STAFF PAPER

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Joint CMAC and GPF Meeting

Project	Primary Financial Statements		
Paper topic	Illustrative examples		

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Purpose of the session

1. The Board plans to publish an exposure draft of proposals for its Primary Financial Statements project by the end of 2019. The exposure draft will include examples illustrating how the Board proposals could be applied in practice.

2. The purpose of this session is to get feedback from CMAC and GPF members to help us develop the illustrative examples by:

   (a) discussing three specific examples:

      (i) presentation of subtotals;

      (ii) disclosures of management performance measures (MPMs); and

      (iii) disclosures of unusual items; and

   (b) considering which other topics should be illustrated by examples.

Background

3. The Primary Financial Statements project is part of the Board's plan to promote Better Communication in Financial Reporting. This project aims to help users make better decisions by improving the structure and content of the primary

Information about the Global Preparers Forum (GPF) is available at www.ifrs.org/groups/global-preparers-forum/

financial statements,[1] with a focus on the statement(s) of financial performance. In particular, the project aims to enhance users' ability to compare entities' financial statements, improve and make consistent the information users get from disaggregation and improve the transparency of management-defined performance measures.

4. The project started in 2016, in response to feedback on the Board's 2015 Agenda Consultation that identified this project as a priority. The Board has since discussed and tentatively decided on the project's scope and proposals. The key areas in the project scope are:

   (a) introduction of additional required subtotals in the statement(s) of financial performance;

   (b) introduction of disclosures about MPMs;

   (c) introduction of guidance for disaggregation of information in the financial statements (including disaggregation principles, disaggregation of operating expenses either by nature or by function in the statement(s) of financial performance, and a requirement to provide information about unusual items); and

   (d) limited changes to the statement of cash flows to improve the consistency of classifications.

5. Agenda Paper 4A provides slides containing an overview of the project's scope and proposals as background information.

6. The Board has held several meetings with CMAC and GPF about this project. Appendix A summarises the topics previously discussed with CMAC and GPF, both individually and at joint CMAC and GPF meetings.

7. The Board will seek GPF and CMAC feedback on a complete set of project proposals once the exposure draft is published.

[1] Primary financial statements consist of the statement of financial position, the statement(s) of financial performance, the statement of changes in equity and the statement of cash flows.

Approach to the session

8. We have prepared draft illustrative examples for each of the following project areas:

   (a) Illustrative Example 1—introduction of required and defined subtotals in the statement of profit or loss, illustrated for a manufacturing entity (pages 8–9);

   (b) Illustrative Example 2—disclosure of MPMs, illustrated for an entity that has two MPMs (pages 12–13); and

   (c) Illustrative Example 3—disclosure of unusual items (pages 15–16).

9. We have also provided a summary of the Board proposals relevant to each illustrative example to help CMAC and GPF members understand and discuss them. Please note that the drafting in this paper is not final and will change during the development of the exposure draft.

10. The exposure draft will include additional examples; we have focused on these three because they illustrate key proposals. Appendix B summarises the topics for which we currently plan to include illustrative examples in the exposure draft.

11. During the breakout session, we are asking CMAC and GPF members to discuss the questions set out on the next page.

Questions for discussion during breakout session

1. For each of the three examples, CMAC and GPF members are asked to answer the following questions (a) and (b). Please discuss examples in the following order:

   Group 1 and 4—start from Illustrative Example 1;

   Group 2—start from Illustrative Example 2; and

   Group 3—start from Illustrative Example 3.

   (a) Is the example useful in illustrating the Board proposals? What improvements do you suggest?

   - CMAC members may want to consider this question focusing on whether the example provides information they would expect to see under the Board proposals.
   - GPF members may want to consider this question focusing on whether the example is helpful in understanding the Board proposals and how they are intended to be applied.

   (b) Are there any aspects of the examples that might result in boilerplate information or information that could be misleading? Are the examples failing to illustrate an important aspect of the proposals? How could we change the examples to avoid these potential problems?

   When answering the questions, please consider both paper-based reports and electronic reports tagged using the IFRS Taxonomy.

