

Joint CMAC-GPF meeting, 14-15 June 2018
Agenda Paper 4

Primary Financial Statements (session 2)

Improving the usefulness of disaggregation in the financial statements

Denise Durant, ddurant@ifrs.org, +44 (0) 20 7246 6469

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.

Copyright © IFRS Foundation. All rights reserved

Disaggregation in the financial statements	
Purpose of this session	3
What do users want and what are the problems we have identified?	4-5
How do proposals in the Primary Financial Statements project address the problems identified?	6-10
Contentious issues	11
Additional information by nature and questions for breakout discussion	12-15
Quantitative thresholds and questions for breakout discussion	16-18
Other issues planned for discussion: templates and minimum line items and questions for breakout discussion	19-23

Purpose of this session

- As a part of the project on Primary Financial Statements, the Board is developing proposals to improve the aggregation and disaggregation of information in the financial statements.
- We would like the views of CMAC and GPF members on possible ways in which to improve disaggregation.
- The discussion will be used as input to further Board discussions.

What do users want?

- Users want more **comparability** and **consistency** in the way information is presented:
 - to compare information across entities and within the same entity.
- Users want more **disaggregation** of functional line items into their natural components to help them make better predictions.
 - For example, ‘cost of sales’, as a functional line item, can provide relevant information about whether the revenue generated from the sale of goods covers direct costs and by what margin. However, having a break-down of cost of sales (eg into labour costs, distribution costs, etc) may also provide relevant information to users.

Problems identified

5

Slides

Items that do not share similar characteristics are grouped together and material large 'other' categories are presented without further disaggregation

6

Financial information (including an analysis of expenses presented in different locations)

7-8

The use of a by-function or by-nature methodology for an analysis of expenses is seen more as a choice rather than as a selection of the method that provides the most useful information for users

9

Functional line items (eg cost of sales or SG&A) are not disaggregated by their natural components

10

How do PFS proposals address the problems identified?

Problems identified

- Items that do not share similar characteristics are grouped together.
- Material large 'other' categories are presented without further disaggregation.

Board's proposals	<ul style="list-style-type: none">• Define the notions 'classification', 'aggregation' and 'disaggregation'.• Develop principles for aggregation and disaggregation in the financial statements.• Illustrate how different characteristics (eg nature, function, measurement basis, persistence, etc) could be used to aggregate or disaggregate financial information.• The Board considered but tentatively decided not to introduce quantitative thresholds to promote more disaggregation (further discussed in slides 16-17).
Benefits for preparers	<ul style="list-style-type: none">• Promote a better understanding of what makes items similar or dissimilar from one another and better guidance for preparers in making judgements about aggregation and disaggregation.
Benefits for users	<ul style="list-style-type: none">• More consistency around aggregation and disaggregation decisions and hence, more comparable information for users.

How do PFS proposals address the problems identified?

Problem identified (1/2)

- Financial information is presented in different locations (ie sometimes in the primary financial statements, sometimes in the notes)

Board's proposal	<ul style="list-style-type: none">• Base the location of financial information on the role of the primary financial statements and the role of the notes suggested in Discussion Paper Disclosure Initiative—Principles of Disclosure. The description of those roles would not override specific requirements of IAS 1.
Proposed roles	<ul style="list-style-type: none">• The role of the primary financial statements is to provide a structured and comparable summary of an entity's recognised assets, liabilities, equity, income and expenses.• The role of the notes is to provide further information necessary to disaggregate, reconcile and explain the items recognised in the primary financial statements; and supplement the primary financial statements with other information.
Benefits for preparers and users	<ul style="list-style-type: none">• Including the roles would help preparers and users of the financial statements identify the boundaries between the primary financial statements and the notes.• Information would be presented in a more consistent basis.

How do PFS proposals address the problems identified?

Problem identified (2/2)

- The analysis of operating expenses is presented in different locations (ie sometimes in the statement(s) of financial performance, sometimes in the notes)

Board's proposal	<p>Require an entity to:</p> <ul style="list-style-type: none">• (a) present its primary analysis of expenses (by function or by nature) in the statement(s) of financial performance; and• (b) when an entity provides primary analysis of expenses using a by-function methodology, require the entity to disclose in a single note additional information on the nature of the expenses. This information would be provided at an entity level, not as a breakdown of each functional line presented.
Benefits for preparers and users	<ul style="list-style-type: none">• Eliminate current diversity in practice on the presentation of an entity's analysis of expenses. Users will be able to more easily access additional information on the nature of expenses as it will be disclosed in a single note.

