STAFF PAPER

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Accounting Standards Advisory Forum

Project	Primary Financial Statements		
Paper topic	ASAF Cover Paper		
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Objective of this meeting

1. The objective of this meeting is to continue our discussion from the July 2017 ASAF meeting about the staff proposals to introduce additional subtotals into the statement(s) of financial performance and also the staff proposals for better communication of other comprehensive income (OCI). At this meeting we will:
   (a) provide an update on the staff proposals, which now include introducing an 'investing' category and two subtotals—'profit before investing, financing and income tax' and EBIT (or 'profit before financing and income tax')—into the statement(s) of financial performance; and
   (b) ask ASAF members for feedback on the staff proposals.
2. This cover paper is accompanied by the three staff papers for the November 2017 Board meeting which describe the current staff proposals. **The Board's tentative decisions on these papers are included in Appendix C.**

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Other information

3. At the July 2017 ASAF meeting[1] the staff presented their proposals for both an EBIT and a management performance measure (MPM) subtotal. Since that meeting, the Board has tentatively decided to prioritise introducing into the statement(s) of financial performance subtotals that facilitate comparisons between entities, such as EBIT, over introducing a MPM subtotal. Nevertheless, once the Board has completed its initial discussions about these comparable subtotals, the staff plan to bring back revised proposals for the MPM subtotal to a future Board meeting.

4. At the September 2017 ASAF meeting we asked for ASAF members' views on the implications of the feedback on the UK Financial Reporting Council Discussion Paper *Improving the Statement of Cash Flows* on the Primary Financial Statements project. We are currently developing our proposals for the statement of cash flows and expect to bring these to the Board in the coming months.

List of Board papers included with this cover paper

5. The Board papers for discussion at this meeting are:

   (a) **Agenda Paper 21A** sets out the staff's proposals for introducing an investing category into the statement(s) of financial performance.

   (b) **Agenda Paper 21B** sets out the staff's proposals for defining finance income/expenses (the 'I' in EBIT).

   (c) **Agenda Paper 21C** sets out the staff's proposals for improving the presentation of OCI.

[1] The papers for this meeting

Questions for ASAF members

Agenda Paper 21A
Do you have any comments or questions on Agenda Paper 21A? In particular: 1. Do you agree with the staff proposal to introduce an ‘investing’ category into the statement(s) of financial performance called ‘income/expenses from investments’? 2. Do you support the staff’s proposed approach to defining ‘income/expenses from investments’? 3. Do you support the staff’s proposed approach to require the presentation of the share of profit or loss of associates and joint ventures in ‘income/expenses from investments’? 4. What do you think we should call the subtotal before ‘income/expenses from investments’ —ie ‘profit before investing, financing and income tax’? Would you support this subtotal being described as ‘operating profit’?

Agenda Paper 21B
Do you have any comments or questions on Agenda Paper 21B? In particular: 1. Do you support the staff proposal to clarify ‘financing activities’? 2. Do you agree with the staff’s proposed approach to present ‘interest’ on defined benefit and decommissioning liabilities as ‘other finance expenses’ below EBIT? 3. Do you agree cash and cash equivalents should be used as a proxy for cash and temporary investments of excess cash?

Agenda Paper 21C
Do you have any comments or questions on Agenda Paper 21C? In particular: 1. Do you support the staff proposal to rename the two categories in the OCI section of the statement(s) of financial performance? 2. Do you agree with the staff’s proposed approach to introduce a new subtotal between the two categories called ‘income after remeasurements reported outside profit or loss’?

Appendix A—Summary of the ASAF meeting on Primary Financial Statements (July 2017)

A1. The purpose of this session was to seek ASAF members' views on staff proposals for addressing the competing needs for comparability and flexibility in reporting financial performance. The package of staff proposals consisted of proposals for the presentation in the statement(s) of financial performance of:

(a) earnings before finance income/expenses and tax (EBIT);

(b) a management performance measure and adjusted earnings per share; and

(c) the share of profit or loss of associates and joint ventures.

