does it agree with the proposed wording for the tentative agenda decision in **Appendix B**?

Appendix A

Summary of outreach conducted

A1. We asked IOSCO and national standard-setters to provide us with qualitative or quantitative information on the following aspects:

> Q1. Are you aware of any difficulties or challenges in your jurisdiction in applying, auditing or enforcing the presentation requirements in IAS 1 regarding the:
>
> (a) presentation of expenses by function;
>
> (b) presentation of additional lines, headings and subtotals;
>
> (c) presentation of additional statements or columns in the primary statements;
>
> (d) application of the materiality and aggregation requirements?
>
> Q2. If you answered 'Yes' to Q1, what are the particular issues encountered in your jurisdiction in applying the requirements in IAS 1 mentioned above?
>
> Q3. If you answered 'Yes' to Q1, what is the prevalent approach/basis followed in your jurisdiction in applying the presentation requirements in IAS 1 regarding the four issues mentioned above? If you see diversity in practice in respect of this, please explain how.

Responses received

A2. We received responses from a member of IOSCO and from 18 national standard-setters. The views received do not reflect the formal views of those organisations.

Responses from national standard-setters

A3. The geographical breakdown for the responses received from national standard-setters is as follows:

Geographical region	Number of respondents
Asia	5
Europe	6
Americas	4
Oceania	2
Africa	1
Total respondents	18

A4. We summarise the results of the outreach in the following paragraphs.

Prevalent approach

A5. Approximately half of the respondents asserted that they:

(a) have not encountered difficulties in the application of the requirements in IAS 1;

(b) do not have major concerns about the presentation choices made by different companies in the application of this Standard; and

(c) have not seen too many divergent practices in the presentation of financial statements across entities and industries.

A6. Most of these respondents sent us links to annual reports to illustrate their views.

A7. One respondent expressed its concern on the flexibility provided by IAS 1 to prepare and present financial statements because, in its opinion, that flexibility might impair the comparability of financial statements.

Address the issues raised as part of the Disclosure Initiative

A8. Some respondents claim that the issues identified in the submission should be addressed as part of the IASB's Disclosure Initiative rather than in a separate project of the Interpretations Committee.

Additional line items/subtotals

A9. One respondent notes that the presentation of EBIT is common and is accepted in its jurisdiction because it constitutes a relevant subtotal.

A10. One respondent claims that the presentation of additional line items or subtotals is common when entities are undergoing restructurings.

A11. One respondent thinks that further guidance regarding the presentation of totals and subtotals within the statement of profit or loss would be beneficial; this respondent claims that it has seen diversity in practice in how entities define 'results of operating activities' and 'financial results'.

A12. Two respondents mentioned that some entities in its jurisdiction isolate "non-recurring items" or "significant items" and present them separately from normal operations in the statement of profit or loss.

A13. A couple of respondents mentioned that the IASB should define the subtotal for "operating income" because they consider that this subtotal is relevant.

Presentation of additional statements or columns

A14. A majority of respondents note that the presentation of additional statements is not common. Some others think that IAS 1 does not allow the presentation of additional statements or columns in the financial statements.

A15. One respondent noted that one of its stakeholders claims that pro forma information is sometimes common in an entity's first set of financial statements.

A16. A couple of respondents noted that some entities in their jurisdictions present an additional column in the financial statements to present a convenient translation from their local currency into another foreign currency.

Materiality and aggregation requirements

A17. A majority of respondents are not aware of any divergence in the application of the materiality and aggregation criteria in IAS 1 and no significant concerns were raised in this respect.

