

# Primary Financial Statements project

Accounting Standards Advisory Forum meeting  
March 2017

ASAF agenda paper 9

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- The purpose of the session is to provide an update on the Board's decisions regarding the scope of the Primary Financial Statements project.
- In July 2016 ASAF meeting, many ASAF members supported the project's focus on the structure and content of the statement(s) of financial performance.

## Question

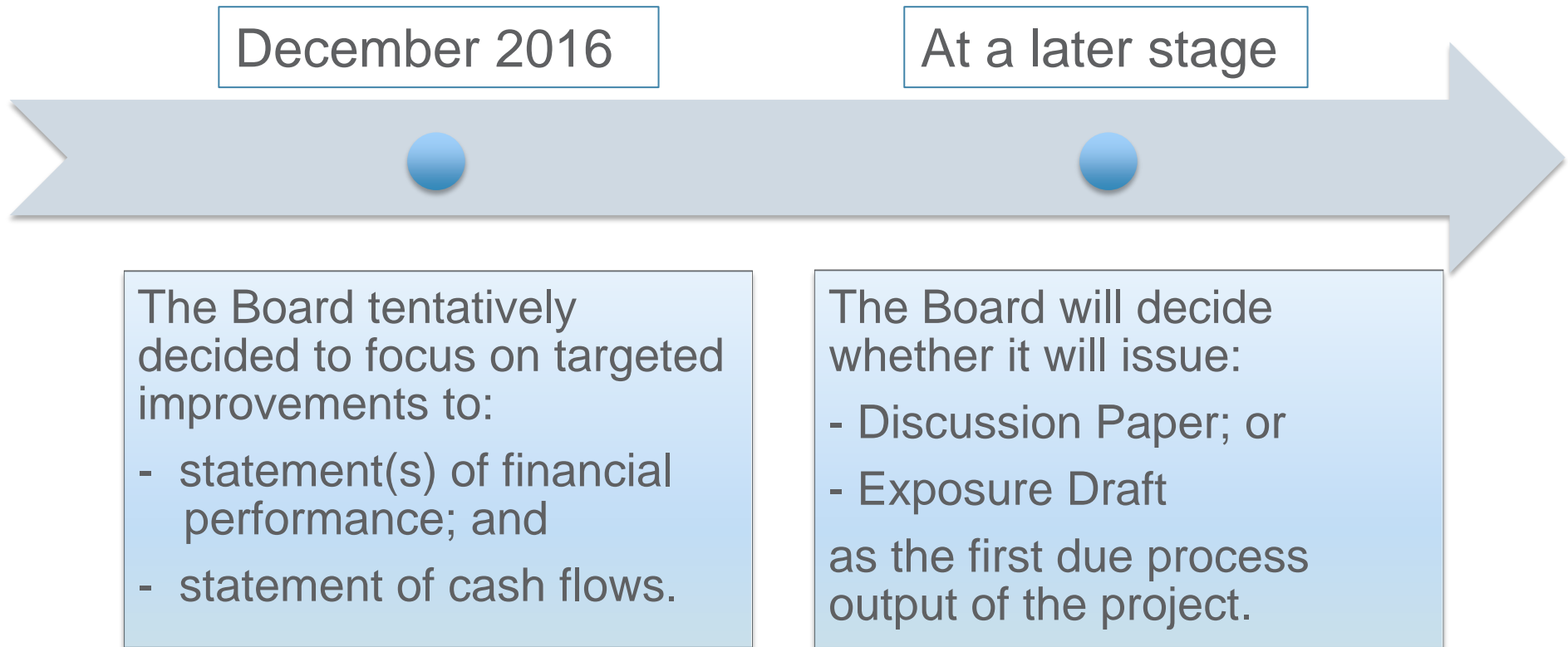
Do you have any question or comments on:

- a) the scope of the project; and
- b) the possible solutions identified in slides 6-14?

We will discuss the topics on slide 6-8 and slide 14 with Board at its March 2017 meeting. We will verbally update the Board for your comments.

# Primary Financial Statements project

- Primary Financial Statements project is an early-stage research project.



## Primary Financial Statements

Statement(s)  
of financial  
performance

Statement of  
cash flows

Statement of  
financial  
position

Statement of  
changes in  
equity

- ✓ requiring additional subtotal(s); EBIT and/or operating profit
- ✓ providing guidance on the performance measures that exclude non-recurring items etc
- ✓ better ways to communicate OCI

- ✓ eliminating options for the classification of interest and dividends
- ✓ aligning the operating section between the statements of cash flows and financial performance
- ✓ requiring a consistent starting point for the reconciliation

- ✗ No specific change is planned in this project, except for possible development of templates for all primary financial statements and greater disaggregation

- ✓ developing templates for primary financial statements
- ✓ achieving greater disaggregation