A2. The staff provided a summary of the June 2017 Board discussions on these proposals.

Earnings before finance income/expenses and tax (EBIT)

A3. Many ASAF members supported the presentation of an EBIT subtotal in the statement(s) of financial performance, but some acknowledged that defining EBIT would be a challenging undertaking for the Board.

A4. Some members challenged the proposed definition for EBIT, raising specific operational issues:

(a) the FASB representative queried whether:

(i) right-of-use assets under a lease contract and derivatives in an asset position—including those not qualifying for hedge accounting but used as an economic hedge—would meet the definition of 'assets arising from financing activities';

(ii) some interest would be excluded from EBIT—for example on zero coupon bonds; and

(iii) EBIT would exclude capitalised interest—for example, interest capitalised in inventories and included in profit or loss as part of the cost of goods sold.

(b) the SAFRC representative:

(i) asked whether all income and expenses representing time value of money—eg interest on a significant financing component under IFRS 15 Revenue from Contracts with Customers—would be excluded from EBIT;

(ii) said the current diversity in practice in the presentation of foreign exchange differences and fair value gains and losses on derivatives should be addressed; and

(iii) queried whether it is appropriate to require a different presentation for income and expenses on interest-bearing investments than for income and expenses on non-interest bearing investments.

A5. Other ASAF members expressed more general concerns about defining and requiring an EBIT subtotal:

(a) the DRSC representative argued that, because users are likely to continue adjusting any subtotal the Board defines and because no consensus exists around the definition of EBIT, the Board should focus on improving disaggregation, rather than on defining EBIT. A Board member said that, nevertheless, many users support introducing a comparable EBIT subtotal as a starting point for their analysis.

(b) the GLASS representative expressed the view that the Board should not encourage users to use EBIT as a starting point for discounted cash flows (DCF) analysis, because EBIT is not a good proxy for free cash flows. However, a Board member said that EBIT is a common and legitimate starting point for DCF analysis. He added that users adjust EBIT in their model to correct for any cash-accruals differences.

(c) the ASBJ and GLASS representatives said presenting an EBIT subtotal is inappropriate in some industries, such as financial services. The ASBJ and AOSSG representatives said the presentation of an EBIT subtotal should be optional, rather than mandatory.

A6. The FASB representative encouraged the Board to consider different terminology going forward. The FASB representative said the label 'earnings before interest and tax' is inappropriate, because the staff proposes to exclude more than just interest (eg foreign exchange differences) and to exclude only income taxes (eg not revenue-based taxes) from the subtotal.

A7. In written comments submitted before the meeting, the CASC requested that the Board consider another term for 'capital structure', as it is already widely used in some jurisdictions with different meanings, so using that term might lead to confusion.

A8. The EFRAG representative suggested the staff should investigate how entities define capital structure in practice by reviewing the disclosures required by IAS 1 paragraphs 134–136.

A9. Other suggestions included:

(a) some ASAF members said the Board should introduce an investing category and/or have three parts to the statement(s) of financial performance (operating, investing, and financing); and

(b) the AOSSG and ASBJ representatives supported the Board considering a broadly-defined operating profit subtotal.

Management performance measures and adjusted earnings per share

A10. ASAF members had some concerns about the staff proposals for introducing a management performance measure in the statement(s) of financial performance. Few comments were made about the staff proposals for an adjusted earnings per share in the statement(s) of financial performance.

A11. Some ASAF members had concerns about allowing too much flexibility in presenting the management performance measure and said there was a need to develop strict guidance about the measure. However, other ASAF members cautioned that the management performance measure might not represent management's view of performance if it is subject to restrictions—for example if some items, such as the share of profit or loss of associates and joint ventures, are required to be presented below EBIT. The AASB/NZASB representative said that the existing guidance in IAS 1, combined with the suggested principles in the Principles of Disclosure Discussion Paper might be sufficient to ensure fair presentation of such measures. The AcSB representative encouraged the

Board to engage with securities regulators about the management performance measure, given the regulatory guidance on non-GAAP measures.