Specific presentation issues

A18. Some respondents have identified diversity in practice in the presentation of the following items:

(a) expenses by function, because some entities allocate expenses to each function in a random way

(b) "cost of sales":

   (i) one respondent claims that it is not clear in paragraphs 34 or 38 in IAS 2 *Inventories* which items should be part of this line item; and

   (ii) another respondent claims that some entities present some of its components outside "cost of sales" and provide with this a "mixed presentation" of expenses (ie by function and by nature);

(c) "finance costs", because this item is required in IAS 1 but not defined and it is not clear whether it includes foreign currency effects and derivative gains and losses;

(d) "share of profit or loss from associates", because some classify this line item as part of other operating income (below "gross profit") or as part of the entity's financial activities, depending on the nature of the associate[9];

(e) "amortisation and impairment expenses" related to capitalised development costs or to productive assets. Some respondents observe that these expenses are sometimes presented as part of "cost of sales" or are sometimes excluded from the gross profit subtotal to classify them within operating profit;

(f) foreign exchange differences, because sometimes these differences are classified as:

   (i) part of "operating profit";

   (ii) attending on the nature of the related transaction (eg exchange differences resulting from the purchase of inventory would be part of "cost of sales"); or

[9] A couple of respondents mentioned that the guidance in IFRS 11 *Joint Arrangements* seems to suggest that the share of profit or loss of associates and joint ventures accounted for under the equity method should be presented within "operating income".

(iii) as part of finance income/costs.

Responses received from regulators

A19. IOSCO members report that they have faced some challenges in enforcing some of the presentation requirements in IAS 1 because of ambiguous requirements in IAS 1.

Additional line items or subtotals

A20. Information in the financial statements is confusing because some entities:

(a) isolate certain transactions in the statement of profit or loss by virtue of their size, incidence or nature;

(b) present multiple subtotals that are not necessary or that are meaningless;

(c) include a subtotal before arriving at their measure of gross profit, which may be confusing;

(d) isolate the effect of non-recurring transactions despite the fact that the presentation of "extraordinary items" is prohibited under IAS 1;

(e) do not provide descriptive labels for the subtotals in the financial statements; or provide labels that are not meaningful or that are inadequate; or

(f) do not provide enough information as to why an additional item, heading or subtotal is presented.

A21. One member noted that there is diversity in practice in the presentation of subtotals (eg presentation of net interest income) in the statement of profit or loss by banking entities.

Disaggregation by function and nature

A22. Some entities, that choose to disaggregate expenses by function, provide limited disaggregation by nature.

A23. Some members also identified divergent practices on how entities allocate items between the operating and financial results in the statement of profit or loss

Additional columns

77. Some members observe that some entities present additional columns in the primary financial statements such as for discontinued operations, or unaudited information for business activities.

78. One member observed that in its jurisdiction the presentation of adjusted financial statements or additional columns in the financial statements is not permitted.

Non-GAAP information

A24. Some IOSCO members note that they object to the presentation of non-GAAP measures as part of the primary financial statements.

A25. Some other respondents mention that in their jurisdiction, securities regulators provide specific rules on the presentation of:

(a) non-GAAP information;

(b) presentation of additional statements; or

(c) "headline earnings".

A26. A couple of respondents mentioned that the format of financial statements is prescribed in its jurisdiction by securities regulators.

Unsolicited comments

A27. We received some unsolicited comments from two global accounting firms.

A28. Both of these commentators agree that the requirements in IAS 1 are based on principles and disagree with issuing further rules and definitions in IAS 1 because they think that this would adversely affect the reporting of an entity's particular circumstances.

A29. They also think that any of the issues raised by the submitter would be more appropriately addressed within the IASB's Disclosure Initiative or Conceptual Framework projects.

Appendix B—

Proposed wording for the tentative agenda decision

B1. The staff propose the following wording for the tentative agenda decision:

IAS 1 *Presentation of Financial Statements*—Issues related to the application of IAS 1

The Interpretations Committee received a request to clarify to clarify the application of some of the presentation requirements in IAS 1 *Presentation of Financial Statements* in the following areas:

(a) Presentation of expenses by function
(b) Presentation of additional lines, headings and subtotals
(c) Presentation of additional statements or columns in the primary statements
(d) Application of the materiality and aggregation requirements.

The submitter claimed that in these areas IAS 1 gives flexibility to preparers when presenting their financial statements and claims that this flexibility may impair the comparability and understandability of the financial statements.

