Primary Financial Statements

Primary Financial Statements project

2015	Dec 2016	2017–2019	Q4 2019
Agenda Consultation identified the project as a priority	Board decision on project scope	Board discussions on topics in project scope	**Publish Exposure Draft for public comment**

objective

Targeted improvements to the primary financial statements with a focus on the statement(s) of financial performance

out of scope

- Fundamental revision of the statements of financial position, cash flows and changes in equity
- Guidance on content of OCI and timing of recycling
- Segment reporting
- Presentation of discontinued operations

Main issues the Board is addressing in the project

Users: Statements of financial performance are not sufficiently comparable between different companies	Introduce **required and defined subtotals** in the statement(s) of financial performance
Users: Non-GAAP measures can provide useful information, but transparency and discipline need to be improved	Introduce disclosure of **Management Performance Measures (MPMs)**
Users: Level of disaggregation does not always provide the information I need	Introduce **requirements to improve disaggregation**

Introducing required and defined subtotals in P&L

(example for general corporates, analysis of expenses by nature)

	Revenue	16,500
	Changes in inventories of finished goods and work in progress	(1,000)
	Raw material and consumables used	(6,000)
	Employee benefits expense	(4,000)
	Amortisation expense	(800)
	Depreciation expense	(1,200)
	Impairment of property, plant and equipment	(500)
1	**Operating profit**	**3,000**
	Share of profit of **integral** associates and JVs	500
2	**Operating profit and share of profit or loss of integral associates and JVs**	**3,500**
	Changes in the fair value of financial assets	250
	Dividend income	50
	Share of profit of **non-integral** associates and JVs	100
3	**Profit before financing and income tax**	**3,900**
	Interest income from cash and cash equivalents	100
	Expenses from financing activities	(1000)
	Unwinding of discount on pension liabilities and provisions	(100)
	Profit before tax	2,900

Operating

Investing

Financing

Profit before financing and income tax

Objective: enable comparison of entities with different capital structures

Items excluded from profit before financing and income tax:

Income from cash & cash equivalents	Expenses (income) from **financing activities**	Expenses from liabilities not arising from financing activities
Used as a proxy for income from excess cash and temporary investments of excess cash	Financing activities are defined as: • receipt or use of a resource (or credit) from a provider of finance • expectation that resource will be returned to provider of finance • expectation that provider of finance is appropriately compensated through finance charge	Includes specified items such as unwinding of the discount on provisions and net interest on net defined benefit liabilities.

Income (expenses) from investments

Objective: enable investors to value investments separately

Definition	'income (expenses) from assets that **generate a return individually and largely independently** of other resources held by the entity' (includes incremental expenses)
Presentation	Required to be presented between the 'operating profit and share of profit of integral associates and joint ventures' subtotal and the 'profit before financing and income tax' subtotal.
Examples (for entities that do not invest in the course of their main business activities*)	• fair value changes and rental income on investment property • interest income on financial assets (other than cash & cash equivalents) • dividends and fair value changes on non-consolidated equity investments

* eg for an investment property company, income from investment properties would be included in operating profit.

Classification of income/expenses for financial entities

Operating income (expenses)	X
Operating profit	X
Share of profit of integral joint ventures and associates	X
Operating profit and share of profit or loss of integral associates and joint ventures	X
Share of profit of non-integral joint ventures and associates	X
Income (expenses) from investments (eg fair value changes in financial assets)	X
Profit before financing and income tax	X
Interest income from cash and cash equivalents	X
Expenses from financing activities	(X)
Unwinding of discount on pension liabilities and provisions	(X)
Profit before tax	X

Included in operating profit for entities that invest* in the course of their main business activities.

To the extent income (expenses) arise from investments made in the course of main business activities.

Included in operating profit for entities that **provide financing to customers** as a main business activity.

Accounting policy choice whether to include all expenses (income) or only those related to the provision of financing to customers.

