Primary Financial Statements
Cover Note

Objective

1 The objective of this session is to obtain your views on the IASB's tentative decisions with respect to the *Primary Financial Statements* project.

2 Preliminary to collecting your views on the IASB's tentative decisions, you will receive:

(a) a presentation from Mazars on the current use of alternative performance measures (APMs) by European listed companies; and

(b) a presentation from the IASB staff on the current status of the *Primary Financial Statements* (PFS) project.

3 The session will start with a presentation from Mazars on current practice with a short Q&A at the end. The IASB will subsequently provide an overview of the PFS project and describe the four main areas of the project. Finally, the EFRAG Secretariat will raise the questions in paragraphs 12-19 below for discussion.

Background

The IASB project and tentative decisions

4 The IASB's *Primary Financial Statements* (PFS) project is examining potential improvements to the structure and content of the primary financial statements, particularly the statement of financial performance. This project is part of the IASB's response to investors' demand for the IASB to undertake a project on performance reporting and is a part of the IASB's *Better Communication in Financial Reporting* initiative.

5 The IASB started the PFS project in 2014 in response to a call from investors that the structure and content of the statement of financial performance varied among entities and that there is often a lack of transparency around how alternative performance measures are calculated or why they are presented. Consequently, it is difficult to compare the financial performance of different entities, even those within the same industry.

6 To address the concerns raised by the users of financial statements, the IASB is exploring the following improvements to the statement of financial performance:

(a) requiring additional subtotals (e.g. operating profit);

(b) removing some of the options in existing IFRS Standards for presentation of income and expenses;

(c) provide guidance on the use of performance measures; and

(d) improving the communication of information about other comprehensive income.

7 In addition, the IASB is currently exploring limited improvements to the statement of cash flows which are focused on increasing comparability between entities by removing classification options in IAS 7 *Statement of Cash Flows* and requiring a consistent starting point for the indirect reconciliation of operating cash flows.

8 For the statement of financial position, the IASB has tentatively decided to require entities to present, as separate line items, goodwill and investments in 'integral' and 'non-integral' associates and joint ventures accounted for using the equity method.

9 Finally, in response to users' requests for greater disaggregation of information, the IASB is exploring the development of principles for aggregation and disaggregation in the financial statements and templates for the primary financial statements for a small number of industries. The IASB is expected to publish a Discussion Paper or Exposure Draft in the second half of 2019.

10 Appendix 1 to this paper provides a summary of the tentative decisions made so far by the IASB.

EFRAG work on this project

11 The EFRAG Secretariat has been closely monitoring the IASB discussions and providing updates to EFRAG TEG and EFRAG User Panel. In addition, the EFRAG Secretariat has also done some limited research on current presentation practice (more details please click here and here).

Questions for EFRAG TEG and EFRAG User Panel members

The use of new subtotals

12 Do EFRAG TEG and EFRAG User Panel members find useful the IASB's proposed structure for the statement of financial performance of general corporates (with operating, investing and financing categories) as laid out in slide 10 of the IASB presentation?

13 Do EFRAG TEG and EFRAG User Panel members find useful the IASB's proposed structure for the statement of financial performance of other types of entities, such as financial entities (the IASB presentation slide 15) (e.g. banks and insurers), investment entities (e.g. investment property companies) and conglomerates (e.g. automobile company that also provides financing to customers and/or makes investments)?

Management Performance Measures

14 Do EFRAG TEG and EFRAG User Panel members find useful the use of MPMs (with no specific constrains) and their reconciliation with the most directly comparable IFRS subtotal in the notes of the financial statements (the IASB presentation slides 17-20)?

15 Do EFRAG TEG and EFRAG User Panel members consider that the benefits of having information about the *Non-Controlling Interest* and *Tax effects* for all adjustments identified in the reconciliation will outweigh the costs for preparers?

Disaggregation and minimum line items

16 Do EFRAG TEG and EFRAG User Panel members consider that it is useful to separate presentation between integral and non-integral associates and joint ventures?