# 1. Require 'EBIT' subtotal

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

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

## 2. Require 'operating profit' subtotal

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

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

### 3. Provide guidance on the performance measures that exclude non-recurring items etc

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

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



### 3. Provide guidance on the performance measures that exclude non-recurring items etc (continued)

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

<i>Example</i>	
	<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*

# 4. Better ways to communicate information about OCI

Concerns raised	Possible solutions	Example
<ul style="list-style-type: none"> <li>• Users do not understand amounts presented in OCI</li> <li>• Current OCI category includes items with different nature</li> <li>• Some think all items reported in OCI should be recycled; others disagree.</li> </ul>	<ul style="list-style-type: none"> <li>• In order to increase the understandability of the OCI category we could consider dividing OCI into different categories and labelling them in a more understandable way (for example, 'Income and expense to be recognised in profit or loss in the future').</li> </ul>	<p><b>Revenue</b></p> <p>...</p> <p><b>Recurring operating profit</b> Non-recurring operating income and expense</p> <p><b>Operating profit</b> Non-operating income and expense</p> <p><b>EBIT</b> Finance income Finance expense</p> <p><b>Pre-tax profit</b> Taxation</p> <p><b>Profit for continuing operations</b> Loss from discontinued operation</p> <p><b>Profit</b> <i>Specified long term revaluations</i> (OCI items not reclassified)</p> <p><i>Profit after specified long term revaluations</i> <i>Income and expense to be recognised in profit in the future*</i> (OCI items that will be reclassified)</p> <p><b>Comprehensive income</b></p>

*\*Achieves 'full-recycling'*

# 5. Targeted improvements on cash flows from operating activities

Concerns raised	Possible solutions	Example
<ul style="list-style-type: none"> <li>Because of the options permitted to present interests and dividends in different cash flow categories, operating cash flows are not comparable</li> </ul>	<ul style="list-style-type: none"> <li>Eliminate the options for presenting interest and dividend</li> </ul>	<p>Cash flows from operating activities  <b>Profit before taxation</b>            Adjustments for:              Depreciation              Interest expense              Increase in trade and other receivables            ...  <del>Interest paid</del>  <del>Income taxes paid</del>            Net cash from operating activities</p> <p>Cash flows from investing activities            ...</p> <p>Cash flows from financing activities  <b>Interest paid</b>            ...</p> <p><b>Income taxes paid</b>            Net increase in cash            Cash at beginning of period            Cash at end of period</p>
<ul style="list-style-type: none"> <li>Operating profit in the statement(s) of financial performance and operating cash flow in the statement of cash flows are disconnected</li> </ul>	<ul style="list-style-type: none"> <li>Require consistency between how an entity defines operating profit in the statement(s) of financial performance and operating cash flow in the statement of cash flows</li> </ul>	
<ul style="list-style-type: none"> <li>Different entities use a different starting point for the indirect reconciliation of cash flows</li> </ul>	<ul style="list-style-type: none"> <li>Requiring a consistent starting point</li> </ul>	

# 6. Provide illustrative examples for the primary financial statements

<b>Concerns raised</b>	<b>Possible solutions</b>	<i>Example (non-financial)</i>
<ul style="list-style-type: none"><li>Financial statements are not comparable even among peer companies</li></ul>	<ul style="list-style-type: none"><li>Provide illustrative examples of structure and format for some industries (eg, non-financial, bank, insurance and property)</li></ul>	<p><b>Revenue</b> Cost of goods sold</p> <p><b>Gross profit</b> Selling costs General and administrative costs R&amp;D costs</p> <p><b>Recurring operating profit</b> Non recurring operating income and expense</p> <p><b>Operating profit</b> Non operating income and expense</p> <p><b>EBIT</b> Finance income Finance expense</p> <p><b>Pre tax profit</b> Taxation</p> <p><b>Profit</b> Specified long term revaluations</p> <p><b>Profit after specified long term revaluations</b></p> <p>Income and expense to be recognised in profit or loss in the future</p> <p><b>Comprehensive income</b></p>

# 6. 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**

# 7. Develop a principle for disaggregating items in the primary financial statements

Concerns raised	Possible solutions
<ul style="list-style-type: none"> <li>Some entities do not present expenses by nature or by function (eg they present operating expenses as a single line item)</li> <li>Some entities present large 'other' category in primary financial statements that make it difficult to compare items presented by different entities</li> </ul>	<ul style="list-style-type: none"> <li>Develop a principle or guidance to achieve greater disaggregation</li> </ul>

<i>Example</i>		
TODAY	Disaggregation (by function)	Disaggregation (by nature)
	Cost of goods sold	<ul style="list-style-type: none"> <li>Raw material</li> <li>Wages</li> <li>Depreciation</li> </ul>
<b>Operating expenses</b>	Selling, General and Administrative expenses	<ul style="list-style-type: none"> <li>Wages</li> <li>Rent</li> <li>Advertisement</li> </ul>
	Research and development	<ul style="list-style-type: none"> <li>Wages</li> <li>Rent</li> <li>Depreciation</li> </ul>

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