A12. The AASB/NZASB representative encouraged the Board to focus on the predictive value of income and expenses, rather than considering a distinction between frequent and infrequent items.

Share of the profit or loss of associates and joint ventures

A13. The AcSB and ASBJ representatives expressed support for a single location for the presentation of the share of profit or loss of all associates and all joint ventures. In contrast, most other ASAF members expressed support for the Board considering whether the location should depend on whether the associate or joint venture is integral to the entity's operations. The AASB/NZASB representative cautioned that—for determining the presentation of associates and joint ventures, but also more generally—the Board should not confuse comparability with uniformity, ie it should not 'make unlike things look alike', referring to paragraph QC23 of the Conceptual Framework for Financial Reporting (Conceptual Framework).

A14. The AOSSG and SAFRC expressed the view that the presentation of the share of profit or loss of associates and joint ventures should be treated similarly to the presentation of the fair value changes in other investments the entity has no control over.

Appendix B—Summary of the Board's tentative decisions to date (September 2017 meetings and earlier)

December 2016 Board meeting

Agenda Paper 21: Scope of the project—cover note

The Board tentatively decided to focus on targeted improvements to the statement(s) of financial performance and to the statement of cash flows. All 11 Board members agreed with this decision.

The Board will decide at a later stage of the project whether it will issue a Discussion Paper or an Exposure Draft as the first due process output of the project. All 11 Board members agreed with this decision.

Agenda Paper 21A: Scope of the project—statement(s) of financial performance

Board members tentatively decided, by consensus, to explore the following topics:

a. requiring additional subtotal(s) in the statement(s) of financial performance—earnings before interest and tax (EBIT) and/or operating profit;
b. removing some of the options for presentation of income and expenses in existing IFRS Standards (eg presentation of net interest cost on the net defined benefit liability);
c. providing guidance on the use of performance measures, including separate presentation of non-recurring, unusual or infrequently occurring items; and
d. better ways to communicate information about other comprehensive income (OCI).

Agenda Paper 21B: Scope of the project—other primary financial statements and segment reporting

The Board tentatively decided to explore the following topics:

a. elimination of options for the classification of the cash effects of interest and dividends in the statement of cash flows. All 11 Board members agreed with this decision.
b. alignment of the operating section across the statement of cash flows and the statement(s) of financial performance. All 11 Board members agreed with this decision.
c. requiring a consistent starting point for the indirect reconciliation of cash flows. All 11 Board members agreed with this decision.
d. development of templates for the statement(s) of financial performance, the statement of cash flows and the statement of financial position for a small number of industries. Eight of 11 Board members agreed and three members disagreed with this decision.
e. development of a principle for aggregating and disaggregating items in the primary financial statements. All 11 Board members agreed with this decision.

The Board tentatively decided not to consider targeted improvements to the statement of financial position unless work on other areas of the primary financial statements identifies possible improvements to that statement. All 11 Board members agreed with this decision.

Additionally, the Board tentatively decided that segment reporting or the presentation of discontinued operations should not be part of the scope of the project. All 11 Board members agreed with this decision.

March 2017 Board meeting

Earnings before interest and tax **(Agenda Paper 21A)**

The Board agreed (by consensus) that the staff should continue to explore:

a. requiring the presentation of an earnings before interest and tax (EBIT) subtotal in the statement(s) of financial performance;
b. defining EBIT as profit before finance income/expenses and tax; and
c. describing finance income/expenses as income/expenses related to the entity's capital structure.

The Board asked the staff to consider:

a. how to define an entity's capital structure; and
b. whether additional guidance would be needed on the treatment of particular items of income and expense (for example, the net interest on net defined benefit liabilities and income/expenses from investments).

