Primary Financial Statements - Update

Objective

1 The objective of the session is to provide an update on the IASB's tentative decisions on its project *Primary Financial Statements* and the preliminary views of EFRAG CFSS and EFRAG TEG members.

Introduction

2 Primary Financial Statements project (PFS Project) is a part of the IASB's theme *Better Communication in Financial Reporting,* which aims to make financial information more useful and to improve the way financial information is communicated to users.

3 In October 2017, EFRAG published its Comment Letter on the IASB's Discussion Paper *Disclosure Initiative - Principle of Disclosures*, where EFRAG called for comprehensive discussion on the use of metrics such as EBIT/EBITDA and on unusual or infrequently occurring items, which are unrelated to the main objective of the IASB's Discussion Paper and are part of the PFS project. EFRAG would also welcome guidance on how performance measures could be fairly presented in financial statements.

4 PFS Project has been added to IASB's work plan in response to a strong demand from investors. Its main objective is to develop targeted improvements to the structure and content of the primary financial statements, what includes:

(a) improving the structure and content of the statements of financial performance;

(b) Improving the disaggregation in the financial statements; and

(c) assessing changes to the statement of cash flows.

5 Apart from the above, under the theme, the IASB is undertaking a number of activities on how advances in technology could influence financial reporting, standard setting and the IFRS Taxonomy in order to develop a digital strategy that will involve exploring ways to further integrate the IFRS Taxonomy into the IASB's standard-setting process.

Improve structure and content of statements of financial performance

Subtotals in the statement of profit or loss

6 To improve comparability between entities, the IASB is currently discussing the introduction of three subtotals in the statement of financial performance, which would introduce three distinct sections: operating, investing and financing activities.

Proposed subtotal	Description
'Operating profit or loss'	Residual category that excludes share of profit from all joint ventures (JVs) and associates
'Operating profit or loss and share of profit or loss of integral associates and JVs'	Excludes income and expenses from investing and financing activities, including share of profit from non-integral associates and JVs

'Profit or loss before financing and income tax'	Excludes income and expenses from financing activities, those related to cash and cash equivalents and unwinding of discount of asset/liabilities

7 The IASB is still to take its tentative decisions on how to apply the project proposals to different industries, including financial entities (e.g. banks and insurers).

8 In addition, the IASB has tentatively decided that entities should present the share of profit from 'integral' associates and joint ventures (JVs) separately from those that are 'non-integral' and provide non-exhaustive list of indicators to help the distinction.

9 Finally, the IASB discussed the labelling of two existing categories in the other comprehensive income (OCI) section of the statement of financial performance (i.e. 'items that will not be reclassified subsequently to profit or loss' and 'items that will be reclassified subsequently to profit or loss'), with the aim of improving understanding of OCI. The IASB tentatively decided to rename the labels to 'remeasurements reported outside profit or loss' and 'income and expenses to be included in profit or loss in the future'. The IASB also discussed the possibility of removing the existing presentation options for OCI.

Use of management performance measures (MPMs)

10 With the objective of allowing preparers to use alternative performance measures and 'tell their own story', the IASB has tentatively decided that all entities should be required to identify measures of profit or loss and other comprehensive income that, in the view of management, communicates the financial performance of the entity.

11 If such a measure is a subtotal or total already permitted or required by IAS 1 *Presentation of Financial Statements*, then the entity should identify this measure and explain why it best communicates management's view of the entity's financial performance. If not, then an entity would be required to disclose this measure in the footnotes and provide a reconciliation of such measure with the most comparable IFRS subtotal/total and additional disclosures.

12 The IASB is still to consider whether to define EBITDA for IFRS purposes and whether or not to consider it as a management performance measure.

Improving disaggregation in financial statements

Principles for aggregating and disaggregating items in the financial statements

13 In reply to users' requests to improve the disaggregation in the financial statements, the IASB is currently developing new principles for aggregation and disaggregation in the financial statements, which may include illustrating how different characteristics could be used to aggregate or disaggregate financial information.