17 Do EFRAG TEG and EFRAG User Panel members consider that the definition of unusual items and related disclosures will help users of financial statements to assess the persistence or sustainability of an entity's financial performance (the IASB presentation slides 22-25)?

Cash Flow Statement

18	Do EFRAG TEG and EFRAG User Panel members consider that the removal of options for the classification of the cash flows from interest and dividends in the statement of cash flows (for financial and non-financial entities) will improve its relevance and comparability (the IASB presentation slides 27-28)?
19	Do EFRAG TEG and EFRAG User Panel members consider that the IASB's proposed structure and definitions for the statement of financial performance should be aligned (to the extent possible) with structure and definitions for the statement of cash flows, considering that both identify operating, investing and financing activities?

Agenda Papers

20 In addition to this cover note, agenda papers for this session are:

(a) Agenda paper 05-02 – Mazars presentation on APM;

(b) Agenda paper 05-03 – IASB presentation on PFS; and

(c) Agenda paper 05-04 – Mazars Report – for background only.

Appendix 1 – Summary of the IASB tentative decisions

Topic	IASB's tentative decisions
General	The IASB tentatively decided to focus on targeted improvements to: a) the statement(s) of financial performance; and b) the statement of cash flows. In September 2018, the IASB decided to move the project to its standard-setting agenda. The IASB will decide at a later stage of the project whether to issue a Discussion Paper or an Exposure Draft as the first due process output of the project.
Statement(s) of financial performance—project scope	The IASB tentatively decided to explore the following: a) requiring additional subtotal(s) in the statement(s) of financial performance; b) removing some of the options for presentation of income and expenses in existing IFRS Standards (e.g. presentation of net interest cost on the net defined benefit liability); c) providing guidance on use of performance measures, including separate presentation of non-recurring, unusual or infrequently occurring items; and d) better ways to communicate information about OCI.
Statement(s) of financial performance - financing activities	The IASB agreed to explore requiring the presentation of an EBIT-type subtotal and to describe it as **profit or loss before financing and income tax**. The IASB tentatively decided that **finance income or expenses** should consist of the following separate line items in the statement(s) of financial performance: a) 'interest income from **cash and cash equivalents** calculated using the effective interest method'; b) 'other income from cash, cash equivalents and financing activities'; and c) 'expenses from financing activities'. The IASB also tentatively decided that this category should include 'interest' income/expenses on liabilities that do not arise from financing activities (i.e. arising from unwinding of a discount), even though they do not meet the proposed definition of expenses from financing activities. ***Cash and cash equivalents*** is used as a proxy for cash and temporary investments of excess cash. The IASB also noted that a separate line item for impairment of cash and cash equivalents may be needed, if material. The IASB tentatively decided to **clarify the description of financing activities** in IAS 7 *Statement of Cash* Flows (and use it in the statement of financial performance) by indicating that a financing activity involves: a) the receipt or use of a resource from a provider of finance (or provision of credit); b) the expectation that the resource will be returned to the provider of finance; and c) 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.

Topic	IASB's tentative decisions
Statement(s) of financial performance - investing category	The IASB agreed to explore the introduction of an **investing category** into the statement(s) of financial performance and tentatively decided to: a) label the investing category as 'income/expenses from investments'; b) 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'; c) provide a list of some items that would typically be treated as investing and a list of some items that would typically not be treated as investing; and d) label the subtotal before the investing category as 'operating profit or loss and share of profit or loss of integral associates and joint ventures'.
Statement(s) of financial performance - associates and joint ventures	The IASB tentatively decided that all entities (including financial entities) should be required to present the results of **integral** associates and joint ventures separately from those of **non-integral** associates and joint ventures. The project's first due-process document should: a) use the IASB's proposed definition of 'income/expenses from investments' as the basis for the split between integral and non-integral investments in associates or joint ventures and include a non-exhaustive list of indicators that could be used in making this distinction; b) propose the presentation in the statement(s) of financial performance of the share of profit or loss of **integral** associates or joint ventures as a line item above the 'income/expenses from investments' category (i.e. above the subtotal **operating profit or loss and share of profit or loss of integral associates and joint ventures**) and require a new subtotal above that line item labelled as **operating profit**; and c) discuss all of the alternative approaches considered by the IASB for presenting the share of the profit or loss of integral associates and joint ventures, both within and outside the 'income/expenses from investments' category, and the IASB's reasons for rejecting those approaches. The IASB suggested that the following indicators (subject to drafting improvements) should be included to help preparers decide whether an associate or joint venture is **integral**: a) the existence of integrated lines of business across the entity and the associate or joint venture that lead to dependency on the associate or joint venture; b) the associate or joint venture's critical supplier or customer status; c) the reporting entity and the associate's or joint venture's sharing of a name or brand; and d) the sharing of capital or borrowing sources, such that the financing for the entity and the associate or joint venture is interrelated. In addition, the IASB tentatively decided to: a) state that the proposed list of indicators should not be prioritised in any way; b) state that the classification of an associate or joint venture as integral or non-integral shall be changed only if the relationship between the reporting entity and the associate or joint venture changes; and

