

Primary Financial Statements

Application to financial entities

Accounting Standards Advisory Forum meeting
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ASAF agenda paper 6A

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- So far we have **excluded financial entities** from the Board's tentative decisions in the PFS project (appendix 3).
- By 'financial entities' we mean:
 - Banks
 - Insurance companies
 - Investment entities
 - Conglomerates that conduct financing activities
- Staff have commenced preliminary research on **financial entities**, focussing on **banks**. Staff plan to do further work relating to **other financial entities**.

Purpose of this session

1. Discuss how the Board's tentative decisions to date could apply to financial entities:

Same principles could apply to all entities, without specific provisions for financial entities

Same principles could apply to all entities, with different specific provisions for financial entities

Different principles might be needed for financial entities

2. Brainstorm ideas for dealing with financial entities

3. Share information about evidence that would be useful to the Board in making decisions relating to financial entities

Questions for ASAF



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1. For which, if any, areas in the project scope (slide 18), do you think the Board should consider different proposals for financial entities? Please explain why.

Questions for ASAF - continued

2. For each subtotal discussed on slides 8-10, do you think the subtotal would be useful for financial entities?
 - a. If you think the subtotal would be useful, how do you think we should define it for financial entities?
 - b. If you think the subtotal would not be useful, do you think we should:
 - develop an alternative subtotal for financial entities
 - not require any specific subtotal for financial entities
 - do something else?
3. Please share information about evidence that would be useful to the Board in making decisions on the way forward for financial entities.

Staff classification of tentative decisions

Same principles could apply to all entities, without specific provisions for financial entities	Same principles could apply to all entities, with different specific provisions for financial entities	Different principles might be needed for financial entities
Management performance measures and adjusted EPS	Eliminating classification options for interest and dividends in the statement of cash flows	1 Finance income/expenses (and EBIT subtotal above)
Presentation of associates/JVs in the statement(s) of financial performance	Consistent starting point for the indirect method in the statement of cash flows	2 Income/expenses from investments (and subtotal above)
Better ways to communicate OCI	Templates for primary financial statements ¹	
(Not) aligning the operating section between the statements of financial performance and cash flows	Disaggregation of items in P&L by nature/by function	
Presentation of cash flows related to associates/JVs	 <p data-bbox="859 1206 1377 1320">Staff rationale explained in Appendix 1</p>	<div style="border: 2px solid orange; padding: 10px; text-align: center;"> <p>Subtotals which we will focus on in the remainder of this presentation</p> </div>
General principles of disaggregation		

