

## STAFF PAPER

September 2018

## IASB® meeting

Project	Primary Financial Statements		
Paper topic	Project proposal – moving the project to the standard-setting programme		
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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

1. The purpose of this paper is to ask the Board whether it wants to move the *Primary Financial Statements* project from the research programme to the standard-setting programme.
2. The *Due Process Handbook* requires the Board to consult with the Advisory Council, ASAF, and accounting standard-setting bodies before making a decision to add a project to its standard-setting programme.<sup>1</sup> We consulted the required bodies and have included their input in this paper.

## Background and content

3. The objective of the Primary Financial Statements project is to explore targeted improvements to the primary financial statements with a focus on the statement(s) of financial performance.
4. The project is part of the Board's research programme. It is not possible to publish an Exposure Draft for a project that is on the research programme;

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<sup>1</sup> *Due Process Handbook*, paragraph 5.6.

however, it is possible to publish a Discussion Paper for a project that is on the Board's standard-setting programme.<sup>2</sup>

5. The Board has not yet decided whether to publish an Exposure Draft or a Discussion Paper as its first due process document for this project. The staff plan to ask the Board to decide whether to publish an Exposure Draft or a Discussion Paper later in the year.
6. The following sections:
  - (a) describe the criteria in the *Due Process Handbook* that have to be met before a project is added to the standard-setting programme (paragraphs 9-10);
  - (b) explain why the staff are of the view that those criteria have been met (paragraphs 11-23); and
  - (c) summarise advice received from ASAF and national standard-setting bodies and from the IFRS Advisory Council (paragraphs 24 – 27).
7. If the Board decides to add a standard-setting project to its agenda, it also needs to decide whether to set up a consultative group for the project. This is discussed in paragraphs 29 – 32.

### **Staff recommendations**

8. The staff recommend that the Board:
  - (a) adds the Primary Financial Statements project to its standard-setting programme; and
  - (b) continues using the expertise of existing advisory bodies instead of establishing a dedicated consultative group for the project.

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<sup>2</sup> Paragraph 4.12 of the *Due Process Handbook* states that the main output of the research programme is expected to be Discussion Papers and research papers. However, paragraph 5.5 of the *Due Process Handbook* states that the Board is not required to publish a Discussion Paper before adding a standard-setting project to its agenda if the Board is satisfied that it has sufficient information and understands the problem and the potential solutions well enough.

## Criteria for adding a project to the standard-setting programme

9.     The *Due Process Handbook* states that when adding a standard-setting project to its agenda or making major amendments to existing Standards, the Board evaluates the merits of adding the project primarily on the basis of the needs of users of financial reports, while also taking into account the costs of preparing the information. When deciding whether a proposed agenda item will address users' needs, the Board considers:
- (a)    whether there is a **deficiency** in the way particular types of transactions or activities are reported in financial reports;
  - (b)    the **importance** of the matter to those who use financial reports;
  - (c)    the **types of entities** likely to be affected by any proposals, including whether the matter is more prevalent in some jurisdictions than others; and
  - (d)    how **pervasive** or acute a particular financial reporting issue is likely to be for entities.<sup>3</sup>
10.    The *Due Process Handbook* also states the Board should only add a standard-setting project if it considers that the benefits of the improvements to financial reporting will outweigh the costs.<sup>4</sup>

## Staff analysis of the Primary Financial Statements project

11.    The following sections describe the work the Board and staff have undertaken to assess:
- (a)    whether there is a deficiency in current reporting and the importance of any deficiency to users of financial statements (paragraphs 12-17);
  - (b)    the types of entity likely to be affected by the proposals (paragraph 18);
  - (c)    the pervasiveness of the problem (paragraph 19); and

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<sup>3</sup> *Due Process Handbook*, paragraph 5.4.

<sup>4</sup> *Due Process Handbook*, paragraph 5.7.

- (d) the costs and benefits of the proposals (Paragraph 20-23).

***Deficiencies in current reporting and importance to users***

12. The project was added to the Board’s research programme in July 2014 in response to the strong demand from users of financial statements to undertake a project on performance reporting. The Board observed that, in order to answer questions about the structure and content of the statement(s) of financial performance, it would also need to think about the structure and content of the other primary financial statements.
13. Feedback received on the Board’s 2015 Agenda Consultation reinforced the view that the Primary Financial Statements project should be a high priority for the Board. Users in particular identified the project as important. Respondents to the Agenda Consultation suggested that the project should focus on performance reporting issues.
14. Consequently, during 2016, the staff undertook research and outreach activities to gather evidence about perceived problems with the presentation of the primary financial statements in order to understand stakeholders’—and in particular users’—views on the areas of the primary financial statements that need improvement.
15. In November 2016 the staff presented an overview of its research and outreach activities to the Board.<sup>5</sup> Some of the major findings on the presentation of financial statements were as follows:
  - (a) the structure and content of the statement(s) of financial performance vary even among entities in the same industry.
  - (b) users of financial statements would like more comparability in the structure and content of the statement(s) of financial performance and would welcome more defined subtotals and line items in that statement.
  - (c) users of financial statements would like to see greater disaggregation of information in the primary financial statements and the notes.