The Interpretations Committee noted that the objective of IAS 1 according to paragraph 1 is to set out "the overall requirements for the presentation of financial statements, guidelines for their structure and minimum requirements for their content". In this respect the Interpretations Committee observed that the guidance in IAS 1 for the presentation of financial statements is mostly based on the use of judgement and allows flexibility in terms of the order of items included and in the layout of the financial statements and noted.

The Interpretations Committee noted that to consider changing the underlying principles for the presentation of the financial statements in IAS 1 would be an issue that is too broad to be addressed by the Interpretations Committee. The Interpretations Committee also observed that some of the related topics raised by the submitter (ie the presentation of subtotals/totals and the application of the materiality concept) have been brought to the attention of the IASB during the agenda consultation and have been discussed as part of the IASB's Disclosure Initiative project.

On the basis of the analysis above, the Interpretations Committee determined that sufficient guidance already exists in IAS 1 for the presentation of the financial statements or is already being developed by the Disclosure Initiative.

It therefore decided that neither an Interpretation nor an amendment to a Standard was necessary and consequently [decided] not to add this issue to its agenda.

Appendix C

Agenda criteria assessment

B1 The staff's assessment of the agenda criteria for the proposed amendment is as follows:[10]

Agenda criteria	
We should address issues (see paragraph 5.16):	
that have widespread effect and have, or are expected to have, a material effect on those affected.	**Yes.** Responses to our outreach request indicate that there are divergent views on the application of the requirements in IAS 1. Respondents expressed more concerns on the presentation of expenses by function and on the presentation of additional line items and subtotals (refer to our summary of outreach conucted in **Appendix A** of this paper).
where financial reporting would be improved through the elimination, or reduction, of diverse reporting methods.	**No.** We think that IAS 1 has sufficient guidance for the presentation of the financial statements. We also observe that additional guidance to IAS 1 is being developed by the Disclosure Initiative regarding totals/subtotals and materiality and aggregation.
that can be resolved efficiently within the confines of existing IFRSs and the *Conceptual Framework for Financial Reporting*.	**No.** We do not think that the underlying presentation principles in IAS 1 should be changed. If the presentation of specific issues needs to be addressed, this could be done within the context of specific Standards.
In addition:	
Is the issue sufficiently narrow in scope so that the Interpretations Committee can address this issue in an efficient manner, but not so narrow that it is not cost-effective for the Interpretations Committee to undertake the due process that would be required when making changes to IFRSs (see paragraph 5.17)?	**No.** We think that the submitter is questioning some of the main principles for the presentation of the financial statements. For this reason, we think that some of the issues raised would be better addressed as part of the Disclosure Initiative project, which has been addressing presentation and disclosure issues in IAS 1 from a broader perspective.
Will the solution that was developed by the Interpretations Committee be effective for a reasonable time period (see paragraph 5.21)? (The Interpretations Committee will not add an item to its agenda if the issue is being addressed in a forthcoming Standard and/or if a short-term improvement is not justified.)	**N/A**

[10] These criteria can be found in the *IFRS Foundation Due Process Handbook* .

Appendix D—submission received

European Securities and Markets Authority

The Chair

Date: 30 October 2013
ESMA/2013/1555

Wayne Upton
Chairman of IFRS IC
Cannon Street 30
London EC4M 6XH
United Kingdom

Agenda item request: Issues related to the application of IAS 1 - Presentation of Financial Statements

Dear Mr Upton,

The European Securities and Markets Authority (ESMA) is an independent EU Authority that contributes to enhancing the protection of investors and promoting stable and well-functioning financial markets in the European Union (EU). ESMA achieves this aim by building a single rule book for EU financial markets and ensuring its consistent application across the EU. ESMA contributes to the regulation of financial services firms with a pan-European reach, either through direct supervision or through the active co-ordination of national supervisory activity.