2. Regarding Appendix B which summarises all topics for which the exposure draft will include illustrative examples, are there:

   - any topics that you think should not, or need not, be included?
   - any other topics that you think should be included?

Illustrative Example 1—presentation of subtotals in the statement of profit or loss

Board proposals for subtotals as background to discussion of specific examples on pages 8 and 9

We have illustrated the requirements for a non-financial entity only. The requirements for the following types of entities are not included in summary of proposals below:

- entities that provide financing to customers as a main business activity (for example, a bank); or
- entities that, in the course of their main business activities, invest in assets that generate a return individually and largely independently of other resources held by the entity (for example, an investment property company).

12. An entity shall present the following subtotals in the statement(s) of financial performance:

    (a) operating profit;

    (b) operating profit and the share of profit or loss from integral associates and joint ventures;

    (c) profit before financing and income tax;

    (d) profit or loss;

    (e) total other comprehensive income; and

    (f) comprehensive income for the period, being the total of profit or loss and other comprehensive income.

13. An entity shall include all income and expenses from its main business activities in the 'operating profit' subtotal.

14. Income and expenses from an entity's main business activities exclude:

    (a) the share of profit or loss of integral associates and joint ventures accounted for using the equity method;

    (b) income or expenses from investments;

    (c) income from cash and cash equivalents;

(d) expenses from financing activities;

(e) interest expenses on liabilities that do not arise from financing activities;

(f) income tax expense;

(g) income or expenses required to be recognised outside the statement of profit or loss; and

(h) income or expenses permitted to be recognised outside the statement of profit or loss that the entity has recognised outside that statement.

15. An entity shall present the share of profit or loss of *integral associates and joint ventures accounted for using the equity method* between the 'operating profit' subtotal and the 'operating profit and the share of integral associates and joint ventures' subtotal.

16. An entity shall include *income/expenses from investments* between the 'operating profit and the share of profit or loss of integral associates and joint ventures' subtotal and 'profit before financing and income tax' subtotal.

17. An entity shall present between the 'profit before financing and income tax' subtotal and the 'profit or loss' subtotal:

(a) income from cash and cash equivalents;

(b) expenses from financing activities;

(c) interest expenses on liabilities that do not arise from financing activities; and

(d) income tax income or expense.

Definitions

Income or expenses from investments	Income or expenses from assets that generate a return individually and largely independently of other resources held by the entity.

Financing activities	The receipt or use of a resource from a provider of finance (or provision of credit) with the expectation that: (a) the resource will be returned to the provider of finance; and (b) the provider of finance will be appropriately compensated through the payment of a finance charge that is dependent on both the amount of the credit and its duration.
Integral associates and joint ventures	Associates and joint ventures accounted for using the equity method that do not generate a return largely independently from the other assets of the entity.

Questions (reproduced from page 4)

(a) Is the example useful in illustrating the Board proposals? What improvements do you suggest?

(b) Are there any aspects of the examples that might result in boilerplate information or information that could be misleading? Are the examples failing to illustrate an important aspect of the proposals? How could we change the examples to avoid these potential problems?

When answering the questions, please consider both paper-based reports and electronic reports tagged using the IFRS Taxonomy.

Illustrative Example 1.1—the statement of profit or loss (expenses analysed by nature)

Required (sub)totals | Optional subtotals

Statement of profit or loss (in thousand CU)

	20X9	20X8
Revenue	17,600	15,200
Changes in inventories of finished goods and work in progress	(250)	(200)
Raw material and consumables used	(6,000)	(5,550)
Employee benefits expense	(4,000)	(3,800)
Depreciation expense	(1,200)	(1,200)
Amortisation expense	(800)	(800)
Impairment of property, plant and equipment	(500)	(200)
Travel expenses	(350)	(200)
Gain on disposal of Subsidiary D	-	440
Litigation expenses	(400)	-
Other operating expenses*	(200)	(250)
Operating profit	3,900	3,440
Share of profit of integral associates and joint ventures	500	600
Operating profit and share of profit of integral associates & JVs	4,400	4,040
Changes in the fair value of financial assets	250	(200)
Share of profit of non-integral associates and joint ventures	300	220
Profit before financing and income tax	4,950	4,060
Interest income from cash and cash equivalents	240	210
Expenses from financing activities	(1,000)	(800)
Unwinding of discount on pension liabilities and provisions	(220)	(210)
Profit before tax	3,970	3,260
Income tax expense	(800)	(700)
Profit for the year	3,170	2,560

*Project proposals require further information about items labelled 'other' to be disclosed in the notes. This additional information is not included in this paper.

