

STAFF PAPER

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IASB Meeting

Project	Primary Financial Statements		
Paper topic	Proposed approach to research the project		
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Purpose of paper

1. This paper seeks your views on the staff’s proposed approach to research in the Primary Financial Statements project.

Structure of paper

2. This paper is structured as follows:
 - (a) background (paragraphs 3-6);
 - (b) staff analysis of the approach (paragraphs 7-22); and
 - (c) staff recommendations (paragraphs 23).

Background

3. In July 2014 the Board added the Primary Financial Statements project to its research agenda. As part of that project, the staff have conducted preliminary research on current financial reporting practice.¹
4. The Request for Views on the 2015 Agenda Consultation (‘the RFV’) explained that the Primary Financial Statements project will examine the purpose, structure and

¹ Paragraph 42 of [Agenda Paper 21](#) for the April 2016 Board meeting describes the work carried out to date.

content of the primary financial statements. Many respondents to the RFV consider that the Primary Financial Statements project to be a high-priority project.²

5. Regarding the focus of the project, many respondents to the RFV think that the Primary Financial Statements project should focus on performance reporting. However, there were mixed views about which aspects of performance reporting the Board should consider:
 - (a) Some respondents suggested that the Board should consider the structure and content of the statement(s) of financial performance (ie the statement of profit or loss and other comprehensive income); and
 - (b) Other respondents suggested that the Board should define a single measure of financial performance or undertake further work on the distinction between profit or loss and other comprehensive income (OCI) (including the use of recycling).

6. Some respondents also commented that the Primary Financial Statements project should consider other issues, for example, the structure and content of the statement of cash flows and implications of digital reporting for the primary financial statements.

Staff analysis

7. The staff consider that the responses to the RFV made it clear that the project should focus on the reporting of financial performance; however there were mixed views regarding which aspects of financial performance we should address. In addition, it was not clear whether respondents thought that the statement of cash flows, the statement of financial position, and the statement of changes in equity need changes, and to what extent. Accordingly, we think it is important to gather evidence for us to understand better the perceived problems with the primary financial statements before defining a detailed scope for the project.

8. In gathering evidence to define the scope of the project more precisely, we propose to:
 - (a) meet with stakeholders to understand their views on the areas of the primary financial statements that need improvement;

² [Agenda Paper 21](#) for the April 2016 Board meeting discusses the feedback from the RFV in more detail.

- (b) review financial statements to better understand existing practice; and
 - (c) review other relevant literature (including academic literature).
9. The staff note that the project on Financial Instruments with the Characteristics of Equity is considering how best to present changes in claims. Consequently, we do not, at this stage, propose to undertake research into possible changes to the statement of changes in equity. However, we will monitor developments on that project in case there are any implications for the Primary Financial Statements project.
10. The following sections discuss our proposed approach to research on:
- (a) reporting of financial performance (paragraphs 11-18);
 - (b) statement of financial position and statement of cash flows (paragraphs 19-21); and
 - (c) digital reporting (paragraph 22).

Reporting of financial performance

11. In the light of the feedback received on the RFV, we think that our research should initially focus on the reporting of financial performance. However, respondents to the request for views suggested different approaches to this work:
- (a) Some suggested that we should focus on the structure and content of the statement(s) of financial performance (see paragraphs 12-15);
 - (b) Others suggested we should define a single measure of performance, or describe the distinction between profit or loss and OCI more precisely than we may be able to achieve in our current work on the *Conceptual Framework* (see paragraphs 16-18).

Structure and content of the statement(s) of financial performance

12. Many respondents, particularly users of financial statements, requested that the Board undertake a project on the structure and content of the statement(s) of financial performance. In particular, these respondents requested that we explore how the statement(s) of financial performance could be improved to provide more useful information to users.

13. In addition, there is a growing concern about the increasing use of alternative performance measures (ie financial measures that are not defined or specified in Standards) or non-IFRS information when companies are communicating their performance to stakeholders. Some recently published research papers highlight the growing concerns in this area:
- (a) One equity research paper states that the authors have received many more questions from investors about ‘adjusted’ or ‘non-GAAP’ earnings than before, partly prompted by media articles highlighting the growing gap between adjusted and IFRS earnings.³
 - (b) Another research paper states that 95 per cent of FTSE 100 companies adjust their IFRS profit figures and that those adjustments almost always have a favourable impact on profit.⁴
 - (c) That other research paper also highlighted that the descriptions of reconciling items are often too broad to be understandable and that the adjustments made are often not comparable between companies.
 - (d) Another report states that restructuring costs labelled as exceptional can appear year after year for some companies.⁵ Many companies in their sample excluded restructuring charges from their measure of underlying earnings (or other adjusted profit measures), despite having restructuring charges in each of the last four years of financial reporting.
 - (e) Another report highlighted that, of investment professionals responding to a survey, only 22 per cent believed that the measures that move markets (including industry-specific, non-GAAP or adjusted numbers) are sufficiently reliable.⁶

³ Citi Research Equities, ‘Valid concerns over adjusted earnings metrics, Mind The Gap: Non-GAAP earnings, why this matters’ (April, 2016)

