

## STAFF PAPER

September 2018

## IASB® Meeting

Project	Primary Financial Statements		
Paper topic	Cover note		
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This paper has been prepared for discussion at a public meeting of the International Accounting Standards Board (Board) and does not represent the views of the Board or any individual member of the Board. Comments on the application of IFRS® Standards do not purport to set out acceptable or unacceptable application of IFRS Standards. Technical decisions are made in public and reported in IASB *Update*.

**Purpose of the meeting**

1. At this meeting, we will seek the Board's views on:
  - (a) applying the proposed subtotals in the statement of profit or loss to financial entities;
  - (b) providing information about unusual or infrequent items;
  - (c) introducing indicators for making the split between 'integral' and 'non-integral' associates and joint ventures; and
  - (d) whether to move the *Primary Financial Statements* project from the research programme to the standard-setting programme.
2. This cover note includes the following:
  - (a) list of papers that will be discussed (paragraph 3);
  - (b) our planned next steps in this project (paragraph 4);
  - (c) a summary of the Board's tentative decisions to date (Appendix A).

**Papers for this meeting**

3. Agenda papers for this meeting:
  - (a) **Agenda Paper 21A** discusses:

- (i) the scope of the Board’s proposal for a subtotal of earnings before finance income/expenses and tax;
  - (ii) the scope of the Board’s proposal for a subtotal of earnings before investments, finance income/expenses and tax;
  - (iii) the implications of proposals in the paper for presentation of subtotals by entities with more than one main business activity; and
  - (iv) the implications of proposals in the paper for presentation of share of profit from investments in associates and joint ventures.
- (b) **Agenda Paper 21B** illustrates the likely effect of the Board’s tentative decisions and the effect of staff proposals on the presentation of information in the statement of financial performance for financial entities. This paper is for information only and has no questions for the Board.
- (c) **Agenda Paper 21C** seeks the Board’s views on staff proposals for the identification of and provision of information about unusual or infrequent items.
- (d) **Agenda Paper 21D** summarises the recent feedback received on the Board’s tentative decision to separate the presentation of the share of results from ‘integral’ associates and joint ventures from ‘non-integral’ associates and joint ventures, and seeks the Board’s views on introducing indicators for making the split.
- (e) **Agenda Paper 21E** asks the Board whether it wants to move the *Primary Financial Statements* project from the research programme to the standard-setting programme.

## Next steps

4. At future Board meetings, we plan to discuss:
- (a) outstanding issues relating to application of project proposals to financial entities;
  - (b) outstanding issues on disaggregation of information;

- (c) whether to define EBITDA;
- (d) outstanding issues on subtotals in the statement(s) of financial performance —including a review of the categories, subtotals and labelling (for example, reviewing the decision not to use the term operating);
- (e) proposals to develop templates for financial statements, including the status and location of such templates;
- (f) the identification of minimum line items to present on the face of the statement(s) of performance;
- (g) which type of consultative document to publish to obtain feedback on the Board’s tentative decisions.

## Appendix A: Summary of the Board’s tentative decisions to date in the project

Topic	Staff condensed summary of Board’s tentative decisions (focus on non-financial entities)
	<i>A full record of the Board’s tentative decisions is available from the December 2016-June 2018 IASB updates.</i>
<b>General</b>	<p>The Board tentatively decided to focus on targeted improvements to the statement(s) of financial performance and to the statement of cash flows.</p> <p>The Board will decide at a later stage of the project whether to issue a Discussion Paper or an Exposure Draft as the first due process output of the project.</p>
<b>Statement(s) of financial performance—project scope</b>	<p>The Board tentatively decided to explore the following topics in this project:</p> <ol style="list-style-type: none"> <li>a. requiring additional subtotal(s) in the statement(s) of financial performance;</li> <li>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);</li> <li>c. providing guidance on use of performance measures, including separate presentation of non-recurring, unusual or infrequently occurring items; and</li> <li>d. better ways to communicate information about other comprehensive income (OCI).</li> </ol> <p>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.</p>
<b>Statement(s) of financial performance—EBIT and finance income and expenses</b>	<p>The Board agreed (by consensus) to explore:</p> <ol style="list-style-type: none"> <li>a. requiring the presentation of an EBIT subtotal in the statement(s) of financial performance; and</li> <li>b. defining EBIT as profit before finance income/expenses and tax.</li> </ol> <p>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:</p> <ol style="list-style-type: none"> <li>a. ‘interest income from cash and cash equivalents calculated using the effective interest method’;</li> <li>b. ‘other income from cash, cash equivalents and financing activities’;</li> <li>c. ‘expenses from financing activities’;</li> <li>d. ‘other finance income’; and</li> <li>e. ‘other finance expenses’.</li> </ol> <p>‘Cash and cash equivalents’ is used in the definition of ‘finance income/expenses’ as a proxy for cash and temporary investments of excess cash. The Board also noted that a separate line item for impairment of cash and cash equivalents may be needed, if material.</p> <p>Other finance income/expenses comprises ‘interest’ income/expenses on liabilities that do not arise from financing activities (unwinding of a discount),</p>

