

The Essentials—Presentation of Financial Statements



IAS 1 *Presentation of Financial Statements* sets out the overall requirements for the presentation of financial statements. One of the features of this IFRS is that it includes guidelines for the structure and content of financial statements, including information about the statement of profit or loss and other comprehensive income (P&L and OCI) and the statement of financial position (balance sheet).

Making the most of what's presented in financial statements

The accounting standard that covers the presentation of financial statements, IAS 1, might be described as the 'friend investors never knew they had'. IAS 1 features principles that are intended to help companies present financial information in a way that gives investors an understanding of their financial performance and financial position.

In this issue of *The Essentials*, we offer a perspective on the Standard that covers how companies present their financial information (IAS 1) and discuss how investors can use this Standard to encourage companies to communicate with candour in financial reporting.

We examine how the boundaries of accounting standards might affect investor perceptions about company disclosures. Finally, we discuss one of the more common questions we hear about IAS 1 – the treatment of extraordinary items.



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Reporting principles investors will want to know

Under IFRS, companies are not required to report financial results using a highly detailed set of reporting templates. While the use of templates would offer a high degree of uniformity across companies, such use can result in companies reporting a large volume of information that still leaves investors struggling to understand performance. They can also give the wrong impression about the degree of comparability between financial statements.

In contrast, the approach taken by the IASB aims to balance the need for comparability across key lines of the financial statements (eg revenue, finance cost, tax expense etc.) with the need for information that reflects a company's specific circumstances. It achieves this by setting out a series of principles for the presentation of financial information in IAS 1.

In this *Essentials*, we highlight two of the principles in IAS 1:

1. Financial statements should fairly present the company's performance; and
2. Disclosure of immaterial items can obscure material information.

We explain how investors can use their knowledge of these fundamental principles of IFRS to have an effective dialogue with management about the presentation of their financial results.



Principles of reporting

Under IAS 1, the list of mandatory line items for companies to report on the face of their financial statements may not appear to be very long and detailed. However, IAS 1 also states that financial statements must report the information needed to fairly present a company's financial performance, financial position and changes in cash flows. This principle encourages management to focus on providing information that is relevant to their circumstances. It also means that management should use judgement when deciding what to put in their financial statements rather than simply reporting a long checklist of potentially irrelevant information. This principle underpins all IFRS disclosures. Knowing that principle can equip investors with the toolkit needed to improve the usefulness, understandability and comparability of the financial statement information that they receive.

1. Is the information complete?

There will be times when a company's financial results cannot be 'fairly presented' by reporting only the minimum line items required by IFRS. In such cases, IFRS is clear in requiring that management must report the additional information needed to allow an investor to understand the financial position, financial performance and changes in cash flows of the company. For example, additional disclosures are required if applying the specific requirements in IFRS is insufficient to enable investors to understand the impact of particular transactions, other events and conditions on the company's financial position and financial performance.

While companies are required to provide all relevant information to investors, it can lead to financial statements looking quite different from one company to the next, with some companies reporting greater detail (or more subtotals) than others. We strongly encourage investors to help management understand the information that investors need to assess performance. With investor input, management will be better informed to meet the reporting requirements set out in IFRS today.

2. Is the information material?

In a similar vein, the requirements under IFRS strive to ensure that critical intelligence is not lost in a sea of irrelevant disclosure.

The list of items that management could report is substantial. IFRS encourages companies to avoid preparing financial reports by mechanically adhering to a checklist of information, but to consider instead whether the information that they report is material.

What does 'material' mean? IAS 1 asks management to consider whether or not the item could influence the investment decisions of those that rely on financial statements. The size and nature of the item or a combination of both are determining factors. With that in mind, we encourage investors to hold a dialogue with management about what is influencing their decisions. This dialogue should help management understand and hopefully improve disclosures of information that is really important to investors.



The boundaries of IFRS

What information is required under IFRS? What line items are not defined by the Standards? The use of 'non-GAAP' measures (also known as non-IFRS or Alternative Performance Measures) is so common that it is understandable if investors struggle to distinguish between numbers that are specified by IFRS and those that are not. So in this edition of *The Essentials*, we shed light on how some aspects of IAS 1 are relevant to the debate about IFRS vs non-GAAP information.

A large number of companies use non-GAAP measures to communicate aspects of their financial performance. Investors tell us that they value the insights that such measures can offer. But they also can lack confidence using them, because:

- it is not always easy to see how the non-GAAP metric has been calculated;

- they do not know if the metric has been subject to external assurance or audit; and
- they do not know if the metric has been consistently calculated over time.

IFRS are based on principles rather than hard and fast rules, thus the boundaries of IFRS are not black and white. IFRS requires management to provide the information that is needed to fairly present performance. While this means that the level of detail of financial statements will vary from company to company, it also means that IFRS allows companies – subject to any local regulatory guidance – to present within audited financial statements measures that are relevant to understanding financial performance. Examples of this appear in the 'Additional items' section of Figure 1.

So what can investors expect to see reported under IFRS?