¹No tentative Board decisions have been made yet

Subtotal 1 — analysis of effect of tentative decisions

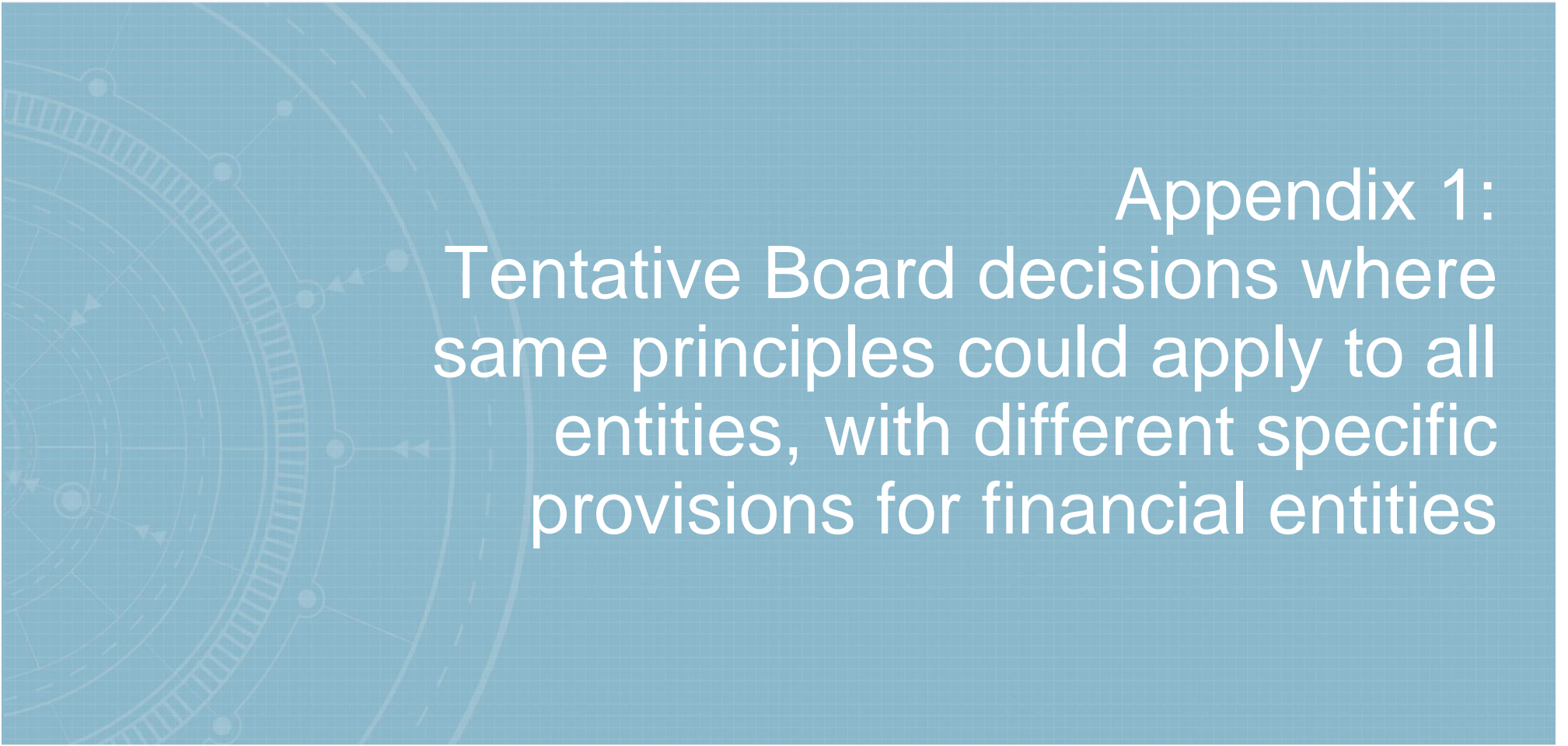
Tentative Board decisions	Application to financial entities
Require a subtotal showing profit before finance income/expenses and income tax	<ul style="list-style-type: none">• Differing views on usefulness of this subtotal for banks:<ul style="list-style-type: none">• the subtotal in principle not useful for banks as incurring finance expenses is part of their core business; but• banks make financing decisions like other entities and presenting income/expenses related to financing separately could be useful.• The proposed definition of financing activities (see slide 9) could be useful for financial entities other than banks as their financing activities might be more akin to corporates.
Require that 'finance income/expenses' consist of the following five line items: <ul style="list-style-type: none">• 'interest income from cash and cash equivalents calculated using the effective interest method';• 'other income from cash, cash equivalents and financing activities'• 'expenses from financing activities'• 'other finance income'; and• 'other finance expenses'.	<ul style="list-style-type: none">• Cash and cash equivalents may play a more important role for financial entities' working capital than for non-financial entities → Classification of interest on cash & cash equivalents as financing may be less appropriate for financial entities• 'Expenses from financing activities' would capture interest on many financial liabilities (incl. customer deposits in banks) → Currently presented as part of net interest margin (NIM) by most banks and considered part of core activities.• 'Other finance income' and 'other finance expenses' could apply to financial entities.