As a result of the review of financial statements carried out by national competent authorities and ESMA's co-ordination activities we have identified several issues related to the application of IAS 1 – *Presentation of Financial Statements* which we would like to bring to the attention of the IFRS Interpretations Committee (IFRS IC) for further consideration. We are aware that the IASB discussed during its September and October 2013 meetings some of the issues linked to the ones raised in this letter. We have included them in the letter in order to provide the IASB with a comprehensive overview of the issues identified in practice on the application and/or enforcement of IAS 1.

A detailed description of the issues is set out in the appendix to this letter. Please do not hesitate to contact us should you wish to discuss any of the issues we have raised.

Yours sincerely,

Steven Maijoor
Chair
European Securities and Markets Authority

CC: Hans Hoogervorst, Chairman International Accounting Standards Board (IASB) esma

APPENDIX – IAS 1 PRESENTATION OF FINANCIAL STATEMENTS

1. As part of their monitoring and supervisory activities, ESMA and national enforcers have identified several issues concerning presentation in the financial statements and the application of IAS 1.

2. ESMA is concerned that the absence of definitions of some concepts in IAS 1 and the lack of implementation guidance gives a lot of flexibility to entities to present their financial statements in ways that may impair the comparability and understandability of the financial statements.

3. In what follows ESMA provides some examples to illustrate the concerns mentioned above. They are grouped based on the nature of the issues raised:

   a. Presentation of expenses by function
   b. Additional lines, headings and subtotals
   c. Additional statements or columns in the primary statements
   d. Materiality and aggregation

a) Presentation of expenses by function

4. ESMA is concerned about the impact of the wording in paragraph 103 of IAS 1 on the comparability of financial statements. According to paragraph 103 of IAS 1, the classification by function of expenses in the income statement may require arbitrary allocations and involve considerable judgement. ESMA observed that sometimes issuers change the presentation of the income statement when using the analysis by function and present financial indicators that may not faithfully represent the performance of the issuer. The following example illustrates this concern.

<u>a.1) Presentation of impairment losses</u>

5. ESMA has identified two different views in relation to the recognition and presentation of impairment losses on capitalised development costs in an income statement presented by function.

6. The issuer has capitalised development costs in accordance with paragraph 57 of IAS 38. At the reporting date, the issuer recognised amortisation and impairment expenses on capitalised development costs and presented them on a separate line after the "Gross profit" subtotal instead of classifying them as part of "Cost of sales".

2

7. **View 1:** According to paragraph 99 of IAS 38, amortisation of intangible assets used in the production process should be included in the carrying amount of inventories. As the development of new technologies and products is used in the issuer's production process, the amortisation of such development costs forms part of the cost of conversion (paragraph 12 of IAS 2).

8. According to this view, impairment losses are similar to idle costs and should be included as part of Cost of sales. The difference between the amortisation and impairment expenses related to capitalised development costs relates to timing alone, thus the recognition of these costs in the income statement depends on the estimated useful life over which capitalised development costs are amortised. Therefore, the cost of inventories should comprise all costs of conversion including impairment (paragraph 10 of IAS 2). Cost of sales should equal the amount of inventories (at cost) recognised as an expense during the period (paragraph 38 of IAS 2).

9. **View 2**: According to this view, including impairment of development costs in Cost of sales distorts margin analysis and, therefore, it should be presented separately from Cost of sales.

10. According to paragraph 103 of IAS 1 "allocating expenses by function may require arbitrary allocations and involve considerable judgement". Paragraphs 85-86 of IAS 1 require an entity to present additional lines in the profit or loss when such information is relevant for the understanding of the entity's financial performance or necessary to explain the elements of financial performance that derive from activities, transactions and events that may differ in frequency, potential for gain or loss and predictability. Therefore, in this view, an issuer should present separately these expenses below the gross margin as these costs are non-recurring.

<u>a.2) Mandatory or voluntary presentation of components of "Cost of sales"</u>

11. Paragraph 97 of IAS 1 requires material items of income and expenses to be disclosed separately and paragraphs 104-105 of IAS 1 require additional information on the nature of expenses to be disclosed when the classification by function of expense is used.