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<sup>5</sup> Agenda Papers 21A-21E from November 2016.

- (d) alternative performance measures can provide relevant information to users. However, users find that there is often a lack of transparency around how these measures are calculated or why they are disclosed.
- (e) users find the permitted presentation alternatives for the statement(s) of financial performance and the statement of cash flows unhelpful as they reduce comparability.
- (f) electronic reporting of financial information is facilitated if there are more required line items and subtotals and greater disaggregation of the information provided.
- (g) users expressed few concerns about the presentation of the statement of financial position.

16. The research and outreach seemed to indicate that the main area of concern for most users of financial statements was presentation of information in the statement(s) of financial performance. Consequently, at its December 2016 meeting the Board tentatively decided to focus on targeted improvements, mainly to the statement(s) of financial performance, rather than a fundamental revision of the presentation of all the primary financial statements. Appendix A describes the scope of the project in more detail.
17. Based on the feedback, research and outreach described in paragraphs 12-16, the staff are of the view that there are deficiencies in the way that information is presented in the primary financial statements and these deficiencies are important to users of financial statements.

***Types of entity affected***

18. It is likely that this project will have a pervasive effect. Although our initial focus has been on presentation in the financial statements of non-financial entities, it is likely that at least some of our proposals (for example the proposals on disaggregation and management performance measures) will affect all entities.

***Pervasiveness of the problem***

19. Our research has indicated that problems with presentation in the primary financial statements, and the statement(s) of financial performance in particular, are pervasive. For example:
- (a) the structure and content of the statement(s) of financial performance vary even among entities in the same industry.
  - (b) there are significant variations in the presentation of information across jurisdiction. The structure and content of the primary financial statements appears to depend significantly on the former accounting requirements in the jurisdiction or guidance from individual regulators.
  - (c) the use of alternative performance measures and the quality of the disclosures about such measures vary across jurisdiction and are dependent on the approach taken by individual regulators.

***Costs and benefits***

20. It is difficult to be certain about the likely costs and benefits of the proposed improvements to the presentation of information in the primary financial statements at this stage of the project. A detailed effects analysis will be conducted before publication of an Exposure Draft. However, our outreach and research has highlighted that users think that improvements to the structure and content of the primary financial statements would be beneficial. In our view, the main benefits of the project would be increased comparability of the statement(s) of financial performance between different entities and increased transparency of performance measures, which in turn would enable investors and other market participants to make better economic decisions.
21. We have discussed the project several times with the Global Preparers Forum (GPF).<sup>6</sup> Feedback from GPF members, including concerns raised about the potential costs of some proposals, has been considered by the Board when making tentative decisions.

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<sup>6</sup> The project was discussed by the GPF at its meeting in March 2018 and at joint meetings with the Capital Markets Advisory Committee in June 2018, June 2017 and June 2016.

22. Two factors are likely to mitigate the costs of implementing the proposals in this project:
- (a) The proposals affect presentation and disclosure requirements; they do not affect recognition and measurement. Consequently, the proposals are likely to have fewer significant systems implications for preparers than projects that affect recognition and measurement as well as presentation and disclosures.
  - (b) We are proposing targeted improvements rather than a fundamental revision of the presentation of primary financial statements.
23. Consequently, the staff’s preliminary assessment, subject to a more detailed effects analysis before issuing an Exposure Draft, is that the benefits of the improvements to financial reporting from this project are likely to outweigh the costs.