Subtotal ① — tentative decision on definition of financing activities

- The Board tentatively decided to clarify the current description of ‘**financing activities**’ in IAS 7 by indicating that a financing activity involves:
 - the receipt or use of a resource from a provider of finance (or provision of credit).
 - the expectation that the resource will be returned to the provider of finance.
 - the expectation that the provider of finance will be appropriately compensated through the payment of a finance charge. The finance charge is dependent on both the amount of the credit and its duration.

Subtotal ② — analysis of effect of tentative decisions

Tentative Board decisions	Application to financial entities
<p>Require a subtotal showing profit before income/expenses from investments, finance income/expenses and income tax</p>	<p>Differing views on usefulness of this subtotal for financial entities:</p> <ul style="list-style-type: none">• subtotal in principle not useful for financial entities as earning income from investments is part of their core business; but• financial entities make investing decisions like other entities and presenting income/expenses related to investing separately could be useful.
<ul style="list-style-type: none">• define ‘income/expenses from investments’ using a principle-based approach as ‘income/expenses from assets that generate a return individually and largely independently of other resources held by the entity’.• provide a list of some items that would typically (not) be treated as ‘investing’ for non-financial entities.	<p>Depends on how the definition of ‘income/expenses from investments’ is read:</p> <ul style="list-style-type: none">• financial assets (equity/debt instruments, customer loans etc) held by financial entities could be seen as generating a return independently of each other.• however:<ul style="list-style-type: none">• returns on assets could be related; and/or• assets could be managed together at a portfolio level.



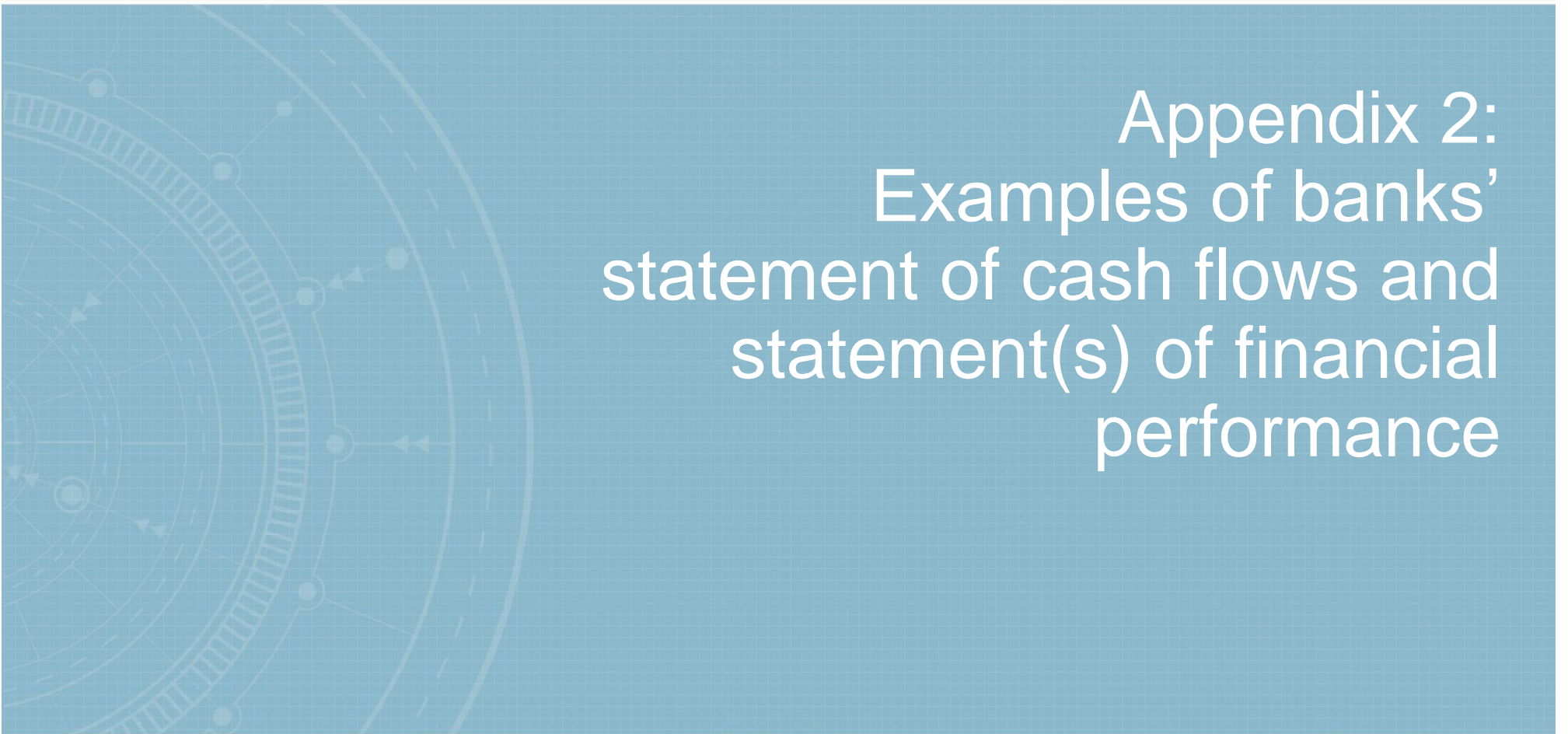
Appendix 1: Tentative Board decisions where same principles could apply to all entities, with different specific provisions for financial entities

