IFRS® Accounting

Staff paper

Agenda Reference 6

Accounting Standards Advisory Forum meeting

Date	**27-28 March 2023**
Project	**Primary Financial Statements**
Topic	**Effects analysis, transition period and effective date**
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Purpose of this session

The purpose of this session is:

1. to update ASAF members on the primary financial statements project (slides 4–5); and
2. to obtain input from ASAF members:
   a. on factors that the IASB should consider in determining the transition period and effective date of the forthcoming IFRS Accounting Standard *General Presentation and Disclosures* (slides 6–8); and
   b. to understand the expected benefits and costs for stakeholders in your region of the forthcoming IFRS Accounting Standard to help develop the Effects Analysis that will be published with the Accounting Standard (slides 13–20).

The appendix contains an overview of the key proposals (slides 21–39).

At the ASAF meeting on 10–11 June 2023 we plan to discuss the illustrative examples which will be included in the forthcoming IFRS Accounting Standard

Questions for ASAF members

1. For entities in your region, what information needed to apply the requirements in the new IFRS Accounting Standard would be readily available?
2. For entities in your region, what new information will they need to gather to apply the requirements in the new IFRS Accounting Standard? Please explain:
   (a) which new information is likely to be easily obtainable, for example, because of similar requirements in local laws or regulations (see slide 19); and
   (b) which new information is likely to require changes in systems and processes to gather and what is the extent of changes that are likely to be required.
3. Are there any entities in your region that are planning to apply early the new IFRS Accounting Standard?
4. Do you have any comments on the expected costs and benefits to preparers and users in your region shown on slides 14–18?
5. Do you have any comments on the expected benefits and additional benefits that we are developing for digital reporting on slide 20?

Overview of the Primary Financial Statements Project

Project overview

Q4 2019	Q1–Q3 2020	Q4 2020 – Q3 2022	Q4 2022	2023
Exposure Draft published	Consultation period	Discussion of feedback and key redeliberations	Targeted outreach on specific topics	Discussion of feedback and complete redeliberations

Objective

- Improve communication in financial statements
- Focus on information included in the statement of profit or loss

Main proposals

1. Require additional **defined subtotals** in statement of profit or loss
2. Require disclosures about **management performance measures**
3. Strengthen requirements for **disaggregating information**

Transition period and effective date

Transition and effective date

x/x/20x1

New Accounting Standard issued

Transition Period

1/1/20x3

Effective date

Prepare financial statements for year ending 31/12/20x3

20x4

Financial statements issued

Proposal in the ED

✓ Transition period of **18-24** months

Proposal in ED

✓ **All** requirements applied at the **same time** by all entities from the effective date, unless an entity elects to apply the requirements **earlier**

✓ Comparative periods restated

Transition and effective date

- The mandatory effective date is set so that jurisdictions have sufficient time to incorporate the new requirements into their legal systems and those applying the Accounting Standards has sufficient time to prepare for the new requirements.
- The Exposure Draft proposed to require entities to apply the forthcoming Accounting Standard after a transition period of 18-24 months from the date of publication with retrospective application.
- Factors considered by the IASB when making this proposal were:
  - ✓ the proposals affect presentation and disclosure and should be more straightforward to implement than changes affecting recognition and measurement; and
  - ✓ entities would not need to consider periods before the start of the earliest comparative period so restatement of comparatives should be relatively straightforward.

Overview of the Effects Analysis

What is an Effects Analysis?

- The IASB publishes a separate effects analysis report when a major new IFRS Accounting Standard is issued. The Due Process Handbook requires the IASB to assess:

the likely costs of implementing new requirements*

the likely ongoing associated costs and benefits*

(the costs and benefits are collectively referred to as effects)

The effects are assessed by the IASB…

in the light of its objective of reporting transparency

in comparison to existing requirements

throughout the development of a new or amended Accounting Standard

*Initial and ongoing costs and benefits are likely to affect different stakeholders in different ways

