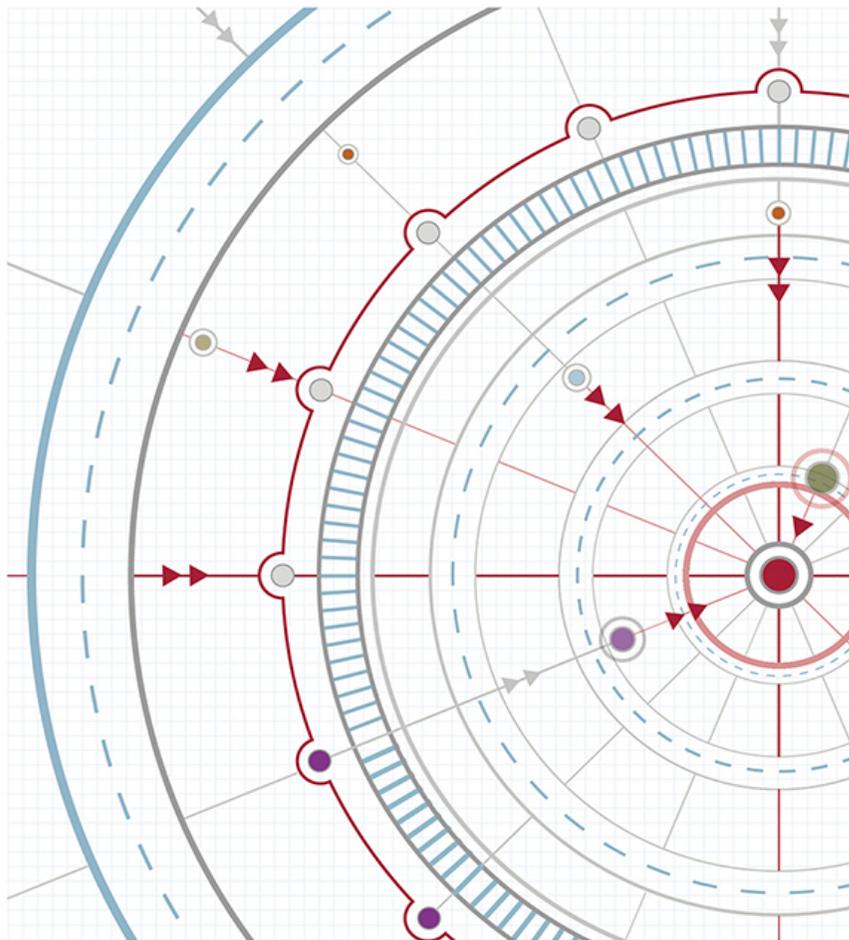


CMAC meeting, 3 November 2016
Agenda paper 4

Primary Financial Statements

Possible approaches



- To help define the scope of the Primary Financial Statements project
- In this session we would like to get your views on possible approaches including:
 - introducing new subtotals
 - introducing alternative EPS
 - introducing illustrative examples of primary financial statements

Primary Financial Statements

Statement of financial performance



✓ Consider structure and content including line items, subtotals and alternative performance measures

Statement of cash flows



✓ Explore whether there is a strong need for improvements to structure and content

Statement of financial position

Statement of changes in equity



✗ Consider as part of Financial Instruments with Characteristics of Equity project

Structure – what we hear

Comparability

VS

Flexibility

Lack of comparability negatively affects usefulness of IFRS financial information

Because of the lack of comparability, users prefer financial statements 'standardised' by data aggregators