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	<p>The Board tentatively decided to clarify the description of ‘financing activities’ in IAS 7 <i>Statement of Cash Flows</i> by indicating that a financing activity involves:</p> <ul style="list-style-type: none"> <li>a. the receipt or use of a resource from a provider of finance (or provision of credit).</li> <li>b. the expectation that the resource will be returned to the provider of finance.</li> <li>c. 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.</li> </ul>
<b>Statement(s) of financial performance—investing category</b>	<p>The Board agreed (by concensus) to explore the introduction of an investing category into the statement(s) of financial performance.</p> <p>The Board tentatively decided:</p> <ul style="list-style-type: none"> <li>a. to relabel the ‘investing’ category as ‘income/expenses from investments’.</li> <li>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’.</li> <li>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’.</li> <li>d. not to label the subtotal before the ‘income/expenses from investments’ category as ‘operating profit’.</li> </ul> <p>The Board tentatively decided that:</p> <ul style="list-style-type: none"> <li>a. entities should be required to present the results of ‘integral’ associates and joint ventures separately from those of ‘non-integral’ associates and joint ventures.</li> <li>b. the project’s first due-process document should: <ul style="list-style-type: none"> <li>i. use the Board’s proposed definition of ‘income/expenses from investments’ as the basis for the split between integral and non-integral investments in associates or joint ventures, and include a non-exhaustive list of indicators that could be used in making this distinction.</li> <li>ii. propose the presentation in the statement(s) of financial performance of the share of profit or loss of integral associates or joint ventures as a line item above the ‘income/expenses from investments’ category and require a new subtotal above that line item.</li> <li>iii. discuss all of the alternative approaches considered by the Board for presenting the share of the profit or loss of integral associates and joint ventures, both within and outside the ‘income/expenses from investments’ category, and the Board’s reasons for rejecting those approaches.</li> </ul> </li> </ul>

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<b>Statement(s) of financial performance—other comprehensive income (OCI)</b>	<p>The Board tentatively decided to rename the two categories in the OCI section of the statement(s) of financial performance as follows:</p> <ul style="list-style-type: none"> <li>a. ‘remeasurements reported outside profit or loss’ (currently ‘OCI items that will not be reclassified subsequently to profit or loss’); and</li> <li>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’)</li> </ul> <p>but not to introduce a new subtotal between these two categories called ‘income after remeasurements reported outside profit or loss’.</p> <p>The Board tentatively decided:</p> <ul style="list-style-type: none"> <li>a. the staff should explore whether there is demand to remove the following presentation options in <i>IAS 1 Presentation of Financial Statements</i> for OCI: <ul style="list-style-type: none"> <li>i. presenting items of OCI either net of related tax effects, or before related tax effects (paragraph 91 of IAS 1); and</li> <li>ii. presenting reclassification adjustments in the statement(s) of financial performance or in the notes (paragraph 94 of IAS 1).</li> </ul> </li> <li>b. not to develop separate guidance or educational material on the presentation of OCI for entities, but to consider both profit or loss and OCI when developing proposals for better aggregation/disaggregation and additional minimum line items.</li> <li>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.</li> </ul>
<b>Management performance measure</b>	<p>The Board tentatively decided:</p> <ul style="list-style-type: none"> <li>a. all entities shall identify a measure (or measures) of profit or comprehensive income that, in the view of management, communicates to users the financial performance of the entity. This measure will: <ul style="list-style-type: none"> <li>i. often only be a subtotal or total specified by paragraph 81A of IAS 1.</li> <li>ii. sometimes be identified by management as a measure that is not a subtotal or total specified by paragraph 81A of IAS 1, but would complement those subtotals or totals. Such a measure is a management performance measure.</li> </ul> </li> <li>b. the following requirements apply to management performance measures described in paragraph a(ii): <ul style="list-style-type: none"> <li>i. a reconciliation would be provided in the notes between that measure and the most directly comparable subtotal or total specified by paragraph 81A of IAS 1;</li> <li>ii. that there should be no specific constraints on management performance measures;</li> <li>iii. the measure would be labelled in a clear and understandable way so as not to mislead users; and</li> <li>iv. the following information is required to be disclosed: <ol style="list-style-type: none"> <li>1. a statement that the measure provides management’s view of the entity’s financial performance and is not necessarily comparable with measures provided by other entities;</li> <li>2. a description of why the management performance measure provides management’s view of performance, including an explanation of <ul style="list-style-type: none"> <li>• how the management performance measure has been calculated and why; and</li> <li>• how the measure provides useful information about an entity’s financial performance</li> </ul> </li> <li>3. sufficient explanation, if there is a change in how the management performance measure is calculated during the year, to help users understand the reasons for and effect of the change.</li> </ol> </li> </ul> </li> </ul>