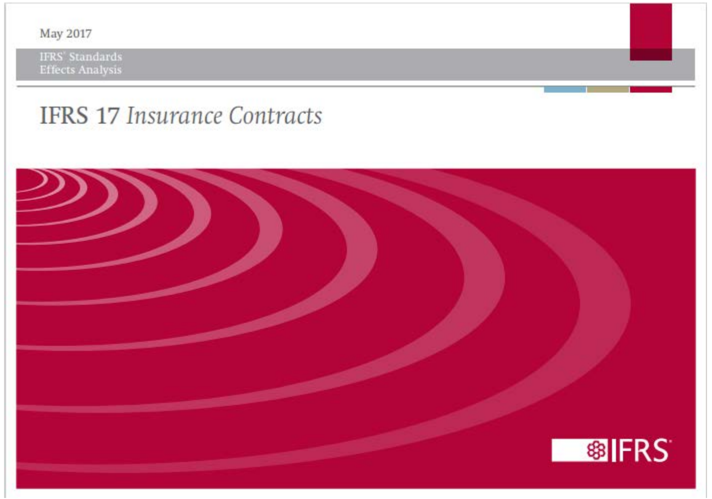
Examples of information included in an Effects Analysis

EFFECTS on reported information	BENEFITS	COSTS
how relevant activities will be reported applying IFRS Standards	how **comparability** will be improved both between different reporting periods for the same company and between different companies in a particular reporting period	how **compliance costs for preparers** will be affected, both on initial application and on an ongoing basis
	how the **ability of users to assess** the amount, timing and uncertainty of a company's **future cash flow** will be affected	how **costs of analysis for users** will be affected (including any costs of extracting data, identifying how the data has been measured and adjusting data for the purposes of including them in, for example, a valuation model)
	whether **better economic decision-making** will be possible as a result of improved reporting	

Effects Analysis on other IFRS Accounting Standards

IFRS 16 *Leases* (LINK)

IFRS 17 *Insurance Contracts* (LINK)



Effects Analysis is a key tool used by the IASB as part of implementation support activities to help stakeholders get ready for implementation.

Effects Analysis on the forthcoming IFRS Accounting Standard

Overall expected benefits and costs for preparers and users

<table>
<tr><th></th><th>Benefits</th><th>Costs</th></tr>
<tr><td>Preparers</td><td rowspan="2">• Additional required subtotals that will provide greater comparability of financial performance across entities and between periods for an entity
• Transparency of reporting of management-defined performance measures to facilitate communication between preparers and users of financial statements
• Aggregation and disaggregation principles that will provide relevant information and facilitate communication between preparers and users of financial statements</td><td>• Most implementation costs would relate to:
✓ the process changes and possible system changes required to implement the new requirements; and
✓ training of staff and communicating changes to reported information to external parties
• Some of the proposed requirements may also result in ongoing costs</td></tr>
<tr><td>Users</td><td>• Mostly initial implementation costs required to adjust models and analysis methods to the new structure of the primary financial statements and additional information provided</td></tr>
</table>

Benefits and costs of proposals related to subtotals

Requirements	Likely benefits	Likely costs (for preparers)
• Present defined operating profit or loss subtotal • Present profit or loss before financing and income taxes subtotal • Require separate information about income and expenses from investments • Present results from associates and joint ventures accounted for using the equity method in a single location	• Greater comparability of financial performance across entities and between periods for an entity • Improve digital consumption with more anchor points	**Implementation costs** • Many would need to change internal processes and some may need to change systems to classify income and expenses into categories **Ongoing costs** • Costs arising from requirement for classifying income and expenses into categories following a business combination or other major business change **Cost mitigating factors** • Introduce the undue cost or effort relief for foreign exchange differences and gains or losses on derivatives not designated as hedging instruments. • Withdrawal of the proposal requiring entities to distinguish between integral and non-integral associates and joint ventures.

Benefits and costs of proposals related to management performance measures (MPMs)

Requirements	Likely benefits	Likely costs (for preparers)
• Disclosure of MPMs (including reconciliation with defined subtotal) in financial statements • Introduce rebuttable presumption for MPMs • Disclose of tax effect and NCI on individual reconciling items • Provide sufficient information to understand the reasons for, and the effect of, the change when changing the calculation of MPMs	• Increase in transparency of MPMs will help management to convey their view and users to focus on measures which management consider important and relevant • Tax and NCI information will allow users to calculate EPS when they make adjustments to MPMs	**<u>Implementation costs</u>** • Identify and provide disclosures in the notes for MPMs including disclosure of the tax effect and NCI for adjustments made in calculating MPMs. **<u>Ongoing costs</u>** • Providing disclosures relating to MPMs, for example the calculation of the tax effect on reconciling items **<u>Cost mitigating factors</u>** • Establish a rebuttable presumption in the definition of MPMs (including application guidance). • Exclude oral communications, transcripts and social media posts from public communications. • Introduce a simplified approach for calculating the tax effect.