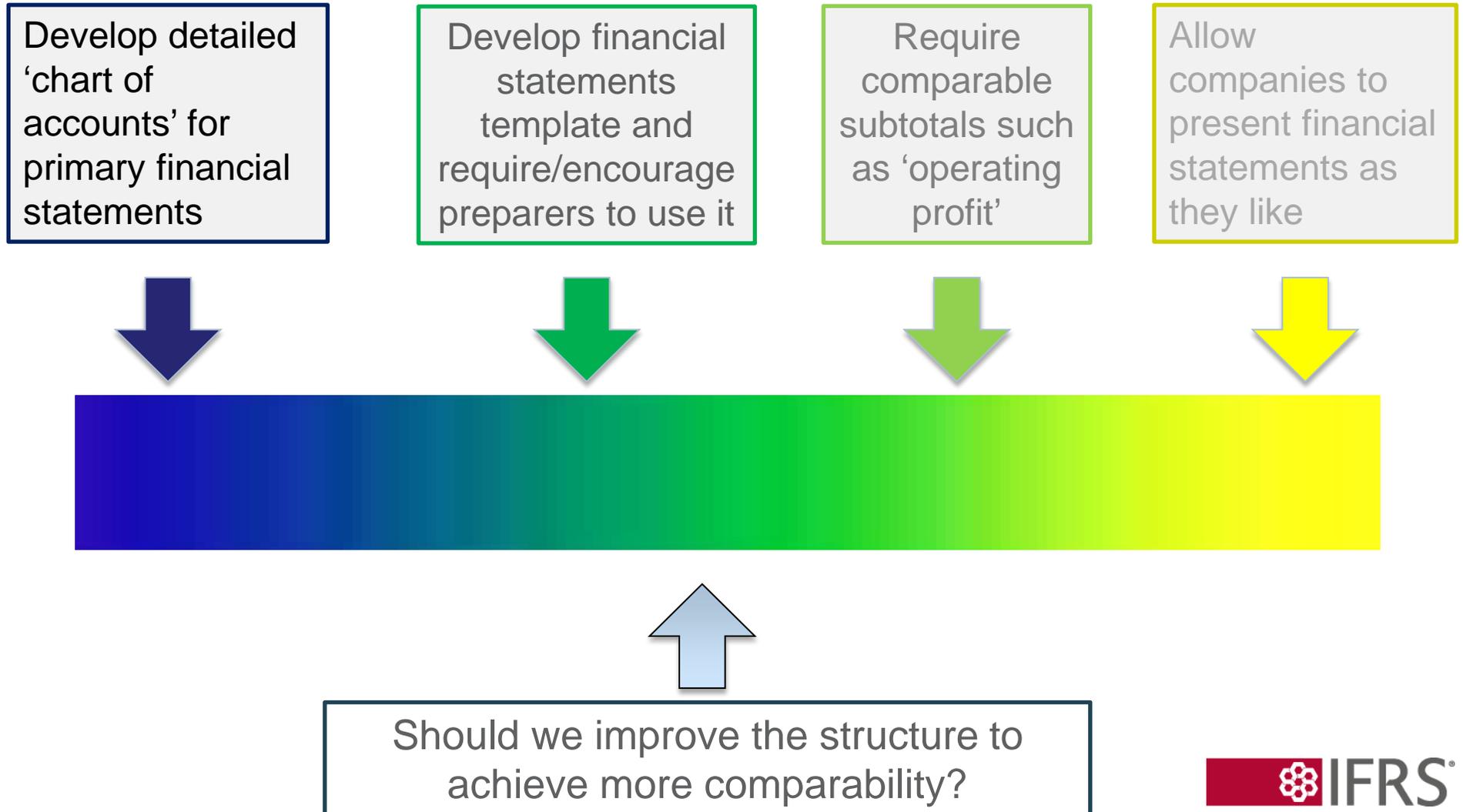
Recognition and measurement should be principle based but presentation should be more structured

Flexibility allows preparers to tell their own story

As long as necessary information is available in the notes, primary financial statements can be concise

IFRS Standards should keep their principle-based nature

Structure – what could be done?



Alternative Performance Measures (APMs) – what we hear

Increasing use of APMs indicates that financial statements are losing their relevance

Alternative performance measures are misleading investors

By presenting more performance measures in financial statements, transparency, comparability and discipline will be enhanced and measures will be audited

The IASB should develop mechanism to allow preparers to present more performance measures in financial statements

APMs – problems

- Some companies communicate performance mainly through APMs.