How do PFS proposals address the problems identified?

Problem identified

- The use of a by-function or by-nature methodology for an analysis of expenses is seen as a choice rather than as selection of the method that provides the most useful information for users.

Board's proposals	<ul style="list-style-type: none">• Describe both methodologies (function and nature).• Add factors that entities could consider in selecting which methodology is more useful.
Proposed factors	<ul style="list-style-type: none">• Method that provides the best information about the key components or drivers of profitability; and that matches how management reports internally to the board or key decision makers and the way the business is run.• Peer industry practice; and• Use of a 'by nature' method when the allocation of expenses to functions does not provide a sufficiently faithful representation of the composition of an entity's functions.
Benefits for preparers and users	<ul style="list-style-type: none">• Adding factors would help preparers determine the methodology that would provide the most useful information to users of financial statements.

How do PFS proposals address the problems identified?

Problem identified

- Functional line items (eg cost of sales or SG&A) are not disaggregated by their natural components.

Board's proposals	<ul style="list-style-type: none">• The Board considered different approaches for disclosing additional information in the notes when an entity uses a by-function approach in the statement(s) of financial performance• The Board required additional information by nature at an entity level, not as a breakdown of each functional line presented (further discussed in slides 12-14).
Benefits for preparers	<ul style="list-style-type: none">• May alleviate the concerns expressed by preparers about being unable to track the original nature of the expenses allocated into an entity's functional activities and would allow entities to disclose information by nature that cannot be easily attributed to a particular functional line.
Benefits for users	<ul style="list-style-type: none">• Provides additional information by nature that users could use in their analysis.

The Board had split views for the following issues:

- Disaggregating functional line items by nature (see slides 12-14)
- Use of quantitative thresholds to disaggregate large 'other' balances (see slides 16-17)

Disaggregating functional line items by nature – advantages and disadvantages

Advantages

Further disaggregation by nature is **useful** because :

- it provides information on how different types of income and expense relate to different activities of the entity; and
- users can apply their assumptions to individual natural components of functional line to help them make better predictions.

Disadvantages

It cannot be easily prepared

- Some preparers are unable to track the original nature of the expenses allocated into an entity's functional activities because their systems are not designed for this purpose.
 - For example, an entity has an information technology (IT) department that serves various functions throughout the organisation. The expenses of the IT department include depreciation and labour expenses. The IT department passes those expenses on to different areas as a single amount called 'IT cost' The nature of each expense is lost in this process.

Disaggregating functional line items by nature – Alternatives considered and Board’s proposal

- The Board considered the following approaches for disclosing additional information in the notes when an entity uses a by-function approach in the statement(s) of financial performance:

A

require disaggregation by nature for each functional line item

entity has flexibility to decide which natural components are disclosed

B

require disaggregation by nature for each functional line item

The Board specifies which natural components should be disclosed

C

require additional information by nature at an entity level, not as a breakdown of each functional line presented

This is the Board’s preferred approach

Disaggregating functional line items by nature – Illustration of alternatives considered for providing information by nature

B: Provide specific natural components associated to specific functional lines (ie highlighted items)

		Functional lines			
		Cost of sales	General and administrative expenses	Selling expenses	TOTAL
Natural components	Changes in inventories of finished goods and work in progress	X			T
	Cost of raw materials and consumables used	X			T
	Net foreign exchange differences	X			T
	Warranty provision	X			T
	Wages and salaries	X	X	X	T
	Pension costs	X	X	X	T
	Post-employment benefits other than pensions		X		T
	Share-based payment expense		X	X	T
	Impairment loss	X	X	X	T
	Depreciation expense	X	X		T
	Amortisation expense of intangible assets	X	X		T
	Advertising expense			X	T
	Transportation costs	X		X	T
Other	X	X	X	T	

C: At an entity level only

A: Flexibility to choose

Questions for breakout discussion

Disaggregating functional line items by nature (slides 12-14)

1. Is additional information by nature useful when providing a functional analysis of expenses?
(in your responses please consider the different approaches we have developed for presenting information by nature in slides 13-14)?

A. **CMAC**
members

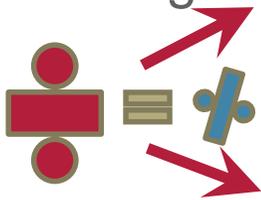
- Is there any particular by-nature information that you consider useful and why? How would users use that additional information?

B. **GPF**
members

- How easy is it for preparers to provide additional information by nature?