Management operating performance measure **(Agenda Paper 21B)**

The Board agreed (by consensus) that the staff should continue to explore:

a. requiring the presentation of a management operating performance measure, rather than seeking to define operating profit, in the statement(s) of financial performance;
b. allowing items to be excluded from the management operating performance measure as long as the subtotal meets the requirements in existing paragraphs 85, 85A and 85B of IAS 1 *Presentation of Financial Statements*; and
c. requiring additional disclosures to provide transparency around presentation of the management operating performance measure.

General guidance on classification, aggregation and disaggregation **(Agenda Paper 21C)**

The Board tentatively decided to develop, along the lines suggested in Agenda Paper 21C:

a. principles for aggregation and disaggregation in the financial statements;
b. definitions of the notions 'classification', 'aggregation' and 'disaggregation; and
c. guidance on the steps involved in applying 'classification', 'aggregation' and 'disaggregation' when preparing financial statements.

Ten Board members agreed and two disagreed with this decision.

The Board tentatively decided to explore providing more guidance on aggregation characteristics. Eleven Board members agreed and one disagreed.

June 2017 Board meeting

The Board continued its discussion from the March 2017 Board meeting about introducing two subtotals in the statement(s) of financial performance—earnings before finance income/expenses and tax (EBIT) and a management performance measure. No decisions were made at this meeting.

September 2017 Board meeting

Structure of the statement(s) of financial performance—introduction of an investing category and additional subtotals (Agenda Paper 21A)

The Board tentatively decided to prioritise introducing into the statement(s) of financial performance subtotals that facilitate comparisons between entities, such as EBIT, over introducing a management-performance measure subtotal. At a future meeting, the Board will discuss how a management-performance measure could be included in the financial statements. All Board members agreed with this decision.

The Board agreed without voting to explore the introduction of an investing category into the statement(s) of financial performance.

The Board tentatively decided that, if it introduces both an investing category and an EBIT (or profit before financing and income tax) subtotal, finance income or expenses should consist of the following separate line items in the statement(s) of financial performance:

a. 'income related to capital structure';
b. 'expenses related to capital structure';
c. 'interest income on a net defined benefit asset or a net asset that arises when a liability not part of an entity's capital structure qualifies for offset with an asset'; and
d. 'interest expenses on liabilities not part of an entity's capital structure'.

Ten of 14 Board members agreed and four disagreed with this decision

Analysis of expenses by function and by nature (Agenda Paper 21B)

The Board tentatively decided to:

a. describe the 'nature of expense' method and the 'function of expense' method used to analyse expenses required by paragraph 99 of IAS 1 Presentation of Financial Statements. Fourteen Board members agreed.
b. continue to require an entity to provide an analysis of expenses using the methodology, either by-function or by-nature, that provides the most useful information to users. Twelve of 14 Board members agreed with this decision and one member disagreed. One member was absent.
c. develop criteria that entities could follow to determine whether a by-function or by-nature methodology provides the most useful information to users. One of those criteria would be that a function of expense analysis would not be appropriate if an entity is unable to allocate natural components to the functions presented on a consistent and non-arbitrary basis. Ten of 14 Board members agreed with this decision and three members disagreed. One member was absent.
d. provide no requirement for entities that use the 'nature of expense' method to provide additional information using the 'function of expense' method. Thirteen of 14 Board members agreed with this decision and one member disagreed.
e. require an entity to:
    i. present its primary analysis of expenses in the statement(s) of financial performance; and
    ii. disclose in a single note any additional information required about expenses (ie an analysis by nature when an entity uses a 'function of expense' method). Fourteen Board members agreed.