	Annual report		Outside of annual report	
	Income statement	MD&A	Press release	Presentation for investors
Revenue	IFRS	IFRS	IFRS	
Revenue increase excluding currency effect		APM	APM	APM
Operating profit	Own definition	Own definition	Own definition	Limited use
Adjusted operating profit (excluding non-recurring items etc)		APM	APM	Limited use
Adjusted operating profit increase excluding currency effect			APM	APM
Adjusted operating margin (Adjusted operating profit / Revenue)		APM		APM
Adjusted operating margin increase excluding currency effect		APM	APM	APM
Net income	IFRS	IFRS	IFRS	Limited use
Adjusted net income		APM	APM	
Comprehensive income	IFRS			
Basic EPS	IFRS	IFRS	IFRS	Limited use
Diluted EPS	IFRS			
Adjusted EPS		APM	APM	Limited use
Adjusted EPS increase excluding currency effect		APM	APM	APM

APMs – what could be done?

- IFRS financial statements could present more performance measures

Operating profit could be standardised

Recurring operating profit could be presented in F/S with transparency of adjustments

Adjusted EPS could be presented in F/S with clear reconciliation

	Performance measures
Operating profit	Own definition
Adjusted operating profit (excluding non-recurring items)	APM
Adjusted EPS (excluding non-recurring items)	APM

IASB could provide guidance on use of APMs*

Possible approaches

1. Require 'EBIT' subtotal

Concerns raised	Possible solutions
<ul style="list-style-type: none">• Users need comparable subtotals as a starting point for their analysis• Many companies present EBIT-type subtotal but it varies and is not comparable	<ul style="list-style-type: none">• Require presentation of comparable EBIT-type subtotal
<ul style="list-style-type: none">• Presentation of financing income and expense varies, even among peers (eg interest cost of pension)	<ul style="list-style-type: none">• Provide principles-based definition of 'financing' activities• Prescribe treatment for some items (eg interest cost of pension)

<i>Example</i>
<p>Revenue All income and expenses excluding finance income/expense and tax</p> <p>EBIT <i>Finance income</i> <i>Finance expense</i></p> <p>Pre-tax profit Taxation</p> <p>Profit</p>
OCI items Comprehensive income

2. Require 'operating profit' subtotal

Concerns raised	Possible solutions
<ul style="list-style-type: none">Many companies present operating profit subtotal but it is not comparable	<ul style="list-style-type: none">Require presentation of operating profit subtotal
<ul style="list-style-type: none">Distinction between operating and non-operating income/expense varies, even among peers (eg result of associate)	<ul style="list-style-type: none">Provide principles-based definition of operating income and expensePrescribe treatment for some items (eg result of associates)

Example
<p>Revenue All income and expenses excluding non-operating income/expense, finance income/expense and tax</p> <p>Operating profit Non-operating income and expense</p> <p>EBIT Finance income Finance expense</p> <p>Pre-tax profit Taxation</p> <p>Profit</p>
<p>OCI items Comprehensive income</p>

3. Require 'recurring operating profit' subtotal

Concerns raised	Possible solutions
<ul style="list-style-type: none"> Users need information about persistency of income and expenses to develop forecast 	<ul style="list-style-type: none"> Require presentation of recurring operating profit subtotal
<ul style="list-style-type: none"> Items classified as non-recurring vary and are not transparent Adjustments may not be consistent period to period Some non-recurring items occur regularly 	<ul style="list-style-type: none"> Require detailed disaggregation of components Require disclosure of 5 or 10 year historical record of adjustments Require explanation of adjustments

<i>Example</i>
<p>Revenue</p> <p>...</p> <p>...</p> <p>Recurring operating profit</p> <p>Non-recurring operating income and expense</p> <p>Operating profit</p> <p>Non-operating income and expense</p> <p>EBIT</p> <p>Finance income</p> <p>Finance expense</p> <p>Pre-tax profit</p> <p>Taxation</p> <p>Profit</p>
<p>OCI items</p> <p>Comprehensive income</p>