Same principles, different specific provisions (1/2)

- Principle of **removing options for classification of interest and dividends** in the statement of cash flows could apply to financial entities, although different classification than for corporates may be more appropriate for interest paid/received for banks and dividends received for investment entities.
- Principle of a **consistent starting point for the statement of cash flows** could apply to financial entities, but may need to be a different starting point than for corporates, depending on which subtotals we require in the statement(s) of financial performance.

Same principles, different specific provisions (2/2)

- **Templates** could apply to financial entities, but separate templates will be required for banks, insurance companies and possibly also investment entities. Conglomerates might need to use a combination of templates.
- Principles of **by nature/by function** presentation of expenses could apply to financial entities, however:
 - there is diversity in how items are disaggregated in banks' statements of financial performance (Appendix 2);
 - additional specific guidance may be useful, for example on how by nature/by function presentation applies to fair value gains/losses.



Appendix 2: Examples of banks' statement of cash flows and statement(s) of financial performance

Example 1

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in € m.	2016
Net Income (loss)	(1,356)
Cash flows from operating activities:	
Adjustments to reconcile net income to net cash provided by (used in) operating activities:	
Provision for credit losses	1,383
Restructuring activities	484
Gain on sale of financial assets available for sale, equity method investments, and other	(899)
Deferred income taxes, net	(312)
Impairment, depreciation and other amortization, and accretion	3,745
Share of net income from equity method investments	(183)
Income adjusted for noncash charges, credits and other items	2,862
Adjustments for net change in operating assets and liabilities:	
Interest-earning time deposits with central banks and with banks w/o central banks	(2,814)
Central bank funds sold, securities purchased under resale agreements, securities borrowed	19,440
Financial assets designated at fair value through profit or loss	20,337
Loans	18,190
Other assets	(7,847)
Deposits	(15,237)
Financial liabilities designated at fair value through profit or loss and investment contract liabilities	8,686
Central bank funds purchased, securities sold under repurchase agreements, securities loaned	16,362
Other short-term borrowings	(10,632)
Other liabilities	(12,888)
Senior long-term debt	12,328
Trading assets and liabilities, positive and negative market values from derivative financial instruments, net	30,341
Other, net	(8,518)
Net cash provided by (used in) operating activities	70,610
Cash flows from investing activities:	
Proceeds from:	
Sale of financial assets available for sale	26,855
Maturities of financial assets available for sale	6,029
Maturities of securities held to maturity	0
Sale of equity method investments	50
Sale of property and equipment	206
Purchase of:	
Financial assets available for sale	(21,639)
Securities held to maturity	0
Equity method investments	(81)
Property and equipment	(725)
Net cash received in (paid for) business combinations/divestitures	2,023
Other, net	(1,479)
Net cash provided by (used in) investing activities	11,239
Cash flows from financing activities:	
Issuances of subordinated long-term debt	815
Repayments and extinguishments of subordinated long-term debt	(1,102)
Issuances of trust preferred securities	121
Repayments and extinguishments of trust preferred securities	(840)
Common shares issued	0
Purchases of treasury shares	(5,264)
Sale of treasury shares	4,983
Additional Equity Components (AT1) Issued	0
Purchases of Additional Equity Components (AT1)	(207)
Sale of Additional Equity Components (AT1)	202
Coupon on additional equity components, pre tax	(333)
Dividends paid to noncontrolling interests	(11)
Net change in noncontrolling interests	(13)
Cash dividends paid to Deutsche Bank shareholders	0
Net cash provided by (used in) financing activities	(1,649)
Net effect of exchange rate changes on cash and cash equivalents	(28)