*Illustrative Example 1.2—the statement of profit or loss (expenses analysed by function)***

Statement of profit or loss (in thousand CU)

	20X9	**20X8**
Revenue	17,600	15,200
Cost of sales	(9,000)	(8,200)
Gross profit	8,600	7,000
Distribution costs	(2,700)	(2,200)
Research expenses	(800)	(800)
Administrative expenses	(1,200)	(1,000)
Gain on disposal of Subsidiary D	-	440
Operating profit	3,900	3,440
Share of profit of integral associates and joint ventures	500	600
Operating profit and share of profit of integral associates & JVs	4,400	4,040
Changes in the fair value of financial assets	250	(200)
Share of profit of non-integral associates and joint ventures	300	220
Profit before financing and income tax	4,950	4,060
Interest income from cash and cash equivalents	240	210
Expenses from financing activities	(1,000)	(800)
Unwinding of discount on pension liabilities and provisions	(220)	(210)
Profit before tax	3,970	3,260
Income tax expense	(800)	(700)
Profit for the year	3,170	2,560

**In this case an entity will also provide a note disclosure of expenses by nature. This note disclosure is not included in this paper.

Illustrative Example 2—disclosure of MPMs

Board proposals for MPMs as background to discussion of specific example on pages 12 and 13[2]

18. Management performance measures are measures of aspects of profit or loss that are used in public communications with users of financial statements outside the financial statements, and which, in management's view complement IFRS-defined totals or subtotals in communicating an entity's performance.

19. An entity shall disclose its management performance measures, if any, in the notes to the financial statements.

20. An entity shall disclose the following information, in a single note, for each management performance measure:

    (a) a reconciliation between the management performance measure and the most directly comparable IFRS-defined subtotal or total;[3]

    (b) the effect on income tax and non-controlling interests of each of the differences between the management performance measure and its most directly comparable subtotal or total;

    (c) a statement that the management performance measure, in management's view, complements IFRS-defined totals or subtotals in communicating the entity's financial performance, and is not necessarily comparable with measures provided by other entities;

[2] We have not included Board tentative decisions about disclosure related to interaction between MPM and segment information. Staff are drafting a paper to ask the Board to clarify such disclosure and whether it is needed.

[3] These include totals and subtotals that are:

i. specified by paragraph 81A of IAS 1 *Presentation of Financial Statements*—including the proposed new required subtotals developed as part of this project; and

ii. not specified by paragraph 81A of IAS 1 but that the Board has decided to exempt from the disclosure requirements for management performance measures, namely:

- profit before tax, profit from continuing operations;
- gross profit (defined as revenue less cost of sales); and
- operating profit before depreciation and amortisation.

(d) a description of why management thinks the management performance measure complements IFRS-defined totals or subtotals, including an explanation of:

   (i) how the management performance measure has been calculated and why; and

   (ii) how the management performance measure provides useful information about an entity's financial performance; and

(e) sufficient explanation, if there is a change in how the management performance measure is calculated, to help users understand the reasons for and effect of the change.

21. Management performance measures:

(a) can only be measures of aspects of profit or loss. They cannot be measures of liquidity or ratios.

(b) shall faithfully represent the financial performance of the entity to the users of financial statements.

(c) shall comply with the requirement in paragraph 45 of IAS 1 for consistency of presentation and classification over time.

(d) shall be labelled in a clear and understandable way so as not to mislead users.

(e) cannot be presented using columns in the statement(s) of financial performance.