<table>
<tr><th>Topic</th><th>IASB’s tentative decisions</th></tr>
<tr><td></td><td>c) amend the disclosure requirements of IFRS 12 Disclosure of Interests in Other Entities to reflect the introduction of the integral and non-integral categorisation of associates and joint ventures by requiring:
i. the disclosure in paragraph 20 to be split between ‘integral’ and ‘non-integral’ associates and joint ventures;
ii. additional disclosure of the factors considered when determining whether associates and joint ventures are ‘integral’ or ‘non-integral’; and
iii. additional disclosure where an equity accounted investment has been reclassified in the period, to indicate how its relationship with the reporting entity has changed.</td></tr>
<tr><td>Classification of income and expenses by financial entities</td><td>The IASB considered the classification of income and expenses in relation to:
a) entities that provide financing to customers as a main business activity; and
b) entities that, in the course of their main business activities, invest in assets that generate a return individually and largely independently of other resources held by the entity.
The IASB tentatively decided that:
a) an entity of the type described in (a) is required to include in operating profit:
i. expenses from financing activities and income from cash and cash equivalents relating to the provision of financing to customers; or
ii. all expenses from financing activities and income from cash and cash equivalents.
b) an entity of the type described in (a) above shall not present the ‘profit before financing and income tax’ subtotal if the entity does not present expenses from financing activities or income from cash and cash equivalents below operating profit. This applies even when such an entity presents in the statement(s) of financial performance the unwinding of a discount on liabilities that do not arise from financing activities.
c) an entity of the type described in (b) above is required to include in operating profit, income (expenses) from investments made in the course of its main business activities.
d) entities with insurance finance income or expenses should include it in the ‘operating profit’ subtotal. (Applying the proposal in (c) related investment income and expenses would also be included in that subtotal.)</td></tr>
<tr><td>Statement(s) of financial performance - other comprehensive income (OCI)</td><td>The IASB tentatively decided to rename the two categories in the OCI section of the statement(s) of financial performance as follows:
a) remeasurements reported outside profit or loss (currently OCI items that will not be reclassified subsequently to profit or loss); and
b) income and expenses to be included in profit or loss in the future (currently OCI items that will be reclassified subsequently to profit or loss).
The IASB tentatively decided the staff should explore whether there is a demand to remove the following presentation options in IAS 1 Presentation of Financial Statements for OCI:</td></tr>
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Topic	IASB's tentative decisions
	a) presenting items of OCI either net of related tax effects, or before related tax effects (paragraph 91 of IAS 1); and b) presenting reclassification adjustments in the statement(s) of financial performance or in the notes (paragraph 94 of IAS 1).
Management performance measure	The IASB tentatively decided that all entities shall identify a measure (or measures) of profit or comprehensive income that, in the view of management, communicates to users the financial performance of the entity. This measure will: a) often only be a subtotal or total specified by paragraph 81A of IAS 1; and b) sometimes be identified by management as a measure that is not a subtotal or total specified by paragraph 81A of IAS 1, but would complement those subtotals or totals. Such a measure is a management performance measure. The following requirements apply to management performance measures described in paragraph b) above: a) a reconciliation would be provided in the notes between that measure and the most directly comparable subtotal or total specified by paragraph 81A of IAS 1; b) that there should be no specific constraints on management performance measures; c) the measure would be labelled in a clear and understandable way so as not to mislead users; and d) the following information is required to be disclosed: i. statement that the measure provides management's view of the entity's financial performance and is not necessarily comparable with measures provided by other entities; ii. a description of why the management performance measure provides management's view of performance, including an explanation of o how the management performance measure has been calculated and why; and o how the measure provides useful information about an entity's financial performance iii. sufficient explanation, if there is a change in how the management performance measure is calculated during the year, to help users understand the reasons for and effect of the change. e) that the reconciliation between the management performance measure and the most directly comparable subtotal or total specified by paragraph 81A of IAS 1 should be provided separately from the operating segment information disclosed in accordance with IFRS 8 *Operating Segments*. However, entities would not be prohibited from also including management performance measures within the operating segment information. Furthermore, the following information would be required to be disclosed: i. an explanation of how the management performance measure differs from the total of the measures of profit or loss for the reportable segments; and ii. if none of the management performance measures fits into the operating segment information, an explanation of why this is the case.