in € m.	2016
Interest and similar income	25,636
Interest expense	10,929
Net interest income	14,707
Provision for credit losses	1,383
Net interest income after provision for credit losses	13,324
Commissions and fee income	11,744
Net gains (losses) on financial assets/liabilities at fair value through profit or loss	1,401
Net gains (losses) on financial assets available for sale	653
Net income (loss) from equity method investments	455
Net income (loss) from securities held to maturity	0
Other income (loss)	1,053
Total noninterest income	15,307
Compensation and benefits	11,874
General and administrative expenses	15,454
Policyholder benefits and claims	374
Impairment of goodwill and other intangible assets	1,256
Restructuring activities	484
Total noninterest expenses	29,442
Income (loss) before income taxes	(810)
Income tax expense	546
Net income (loss)	(1,356)

Diversity across entities in line items/subtotals presented

Cash flows related to some liabilities are classified as 'financing' in the cash flow statement

Example 2

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For the year ended 31 December	2016 £m
Continuing operations	
Reconciliation of profit before tax to net cash flows from operating activities:	
Profit before tax	3,230
Adjustment for non-cash items:	
Allowance for impairment	2,357
Depreciation, amortisation and impairment of property, plant, equipment and intangibles	1,261
Other provisions, including pensions	1,964
Net profit on disposal of investments and property, plant and equipment	(912)
Other non-cash movements including exchange rate movements	(20,025)
Changes in operating assets and liabilities	
Net (increase)/decrease in loans and advances to banks and customers	(25,385)
Net decrease in reverse repurchase agreements and other similar lending	14,733
Net increase/(decrease) in deposits and debt securities in issue	49,064
Net (decrease) in repurchase agreements and other similar borrowing	(4,852)
Net (increase)/decrease in derivative financial instruments	(2,318)
Net (increase)/decrease in trading assets	(5,577)
Net increase/(decrease) in trading liabilities	880
Net decrease/(increase) in financial investments	807
Net (increase) in other assets	(2,629)
Net (increase)/decrease in other liabilities	(532)
Corporate income tax paid	(780)
Net cash from operating activities	11,286
Purchase of available for sale investments	(65,086)
Proceeds from sale or redemption of available for sale investments	102,515
Purchase of property, plant and equipment and intangibles	(1,707)
Proceeds from sale of property, plant and equipment and intangibles	358
Proceeds from part disposal of investment in BACL	595
Other cash flows associated with investing activities	32
Net cash from investing activities	36,707
Dividends paid	(1,304)
Issuance of subordinated debt	1,457
Redemption of subordinated debt	(1,143)
Net issue of shares and other equity instruments	1,400
Repurchase of shares and other equity instruments	(1,587)
Net purchase of treasury shares	(140)
Net redemption of shares issued to non-controlling interests	-
Net cash from financing activities	(1,317)
Net cash from discontinued operations	405
Effect of exchange rates on cash and cash equivalents	10,473
Net increase/(decrease) in cash and cash equivalents	57,554