12. In ESMA's experience, entities do not believe it to be clear whether providing the amount of each component of cost of sales is required in all cases. Entities refer to paragraph 29 of IAS 1 which states that "an entity shall present separately each material class of similar items" and "items of a dissimilar nature or function unless they are immaterial (please refer also to par. 46 in this letter).

b) Additional lines, headings and subtotals

13. Paragraph 85 of IAS 1 requires issuers to present additional lines, headings and subtotals when such information is relevant for understanding an entity's financial performance. This requirement allows issuers to adapt the presentation of the income statement based on the nature of their business, sector or industry.

14. However, the lack of definitions of concepts such as "operating result" or "financial results", and implementation guidance or examples in IAS 1 is likely to increase diversity in how the requirements are applied, which may impair the understandability and comparability of the financial statements. Illustrative examples identified by national enforcers are included below.

b.1) Classification – Operating/Financial Results

15. Although IAS 1 does not define "Results of operating activities", paragraph BC56 of IAS 1 states that "an **entity may elect to disclose the results of operating activities**, or similar line item, even though this **term is not defined**. In such cases, the Board notes that the entity should ensure that the amount disclosed is representative of activities that would normally be regarded as "operating".

16. As indicated in paragraph BC56 of IAS 1, in the IASB's view, it would be misleading and impair the comparability of financial statements if items of an operating nature were excluded from the results of operating activities, even if that had been industry practice. For example, it would be inappropriate to exclude items clearly related to operations (such as inventory write-downs and restructuring and relocation expenses) because they occur irregularly or infrequently or are unusual in amount. Similarly it would be inappropriate to exclude items on the grounds that they do not involve cash-flows, such as depreciation and amortisation expenses".

17. Paragraph 6 of IAS 7 defines "Operating activities" as "the principal revenue-producing activities of the entity and other activities that are not investing or financing activities". However, as shown by recent discussions that took place at the IFRS IC on the definitions of operating, financing and investing cash-flows, distinguishing between these three categories may be challenging, based on the existing IFRS literature.

18. During its March 2013 meeting, the IFRS I Cdecided not to propose that the IASB further clarifies the application of the primary principles in IAS 7 for the classification of cash flows. Moreover, the IFRS IC thought that making amendments to IAS 7 on a piecemeal basis would not be appropriate.

19. ESMA has found cases in which there is diversity in how entities allocate items between the operating and financial result.

b.2) Headings and Subtotals non-recurring items / operating profit

20. During the normal course of business, entities may enter into transactions that do not relate to their daily operating activities. Transactions like business combinations and disposals of businesses or assets may have a significant impact on the income statement; however, these transactions are not necessarily frequent or regular.

21. In accordance with paragraphs 86 and 101 of IAS 1, entities may include additional line items, amend descriptions and the ordering of items in order to explain the elements of financial performance due to various activities, transactions and other events which may differ in frequency, potential for gain or loss and predictability.

22. In order to isolate those effects, entities often group them into separate lines and subtotals so that the recurring result is presented without the effects of the non-recurring transactions. However, the practice of presenting non-recurring items may be interpreted as a way to present "extraordinary items" in the financial statements despite the fact that extraordinary items are not allowed (paragraph 87 of IAS 1), and the items are not identified or classified as such.

23. It can also be argued that additional lines and subtotals, as permitted by IAS 1, may add complexity to the analysis of the financial statements, which may become difficult to understand if entities use subtotals and additional headings to isolate the effects of non-recurring transactions from classes of expense or income.

b.3) Separate line for results of entities accounted for using the equity method

24. Paragraph 82 of IAS 1 states that "As a minimum, the statement of comprehensive income shall include line items that present the following amounts for the period: (...) (c) share of the profit or loss of associates and joint ventures accounted for using the equity method". IAS 28, IAS 31 and IFRS 11 are silent on the presentation of the "share of profit or loss of associates and joint ventures accounted for using the equity method".