To illustrate how the ‘boundaries of IFRS’ work in practice, we have set out in Figure 1 the level of disclosure that you can expect to see in a statement of profit or loss. All of these items are subject to materiality. This means that any line items deemed to not be individually material may be aggregated with other items. In a similar vein, materiality also allows management to disaggregate a line item if it would assist in understanding performance.

Figure 1: What to look for in a P&L

Required Items in P&L	Additional items, headings and subtotals that are relevant to an understanding of financial performance
Revenue Gains/losses from derecognising financial assets (amortised cost) Finance costs Share of P&L of associates and JVs using equity method Gain/loss from reclassifying financial assets to fair value (from previous method) Tax expense Discontinued operations Profit attributable to non-controlling interest Profit or Loss Total other comprehensive income Comprehensive income (for the parent, and for non-controlling interest)	For example: Profit before tax Profit before interest and tax Profit before interest, tax, depreciation and amortisation
<div style="border: 1px dashed #4a7c9d; padding: 5px; margin-top: 10px;"> All of these items must be presented on the face of the P&L, if material. </div>	<div style="border: 1px dashed #4a7c9d; padding: 5px; margin-top: 10px;"> Investors may see this presented: (i) on the face of financial statements, or (ii) in the notes. Presenting subtotals that are relevant to understanding financial performance features some requirements that are important to investors: <ul style="list-style-type: none"> • Verifiable: sub-totals must be made up of line items presented under IFRS. • Transparency: presented and labelled to support clarity and understandability. • Consistency: presented consistently from period to period. • Not given ‘special treatment’: these figures cannot be given more prominence than the subtotals and totals that are required under IFRS. </div>

Material items of income and expense to disclose separately

Circumstances that could warrant separate disclosure include:

- Write-downs to inventories, PP&E (and reversals of write-downs)
- Restructuring of activities (and reversals of any provisions)
- Disposals of PP&E
- Disposals of investments
- Discontinued operations
- Litigation settlements
- Other reversals of provisions

Investors may see these items presented:
 (i) on the face of financial statements, or (ii) in the notes.

Companies are required to disclose line items, subtotals, totals of income and expense that they believe to be relevant to understanding financial performance.

What does this mean in terms of how sub-totals such as EBIT or EBITDA are presented in the P&L?

The requirements for the categories described in Figure 1 effectively allow for IAS 1 to deal with commonly analysed sub-totals such as EBIT (earnings before interest and tax) or EBITDA (earnings before interest, tax, depreciation and amortisation) on the face of the P&L under certain conditions (for example, if expenses are presented by nature).

What does this mean for ‘non-GAAP’ information presented in communications outside of the financial statements?

Non-GAAP financial information reported outside of the financial statements (eg in analyst presentations) falls outside the scope of IFRS’ reporting requirements. Typical examples include many industry-specific activity indicators such as ‘same store sales’ or ‘revenue per user’, and financial ratios such as ‘return on capital employed’ or ‘return on invested capital’.



IFRS vs US GAAP

We often receive questions from investors about the differences between the format and nature of disclosures made by companies under IFRS and those under US GAAP.

Is IFRS so dissimilar from US GAAP?

While there are differences in reporting requirements under the two sets of Standards, some of the differences that investors observe can also be explained by regulatory reporting requirements.

Reporting 'extraordinary' items

Companies frequently report an adjusted earnings figure in presentations or press releases that do not appear on the face of the statement of profit or loss. While this practice is not unique to companies reporting under IFRS, investors tell us that one of the most commonly cited reasons for this is that labelling line items as 'extraordinary' is prohibited under IFRS. For this reason, we are told, companies need to report the impact of one-time or infrequent events through non-GAAP reporting.

Why doesn't IFRS include 'extraordinary' items?

Partly because the term offers little insight into the nature of the activity or event that has occurred. It can leave investors wondering whether the extraordinary is, in fact, truly ordinary.

IFRS requires companies to disclose information about material events.

As we have mentioned in this *Essentials*, IFRS requires companies to disclose – either on the face of the primary statements or in the notes – any information that is material to understanding the performance of a company. And IAS 1 specifically provides that companies can separately disclose individual items of income and expense in the P&L, when they are material. Investors should understand that this effectively supports their desire to obtain transparency into events and activities that they usually consider to be infrequent, such as disposals of investments, restructurings of activities etc.

For investors worried about how a company discloses 'pre-extraordinary' profit metrics, a helpful cross-check can be to compare the 'one timers' mentioned in company press releases or slide decks with what is disclosed in the notes to the financial statements. If items that are material or infrequent are not being disclosed in the notes, then an investor might engage with a company to understand why that is the case.



Contact us

If you would like to learn more about the presentation of financial statements, *The Essentials* series or the IASB's investor engagement activities, visit: go.ifrs.org/Investor-Centre.

This issue of *The Essentials* has been compiled by the IFRS Foundation Education Initiative staff. The IFRS Foundation is an independent, not-for-profit organisation working in the public interest. One of the principal objectives of the IFRS Foundation is to develop a single set of high quality, understandable, enforceable and globally accepted International Financial Reporting Standards (IFRS) through its standard-setting body, the International Accounting Standards Board (IASB).

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