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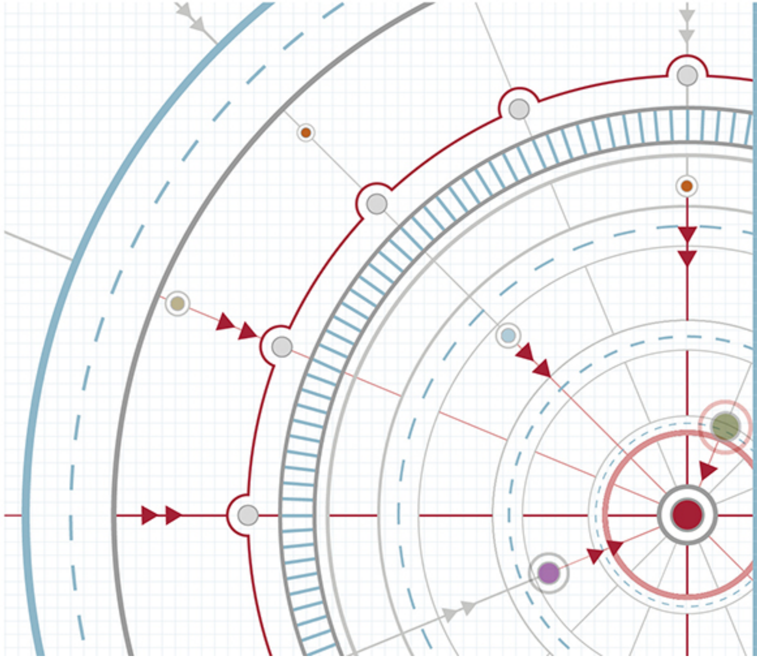

Principle-based Reporting and Technology

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The views expressed in this presentation are those of the presenter, not necessarily those of the International Accounting Standards Board (the Board) or IFRS Foundation.

Agenda

- Introduction
- Specific concerns–Primary Financial Statements
- Break-out discussion

Introduction

What do we mean by principle-based?

IFRS Standards are based around principles – not rules. Some examples related to the presentation within the primary financial statements are:

- IAS 1 paragraph 30 "... If a line item is not individually material, it is aggregated with other items either in those statements or in the notes ..."
- IAS 1 paragraph 82 requires presenting specific line items on the statement of profit or loss but the list is very limited.
- IAS 1 paragraph 85 "An entity shall present additional line items (including by disaggregating the line items listed in paragraph 82), 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."

Interaction with electronic reporting?

- We hear from some stakeholders that they see a conflict between principle-based standard-setting and structured electronic reporting (see slides 6–7).
- Others have expressed the view that useful electronic reporting requires some level of standardisation, especially for the primary financial statements.

Responses to consultations

- A theme we see in responses to IFRS Taxonomy-related consultations is a worry that the Taxonomy could negatively affect the principle-based nature of the IFRS Standards. For example concerns of this nature were raised by:
  - Many respondents to the Invitation to comment *IFRS Taxonomy Due Process*
  - Some of those responding to questions on the IFRS Taxonomy in the *Trustees' Review of Structure and Effectiveness*

Example comments

Singapore Accounting Standards Council (ASC):
"We are particularly concerned that the prescriptive nature of [the] IFRS Taxonomy would not align well with the principle-based IFRS …"

Deutsches Rechnungslegungs Standards Committee e.V. (DRSC):
"… we are concerned that mandatorily bearing taxonomy constraints and limitations in mind when developing standards bears the risk of the standards themselves becoming more rules- and less principles-based …"

Rådet för finansiell rapportering [The Swedish Financial Reporting Board]:
"We fear that bringing XBRL into standard setting will be detrimental to the principle based approach, particularly as regards the presentation of disclosures."

Emphasis added during slide formatting

Some views from users—CMAC

Structured electronic reporting was discussed at the February 2016 CMAC meeting. Views expressed included:

- Electronic reporting facilitates user-driven data standardisation, provided a computer-readable and complete disaggregation of disclosures exist.
- A result of electronic reporting is that entity-specific detail may become more accessible.
- Electronic reporting can lack the full context and information provided in a traditional annual report, which some believe may be misleading.

Example areas for discussion

Judgement

Principle-based definition of the the nature of items such as recurring items

Better technology handling of entity-specific content

Taxonomy design to represent more of the data, eg more use of dimensional modeling

Standard-setting

Financial statements illustrative examples

Technology

Disclosure of comparable subtotals, such as operating profit and EBIT

Consistency

Taxonomy design – more focus on core requirements

And any other suggestions!

Specific concerns– Primary Financial Statements

1. Require subtotals such as ‘operating profit’ and/or ‘EBIT’

Example

Revenue
All income and expenses excluding non-operating income/expense, finance income/expense and tax
Operating profit*
Non-operating income and expense
EBIT*
Finance income
Finance expense
Pre-tax profit
Taxation
Profit

*some guidance could be provided to improve comparability of these subtotals among peers, for example, by determining how particular items need to be classified; some judgement is still permitted

	Standard-setting/ paper reporting	Structured electronic reporting
Benefits	• Improved (although not perfect) comparability.	?
Challenges	• Difficult to directly define the nature of operating items. • One approach may be to provide a principle-based definition of ‘financing and non-operating items’ in order to arrive at an operating profit (ie it is a residual concept).	?

2. Allow companies to present ‘recurring operating profit’

Example

Revenue

…

Recurring operating profit*

Non-recurring operating income and expense

Operating profit

Non-operating income and expense

EBIT

Finance income

Finance expense

Pre-tax profit

Taxation

Profit

*recurring operating profit may reflect ‘management’s view’; supplemented by detailed disaggregation of non-recurring items. In many cases companies present the information outside of financial statements currently.

