

Primary Financial Statements

Joint CMAC-GPF meeting
June 2019

This is for background information only and no discussion is intended on this slide deck in the session

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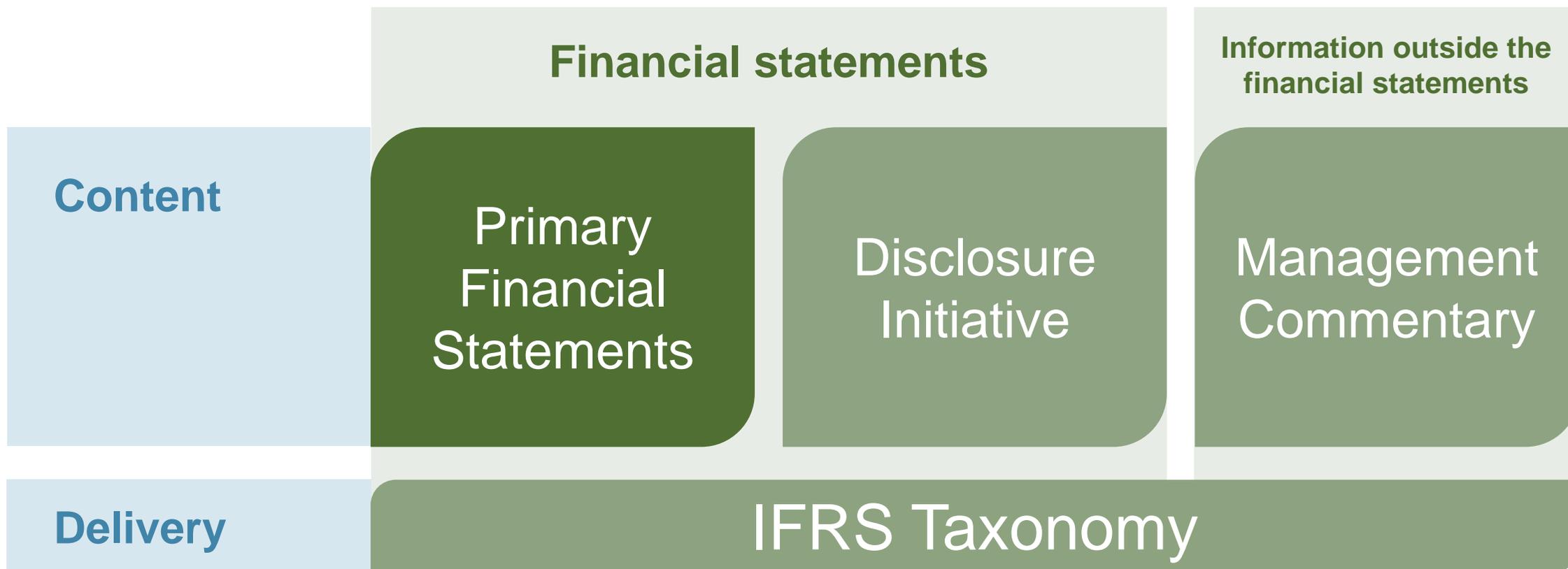
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Project background & overview

Better Communication in Financial Reporting



Primary Financial Statements project




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 PFS 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**

Full scope of the project

Statement(s) of financial performance	Statement of cash flows
Introducing subtotals & categories facilitating comparisons between entities	Eliminating classification options (interest/dividends)
Introducing disclosure of management performance measures	Introducing consistent starting point for the indirect method
Improving communication of OCI	Prescribing classification of cash flows related to associates/JVs

Improving disaggregation in financial statements by:
Introducing principles of disaggregation in financial statements
Requiring disaggregation by nature or by function in the statement(s) of financial performance
Requiring disclosure of unusual items
Requiring minimum line items in the primary financial statements
Developing illustrative examples of primary financial statements for a small number of industries

Defined subtotals in the statement(s) of financial performance

Tentative Board decisions

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

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 **Objective:** enable comparison of entities with different capital structures

Items excluded from profit before financing and income tax:

Income from cash & cash equivalents

Used as a proxy for income from excess cash and temporary investments of excess cash

Expenses (income) from financing activities

- 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

Expenses from liabilities not arising from financing activities

Includes specified items such as unwinding of the discount on provisions and net interest on net defined benefit liabilities.

Income (expenses) from investments

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 **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’

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.

Presentation of associates and JVs



Preparer A

My associates and JVs are a part of my main business, so I want to include my share of their results in my key performance measures.