Appendix C—Summary of the Board's tentative decisions at the November 2017 meeting

Presentation of an investing category in the statement(s) of financial performance (Agenda Paper 21A)

The Board tentatively decided:

a. to relabel the 'investing' category as 'income/expenses from investments'. Twelve Board members agreed and one member disagreed with this decision. One member was absent.
b. to define 'income/expenses from investments' using a principle-based approach as 'income/expenses from assets that generate a return individually and largely independently of other resources held by the entity'. Eleven Board members agreed and three members disagreed with this decision.
c. to provide a list of some items that would typically be treated as 'investing' and a list of some items that would typically not be treated as 'investing' for non-financial entities. Thirteen Board members agreed and one member disagreed with this decision.
d. not to label the subtotal before the 'income/expenses from investments' category as 'operating profit'. Ten Board members agreed and four disagreed with this decision.

The Board did not to reach a decision on the presentation of the share of the profit or loss of associates and joint ventures accounted for using the equity method. The Board therefore directed the staff to include in the project's first due-process document a discussion of the different possible approaches. That discussion would, in particular, consider the following two approaches:

a. including the share of the profit or loss of all associates and joint ventures accounted for using the equity method within a single category.
b. including the share of profit or loss of integral associates or joint ventures above the 'income/expenses from investments' category; and the share of profit or loss of non-integral associates or joint ventures within the 'income/expenses from investments' category.

Definition of finance income/expenses (Agenda Paper 21B)

The Board tentatively decided to:

a. use 'cash and cash equivalents' in the definition of 'finance income/expenses' as a proxy for cash and temporary investments of excess cash. Ten Board members agreed and four members disagreed with this decision.
b. require that 'finance income/expenses' consist of the following five line items:
    i. 'interest income from cash and cash equivalents calculated using the effective interest method';
    ii. 'other income from cash, cash equivalents and financing activities';
    iii. 'expenses from financing activities';
    iv. 'other finance income'; and
    v. 'other finance expenses'.

   Twelve Board members agreed and two members disagreed with this decision. Some Board members made some drafting suggestions for the line items. The Board also noted that a separate line item for impairment of cash and cash equivalents may be needed, if material.

c. clarify the current description of 'financing activities' in IAS 7 *Statement of Cash Flows* by indicating that a financing activity involves:
    i. the receipt or use of a resource from a provider of finance (or provision of credit).
    ii. the expectation that the resource will be returned to the provider of finance.

iii. the expectation that the provider of finance will be appropriately compensated through the payment of a finance charge. The finance charge is dependent on both the amount of the credit and its duration.

All fourteen Board members agreed. Some Board members made drafting suggestions.

Better ways to communicate other comprehensive income (OCI) (Agenda Paper 21C)

The Board tentatively decided to rename the two categories in the OCI section of the statement(s) of financial performance as follows:

a. 'remeasurements reported outside profit or loss' (currently 'OCI items that will not be reclassified subsequently to profit or loss'); and
b. 'income and expenses to be included in profit or loss in the future' (currently 'OCI items that will be reclassified subsequently to profit or loss').

Eight of fourteen Board members agreed and six disagreed with this decision.

The Board tentatively decided not to introduce a new subtotal between the two categories in the OCI section of the statement(s) of financial performance called 'income after remeasurements reported outside profit or loss'. Twelve of fourteen Board members agreed with this decision and two disagreed.

The Board tentatively decided:

a. that the staff should explore whether there is a demand to remove the following presentation options in IAS 1 *Presentation of Financial Statements* for OCI:
    i. presenting items of OCI either net of related tax effects, or before related tax effects (paragraph 91 of IAS 1); and
    ii. presenting reclassification adjustments in the statement(s) of financial performance or in the notes (paragraph 94 of IAS 1).

    All Board members agreed with this decision.
b. not to develop separate guidance or educational material on the presentation of other comprehensive income for entities, but to consider both profit or loss and OCI when developing proposals for better aggregation/disaggregation and additional minimum line items. Thirteen of fourteen Board members agreed with this decision and one abstained.
c. not to develop educational material for investors in the form of case studies that illustrate why it is important for users of financial statements to consider items of OCI in their analysis of companies. All Board members agreed with this decision.