IFRS Accounting

Benefits and costs of proposals related to disaggregation

<table>
<tr><th>Requirements</th><th>Likely benefits</th><th>Likely costs (for preparers)</th></tr>
<tr><td>General disaggregation requirements</td><td>• Primary financial statements that provide an understandable overview
• Notes that provide material information</td><td rowspan="3"><u>Implementation costs</u>
• Incremental costs to gather information that is not being gathered today
<u>Ongoing costs</u>
• Ongoing costs of assessing whether to disaggregate information applying the new requirements especially following a major business change
<u>Cost mitigating factors</u>
• Withdrawal of the proposal to disclose analysis of total operating expenses by nature in the notes when an entity reports operating expenses by function
• Withdrawal of prohibition on a mixed presentation
• Withdrawal the proposal to require disclosure of unusual income and expenses</td></tr>
<tr><td>Aggregating items and using meaningful labels</td><td>• Meaningful labels used to describe items</td></tr>
<tr><td>Disclose the amounts of depreciation, amortisation and employee benefits included in each function line item in the statement of profit or loss ★</td><td>• Linkage between information provide in the primary financial statements and in the notes</td></tr>
</table>

★ *Aspects of proposal to be redeliberated in a future IASB meeting*

Cost to preparers for education and communication

Cost for education	Costs of educating internal stakeholders on classifying income and expenses in the operating, investing and financing categories.
Cost for communication	Costs of communicating changes to reported information to external parties (for example, investors and lenders).

These costs arise for all new requirements and are expected to be incurred when first implementing the proposals

Local laws or regulations

- In addition to IFRS Accounting Standards, some jurisdictions also have local laws or regulations for presentation and disclosure in financial statements. For example, requirements to disclose all or some operating expenses by nature when an entity reports operating expense by function in the statement of profit or loss.
- Such regulations may make the requirements in the new IFRS Accounting Standard easier to apply and result in lower implementation costs.

Benefits for digital reporting

Likely benefits from the proposals as of today

- **Some proposals** are likely to provide similar benefits to paper-based and digital users (thus reducing the cost of obtaining information for digital users), for example:
  - ✓ comparability of defined subtotals (such as operating profit or loss)
  - ✓ disclosures on management performance measures (included in financial statements, thus more likely to be tagged)

Additional benefits that we are developing

- **Other proposals** are not likely to provide similar benefits to paper-based and digital users without further development. For example, proposals that will improve how information is communicated – focussing in particular on providing users with a better understanding of 'relationships':
  - ✓ relationships between items presented in primary financial statements; and
  - ✓ relationships between items presented in primary financial statements and items disclosed in notes

We are exploring modelling approaches to IFRS Accounting Taxonomy that could facilitate digital users in consuming information (specifically with regard to 'relationship information')

Appendix – Key proposals

Statement of profit of loss

Revenue	Operating
Other income	
Changes in inventories of finished goods and work in progress	
Raw materials used	
Employee benefits	
Depreciation	
Amortisation	
Operating profit	
Income and expenses from associates and joint ventures	Investing
Operating profit and income from associates and joint ventures (specified subtotal)	
Income and expenses from investments	
Income and expenses from cash and cash equivalents	
Profit before financing and income tax	
Income and expenses from liabilities that arise from transactions that involve only the raising of finance	Financing
Unwinding of discount on provisions	
Profit before tax	
Income tax	
Profit for the year	

Line items illustrate what is included in each category and do not necessarily denote specified line items. An entity would present line items that provide an understandable overview of the entity's income and expenses. We will discuss illustrative examples at the joint CMAC and GPF meeting in June.

What is in the operating category?