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<b>Management performance measure (continued)</b>	<p>c. that the reconciliation between the management performance measure and the most directly comparable subtotal or total specified by paragraph 81A of IAS 1 should be provided separately from the operating segment information disclosed in accordance with IFRS 8 <i>Operating Segments</i>. However, entities would not be prohibited from also including management performance measures within the operating segment information. Furthermore, the following information would be required to be disclosed:</p> <ul style="list-style-type: none"> <li>i. an explanation of how the management performance measure differs from the total of the measures of profit or loss for the reportable segments; and</li> <li>ii. if none of the management performance measures fits into the operating segment information, an explanation of why this is the case.</li> </ul> <p>For the purposes of these proposals, paragraph 81A of IAS 1 would include the existing subtotals in that paragraph, the proposed new required subtotals developed as part of this project, for example, profit before investing, financing and tax. The Board tentatively decided to expand the list of subtotals and totals that would not be considered management performance measures to include the following commonly used subtotals: profit before tax, profit from continuing operations, and gross profit, defined as revenue less cost of sales. The Board members advised caution in drafting to clearly distinguish these three commonly used subtotals from those that are specifically required to be presented by all entities in paragraph 81A of IAS 1.</p> <p>The Board also asked the staff to clarify in drafting that management performance measures provide additional information that complements the subtotals and totals specified by paragraph 81A of IAS 1, rather than provides a better view of financial performance.</p> <p>The above tentative decisions describe disclosure requirements for management performance measures in the notes only. Consequently, it does not affect the presentation of additional subtotals in the statement(s) of financial performance in accordance with paragraphs 85–85A of IAS 1.</p> <p>The Board tentatively decided to require the reconciliation described in paragraph b(i) to be disclosed in the notes rather than be provided below the statement(s) of financial performance.</p>
<b>Adjusted earnings per share (EPS)</b>	<p>The Board tentatively decided that, if an entity identifies a management performance measure,</p> <ul style="list-style-type: none"> <li>a. it will be required to disclose in the notes the effect of tax and non-controlling interests separately for each of the differences between the management performance measure and the most directly comparable subtotal or total in paragraph 81A in IAS 1.</li> <li>b. it will not be required to disclose in the notes adjusted EPS calculated consistently with the management performance measure.</li> </ul> <p>The Board also tentatively decided that</p> <ul style="list-style-type: none"> <li>a. an entity would continue to be permitted to disclose adjusted EPS.</li> <li>b. an entity would be prohibited from presenting adjusted EPS in the statement(s) of financial performance.</li> </ul>
<b>Statement of cash flows—project scope</b>	<p>The Board tentatively decided to explore the following topics in this project:</p> <ul style="list-style-type: none"> <li>c. elimination of options for the classification of the cash effects of interest and dividends in the statement of cash flows;</li> <li>d. alignment of the operating section across the statement of cash flows and the statement(s) of financial performance; and</li> <li>e. requiring a consistent starting point for the indirect reconciliation of cash flows.</li> </ul>