*in assets that generate a return individually and largely independently of other entity resources

Example—Bank with multiple business activities

Extract from statement(s) of financial performance	
Interest income*	X
Interest expense	(X)
Net interest income	X
Fee and commission income	X
Fee and commission expense	(X)
Net fee and commission income	X
Net trading income	X
Net investment income	X
Credit impairment losses	(X)
Employee benefit expenses	(X)
General and administrative expenses	(X)
Operating profit	X
Share of profit of integral associates and joint ventures	X
Operating profit and share of profit of integral associates and JVs	X
Share of profit of non-integral associates and joint ventures	X
Unwinding of discount on pension liabilities	(X)
Profit before tax	X

Bank with multiple business activities, including investing and customer financing activities.

all expenses from financing activities in operating profit, rather than below ‘profit before financing and tax’

income (expenses) from **investments** made in the course of the entity’s **main business activity** are included in operating profit.

entity does not present ‘profit before financing and income tax’ subtotal

*Interest revenue calculated using the effective interest method would be presented separately (IAS 1.82(a)(i))

Management performance measures (MPMs)

Disclosure in the notes of measures of profit not defined by IFRS Standards

In management's view **complements** IFRS-defined totals or subtotals in communicating an entity's performance

Same measure must be used in public communications with users **outside financial statements**

Must **faithfully represent** the financial performance of the entity to the users

Accompanied by disclosures to **enhance transparency,** in a **single note** —including a **reconciliation** to the closest IFRS-defined total or subtotal (see example on next slide)

IFRS

Example of MPM reconciliation

The MPM is disclosed in a **separate reconciliation** in the **notes**:

		Tax	NCI
Adjusted operating profit (MPM)	4,400		
Restructuring expenses for the closure of Factory A	(1,000)	200	50
Impairment of asset B	(400)	80	-
Operating profit (IFRS-specified)	3,000		

Most directly comparable subtotal/total specified by IFRS Standards—can be:

- any of the subtotals required by para. 81A of IAS 1;
- any of the three subtotals proposed in this project;
- profit before tax, profit from continuing operations or gross profit; or
- operating profit before depreciation and amortisation

Tax effect is based on a **reasonable pro rata allocation** of the current and deferred tax of the entity in the tax jurisdiction concerned; or a more appropriate allocation.

What does this mean for EBITDA?

Existing practice is likely to continue, ie:

- Diversity in how companies define EBITDA
- Not all companies will disclose an EBITDA measure

However, the Board's proposals would have the following benefits:

Improved transparency

If companies disclose an EBITDA-type measure that is not defined as operating profit before D&A, they will need to provide disclosures that explain how they have calculated EBITDA, including a **reconciliation**

Comparable starting point & improved disaggregation

Investors will have the **building blocks** to calculate their own EBITDA:

- a comparable starting point (defined operating profit or profit before financing)
- information on operating expenses by nature including depreciation, amortisation and impairment.

Disaggregation

General	Improved principles, definitions and guidance on aggregation and disaggregation (eg on ‘other’ balances)
Expense analysis	• primary analysis of operating expenses in the statement(s) of financial performance **by nature or by function** • when primary analysis of expenses is presented by function, a **full analysis of expenses by nature in the notes** is required.
Unusual items	• **Definition:** ‘income or expenses with limited predictive value because it is reasonable to expect that similar items will not arise for several future annual reporting periods. Similar items are income or expenses that are similar in type and amount.’ • Required note disclosing **unusual items**, **attributed to P&L line items**
Illustrative examples	• for the statement(s) of financial performance, statement of cash flows and other notes introduced by the project • for a limited number of industries

Non-mandatory illustrative examples

	Types of entities
Statement(s) of financial performance	• a non-financial entity (both by function and by nature) • an investment property company • an insurer • a traditional bank with no material investing activities • a bank with both investing and customer financing activities • a bank-insurer • a manufacturer that conducts investing activities • a manufacturer that provides financing to customers
Statement of cash flows	• a financial entity • a non-financial entity (Based on the current illustrative examples in IAS 7)

+ Any notes that are introduced or amended by the project