Includes, **but is not limited to**, income and expenses from an entity's main business activities

Defined as a default—includes income and expenses not classified in other categories

- Works for **different business models**
- A direct definition would require **significant judgement** which may result in operating profit not being comparable
- Avoids creation of a **'non-operating' category** that is neither operating, investing or financing, which may be used opportunistically

Includes volatile and unusual income and expenses arising from an entity's operations

- The category is intended to provide a **complete** picture of the entity's operations for the period

What is in the investing category?

- Income and expenses from associates and joint ventures accounted for using the equity method ★
- Income and expenses from assets that generate a return individually and largely independently of other resources held by an entity, including cash and cash equivalents

Examples (classified in the operating category when investing as a main business activity)

- rental income and remeasurements of investment property
- interest income and fair value changes on financial assets
- dividends and fair value changes on non-consolidated equity investments

★ *Feedback received in targeted outreach will be considered at a future IASB meeting*

What is in the financing category?

All income and expenses from liabilities that involve only the raising of finance

A transaction that involves only the raising of finance is a transaction that involves:

- The receipt by the entity of cash, an entity's own equity instruments or a reduction in a financial liability; and
- The return by the entity of cash or an entity's own equity instruments

For example, typical loan contract involves only the receipt of cash and the return of cash

Interest expense and the effects of changes in interest rates from other liabilities

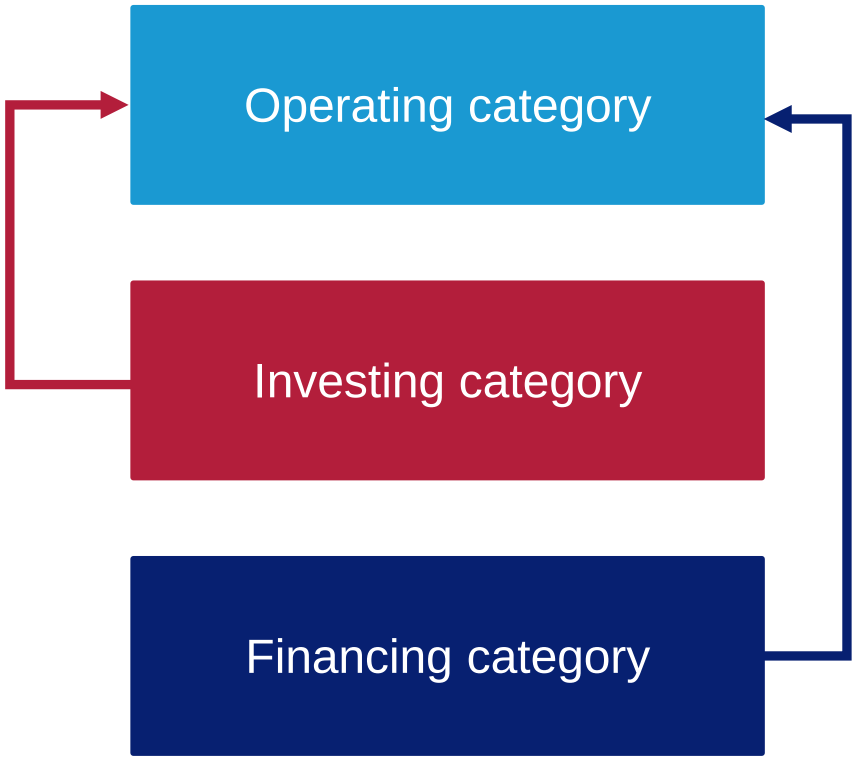
For other liabilities, including lease liabilities, **interest expense and the effect of changes in interest rates** are classified in the financing category when such amounts are identified applying the requirements of IFRS Accounting Standards (eg IAS 19 or IAS 37)

For example, a lease liability involves the receipt of a right-of-use asset and the return of cash

Entities with specified main business activities

Operating profit is intended to include, but is not limited to, income and expenses from an entity's main business activities

The IASB proposes requirements for some entities, such as banks, to classify income and expenses in the operating category that would otherwise be classified in the investing or financing categories



Entities that provide financing to customers as a main business activity

Operating

Income and expenses from transactions that involve only the raising of finance

- Classified in the operating category by entities that provide financing to customers as a main business activity, such as banks and entities that provide financing to customers to purchase the entity's products
- Accounting policy choice whether to classify in the operating category ***all*** such income and expenses or ***only*** those related to providing financing to customers

