

This paper has been prepared by the EFRAG Secretariat for discussion at a public meeting of EFRAG TEG-CFSS. The paper forms part of an early stage of the development of a potential EFRAG position. Consequently, the paper does not represent the official views of EFRAG or any individual member of the EFRAG Board or EFRAG TEG-CFSS. The paper is made available to enable the public to follow the discussions in the meeting. Tentative decisions are made in public and reported in the EFRAG Update. EFRAG positions, as approved by the EFRAG Board, are published as comment letters, discussion or position papers, or in any other form considered appropriate in the circumstances.

## **Primary Financial Statements Cover Note**

### **Objective**

- 1 The objective of the session is to discuss:
  - (a) the feedback to the UK Financial Reporting Council (FRC UK) Discussion Paper *Improving the Statement of Cash Flows* and consider how the findings might influence the *Primary Financial Statements* project; and
  - (b) the findings from the research by the New Zealand Accounting Standards Board (NZASB) on the views of investors about the usefulness of Alternative Performance Measures (APMs).

### **Background**

- 2 This research project is examining potential improvements to the structure and content of the primary financial statements with a particular focus on the statement(s) of financial performance and the statement of cash flows.
- 3 For example, the IASB is exploring whether it should:
  - (a) require additional subtotals in the statement(s) of financial performance (e.g. earnings before interest and tax (EBIT));
  - (b) provide guidance on the use of performance measures (e.g. separate presentation of non-recurring, unusual or infrequently occurring items);
  - (c) reduce presentation choices (e.g. cash effects of interest and dividends); and
  - (d) require a consistent starting point for the indirect reconciliation of cash flows.
- 4 In addition, this project will examine:
  - (a) the implications of digital reporting for the structure and content of the primary financial statements;
  - (b) the development of templates and principles for aggregating and disaggregating items in the primary financial statements; and
  - (c) changes to the statement of financial position if work in other areas highlights the need for change.

### **UK FRC Discussion Paper *Improving the Statement of Cash Flows***

- 5 In October 2016 the UK Financial Reporting Council (FRC) published the Discussion Paper *Improving the Statement of Cash Flows* (DP) with the objective of stimulating debate on the opportunities to make the statement of cash flows more useful and provide input to the IASB's project on Primary Financial Statements.

- 6 In November 2016 EFRAG CFSS and EFRAG TEG received a presentation on the DP published by the FRC. At that meeting, members generally agreed that the statement of cash flows could be improved and, in particular, supported the suggestion to better articulate the objective of the statement of cash flows. However, mixed views were expressed on some of the other proposals in the Discussion Paper.
- 7 In July 2017 the FRC published a feedback statement that provides an overview of the 22 comment letters received and FRC Staff is now presenting this feedback to EFRAG CFSS and EFRAG TEG before presenting it to the Accounting Standards Advisory Forum (ASAF).
- 8 As a next step, the IASB will consider some improvements to the statement of cash flows with the objective of eliminating some diversity in practice and achieving consistency with the statement(s) of financial performance. In particular, the IASB is going to consider whether it should:
  - (a) eliminate options for the classification of interest and dividends in the statement of cash flows;
  - (b) align the operating section across the statement(s) of financial performance and the statement of cash flows;
  - (c) require a consistent starting point for the indirect reconciliation of cash flows; and
  - (d) proceed with any of the FRC suggestions included in the DP.
- 9 In regard to paragraph 8(d) above, the appendix of agenda paper 10-05 includes an initial IASB staff analysis of possible implications for the Primary Financial Statements project. In summary, the IASB staff is likely to explore some but not all the changes suggested in the FRC Discussion Paper because their intention is to focus on targeted improvements. Thus, the IASB is likely to discuss:
  - (a) aligning the notion of 'operating activities' for both the statement of cash flows and the statement(s) of financial performance;
  - (b) cash outflows to acquire property, plant and equipment being classified as 'operating activities';
  - (c) cash flows on financing liabilities (including interest) being reported in the financing category of the cash flow statement;
  - (d) cash flows relating to tax being reported in a separate section;
  - (e) refinements to the requirements in IAS 7 *Statement of Cash Flows*, paragraph 22 on reporting cash flows on a net basis;
  - (f) requiring a reconciliation between operating income and cash flows from operating activities, including when a direct method cash flow statement is presented; and
  - (g) more disaggregation, including disaggregation of changes in working capital.
- 10 Where the FRC staff has suggested more significant changes to the statement of cash flows, the IASB Staff proposes that such suggestions could be considered when determining the IASB's future research projects.