For the year ended 31 December	2016 £m
Continuing operations	
Interest income	14,541
Interest expense	(4,004)
Net interest income	10,537
Fee and commission income	8,570
Fee and commission expense	(1,802)
Net fee and commission income	6,768
Net trading income	2,768
Net investment income	1,324
Other income	54
Total income	21,451
Credit impairment charges and other provisions	(2,373)
Net operating income	19,078
Staff costs	(9,423)
Infrastructure costs	(2,998)
Administration and general expenses	(2,917)
Provision for UK customer redress	(1,000)
Provision for ongoing investigations and litigation relating to Foreign Exchange	-
Operating expenses	(16,338)
Share of post-tax results of associates and joint ventures	70
Profit/(loss) on disposal of subsidiaries, associates and joint ventures	420
Profit before tax	3,230
Taxation	(993)
Profit/(loss) after tax in respect of continuing operations	2,237
Profit after tax in respect of discontinued operation	591
Profit after tax	2,828

Diversity across entities in line items/subtotals presented

Cash flows related to some liabilities are classified as 'financing' in the cash flow statement



Appendix 3: Project scope and the Board's tentative decisions to date*

* The Board has not concluded the discussion relating to corporates so some tentative decisions might change prior to issuing consultation document

Statement(s) of financial performance	Statement of cash flows
<p>① Subtotals & categories facilitating comparisons between entities:</p>	<p>④ Eliminating classification options (interest/dividends)</p>
<p>A. Finance income/expense B. Income/expenses from investments C. Presentation of associates/JVs</p>	<p>⑤ (Not) aligning the operating section between the statements of cash flows and financial performance</p>
<p>② Management performance measures and adjusted EPS</p>	<p>⑥ Consistent starting point for the indirect method</p>
<p>③ Better ways to communicate OCI</p>	<p>⑦ Cash flows related to associates/JVs</p>
All primary financial statements	
<p>⑧ Developing templates for primary financial statements¹</p>	
<p>⑨ Achieving greater disaggregation</p> <p>A. General principles B. By nature/by function C. Minimum line items¹</p>	

¹No tentative Board decisions have been made yet

Tentative decisions: Statement(s) of financial performance (1/4)

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① A Finance income/expense and EBIT

Require a **subtotal** showing **profit before finance income/expenses and income tax**

Require that '**finance income/expenses**' consist of the following five line items:

- i. 'interest income from cash and cash equivalents calculated using the effective interest method';
- ii. 'other income from cash, cash equivalents and financing activities'
- iii. 'expenses from financing activities'
- iv. 'other finance income'; and
- v. 'other finance expenses'.

Use '**cash and cash equivalents**' in the definition of 'finance income/expenses' as a proxy for cash and temporary investments of excess cash.

Clarify the current description of '**financing activities**' in IAS 7 by indicating that a financing activity involves:

- i. the receipt or use of a resource from a provider of finance (or provision of credit).
- ii. the expectation that the resource will be returned to the provider of finance.
- iii. the expectation that the provider of finance will be appropriately compensated through the payment of a finance charge. The finance charge is dependent on both the amount of the credit and its duration.

Tentative decisions: Statement(s) of financial performance (2/4)

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① B Income/expenses from investments (& subtotal above)

Require a **profit before income/expenses from investments, finance income/expenses and income tax** subtotal

Define ‘income/expenses from investments’ as ‘income/expenses from assets that generate a return individually and largely independently of other resources held by the entity’.

Provide a **list** of some items that would typically (not) be treated as ‘investing’ for non-financial entities.

① C Presentation of associates/JVs

Require entities to present the results of ‘**integral**’ associates and joint ventures **separately** from those of ‘**non-integral**’ associates and joint ventures.

Use the proposed **definition** of ‘income/expenses from investments’ as the basis for the split, and include a non-exhaustive list of **indicators** for making this distinction.