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<tr><td></td><td>For the purposes of these proposals, paragraph 81A of IAS 1 would include the existing subtotals in that paragraph, the proposed new required subtotals developed as part of this project, for example, profit before investing, financing and tax. The IASB tentatively decided to expand the list of subtotals and totals that would not be considered management performance measures to include the following commonly used subtotals: profit before tax, profit from continuing operations, gross profit, defined as revenue less cost of sales, and operating profit before depreciation and amortisation. The IASB members advised caution in drafting to clearly distinguish these three commonly used subtotals from those that are specifically required to be presented by all entities in paragraph 81A of IAS 1.

The IASB also asked the staff to clarify in drafting that management performance measures provide additional information that complements the subtotals and totals specified by paragraph 81A of IAS 1, rather than provides a better view of financial performance.

The above tentative decisions describe disclosure requirements for management performance measures in the notes only. Consequently, it does not affect the presentation of additional subtotals in the statement(s) of financial performance in accordance with paragraphs 85–85A of IAS 1.

The IASB tentatively decided to require the reconciliation described in paragraph a) above to be disclosed in the notes rather than be provided below the statement(s) of financial performance.

The IASB tentatively decided to prohibit the use of columns to present information about management performance measures in the statement(s) of financial performance.</td></tr>
<tr><td>Adjusted earnings per share (EPS)</td><td>The IASB tentatively decided that, if an entity identifies a management performance measure,
a) it will be required to disclose in the notes the effect of tax and non-controlling interests separately for each of the differences between the management performance measure and the most directly comparable subtotal or total in paragraph 81A in IAS 1; and
b) it will not be required to disclose in the notes adjusted EPS calculated consistently with the management performance measure.