**Advice from ASAF and Advisory Council**

24. ASAF discussed this topic at their July 2018 meeting. In summary, most ASAF members thought the Primary Financial Statements project met the criteria for adding a project to the standard-setting programme.
25. ASAF members were not asked for advice on whether the first due process document in this project should be an exposure draft or a discussion paper. However, whilst they think that the criteria for adding a project to the standard-setting programme are met, many ASAF members think that the first due process document should be a discussion paper. This is because, in their view, more research is needed on feasible solutions, in particular for financial entities.
26. The full summary of the ASAF meeting is included in Appendix C.
27. The IFRS Advisory Council discussed this topic at their September 2018 meeting. The Advisory Council members made the following comments:
- (a) One council member questioned whether the Board could make a decision on moving to standard-setting before it knows what the first due process document will be. (see paragraph 28)

- (b) One council member expressed strong support because they saw there are a significant number of alternative performance measures moving into the financial statements and they think now is the time for the Board to address the issue.
28. The staff recognises the link between the decision to move a project from the research to the standard-setting agenda, and the decision to publish an Exposure Draft or a Discussion Paper. However, the staff does not think that both decisions need to be made at the same time, as the decision criteria are different. Also, as noted in paragraph 4, it is not possible for the Board to decide to publish an Exposure Draft if the project is not a standard-setting project.
29. Based on the assessment of the criteria for adding a project to the standard-setting programme and the advice from ASAF and the IFRS Advisory Council, the staff recommends that the Primary Financial Statements project is added to the standard-setting programme.

**Question 1**

Does the Board agree with the staff recommendation to move the Primary Financial Statements project from the research programme to the standard-setting programme?

**Project consultative group**

30. The IFRS Foundation Due Process Handbook requires the Board to consider whether it should establish a consultative group for each major project it adds to its standard-setting programme. The objective of consultative groups is to give the Board access to additional practical experience and expertise<sup>7</sup>.
31. The Handbook states that it is not mandatory to have such a group, but if the Board decided not to have it, it must explain why on the project page and inform the Due Process Oversight Committee.
32. Relevant extracts from the Handbook are in Appendix B.

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<sup>7</sup> *Due Process Handbook*, paragraphs 3.58–3.59, reproduced in Appendix B



33. The staff think that there is no need for a dedicated consultative group for the Primary Financial Statements because:
- (a) the project does not require detailed specialist knowledge; and
  - (b) the Board’s existing consultative groups have the necessary practical experience and expertise on financial statement presentation to advise on this project. We have already consulted extensively with ASAF, GPF and CMAC and plan to continue using these groups to provide advice on the project.

<b>Question 2</b>
<p>Does the Board agree with the staff recommendation that a consultative group is not needed for this project? If not, why?</p>

**Next steps in due process – type of consultation document**

34. After the Board has discussed all major areas in the scope of the project, the staff are planning to bring a paper to ask the Board which due process document it wants to publish to obtain feedback on the project proposals. If the Board decides to keep the project on the research programme, the next due process document will be a Discussion Paper. If the Board decides to move the project to the standard-setting programme, the next due process document can be either a Discussion Paper or an Exposure Draft.
35. The Handbook does not set out criteria to help the Board decide whether to publish a Discussion Paper or an Exposure Draft. However, it sets out required content, which is different for the two types of documents:

**Discussion Papers**

4.12 Discussion and research papers typically include a comprehensive overview of the issue, possible approaches to addressing the issue, the preliminary views of its authors or the IASB and an invitation to comment.

4.13 Discussion Papers are issued by the IASB and present the analysis and collective views of the IASB on a particular

topic.... Discussion Papers do not contain a Basis for Conclusions or any dissenting opinions. The discussion itself should reflect and convey differences in views of the IASB members.

### **Exposure Drafts**

6.2 An Exposure Draft sets out a specific proposal in the form of a proposed Standard (or amendment to a Standard) and is therefore generally set out in the same way as, and has all of the components of, a Standard. The main differences are that the:

(a) Basis for Conclusions is written to explain the IASB's rationale for the proposal, and is not a draft of the rationale for the final Standard or final amendments to the Standard; and

(b) consequential amendments need not be set out in as much detail as they would be in a final Standard, particularly where such amendments are changes to cross-references or terminology and other matters that are more administrative in nature.

36. The staff plan to prepare an analysis of additional work that will be required if the Board decides to publish an Exposure Draft which will include preparation of an effects analysis<sup>8</sup> to accompany the Basis for Conclusions as well as consequential amendments to other IFRS Standards.

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<sup>8</sup> *Due Process Handbook*, paragraph 3.74.