25. Taking into account the option to include additional lines in the statement of comprehensive income, it can be argued that an issuer may choose to present separately (i) its share of the results of associates and (ii) joint ventures that are accounted for using the equity method.

26. Additionally, it can also be argued that due to the lack of a definition of "Operating result", an issuer may include in the operating result its share of profit or losses of joint ventures in which it considers the joint ventures' results to be part of its operating activities.

b.4) Additional income statement lines in the interim financial statements

27. National enforcers have found difficulties in relation to the application of the requirements in IAS 34 - *Interim financial statements* and with the fact that certain aspects of interim financial reporting are not defined. The example below illustrates these difficulties:

28. The issuer is a company with research and development costs only (no production). In the interim condensed financial statements prepared in accordance with paragraph 8 of IAS 34, the issuer recognised impairment losses on a development project. In the income statement, the amount attributable to the impairment on the development project was presented together with amortisation of other intangible assets and no additional disclosures were included in the notes regarding the impairment.

29. Although the issuer considered that the item fulfilled the criteria in paragraphs 97-98 of IAS 1 and therefore required additional lines to be in the annual financial statements, it only mentioned the effect of impairment in the management report in accordance with paragraph 16A, c) of IAS 34. The issuer justified this presentation on the basis that impairment loss was not a recurring event and thus, it should not be presented on a separate line in the income statement in the interim financial statements.

30. **View 1.** The issuer does not need to present impairment as an additional line on the income statement in the interim financial statements. Paragraphs 85-86 of IAS 1, which requires an entity to present additional line items if such presentation is relevant and necessary to explain the elements of financial performance arising from non-recurring activities, transactions and events, do not apply to interim financial statements.

31. Indeed, paragraph 4 of IAS 1 states that the standard "does not apply to the structure and content of condensed interim financial statements prepared in accordance with IAS 34. However, paragraphs 15–35 apply to such financial statements". Consequently, paragraphs 85-86 and 97-98 of IAS 1 are not applicable to condensed interim financial statements.

32. Moreover, paragraph 10 of IAS 34 states that "if an entity publishes a set of condensed financial statements in its interim financial report, those condensed statements shall include, at a minimum, each of the headings and subtotals that were included in its most recent annual financial statements and the selected explanatory notes as required by this Standard."

33. This view leads to the conclusion that since the issuer did not include a separate line to present impairment losses in the most recent annual financial statements, the issuer does not need to provide a separate line in the interim condensed financial statements. Moreover, paragraph 16A of IAS 34 allows the impact of significant events and transaction (as required by paragraphs 15-15C of IAS 34) to be

provided elsewhere in the interim financial report. In the absence of a definition of financial report, it can be considered that this refers to the management report in addition to the financial statements.

34. **View 2.** The issuer has to include a separate line in the income statement and provide explanations in the interim condensed financial statements. Although the first sentence of paragraph 10 of IAS 34 refers to the most recent financial statements, the issuer should also take into account which line items are expected to be included in the next annual financial statements. Therefore, if there is a material change during the year, the issuer should not only consider previous financial statements but also take into account events that will be presented in the next annual financial statements. The second sentence of paragraph 10 of IAS 34 "additional line items or notes shall be included if their omission would make the condensed interim financial statements misleading" seems to supports this assumption.

35. Therefore, this view leads to the conclusion that the information about impairment should be disclosed in the notes of the interim condensed financial reporting according to paragraphs 10 and 15B (b) of IAS 34. The description in the management report may add information to the disclosures in the notes, but should not replace them. In this view it is considered that "financial reporting" notion in IAS 34 comprise only financial statements but not the management report.