Require presentation of the share of profit or loss of integral associates or joint ventures as a **line item above the ‘income/ expenses from investments’ category** and require a **new subtotal above** that line item.

Tentative decisions: Statement(s) of financial performance (3/4)

② Management performance measures (MPMs)

- All entities should specify their key performance measure(s) in the financial statements;
 - If any of these measures are not specified or defined in IFRS Standards, an entity should identify such measures as **management performance measures**; and
 - The key performance measures identified in the financial statements should include, as a minimum, the key performance measures communicated in the **annual report**.
-
- Entities should present an MPM as a **subtotal** in the **statement(s) of financial performance**, if it fits in the Board's proposed structure for the statement(s) and satisfies the requirements in IAS 1 for subtotals.
 - If an MPM **does not fit** in the statement(s) of financial performance, a **separate reconciliation should be disclosed in the notes** between the MPM and the most appropriate measure specified or defined in IFRS Standards.

No specific constraints on MPMs provided in a separate reconciliation.

Reconciliation to measure specified or defined in IFRS Standards should be provided **separately from the operating segment information** (IFRS 8)—however, no prohibition from also including MPMs within the operating segment information.

Tentative decisions: Statement(s) of financial performance (4/4)

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② Management performance measures (MPMs)—disclosures

Description of why the MPM provides management's view of performance, including an explanation of **how the MPM has been calculated and why**.

Sufficient **explanation**, if there is a **change** in how the MPM is calculated during the year, to help users understand the reasons for and effect of the change.

An explanation of **how the MPM differs** from the total of the measures of profit or loss for the reportable segments.

If **none of the MPMs fits** into the **operating segment** information, an **explanation** of why this is the case.

③ Better ways to communicate OCI

Rename the two categories in the OCI section of the statement(s) of financial performance to 'remeasurements reported outside profit or loss' and 'income and expenses to be included in profit or loss in the future'.

Explore whether there is a demand to **remove presentation options** in IAS 1 for OCI (IAS 1, para 91 & 94)

Tentative decisions: Statement of cash flows

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④ Eliminating classification options (interest/dividends)

Cash flows arising from **interest incurred on financing activities** should be classified as financing cash flows.

Cash flows arising from **interest paid** that is **capitalised** as part of the cost of an asset should be classified as financing cash flows.

Cash flows arising from **dividends paid** should be classified as financing cash flows.

Amend the definition of 'investing activities' in IAS 7 to clarify that **interest and dividends received** should be classified as investing cash flows.

⑤-⑦ Other improvements to the statement of cash flows

Require a **consistent subtotal as the starting point** for the indirect reconciliation of cash flows from operating activities, ie 'profit before investing, financing and income tax'.

No alignment between the operating section of the statement of cash flows and a corresponding section in the statement(s) of financial performance.

No other improvements to the statement of cash flows, besides the improvements mentioned above will be made.

Separate presentation of cash flows from **integral** and **non-integral** associates and joint ventures within the 'investing activities' section

Tentative decisions: All primary financial statements

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⑧ Developing templates for primary financial statements

Explore development of templates for the statement(s) of financial performance, the statement of cash flows and the statement of financial position for a small number of industries.

⑨ Achieving greater disaggregation—A. General principles

Develop, along the lines suggested in March 2017 Agenda Paper 21C:

- principles for aggregation and disaggregation in the financial statements;
- definitions of the notions 'classification', 'aggregation' and 'disaggregation'
- guidance on the steps involved in applying 'classification', 'aggregation' and 'disaggregation' when preparing financial statements.

⑨ Achieving greater disaggregation—B. By nature/by function

Describe the 'nature of expense' method and the 'function of expense' method

Develop **criteria** that entities could follow to determine whether a by-function or by-nature methodology provides the **most useful information** to users

Require **primary analysis** of expenses in the **statement(s) of financial performance**

Require an **analysis by nature** when an entity uses a 'function of expense' method in a **single note**

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