**Questions for EFRAG CFSS and EFRAG TEG members**

- 11 What, in your view, are the implications of the FRC Discussion Paper (including the responses) for the IASB's project on Primary Financial Statements?
- 12 Do EFRAG CFSS and EFRAG TEG members have any questions or comments about the IASB staff's plans for considering the feedback on the FRC Discussion Paper (see Agenda Paper 10-05, paragraphs 7-8) and the analysis in the appendix to Agenda Paper 10-05?

**Research results of the New Zealand Accounting Standards Board (NZASB) on the views of investors about the usefulness of alternative performance measures**

- 13 In July 2017 the External Reporting Board (XRB) published its survey findings *Alternative Performance Measures: A New Zealand user-needs survey*.
- 14 The XRB undertook this survey of New Zealand users to better understand how Alternative Performance Measures (APMs) are viewed and whether APMs are effective in meeting their needs. A summary of the report can be found in agenda paper 10-06. The full report can be found [here](#).
- 15 EFRAG has recently discussed the usefulness of APMs with European users of financial statements on a number of different occasions. In particular, we have discussed this topic with EFRAG User Panel members and financial analysts in a number of outreach events on the IASB Discussion Paper *Disclosure Initiative - Principles of Disclosure* (joint user outreach events in June 2017 in Oslo and July 2017 in Brussels).
- 16 The feedback received from European users is generally consistent with the views expressed by New Zealand users. More specifically, European users:
  - (a) emphasised the usefulness and importance of non-GAAP measures to understand business performance;
  - (b) had mixed views on the presentation of APMs in the financial statements. Some considered that the use of non-GAAP information should not be restricted as long as the information is explained and reconciled while others were concerned that wide spread use of non-GAAP information within the financial statements may lead to additional complexity and undermine IFRS information
  - (c) emphasised the need for guidance on the use of APMs within the financial statements as they considered that there is often a lack of transparency and consistency in the use and calculation of non-GAAP measures within primary financial statements. For example, there is a need to provide better disclosures on how the information is generated and how it reconciles with IFRS measure; they also suggested that the principles in the ESMA Guidelines on *Alternative Performance Measures* could be extended to APMs presented within the financial statements to increase transparency on their use;
  - (d) noted that it is important to clearly identify the non-GAAP information and the extent to which the non-financial information is audited;
  - (e) highlighted that there could be merits in having principles to determine some commonly-used measures such as EBIT and EBITDA, while noting the challenges of achieving a single definition that could be applied across jurisdictions and industries; and
  - (f) explained that information about non-recurring, infrequent or unusual transactions is important to users but they noted that management tends to

remove negative aspects of performance from operating profit. Any guidance on this area should aim at preventing abuses and providing complete and transparent information about the transactions and events and the assessments made by management.

**Question for EFRAG CFSS and EFRAG TEG members**

- 17 Do EFRAG CFSS and EFRAG TEG members have any comments on the research results of the New Zealand Accounting Standards Board on APMs?

**Agenda Papers**

- 18 In addition to this cover note, agenda papers for this session are:
- (a) Agenda paper 10-02 - ASAF Paper 02 FRC DP Cover Paper;
  - (b) Agenda paper 10-03 - ASAF Paper 02A FRC DP *Improving Statement of Cash Flows*.
  - (c) Agenda paper 10-04 - ASAF Paper 02B Feedback Statement *Improving the Statement of Cash Flows*.
  - (d) Agenda paper 10-05 - ASAF Paper 02C FRC DP *Improving Statement of Cash Flows*.
  - (e) Agenda paper 10-06 – ASAF 01 XRB Presentation *Alternative Performance Measures* -