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<b>Statement of cash flows—general</b>	<p>The Board tentatively decided to:</p> <ul style="list-style-type: none"> <li>a. remove from IAS 7 options for the classification of interest and dividends paid and of interest and dividends received and prescribe a single classification for each of these items.</li> <li>b. clarify that: <ul style="list-style-type: none"> <li>i. cash flows arising from interest incurred on financing activities should be classified as financing cash flows.</li> <li>ii. cash flows arising from interest paid that is capitalised as part of the cost of an asset should be classified as financing cash flows.</li> <li>iii. cash flows arising from dividends paid should be classified as financing cash flows.</li> </ul> </li> <li>c. amend the definition of ‘investing activities’ in IAS 7 to clarify that interest and dividends received should be classified as investing cash flows.</li> </ul> <p>The Board tentatively decided:</p> <ul style="list-style-type: none"> <li>a. to require a consistent subtotal as the starting point for the indirect reconciliation of cash flows from operating activities. This subtotal should be ‘profit before investing, financing and income tax’.</li> <li>b. not to align the operating section of the statement of cash flows with a corresponding section in the statement(s) of financial performance.</li> <li>c. not to make other further improvements to the statement of cash flows, besides those mentioned above.</li> </ul>
<b>Statement of cash flows—associates and joint ventures</b>	<p>The Board tentatively decided to propose:</p> <ul style="list-style-type: none"> <li>a. separate presentation of (i) the investing cash flows that arise between an entity and its ‘integral’ associates and joint ventures and (ii) the investing cash flows that arise between an entity and its ‘non-integral’ associates and joint ventures. The split between ‘integral’ and ‘non-integral’ associates and joint ventures would be the same for the statement of cash flows as for the statement(s) of financial performance.</li> <li>b. the separate presentation of the investing cash flows of ‘integral’ and ‘non-integral’ associates and joint ventures should be within the ‘investing activities’ section of the statement of cash flows.</li> </ul>
<b>Other topics—project scope</b>	<p>The Board tentatively decided to explore the following topics:</p> <ul style="list-style-type: none"> <li>a. 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.</li> <li>b. development of a principle for aggregating and disaggregating items in the primary financial statements.</li> </ul> <p>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.</p> <p>Additionally, the Board tentatively decided that segment reporting and the presentation of discontinued operations should not be part of the scope of the project.</p>
<b>Principles of aggregation</b>	<p>The Board tentatively decided to develop:</p> <ul style="list-style-type: none"> <li>a. principles for aggregation and disaggregation in the financial statements;</li> <li>b. definitions of the notions ‘classification’, ‘aggregation’ and ‘disaggregation; and</li> </ul>



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<b>and disaggregation</b>	<ul style="list-style-type: none"> <li>c. guidance on the steps involved in applying ‘classification’, ‘aggregation’ and ‘disaggregation’ when preparing financial statements.</li> <li>d. guidance on disaggregation by nature and by function in the statement of financial performance</li> </ul> <p>The Board tentatively decided to include a principle for determining the location of financial information in the primary financial statements or the notes that is based on the role of the primary financial statements and the role of the notes suggested in Discussion Paper Disclosure Initiative—Principles of Disclosure. That principle would not override the specific requirements of IAS 1 for the presentation of minimum line items and subtotals in the primary financial statements. An entity should also apply that principle when a Standard allows entities to determine whether to provide financial information in the primary financial statements or in the notes.</p> <p>The Board discussed whether to introduce numerical thresholds or rebuttable presumptions for aggregating or disaggregating financial information but decided not to introduce such thresholds. Instead, the Board decided to explore whether principle-based guidance could be developed to encourage further disaggregation of large residual balances or ‘other’ balances.</p> <p>The Board will explore further ways to improve disaggregation in the financial statements, which may include illustrating how different characteristics could be used to aggregate or disaggregate financial information. The Board clarified that any further guidance developed in this respect would not override specific aggregation or disaggregation requirements in individual IFRS Standards.</p> <p>The Board tentatively decided to:</p> <ul style="list-style-type: none"> <li>a. describe the ‘nature of expense’ method and the ‘function of expense’ method used to analyse expenses required by paragraph 99 of IAS 1.</li> <li>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.</li> <li>c. describe factors that entities would consider to determine whether a by-function or by-nature methodology provides the most useful information to users. These are:             <ul style="list-style-type: none"> <li>a. which method provides the best information about the key components or drivers of profitability;</li> <li>b. which method most closely matches how management reports internally to the board or key decision makers and the way the business is run;</li> <li>c. peer industry practice; and</li> <li>d. whether the allocation of expenses to functions would be so arbitrary that it would not provide a sufficiently faithful representation of the composition of an entity’s functions. In such cases, a ‘by nature’ method should be used.</li> </ul> </li> <li>d. provide no requirement for entities that use the ‘nature of expense’ method to provide additional information using the ‘function of expense’ method.</li> <li>e. require an entity to:             <ul style="list-style-type: none"> <li>i. present its primary analysis of expenses in the statement(s) of financial performance; and</li> <li>ii. 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 expense. This information would be provided at an entity level, not as a breakdown of each functional line presented.</li> </ul> </li> </ul>