The IASB also tentatively decided that:
a) an entity would continue to be permitted to disclose adjusted EPS; and
b) an entity would be prohibited from presenting adjusted EPS in the statement(s) of financial performance.</td></tr>
<tr><td>Statement of cash flows - general</td><td>The IASB tentatively decided:
a) to eliminate options for the classification of the cash flows from interest and dividends in the statement of cash flows;
b) to require the operating profit subtotal as the starting point for the indirect reconciliation of cash flows from operating activities; and
c) not to align the operating section of the statement of cash flows with a corresponding section in the statement(s) of financial performance.</td></tr>
<tr><td>Statement of cash flows - classification</td><td>The IASB tentatively decided all entities shall:
a) classify cash flows from dividends paid as financing cash flows;</td></tr>
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Topic	IASB's tentative decisions
	b) separately present the investing cash flows of **integral** and **non-integral associates and joint ventures** accounted for using the equity method within the **investing activities** section of the statement of cash flows. The split between **integral** and **non-integral** associates and joint ventures should be the same for the statement of cash flows as for the statement(s) of financial performance; and **non-financial entities** shall classify: c) cash flows arising from interest incurred on financing activities as financing cash flows; d) cash flows arising from interest paid that is capitalised as part of the cost of an asset as financing cash flows; and e) cash flows arising from interest and dividends received as investing cash flows (the IASB tentatively decided to amend the definition of **investing activities** in IAS 7 accordingly). The IASB tentatively decided **financial entities** (entities that provide financing to customers as a main business activity and/or invest in the course of their main business activities in assets that generate a return individually and largely independently of other resources) shall classify cash flows from dividends received, interest paid and interest received each in a single section of the statement of cash flows. Financial entities shall determine the section in which to classify these cash flows as follows: a) if the entity presents related income (expenses) in a single section of the statement(s) of financial performance, the entity shall present related cash flows in that section; or b) if the entity presents related income (expenses) in more than one section of the statement(s) of financial performance, the entity shall make an accounting policy choice regarding the section of the statement of cash flows in which to present related cash flows.
Other topics - project scope	The IASB tentatively decided to explore the following topics: a) 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; and b) development of a principle for aggregating and disaggregating items in the primary financial statements. The IASB tentatively decided not to consider targeted improvements to the statement of financial position (other than those described below) unless work on other areas of the primary financial statements identifies possible improvements to that statement. Additionally, the IASB tentatively decided that segment reporting and the presentation of discontinued operations should not be part of the scope of the project.
Templates or examples	The IASB tentatively decided: a) to develop non-mandatory examples to illustrate the IASB's decisions regarding this project. b) to develop illustrative examples of: i. the statement(s) of financial performance for different types of entities;

Topic	IASB's tentative decisions
	ii. the statement of cash flows for a financial entity and a non-financial entity based on the current illustrative examples in IAS 1; and iii. any notes that are introduced or amended by the project; and c) to include illustrative examples for the statement(s) of financial performance for the following types of entity: i. a non-financial entity (both by function and by nature); ii. an investment property company; iii. an insurer; iv. a traditional bank with no material investing activities; v. a bank engaged in both investing and customer financing activities; vi. a bank-insurer; vii. a manufacturer that conducts investing activities; and viii. a manufacturer that provides financing to customers.
Principles of aggregation and disaggregation	The IASB tentatively decided to include a principle for determining the location of financial information in the primary financial statements or the notes that is based on the role of the primary financial statements and the role of the notes suggested in Discussion Paper *Disclosure Initiative - Principles of Disclosure*. That principle would not override the specific requirements of IAS 1 for the presentation of minimum line items and subtotals in the primary financial statements. An entity should also apply that principle when a Standard allows entities to determine whether to provide financial information in the primary financial statements or in the notes. The IASB tentatively decided on the following principles for aggregation and disaggregation: **Principle 1**: Items that share similar characteristics should be classified and aggregated together; **Principle 2**: Items that are dissimilar from other items should not be combined with other items and should be separated or disaggregated; and **Principle 3**: Aggregation and disaggregation in the financial statements should not obscure relevant information or reduce the understandability of the information presented and should also contribute to a faithful representation of the items presented. The IASB tentatively decided to define **classification, aggregation and disaggregation** as follows: a) classification is the sorting of assets, liabilities, equity, income and expenses and cash flows on the basis of shared characteristics; b) aggregation is the adding together of individual items that share characteristics and are classified together; and c) disaggregation is the separation of an item or group of items into dissimilar component parts. The IASB tentatively decided to provide guidance on the steps involved in aggregation and disaggregation being as follows: a) classifying the effects of individual transactions or other events into assets, liabilities, equity, income and expenses;

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b) separating assets, liabilities, equity, income and expenses into groups based on their characteristics (for example, their nature, their function, their measurement basis or another characteristic) resulting in the presentation of line items that share at least one characteristic in the primary financial statements; and
c) separating the line items presented in the primary financial statements based on further characteristics resulting in the separate disclosure of items in the notes, if those items are material.