What is a quantitative threshold?

- A way to overcome the over-aggregation of line items could be to introduce quantitative thresholds for the disaggregation of large residual or 'other' category (eg other expenses).
- A threshold is 'a level at which something comes into effect'. It implies defining:
 - **A numerator:** specific item to which the threshold would apply.
 - **A limit** i.e. a percentage
 - **A denominator:** the line item total or subtotal that serves as a basis for determining if the threshold has been met or not.



For example, if a threshold is imposed requiring or encouraging the disaggregation of expenses that exceed 10% of total 'other expenses', the entity would then disaggregate further all the expenses that exceed the 10% threshold as shown in the illustration below:

Assuming a threshold of 10%			
Other expenses		%	
Legal costs on litigation	54	3%	
Insurance	199	9%	
Auditors' remuneration	135	6%	
Repair and maintenance costs	1,304	61%	→ Further disaggregation
Utilities	142	7%	
Other	316	15%	→ Further disaggregation
	2,150		

Quantitative thresholds— advantages and disadvantages

- The Board considered, but tentatively decided **not** to introduce quantitative thresholds to promote more disaggregation.

Advantages 	Disadvantages 
<ul style="list-style-type: none">• Potentially encourages greater disaggregation, resulting in more relevant information• more enforceable than qualitative requirements or principles	<ul style="list-style-type: none">• may override materiality judgements• it could be difficult for the Board to develop quantitative thresholds

- Instead, the Board asked the staff to explore whether **principle-based guidance** could be developed to encourage further disaggregation of **large residual balances or 'other' balances**.

Quantitative thresholds (slides 16-17)

1. Do you think quantitative thresholds should be used to encourage or require more disaggregation in the financial statements? If so, would information disaggregated through the use of quantitative thresholds:
 - A. **CMAC members**
 - help you perform your analysis?
 - B. **GPF members**
 - ensure entities provide a better insight in their activities? Why or why not?

Other issues planned for discussion

The Board is planning to discuss at a future meeting the following topics:

- Use of **templates** (see slide 20)
- Use of **minimum line items** (see slide 21)
- **Advantages and disadvantages** of templates and minimum line items (see slide 22)

Templates – What did we observe in our research?

- The Board is considering developing financial statement templates for a small number of industries.
- IAS 1 and IAS 7 already include illustrative examples:
 - Limited mainly to primary financial statements
 - Generic, not specific to any industry
 - Non-mandatory (accompanying but not part of the standards)
- Feedback from IASB advisory bodies including CMAC and GPF indicated an interest in templates being developed.
- We obtained feedback from national standard-setters (NSS) about the use of templates in their jurisdictions:
 - most jurisdictions surveyed provide templates for entities applying local GAAP; and
 - a few jurisdictions provide templates for IFRS preparers.

Minimum line items – What did we observe in our research?

- IFRS Standards already require a list of minimum line items to be presented in the primary financial statements (eg par 82 in IAS 1).
- CMAC members have suggested that additional line items could be mandated (eg cost of sales, SG&A, R&D, restructuring costs).
- According to our NSS survey minimum line items are required for the statement(s) of performance:
 - *For entities applying local GAAP.* Minimum line items resembled the line items required in IFRS Standards, and many also required operating profit.
 - *For entities applying IFRS Standards.* A few jurisdictions also required minimum line items in addition to those required by IFRS Standards, for example gross profit and operating profit

Templates and minimum line items – advantages and disadvantages

Advantages

- Increased comparability
- Provide entities with more guidance
- Potential improvement in the IFRS Taxonomy

Disadvantages

- Potential conflict with regulators' guidance
- Risk that non-mandatory templates or minimum line items could be treated as mandatory by regulators
- There are already providers of comprehensive educational materials that show examples of templates for the primary financial statements

Questions for breakout discussion

(for both CMAC and GPF members)

Templates and minimum line items (slides 20-22)

1. Should the Board consider developing templates and/or minimum line items for the primary financial statements for a small number of industries? If so:
 - a) Should templates and/or minimum line items be mandatory or non-mandatory?
 - b) Should we develop templates for some (or all) primary financial statements?
 - c) Which industries should we develop templates and/or minimum line items for?
 - d) How do you think we can identify line items for templates and/or minimum line items?

Get involved

Find out more: www.ifrs.org

Follow us:



@IFRSFoundation



IFRS Foundation
International Accounting Standards Board



IFRS Foundation



IFRS Foundation

Join our team: go.ifrs.org/careers