14 The IASB also discussed ways of helping preparers decide which presentation of expenses, by nature of by function, provides the most useful information to users about the entity's performance. The IABS tentatively decided to develop a list of factors (e.g. peer industry practice) that could be added to IAS 1 to be used in deciding whether an entity should use a by-nature or by-function presentation. When using a by-function method, the IASB decided to emphasise that an entity is required to provide additional analysis using a by-nature method in the notes.

Unusual or infrequent items, minimum line items and illustrative examples

15 The IASB received many requests from users to develop guidance on the use of unusual or infrequent items, where there is often perceived abuse and lack of clarification of the categories used. The IASB tentatively decided to develop principles-based guidance to help entities to identify unusual or infrequent items and to require separate disclosures in the notes about these items as well as attributing them to the appropriate line items in the statement of financial performance.

16 The IASB also discussed the existing requirements of minimum line items and their relation with the IASB's tentative decisions on additional subtotals and tentatively

decided to clarify that line items may need to be presented in more than one section. Also, minimum line items necessitate separate presentation, regardless of the method of analysis of expenses in the operating profit section. The IASB also provided some operational relief by tentatively deciding to remove the requirement to present ‘finance costs’. The IASB is still to consider principles to decide when to present items as line items and possible additional required line items.

17 Finally, the IASB tentatively decided to develop non-mandatory examples to illustrate how the proposals would be applied to a number of industries.

Statement of cash flows

18 The IASB discussed the possibility of eliminating options in statement of cash flows to address the concerns raised by the users on the lack of comparability and tentatively decided to specify the classification of cash effects of interest and dividends. The IASB clarified that ‘interest incurred on financing activities’, ‘interest paid that is capitalised as part of the cost of an asset’ and ‘dividends paid’ are to be classified as financing cash flows. ‘Interest and dividends received’ are to be classified as investing cash flows.

19 To address diversity in practice, the IASB also tentatively decided to require a single starting point for the indirect method of reconciliation of cash flows which should be ‘operating profit or loss and share of profit or loss of integral associates and JVs’.

20 Finally, the IASB has decided not to align the different activities (operating, financing and investing) between the statement of financial performance and the statement of cash flows.

Preliminary views of EFRAG CFSS and EFRAG TEG

21 In general, EFRAG TEG and EFRAG CFSS expressed support for the IASB tentative decision to introduce additional subtotals in the statement of financial performance which will have different formats considering specific sectors. They also welcomed the proposal to have non-mandatory illustrative examples for specific industries. However, they acknowledged that challenges may arise within specific industries.

22 Regarding MPMs, EFRAG TEG and EFRAG CFSS welcomed additional guidance on their use but expressed mixed opinions on whether entities should be required to identify and disclose MPMs within the financial statements and identify a measure that is already presented on the face of statement of profit and comprehensive income as the ‘best’ depiction of performance. Additionally, concerns were expressed with respect to MPMs disrupting the comparability between entities and with giving IFRS prominence to MPMs.

23 EFRAG TEG and EFRAG CFSS did not think that the proposed re-labelling of categories in OCI would improve understanding of OCI. Conversely, this might create confusion and result in uncertainty about the existing categories.

24 On the level of aggregation and disaggregation, EFRAG TEG and EFRAG CFSS suggested that the IASB should not be too prescriptive when developing further guidance as the goal was not absolute consistency between entities. Additionally, members welcomed additional guidance to help entities determine whether by-function or by-nature presentation of expenses in the operating profit should be used and noted that in some industries a mixed model was useful.

25 EFRAG TEG and EFRAG CFSS expressed general support for the targeted improvements to the statement of cash flows.

Questions for EFRAG Board and EFRAG TEG

26 Does EFRAG Board and EFRAG TEG have comments on the above update and preliminary views?