Financing

Specified income and expenses from other liabilities classified in the financing category (same approach for all entities)

★ *The accounting policy choice to classify in the operating category either all income and expenses from cash and cash equivalents or the portion related to providing financing to customers will be discussed at a future IASB meeting*

Entities that invest as a main business activity

Operating

Income and expenses from assets that generate a return individually and largely independently of other resources held by an entity

- Classified in the operating category by entities that invest in those assets as a main business activity, such as insurers, investment entities and investment property companies
- Applies to cash and cash equivalents if invest in financial assets as a main business activity

Investing

Income and expenses from associates and joint ventures accounted for using the equity method classified in the investing category (same approach for all entities)

Statement of profit or loss — financing and investing as main business activities

Interest revenue calculated using the effective interest method

Interest expense

Net interest income

Fee and commission income

Fee and commission expense

Net fee and commission income

Net trading income

Net investment income, including cash and cash equivalents

Credit impairment losses

Employee benefits expense

Depreciation and amortisation expenses

Operating profit

Share of profit or loss of associates and joint ventures

Specified income and expense on other liabilities (incl. interest on lease liabilities)

Profit before tax

Income tax

Profit for the year

Operating

Non-main Investing and financing

Line items illustrate what is included in each category and do not necessarily denote specified line items. An entity would present line items that provide an understandable overview of the entity's income and expenses. We will discuss illustrative examples at the joint CMAC and GPF meeting in June.

Statement of profit of loss—insurance as a main business activity

Insurance revenue	Operating
Insurance service expenses	Operating
Insurance service results	Operating
Interest revenue calculated using the effective interest rate method	Operating
Dividends and fair value changes on financial assets	Operating
Other impairment losses	Operating
Insurance finance expenses	Operating
Net financial result	Operating
Other expenses	Operating
Operating profit	
Share of profit or loss of associates and joint ventures accounted for using equity method	Investing
Profit before financing and income tax	
Specified income and expense on other liabilities (incl. interest on lease liabilities)	Financing
Profit before tax	
Income tax	
Profit for the year	

Line items illustrate what is included in each category and do not necessarily denote specified line items. An entity would present line items that provide an understandable overview of the entity's income and expenses. We will discuss illustrative examples at the joint CMAC and GPF meeting in June.

What are MPMs?

Performance measures

Non-Financial performance measures

For Example:

- Number of subscribers
- Customer satisfaction score
- Store surface

Financial performance measures

(Sub)totals of income and expenses

IFRS-Specified
For example:

- Operating profit
- Operating profit before depreciation amortisation and specified impairments

MPMs

For example:

- Adjusted profit or loss
- Adjusted operating profit
- Adjusted EBITDA

Other measures that are not subtotals of income/expenses
For example:

- Free cash flow
- Return on equity
- Net debt
- Same-store sales

What disclosures will be required for MPMs?

Reconciliation	Reconciliation between MPM and the most directly comparable subtotal or total specified by IFRS Accounting Standards, including the income tax effect and effect on non-controlling interests ★
Why an MPM communicates management's view	Includes an explanation of how the MPM is calculated and how the measure provides useful information about the entity's performance. Explanation should refer to individual reconciling items where necessary
Not necessarily comparable with other entities	A statement that MPM provides management's view of an aspect of the entity's financial performance and is not necessarily comparable with measures provided by other entities
Changes in calculation	Explanation of any changes in how the entity calculates its MPMs or which MPMs it provides ★

★ *To be discussed at a future IASB meeting*

Definition of MPMs

Subtotals of income and expenses not specified by IFRS Accounting Standards that:

Are used in public communications outside financial statements (excluding oral communications, transcripts and social media posts)

=

Communicate management's view of an aspect of an entity's financial performance

Rebuttable presumption that a subtotal used in public communications represents management's view of an aspect of an entity's financial performance—rebutted with reasonable and supportable evidence ★

The rebuttable presumption is intended to:

- reduce the subjectivity involved in identifying the subtotals that represent management's view; and
- avoid requiring entities to include as management performance measures, subtotals of income and expenses that do not represent management's view of an aspect of the entity's performance

★ *Refinements to the rebuttable presumption to be discussed at a future IASB meeting*

What might a reconciliation look like?