	Standard-setting/ paper reporting	Structured electronic reporting
Benefits	• Information about the persistency of earnings may help a user to better predict future cash flows. • More discipline: greater consistency in presentation and audited data. • More transparency: leading to an improved understanding.	?
Challenges	• Very difficult to define ‘recurring’ . • One approach may be to provide a principle-based definition of ‘recurring’, allow some management judgement and require a detailed disaggregation of non-recurring items.	?

3. Develop examples and encourage preparers to use

*Example (non-financial)**

Revenue
Cost of goods sold
Gross profit
Selling costs
General and administrative costs
R&D costs
Recurring operating profit
Non-recurring operating income and expense
Operating profit
Non-operating income and expense
EBIT
Finance income
Finance expense
Pre-tax profit
Taxation
Profit

*Some guidance for subtotals, but no rigid definitions for each item
*Some variations for industries (eg bank)

	Standard-setting/paper reporting	Structured electronic reporting
Benefits	• More consistency in presentation, which may contribute to an improved understanding.	?
Challenges	• May need to be an 'example', rather than a 'required' template, to allow judgement. • Need to consider adding principle-based criteria in order to aggregate immaterial items.	?

Break-out discussion

IFRS

Aims

- Our aim today is to discuss this perceived conflict and how it may be addressed, specifically:
  - identify what may be causing concerns about electronic reporting;
  - identify what may be causing concerns about the IFRS Taxonomy;
  - consider how the principle-based nature of the IFRS Standards relates to this perceived conflict;
  - look at how we may address the concerns – do the answers sit within the IFRS Standards, the technology or somewhere in between?
  - to identify whether technology (including structured electronic reporting) has specific implications that the Board needs to consider within the Primary Financial Statements project.

General questions

1. Why is there concern about a conflict between principle-based standards and electronic reporting? What do you see as the reasons for these concerns and do you agree with them?
2. What can we do to address these concerns?
   a. Are there changes we could make to the IFRS Taxonomy?
   b. What could the Board do when setting IFRS Standards to facilitate electronic reporting?

Question—Primary Financial Statements

3. Appendix 1 illustrates some of the concerns with the current structure of profit or loss that we are trying to address as part of the Primary Financial Statements project. Slides 11-13 illustrate some of the possible approaches being considered as part of that project:
   - What do you see as the benefits and challenges for electronic reporting of the suggested approaches?
   - Is there anything else we should consider?

Note: We are not asking today for your views on what is the best approach to take within the Primary Financial Statements project. We are also not seeking comments on the specifics of the templates or the actual definitions of subtotals.

Break-out group members

A

Board Room

B

Victoria Room (downstairs – GFW)

C

Cannon Room (downstairs – GFE)

Report back

- There will be 5–10 minutes for a representative from each break-out group to report back.
- Followed by ITCG discussion of conclusions and recommendations.

Appendix 1

Identified problems with the structure of the profit and loss account

Current requirements in IAS 1

- Paragraph 82 only requires the presentation of the following items:

Statement of financial performance
Revenue
Impairment losses
Finance costs
Gains/losses from derecognition of financial assets
Gains/losses from reclassification of financial assets
Share of result of associates
Tax expense
Gains/losses from discontinued operations
Profit or loss

- Additional line items are required when relevant to an understanding of an entity’s performance, paragraph 85 (eg profit before tax)

Inconsistent structure

- We observe inconsistencies in structure even within the same industry:

Company A	Company B	Company C	Company D
Revenue	Revenue	Revenue	Revenue
Cost of goods sold	Cost of goods sold	Operating expenses	
Distribution cost	Selling cost (including marketing costs)		
Marketing and administrative costs	General and administrative cost		
R&D cost	R&D cost		
Other cost	Other cost		
Adjusted operating profit	Adjusted operating profit	Adjusted operating profit	
Non-recurring items	Non-recurring items	Non-recurring items	
Operating profit	Operating profit	Operating profit	Operating profit

Classification and disaggregation of items vary among peer companies

Lack of comparable subtotals

- Even ‘Operating profit’ subtotal is not comparable:

Company E	Company F	Company G	Company H
Revenue	Revenue	Revenue	Revenue
Operating expenses	Operating expenses	Operating expenses	Operating expenses
Interest cost of pension			Interest cost of pension
	Share of result of associates		
Operating profit	**Operating profit**	**Operating profit**	**Operating profit**
Financial income/ expense	Financial income/ expense	Financial income/ expense	Financial income/ expense
	Interest cost of pension		
Share of result of associates		Share of result of associates	
Tax	Tax	Tax	Tax
			Share of result of associates
Profit	Profit	Profit	Profit

Entities create their own structure and content ‘to tell their story’

Performance measures are confusing

- Even among companies in the same industry, 'adjusted operating profit' is not consistent, comparable, or transparent:

Adjustments made to operating profit	Peer companies in the same industry			
	Company I	Company J	Company K	Company L
Acquisition related cost	Yes	Yes	Yes	Not clear
Amortisation of intangibles	Not clear	No	Not clear	Yes
Restructuring	No	Not clear	Yes	Not clear
Impairment of PPE	No	Yes	Not clear	Not clear
Impairment of intangible	No	Yes	Not clear	Not clear
Impairment of goodwill	Yes	Yes	Yes	Not clear
Disposal of PPE	No	Not clear	Not clear	Yes
Disposal of business	Yes	Yes	Yes	Not clear
Litigation cost	No	Not clear	Yes	Not clear

Yes	The company adjusts the item when calculating the adjusted operating profit.
No	The company does not adjust the item when calculating the adjusted operating profit.
Not clear	The company's policy was not clear on the footnote disclosure.

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