

STAFF PAPER

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IASB® Meeting

Project	Primary Financial Statements		
Paper topic	Cover note		
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Purpose of the meeting

1. At the December 2016 Board meeting, the Board asked the staff to explore topics for possible inclusion in the first due process document of the Primary Financial Statements project. The Board also agreed to decide at a later stage of the project whether it will issue a Discussion Paper or an Exposure Draft as the first due process document of the project.
2. The purpose of this meeting is to ask the Board to make tentative decisions on the following:
 - (a) additional subtotals in the statement(s) of financial performance; and
 - (b) guidance on classification, aggregation and disaggregation.

Papers for this meeting

3. The papers being presented at this meeting are:
 - (a) **Earnings before interest and taxes (EBIT) (AP 21A)**: proposals for introducing a comparable EBIT subtotal in the statement(s) of financial performance;

- (b) **Management operating performance measure (AP 21B):** proposals for introducing a new subtotal—management operating performance measure—into the statement(s) of financial performance; and
- (c) **General guidance on classification, aggregation and disaggregation (AP 21C):** proposals for adding definitions, principles, and process guidance for classification, aggregation and disaggregation as it relates to both the primary financial statements and the notes.

Summary of staff recommendations

Subtotals in the statement(s) of financial performance (AP21A and AP21B)

4. Many users would like additional required subtotals in the statement(s) of financial performance, especially ones that provide relatively comparable anchor points within that statement. Users often require a comparable starting point for valuation and ratio analysis. On the other hand, preparers would prefer the flexibility to tell their own story using management defined performance measures. Although, management defined performance measures are often not comparable between entities, many users say that they find such performance measures useful in their analysis.
5. The staff acknowledge the tension between flexibility and comparability that these competing needs present. In response, the staff propose in AP 21A and AP 21B two additional required subtotals. The staff think that the combination of the EBIT subtotal and a management operating performance measure could provide the following benefits to users:
 - (a) the EBIT subtotal will provide a comparable starting point among different entities and can be used for screening or ratio analysis;
 - (b) the management operating performance measure, by contrast, would provide a measure management uses to assess its progress toward its objective or indicate the key drivers of its performance; and
 - (c) explanation and disclosure of reconciling items between the management operating performance measure and EBIT would provide transparency about which items are excluded from management operating performance

measures compared with EBIT. This information helps users to understand how management operating performance measures are different across different entities and allows users to reconcile those different performance measures. In addition, transparency about the items excluded from management operating performance measure could help users assess whether reported earnings are persistent.

General guidance on classification, aggregation and disaggregation (AP21C)

6. We have also heard from many users that some line items within the primary financial statements provide information that is too highly aggregated to be useful. For example, users noted that:
 - (a) ‘selling, general and administrative expenses’ or ‘costs of sales’ are commonly presented as a single line item and not disaggregated by their natural components (ie labour cost, cost of materials, etc); and
 - (b) large ‘other’ categories (ie other assets, other liabilities, other operating cash flows) are commonly presented without further disaggregation, causing important information to be obscured or lost.

7. Aggregation and disaggregation are required in a variety of IFRS Standards but an overarching general principle or guidance does not exist in IFRS Standards to describe those notions. The Conceptual Framework describes classification and aggregation but does not provide further guidance on how the terms are applied or describe disaggregation. This can lead to different interpretations of what aggregation and disaggregation mean leading to an inconsistent application of IFRS Standards, which in turn could lead to confusion for users when they analyse IFRS financial statement information.

8. The staff recommend adding in IFRS Standards three principles for classification, aggregation and disaggregation as well as some general guidance to define the notions of ‘classification’ ‘aggregation’ and ‘disaggregation’ and to describe the steps involved when applying them in the preparation of the primary financial statements and the notes. The staff further discuss the characteristics that could be used to

aggregate (or disaggregate) items in the primary financial statements and in the notes and ask the Board if we should explore providing more guidance in this respect.

Next steps

9. At future Board meetings, we plan to discuss:
 - (a) adjusted basic earnings per share;
 - (b) better ways to communicate information about other comprehensive income;
 - (c) targeted improvements in the statement of cash flows:
 - (i) elimination of options for the classification of the cash effects of interest and dividends in the statement of cash flows;
 - (ii) alignment of the operating section across the statement of cash flows and the statement(s) of financial performance; and
 - (iii) requiring a consistent starting point for the indirect reconciliation of cash flows; and
 - (d) development of illustrative examples, including those for specific industries, for the primary financial statements.