		Tax	NCI
Adjusted operating profit (MPM)	**52,870**	**Tax**	**NCI**
Restructuring in Country X (incl. in employee benefits)	(5,400)	900	(1,020)
Revenue adjustment (incl. in revenue)	(6,200)	1,550	-
Operating profit (IFRS-specified)	**41,270**		

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

- operating profit, profit before financing and income tax;
- gross profit and subtotals similar to gross profit;
- profit before tax, profit from continuing operations, profit or loss;
- total other comprehensive income, comprehensive income;
- operating profit before depreciation, amortisation and specified impairments
- operating profit and income and expense from investments accounted for using the equity method

Simplified approach to calculating the tax effect ★

★ *To be discussed at a future IASB meeting*

What will be the disaggregation requirements?

General requirements and specified line items	Roles of the primary financial statements (PFS) and the notes	Principles for aggregation and disaggregation
	Specified line items	Aggregating items and using meaningful labels
Specific requirements	Disclosure of amounts included in each line item of profit or loss for depreciation, amortisation and employee benefits ★	Present operating expenses by nature and by function (mixed presentation permitted)

★ *Aspects of proposal to be redeliberated in a future IASB meeting*

What would be the general requirements?

Roles of PFS and the notes	• Describe the roles of PFS and the notes and refer to understandability in the description of the role of PFS
Principles for aggregation and disaggregation	• Single dissimilar characteristic can be enough to disaggregate if resulting information is material • Application guidance on when disaggregation in the notes would result in material information and when disaggregation in the PFS would result in a more understandable overview
Specified line items	• New specified line items, including operating profit, profit before financing and income tax and goodwill in the statement of financial position
Aggregating items and using meaningful labels	• Use meaningful labels – only use the label ‘other’ when unable to find a more informative label • Explanation of what is included in an aggregation of varied immaterial items – e.g. amount consists of several unrelated immaterial items with an indication of the nature and amount of the largest item

Disclosure of operating expenses by nature in the notes

The Exposure Draft proposed that an entity that reports expenses by function in the statement of profit or loss discloses in the notes an analysis of total operating expenses by nature

Some respondents (users, standard-setters and accountancy bodies) agreed

Some respondents (preparers and their representative bodies) disagreed

To achieve a more balanced outcome between costs for preparers and benefits for users the IASB has tentatively decided to:

- require an entity to disclose the amounts of depreciation, amortisation and employee benefits included in each function line item in the statement of profit or loss; and ★
- add an exemption to the general requirement to disaggregate material information that would apply to information about the nature of operating expenses included in a function line item in the statement of profit or loss. Specific disclosure requirements in IFRS Accounting Standards relating to operating expenses would still apply.

★ *Aspects of this proposal to be considered at a future IASB meeting*

Disclosure of operating expenses by nature in the notes

Statement of profit or loss	202X[1]
Revenue	3000
Cost of goods sold	(600)
Gross profit	**2400**
Other income	500
Selling expenses	(400)
Research and development expenses	(300)
General and administrative expenses	(200)
Impairment losses on trade receivables	(100)
Operating profit (loss)	**1900**

IASB's tentative decision (illustrating depreciation and employee benefits)[2]	202X[1]
Depreciation	**(500)**
Cost of goods sold	*(250)*
Selling expenses	*(150)*
Research and development expenses	*(50)*
General and administrative expenses	*(50)*
Employee benefits	**(400)**
Cost of goods sold	*(200)*
Selling expenses	*(100)*
Research and development expenses	*(50)*
General and administrative expenses	*(50)*

[1] Comparative reporting period not depicted in example for simplification purposes

[2] Amortisation not illustrated. Additional specified nature expenses may be required in the final proposal

Changes to the statement of cash flows

Operating profit or loss subtotal to be the starting point for the indirect method of reporting cash flows from operating activities

Dividends received ★	→	Investing category ★
Dividends paid	→	Financing category
Interest paid	→	Financing category ★
Interest received	→	Investing category ★

★ Classified in a single category (either as operating, investing or financing activities) in the statement of cash flows by an entity with specified main business activities

★ *Classification of dividends received from associates and joint ventures accounted for using the equity method to be discussed in a future IASB meeting*

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