Questions (reproduced from page 4)

(a) Is the example useful in illustrating the Board proposals? What improvements do you suggest?

(b) Are there any aspects of the examples that might result in boilerplate information or information that could be misleading? Are the examples failing to illustrate an important aspect of the proposals? How could we change the examples to avoid these potential problems?

When answering the questions, please consider both paper-based reports and electronic reports tagged using the IFRS Taxonomy.

Illustrative Example 2—note on MPMs

Note M—Management performance measures

The Group has included within its financial statements two management performance measures, that is, Adjusted operating profit and Adjusted net profit.

The management performance measures provide management's view of the Group's financial performance. They are not defined by IFRS Standards and therefore may not be comparable to similar measures used by other companies. They are provided to complement IFRS measures, and are not intended to be a substitute for IFRS measures.

These management performance measures are used for budget planning and setting management remuneration. They are also used in communications with investment analysts and credit rating agencies.

We believe the management performance measures help readers to assess underlying trends in profitability over time, because they exclude income and expenses that are volatile or are not expected to persist.

The management performance measures are adjusted for the effect of unusual items (see Note N) and the effect of fair value gains and losses on financial assets. In the management's view, both unusual items and fair value gains and losses from financial assets should be excluded when assessing trends, unusual items because of their limited predictive value and fair value gains and losses because of their volatility.

continued…

FY20X9

(in thousand CU)

	Reconciliation from management performance measure to IFRS measure		Tax and NCI effect	
			Income tax effect	Effect attributable to NCI (post-tax)
Management performance measure	**Adjusted operating profit**	**Adjusted net profit**		
	5,300	**4,220**		
Restructuring costs (pre-tax)	(1,000)	(1,000)	150	(85)
Litigation expenses from Case C (pre-tax)	(400)	(400)	-	-
Fair value gains and losses (pre-tax)	-	250	(50)	-
Income tax adjustments	-	100		
IFRS defined subtotal	**Operating profit**	**Profit for the year***		
	3,900	**3,170**		

FY20X8

(in thousand CU)

	Reconciliation from management performance measure to IFRS measure		Tax and NCI effect	
			Income tax effect	Effect attributable to NCI (post-tax)
Management performance measure	**Adjusted operating profit**	**Adjusted net profit**		
	3,000	**2,390**		
Gain on disposal of Subsidiary D (pre-tax)	440	440	(110)	-
Fair value gains and losses (pre-tax)	-	(200)	40	-
Income tax adjustments	-	(70)		
IFRS defined subtotal	**Operating profit**	**Profit for the year***		
	3,440	**2,560**		

*Profit for the year is after income tax and pre-NCI (non-controlling interests).

Illustrative Example 3—disclosure of unusual items

Board proposals for unusual items as background to discussion of specific example on pages 15 and 16

22. Unusual items are 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.

23. Gains and losses arising from the remeasurement of items required to be measured at current value, including fair value, generally should not be classified as unusual items.

24. An entity shall disclose the following information about unusual items in a separate note:

    (a) the amount of income or expenses classified as unusual items recognised in the reporting period, attributed to line items in the statement(s) of financial performance. In addition, an entity shall attribute unusual expenses to categories of expense by nature, regardless of its method of analysis of expenses in the statement(s) of financial performance.

    (b) a narrative description of the transactions or other events that gave rise to unusual income or expenses during the reporting period.

Questions (reproduced from page 4)
(a) Is the example useful in illustrating the Board proposals? What improvements do you suggest?
(b) Are there any aspects of the examples that might result in boilerplate information or information that could be misleading? Are the examples failing to illustrate an important aspect of the proposals? How could we change the examples to avoid these potential problems?
When answering the questions, please consider both paper-based reports and electronic reports tagged using the IFRS Taxonomy.

Illustrative Example 3—note on unusual items

Note N—Unusual items

(This entity analyses expenses by function)

FY20X9

The following table analyses unusual items included in the statement of profit or loss for the reporting period. There were no unusual items included in the statement of other comprehensive income.