⁴ PwC, ‘An alternative picture of performance’ (January, 2016)

⁵ S&P, ‘Why Inconsistent Reporting Of Exceptional Items Can Cloud Underlying Profitability At Nonfinancial FTSE 100 Companies’ (February, 2014)

⁶ PwC, ‘Corporate performance: What do investors want to know? Reporting adjusted performance measures’ (July, 2014)

14. Hence, as an initial step, we propose to undertake research into possible improvements to the structure and content of the statement(s) of financial performance, including research into the use of alternative performance measures. Respondents to the RFV made various suggestions in relation to the structure and content of statement(s) of financial performance and we would like to consider them. These suggestions include:

- (a) standardising the structure of the statement(s) of financial performance;
- (b) standardising some subtotals in the statement(s) of financial performance (for example, operating profit);
- (c) considering disaggregation of line items;
- (d) considering whether to remove options that allow some items to be included in either operating expense or financing expense; and
- (e) analysing the use of alternative performance measures and non-IFRS information.

15. We note that the Principles of Disclosure Discussion Paper will discuss the use of alternative performance measures. Feedback from that Discussion Paper will contribute to our research in this area.

Defining a single measure of performance or describing the distinction between profit or loss and OCI more precisely

16. Many respondents to the RFV requested that we undertake a project to define a single measure of financial performance or work on the distinction between profit or loss and OCI (including the use of recycling).

17. The staff do not recommend carrying out such work at this stage because:

- (a) over the years the IASB has made various proposals for how the financial performance of an entity could be portrayed. However, those proposals have not received wide support.
- (b) the Board has consistently expressed the view that financial performance is a multi-faceted notion and that a one-cut distinction between types of income and expenses is not meaningful or helpful. We think that our

proposed focus on the structure and content of statement(s) of financial performance (rather than on defining a single performance measure) would be consistent with this view.

- (c) In the Conceptual Framework project, the Board attempted to develop detailed guidance on the use of OCI and recycling but has only managed to develop high-level guidance in this area. The staff believe that it is unlikely that further research in this area will be successful. In addition, we believe that making improvements to the structure and content of the statement(s) of financial performance so that they provide better information about an entity's performance may reduce the need to report income and expense in OCI.

- 18. Hence, the staff do not recommend carrying out work on defining more precisely a single measure of performance or on the distinction between profit or loss and OCI at this stage. However, we may revisit this topic if research on other areas suggests possible approaches (including possible approaches that could address the known problems with OCI).

Statement of financial position and statement of cash flows

- 19. We believe that our research work on the statement of financial position and the statement of cash flows should focus on identifying whether there are problems with the current structure and content of these statements. In particular, we think that research into the interactions between items reported in the statement(s) of financial performance and the statement of cash flows could highlight possible improvements to the statement of cash flows.
- 20. The UK Financial Reporting Council (FRC) is carrying out research to develop proposals for the improvement of the statement of cash flows. The Board discussed some proposals in October 2014 and in December 2014.⁷ The staff of the FRC are currently reviewing this work with the aim of publishing a Discussion Paper. That paper will set out the view of the FRC's staff, rather than tentative views of the FRC itself or of the IASB. The Discussion Paper is intended to suggest improvements to

⁷ Refer to [Agenda Paper 11A\(c\)](#) from October 2014 and [Agenda Paper 11B](#), from December 2014.

the statement of cash flows that might be considered in the Primary Financial Statements project. We think that feedback from the Discussion Paper will help establish whether there is demand for changes to the statement of cash flows.

21. We are aware of fewer concerns about the structure and content of the statement of financial position but we believe it would be useful to undertake some research aimed at identifying whether there are any problems in practice with this statement.

Digital reporting

22. Some respondents suggested that the Board should consider the interaction between digital reporting and the Primary Financial Statements project. We think that the use of digital reporting is likely to have implications for the structure and content of the primary financial statements. Consequently, we believe that we should undertake research to establish those implications.

Staff recommendations

23. The staff believe that further research work is needed before it is possible to describe in detail the scope of the Primary Financial Statements project. However, the staff recommend that:
 - (a) initial research work should focus on the reporting of financial performance. In particular, we think that the research should focus on the structure and content of the statement(s) of financial performance, including whether there should be a requirement to include a defined sub-total for operating profit and the use of alternative performance measures;
 - (b) we do not undertake research into defining a single measure of performance or describing the distinction between profit or loss and other comprehensive income (OCI). (However, we may revisit this recommendation if research on other areas suggests possible approaches);
 - (c) we undertake research to establish whether there is any demand for changes to the statement of cash flows and the statement of financial position. This

research would include any feedback on the proposed discussion paper on the Statement of Cash Flows being prepared by the staff of the UK FRC;

- (d) we do not, at this stage, undertake research into possible changes to the statements of changes in equity as part of this project; and
- (e) we undertake research to determine the implications of digital reporting for the structure and content of primary financial statements.

Question for the Board

Does the Board agree with the proposed approach as set out in paragraph 23?