## Appendix A—Scope of the Primary Financial Statements Project

- A1. The scope of the Primary Financial Statements project is designed to address the concerns about financial statement presentation identified by the research and outreach conducted in 2016 (see paragraph 15).
- A2. For the statement(s) of financial performance, the Board is exploring 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 alternatives for presentation of income and expenses in existing IFRS Standards (for example, presentation of net interest cost on a net defined benefit liability); and
  - (c) providing guidance on the use of performance measures, including separate presentation of non-recurring, unusual or infrequently occurring items.
- A3. The Board has tentatively decided not to attempt to positively define an operating profit subtotal. Although many users supported the idea, the Board’s initial research suggested that it would be difficult to reach a consensus on what should be included in operating profit.
- A4. The Board tentatively decided not to develop guidance on which items of income or expense should be reported in other comprehensive income or when such items should be recycled as it has developed high-level guidance on this topic as part of its *Conceptual Framework*. However, the Board is exploring better ways of communicating information about other comprehensive income.
- A5. For the statement of cash flows the Board is exploring the following topics:
- (a) elimination of options for the classification of the cash effects of interest and dividends in the statement of cash flows; and
  - (b) requiring a consistent starting point for the indirect reconciliation of cash flows.
- A6. The Board is also exploring:

- (a) the development of templates for the primary financial statements for a small number of industries; and
- (b) the development of a principle for aggregating and disaggregating items in the primary financial statements.

A7. In light of the feedback from users which suggested that they had fewer concerns about the presentation of information in the statement of financial position, the Board has tentatively decided not to consider targeted improvements to that statement unless work on other areas of the primary financial statements identifies possible improvements.

A8. In addition, the Board decided not to consider changes to the following as part of this project:

- (a) the statement of changes in equity. The Board has a separate project on Financial Instruments with Characteristics of Equity which may consider changes to that statement.
- (b) segment reporting. The Board decided not to consider segment reporting as part of this project because it would significantly increase the scope of the project, potentially delaying improvements to the structure and content of the primary financial statements.
- (c) the presentation of discontinued operations.

**Appendix B – Extract from due process handbook on consultative groups****Consultative groups**

3.58 The IASB usually establishes a consultative group for each of its major projects, such as a specialist or expert advisory group. Consultative groups give the IASB access to additional practical experience and expertise.

3.59 Once a project is added to the IASB's standard-setting programme it must consider whether it should establish a consultative group for the project. It is not mandatory to have such a group, but if the IASB decides not to do so, it must explain why on the project page and inform the DPOC. The composition of a consultative group should reflect the purpose for which the group is being formed, bearing in mind the need to ensure that it draws on a diverse and broad membership. The IASB would normally advertise for nominations and applications via its website, but it can also approach parties directly. The IASB may also establish or host specialist advisory groups whose membership reflects a particular sector, such as investors or preparers that meet regularly to provide advice on a wide range of topics rather than on a specific project. The DPOC reviews the proposed composition of each group to ensure that there is a satisfactory balance of perspectives, including geographical balance.

## **Appendix C – feedback from ASAF**

The summary of the July 2018 ASAF discussion is reproduced below.

### **Primary Financial Statements**

- C1. The purpose of this meeting was to seek ASAF members' advice on moving the Primary Financial Statements project from the research programme to the standard-setting programme.
- C2. The OIC, CASC, EFRAG, ANC, AcSB, AOSSG, FASB and ASBJ members said that they thought the project has met the due process criteria for moving to a standard-setting phase, with additional comments as follows:
- (a) the CASC, ANC and ASBJ members said that they thought the next due process document for the project should be a Discussion Paper because there are still several unresolved issues and differences in views on the proposals.
  - (b) the AcSB member said they had heard support for the proposals on subtotals in the statement(s) of financial performance.
  - (c) the EFRAG and AOSSG members said that more work and research is needed on the project, such as extending the current proposals to cover more sectors including financial entities and conglomerates.
  - (d) the FASB member questioned whether stakeholders would perceive the benefits as outweighing the costs. She stated that in the US there had been significant resistance from preparers to suggested changes in presentation. The GLASS member said that different users have different views on how to achieve comparability and that a trade-off between flexibility and comparability will be needed.
- C3. The DRSC and NZASB members said it was difficult to separate the question of whether the project should be a standard-setting project from whether the first

due process document should be a Discussion Paper or an Exposure Draft. They said the next due process document should be a Discussion Paper that focuses on identifying feasible solutions to the identified problems including the application of the proposals to the financial sector and conglomerates.

- C4. The ASBJ member questioned whether there would be any difference between a Discussion Paper published as part of a research project and a Discussion Paper published as part of a standard-setting project. A Board member clarified that a Discussion Paper in a research project asks whether there is a financial reporting problem and considers feasible solutions; in standard-setting projects, the financial reporting problem has been identified.
- C5. The FASB member said that the conversation should move on from whether there is a problem, commenting that if you leave a project on the research programme for too long, stakeholders will question whether there really is a problem.
- C6. The EFRAG member asked whether there are additional criteria to consider when deciding whether to publish a Discussion Paper or an Exposure Draft. Staff responded that an effects analysis will be required if an Exposure Draft is published.