(in thousand CU)

P/L line item by function	Restructuring costs	Litigation expenses arising from Case C	Total
Cost of sales	900		900
Administrative expenses	100	400	500
Unusual items total	1,000	400	1,400

Line item by nature	Restructuring costs	Litigation expenses arising from Case C	Total
Employee benefits expenses	550		550
Impairment of property, plant and equipment	350		350
Travel expenses	100		100
Litigation expenses		400	400
Unusual items total	1,000	400	1,400

continued…

Restructuring costs

We moved one of our main factories from Country A to Country B in response to uncertainty caused by proposed legal changes restricting the operation of foreign companies in Country A (see Note Y for details of the operating environment in Country A). This resulted in restructuring costs of CU1,000,000, including redundancy payment to factory staff, impairment losses on factory machinery and travel expenses to arrange relocation.

Litigation expenses arising from Case C

Litigation expenses of CU400,000 arose from Court Case C in which we paid damages to a customer due to the consequences of incomplete labelling of one of our products. We have since taken measures to remedy labelling procedures.

FY20X8

Gain on disposal of Subsidiary D

Gain on disposal of Subsidiary D of CU440,000 arose from the disposal of former subsidiary D in Country E (see Note Z for details of the disposal of Subsidiary D). This gain is included in ‘Gain on disposal of Subsidiary D’ in the statement of financial performance.

Appendix A—Summary of topics discussed in past meetings

Joint CMAC and GPF meeting

Date	Topic	Minutes
Jun 2016	• Improving the statement of cash flows • Issues in current financial reporting	Jun 2016 minutes
Jun 2017	• Comparability and flexibility in performance reporting	Jun 2017 minutes
Jun 2018	• EBITDA and unusual or infrequently occurring items • Improving the usefulness of disaggregation in the financial statements	Jun 2018 minutes

CMAC meeting

Date	Topic	
Feb 2016	• Operating profit	Feb 2016 minutes
Nov 2016	• Possible approaches	Nov 2016 minutes
Mar 2017	• Consumption of financial information by users	Mar 2017 minutes
Oct 2017	• Project update • Financial institutions and performance reporting	Oct 2017 minutes
Mar 2018	• Requirements for management performance measures • Presentation of the share of profit or loss of associates and joint ventures	Mar 2018 minutes
Nov 2018	• Updated overview of the project • Effects analysis	Nov 2018 minutes

GPF meeting

Date	Topic	
Mar 2018	• Requirements for management performance measures and adjusted EPS • Presentation of the share of profit or loss of associates and joint ventures	Mar 2018 minutes
Nov 2018	• Updated overview of the project • Effects analysis	Nov 2018 minutes

Appendix B—Topics for which we plan to provide illustrative examples

B1. The exposure draft will include illustrative examples for the statement(s) of financial performance for the following types of entities:

- (a) a non-financial entity (disaggregation of expenses in the 'operating profit' subtotal both by function and by nature, see Illustrative Example 1 in this paper);
- (b) an investment property company;
- (c) an insurer;
- (d) a bank with no material investing activities;
- (e) an entity engaged in more than one business activity including both investing and financing:
    - (i) a bank engaged in both investing and customer financing activities; and
    - (ii) a bank-insurer; and
- (f) an entity engaged in more than one business activity, including either an investing or a financing activity:
    - (i) a manufacturer that conducts investing activities; and
    - (ii) a manufacturer that provides financing to customers.

B2. It will also include illustrative examples for the statement of cash flows for a financial and non-financial entity by updating the current Illustrative Examples accompanying IAS 7 *Statement of Cash Flows*.

B3. In addition, the exposure draft will include illustrative examples for any notes that are introduced or amended by the project. This will include notes on:

- (a) integral and non-integral associates and joint ventures;
- (b) management performance measures (see Note M in Illustrative Example 2);
- (c) composition of aggregated items for 'other' balances;
- (d) analysis of the nature of expenses required when an entity provides its primary analysis of expenses using a by-function methodology; and
- (e) unusual items (see Note N in Illustrative Example 3).