The share of associates' and joint ventures' profit is after financing and after tax so I want to analyse them separately.



User B

Tentative Board decisions

Separately present 'integral' and 'non-integral' associates and joint ventures in statements of financial performance and cash flows.

Use definition of income/expenses from investments to classify as 'integral' or 'non-integral': generate returns largely independently of other resources.

Definition supplemented with indicators for determining whether a joint venture or associate is 'integral' or 'non-integral'.

Classification of income/expenses for financial entities

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Operating income (expenses)	X
Operating profit	X
Share of profit of integral associates and joint ventures	X
Operating profit and share of profit or loss of integral associates and joint ventures	X
Share of profit of non-integral associates and joint ventures	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

Tentative Board decisions

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**
—see next slide

MPMs—proposed disclosures in the notes

A **reconciliation** of the MPM(s) to the **most directly comparable subtotal or total specified by IFRS Standards**

Requirements in IAS 1.45 for **consistent presentation** apply. If there is a **change** in how the MPM is calculated, sufficient explanation should be provided to help users understand the reasons for and effect of the change

A statement that the MPM provides **management's view** of the entity's financial performance and is **not necessarily comparable** with measures provided by other entities

The **effect of tax and non-controlling interests** separately for each of the differences between the MPM and the most directly comparable subtotal or total specified by IFRS Standards.

A description of **why the MPM provides management's view of performance**, including explanation of:

- **how** the MPM has been **calculated** and **why**; and
- **how** the measure provides **useful information** about an entity's financial performance.

- An explanation of how MPM **differs** from the **total of the measures of profit or loss for the reportable segments**; and
- If **none of the MPMs fits** into the operating segment information, an **explanation** of why this is the case

Example of MPM reconciliation

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

Adjusted operating profit (MPM)	4,400	Tax	NCI
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—this means entities are unlikely to be required to disclose tax and NCI for depreciation and amortisation.

Can an MPM be presented on the face of the P&L?

In addition to disclosing MPMs in a single note, some MPMs may be presented within the statement(s) of financial performance.

The Board **expects this to be rare** because additional requirements apply:

1

The Board tentatively decided to prohibit columnar presentation of MPMs

2

MPMs can only be presented as a subtotal if they **fit into the structure** of the statement(s) of financial performance ie:

- they should not disrupt the by nature/by function analysis of expenses
- they should not adjust for income/expenses from multiple P&L sections

3

Additional subtotals should be **measured in accordance with IFRS Standards*** and relevant to an understanding of the entity's financial performance

*see para. 85 and 85A of IAS 1

Improving disaggregation

Tentative Board decisions

General

Improved principles, definitions and guidance on aggregation and disaggregation (eg on 'other' balances)

Expense analysis

- Entities are required to present their primary analysis of operating expenses by nature **or** by function in the statement(s) of financial performance.
- When primary analysis of expenses is presented by function, entities are required to disclose a **full analysis of expenses by nature in the notes**.

Unusual items

- **Definition of unusual items:** '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.'
- Requirement for all entities to provide a note disclosing **unusual items, attributed to line items** in the statement(s) of financial performance.

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

Statement of cash flows

Tentative Board decisions

Tentative Board decisions

Single starting point for the indirect reconciliation: **Operating profit**

Removal of classification options for interest and dividends



Cash flow item	IAS 7 classification	Tentative Board decision— non-financial entities	Tentative Board decision— financial entities
Interest paid	Operating or financing	Financing	Operating or financing*
Dividends paid	Operating or financing	Financing	Financing
Interest received	Operating or investing	Investing	Operating, investing or financing*
Dividends received	Operating or investing	Investing	Operating or investing* (always investing for equity-accounted investments)

* Depends on classification of related income/expenses in P&L

Statement of cash flows – illustration (indirect method)

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Operating profit	X
Adjustments for:	
Depreciation	X
[...]	
Income taxes paid	(X)
Net cash from operating activities	X
Acquisition of integral joint venture X	(X)
Acquisition of non-integral associate Y	(X)
Dividends received from integral associate A	X
Dividends received from non-integral associate B	X
Purchase of property, plant and equipment	(X)
[...]	
Net cash used in investing activities	(X)
Dividends paid	(X)
[...]	
Net cash used in financing activities	(X)
Net increase in cash and cash equivalents	X

Consistent starting point for indirect method for operating cash flows

Separate presentation of cash flows from integral and non-integral associates and joint ventures within investing cash flows

Elimination of classification options for interest and dividends

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