The IASB tentatively decided to provide the following additional guidance for material balances comprised of immaterial items:

Items presented in the primary financial statements or disclosed in the notes shall be described in a way that faithfully represents the items they aggregate. Faithful representation could be achieved by using item labels that describe the shared characteristics that form the basis of the aggregation. In producing financial statements, an entity may identify items that do not appear to share characteristics with other items and are not material but that when aggregated would result in a material balance. Labelling these items with a non-descriptive label such as other would not faithfully represent these items without additional information. In order to faithfully represent these items, an entity shall:
a) reconsider whether the immaterial item(s) share similar characteristics with other immaterial item(s) and can be aggregated to create a material item that can be described in a manner that faithfully represents the aggregated items;
b) consider whether the aggregated items may be described in a way that faithfully represents the dissimilar items without changing the level of aggregation; and
c) if (a) and (b) are impractical, disclose information in the notes about the composition of the aggregated item, for example, the balance consists of several unrelated immaterial amounts, the largest balance of which is CU10 of property maintenance expenses.
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<tr><td>Disaggregation - analysis of operating expenses</td><td>
The IASB tentatively decided to:
a) describe the nature of expense method and the function of expense method used to analyse expenses required by paragraph 99 of IAS 1.
b) continue to require an entity to provide an analysis of expenses using the methodology, either by-function or by-nature, that provides the most useful information to users.
c) describe factors that entities would consider when determining whether a by-function or by-nature methodology provides the most useful information to users. These are:
i. which method provides the best information about the key components or drivers of profitability;
ii. which method most closely matches how management reports internally to the board or key decision makers and the way the business is run;
iii. peer industry practice; and
iv. whether the allocation of expenses to functions would be so arbitrary that it would not provide a sufficiently faithful representation of the
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Topic	IASB’s tentative decisions
	composition of an entity’s functions. In such cases, a ‘by nature’ method should be used. d) provide no requirement for entities that use the ‘nature of expense’ method to provide additional information using the ‘function of expense’ method. e) require an entity: i. to present its primary analysis of expenses in the statement(s) of financial performance. ii. when an entity provides primary analysis of expenses using a by-function methodology, require the entity to disclose in a single note additional information on the nature of the expense. This information would be provided at an entity level, not as a breakdown of each functional line presented.
Disaggregation - separate disclosure of unusual items	The IASB tentatively decided to: a) require separate disclosure of information about unusual items regardless of whether an entity chooses to disclose a management performance measure; b) require separate disclosure of unusual items in the notes to the financial statements and require that those items be attributed to line items in the statement(s) of financial performance; c) define unusual items along the following lines: **Unusual items** are income or expenses with limited predictive value because it is reasonable to expect that similar items will not arise for several future annual reporting periods. **Similar items** are income or expenses that are similar in type and amount.’ d) state that gains and losses arising from the remeasurement of items required to be measured at current value (including fair value) generally should not be classified as unusual items. e) require entities to attribute unusual expenses to categories of expense by nature, regardless of their method of analysis of expenses in the statement(s) of financial performance. f) require entities to provide a narrative description of the transactions or other events that give rise to **unusual items**; and g) not require entities to provide information about income or expenses related to unusual income or expenses (unless those income or expenses themselves meet the definition of unusual items).
Minimum line items	The IASB tentatively decided: a) to clarify that the line items that are required to be presented in the statement(s) of financial performance may need to be presented in more than one section of that statement; b) to remove the requirement in paragraph 82(b) of IAS 1 to present ‘finance costs’ in the statement(s) of financial performance; and c) to clarify that when line items are required to be presented in the statement(s) of financial performance, that requirement necessitates separate presentation, regardless of the method of analysis of expenses within operating profit.

Topic	IASB's tentative decisions
	d) to require entities to present in the statement of financial position: i. goodwill; ii. investments in 'integral' associates and joint ventures accounted for using the equity method; and iii. investments in 'non-integral' associates and joint ventures accounted for using the equity method. e) not to add amortisation, depreciation or research and development expenditure to the list of line items in paragraph 82 of IAS 1 required to be presented in the statement(s) of financial performance.