4. Introduce alternative ‘earnings per share’

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Concerns raised	Possible solutions
<ul style="list-style-type: none">Alternative earnings per share are widely used for communication with users of financial statements	<ul style="list-style-type: none">Allow presentation of alternative earnings per share (eg recurring earnings per share)
<ul style="list-style-type: none">Calculation of these figures are often not transparent	<ul style="list-style-type: none">Require disclosure of the calculation (including a 5 year historical record of the items excluded) and the reason for presenting it

Example	
	<i>Per share</i>
<i>Recurring earnings*</i>	X
Earnings (profit)	X

** ‘Recurring earnings’ represent profit before post-tax non-recurring operating income and expense in slide 12*

5. Provide illustrative examples for the primary financial statements

Concerns raised	Possible solutions	Example (non-financial)
<ul style="list-style-type: none"> Financial statements are not comparable even among peer companies 	<ul style="list-style-type: none"> Provide illustrative examples of structure and format for different industries (eg, non-financial, bank, insurance and property) 	<p>Revenue <i>Cost of goods sold</i></p> <p>Gross profit <i>Selling costs</i> <i>General and administrative costs</i> <i>R&D costs</i></p> <p>Recurring operating profit <i>Non recurring operating income and expense</i></p> <p>Operating profit <i>Non operating income and expense</i></p> <p>EBIT <i>Finance income</i> <i>Finance expense</i></p> <p>Pre tax profit <i>Taxation</i></p> <p>Profit <i>Specified long term revaluations</i></p> <p>Profit after specified long term revaluations</p>
<ul style="list-style-type: none"> In many jurisdictions, entities create entity-specific taxonomy items which hinder comparability and reduces usefulness of the taxonomy 	<ul style="list-style-type: none"> Define core elements of financial statements and core taxonomy 	<p><i>Income and expense to be recognised in profit or loss in the future</i></p> <p>Comprehensive income</p>

5. Provide illustrative examples for the primary financial statements (continued)

Example (bank)

Example (property)

Interest income
Interest expense
Net interest income
Fee and commission income
Fee and commission expense
Net fee and commission income
Net income from instruments held for trading
Net income from other instruments at FVTPL
Operating expenses
Recurring operating profit
Non-recurring operating income and expense
Operating profit
Non-operating income and expense (including results of associates)
(EBIT)*
(Finance income)
(Finance expense)
Pre-tax profit
Taxation
Profit
Specified long term revaluations
Profit after specified long term revaluations
OCI items that will be reclassified
Comprehensive income

Rental income
Service charge income
Service charge expense
Net rental income
Sales of inventory property
Cost of sales of inventory property
Profit on sale of inventory property
Profit on disposal of investment property
Valuation gain from investment property
Net gains on investment property
Administrative expense
Recurring operating profit
Non-recurring operating income and expense
Operating profit
Non-operating income and expense (eg results of associates)
EBIT
Finance income
Finance expense
Pre-tax profit
Taxation
Profit
Specified long term revaluations
Profit after specified long term revaluations
OCI items that will be reclassified
Comprehensive income

* For banks, most interest income and expense are operating and hence above EBIT. However interest paid on liabilities classified as capital for regulatory purposes (ie Tier 2 liabilities) could be regarded as financing and hence EBIT would be before these items.

Question 1

Do you think we should explore*:

1. Requiring 'EBIT' subtotal
2. Requiring 'operating profit' subtotal
3. Requiring 'recurring operating profit' subtotal
4. Introducing alternative 'earnings per share'
5. Providing illustrative examples for the primary financial statements

* These approaches are not mutually exclusive

Question 2

If you think we should explore introducing recurring operating profit subtotal, what, do you think, is the best way to explore?

- a) providing principle based guidance and allow management to classify recurring/non-recurring. In addition, requiring transparency through disaggregation of items and disclosure of history of adjustments.
- b) detailed rules for classification of recurring/non-recurring items
- c) Other

Question 3

Are there any other changes to the structure and content of the primary financial statements that we should explore as part of this project?

- statement of financial performance
- statement of cash flows
- statement of financial position

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