36. We acknowledge that the IFRS IC is currently working on further improvements to clarify the information that may be cross-referred from the interim financial statements and which might have an impact on the matter identified above.

c) Additional statements or columns in the primary statements

37. As part of the review of financial statements, we observed that some issuers provide additional information to the set of financial statements as described in paragraph 10 of IAS 1. For instance, "proforma" information is sometimes presented as an extra-column or as a separate statement reconciling information presented as pro-forma with the information presented in the financial statements. Illustrative examples identified by national enforcers are included below.

c.1) Additional statements or reconciliations

38. The issuer presented a reconciliation of the group's operating profit to the result attributable to owners on the same page as the income statement. The issuer indicated that the basis for such presentation is the fact that reconciliation is important for users in understanding how the business is managed.

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39. **View 1:** On the basis of the provisions of paragraphs 7 and 10 of IAS 1, the reconciliation should not be presented together with the primary statement as it leads to lack of clarity on the relevance of the different statements presented and un-clear/diffuse information regarding the different earnings statements of the issuer.

40. In this view, only the income statement prepared in accordance with IAS 1 can be presented as a primary statement. Since this reconciliation is not required by IAS 1 it cannot be presented together with primary statements. Reconciliations should either be included in the notes as non-GAAP information or in the management report, with sufficient disclosure to enable a proper understanding of the items included.

41. **View 2:** Although IAS 1 is written on the assumption that only the "primary statements" presented will be those defined in IAS 1, there is no prohibition in of additional statements or additional information being provided on the face of the primary statements.

42. Additionally, it could also be argued that if this reconciliation is not labelled as a "statement" and if it comes after the primary statements defined in IAS 1, even if presented on the same page, it could be viewed as a footnote and not as another statement.

<u>c.2) Additional columns</u>

43. We have observed that some issuers, instead of providing additional lines or notes, present extra columns in the primary statements and justify that approach by providing a better understanding of transactions and simplification of reconciliations. Such presentations often occur when presenting pro-forma information, but may also appear when an issuer wishes to isolate non-recurring items or re-measurements.

44. Issuers justify this practice by making analogies to paragraphs 85-86 of IAS 1 which allow entities to present additional lines, headings and subtotals if they are relevant to understanding financial performance.

45. Whereas, some argue that analogy is possible as the presentation by column provides information that is clearer when the impacts of unusual and infrequent transactions affect more than one line of items of the primary statements, others believe that including columns is not in compliance with IAS 1.

d) Materiality and aggregation

46. Based on our experience, we believe that the wording in IAS 1 (paragraphs 29-30 and 97-98 of IAS 1) allows different level of disclosures depending on whether issuers consider income and expenses as "classes of items" or "items". The application of those requirements may lead some issuers to disclose material **items** (as mandated by paragraph 29 of IAS 1), but not material **classes of similar items**. The example bellow illustrates this matter.

Materiality and aggregation in operating segment information

47. The issuer's internal management reporting is based upon four main operating segments. Management assesses the performance of operating segments based on revenue and earnings before interest and taxes (EBIT).

48. EBIT includes an allocation of various expenses (for instance overheads). The effects of non-recurring items such as impairment expenses are excluded from management's measurement basis. Interest income and expenses and tax are not allocated to the operating segments. Research and development expenses are included in EBIT. Research and development are presented as a separate line item on the face of the income statement, but they are not disclosed separately in the operating segment information.

49. According to paragraph 23(f) of IFRS 8 – *Operating Segments*, an entity shall disclose material items of income and expense disclosed in accordance with paragraph 97 of IAS 1 for each reportable segment if the specified amounts are included in the measure of segment profit or loss reviewed by the chief operating decision maker (CODM), or are otherwise regularly provided to the CODM even if not included in that measure of segment profit or loss.

50. One view is that, although these material items of income and expenses are presented to the CODM, they form a class of items and not an individually material item. Consequently, entities can avoid a separate disclosure in segment reporting, as paragraph 97 of IAS 1 explicitly refers to material **items** only, disclosure of research and development expenses per segment is not required according to paragraph 23(f) of IFRS 8.

51. The alternative view is that this information should be disclosed separately in the segment information as this information is regularly provided to the CODM and these classes are presented separately in the income statement.