

# Primary Financial Statements

Project status  
EFRAG TEG/User panel  
April 2019

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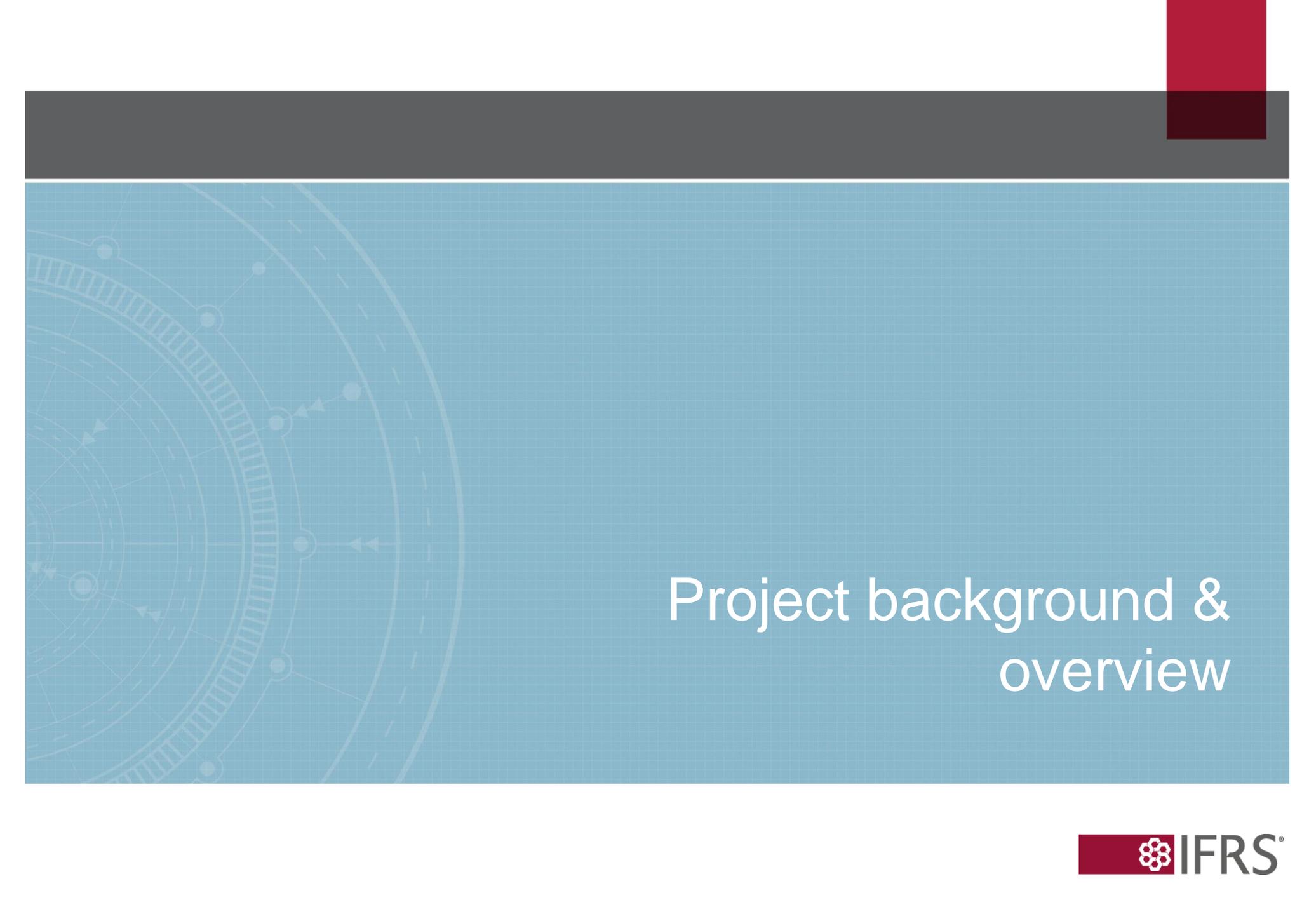
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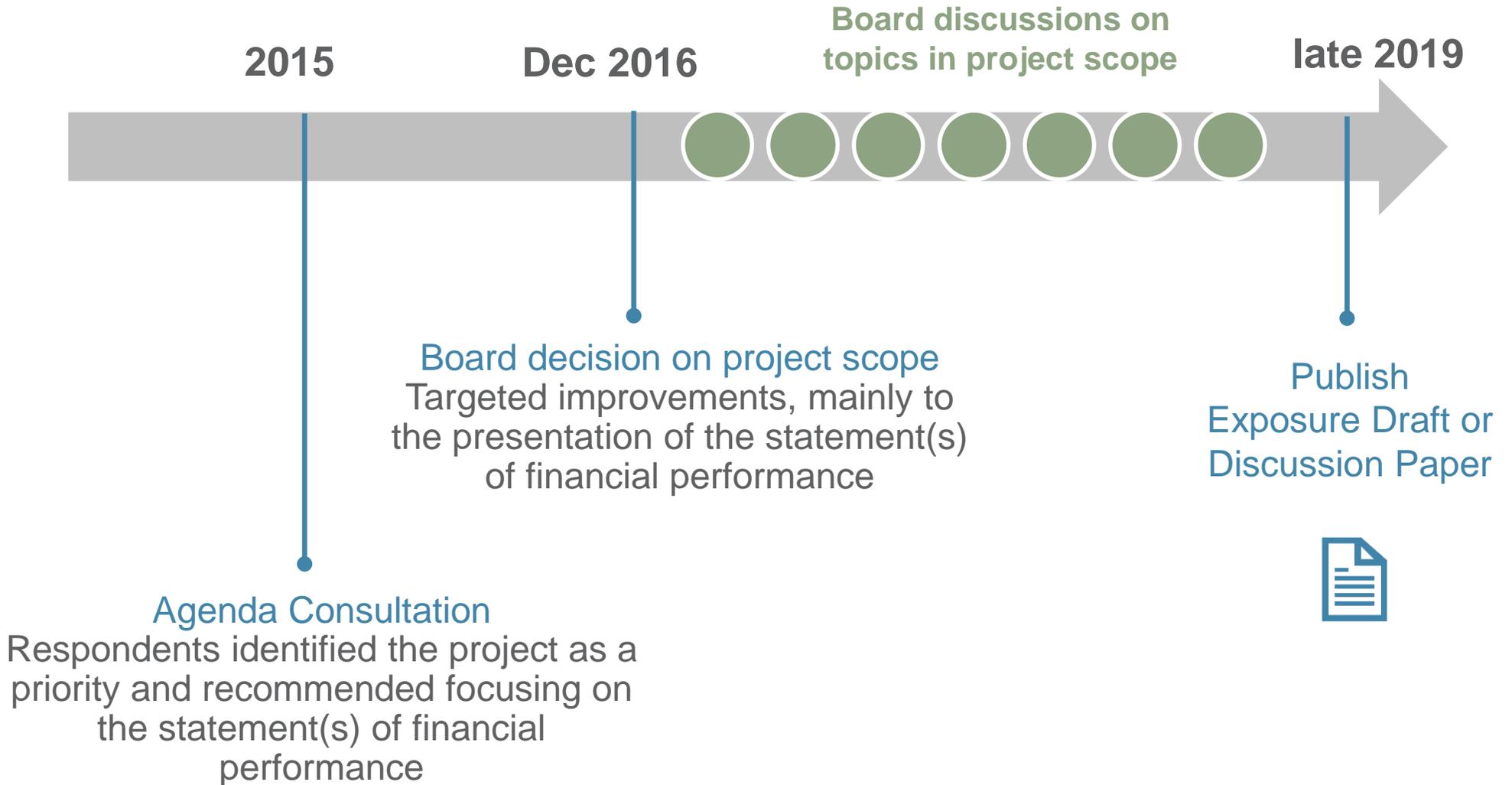


# Project background & overview

## Better Communication in Financial Reporting



# Project timeline

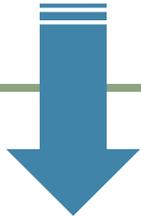


# Overall project objective



## Objective of the Primary Financial Statements project

Targeted improvements to the primary financial statements with a focus on the statement(s) of financial performance



### Primary Financial Statements

Statement(s)  
of financial  
performance

Statement  
of financial  
position

Statement  
of cash  
flows

Statement  
of changes  
in equity

# Stakeholder feedback and key tentative Board decisions

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Statements of financial performance are not sufficiently comparable between different companies

Introduce **defined subtotals** in the statement(s) of financial performance



Non-GAAP measures can provide useful information, but transparency needs to be improved

Introduce disclosure of **management performance measures**



I need flexibility to tell my company's story

Improve **disaggregation**

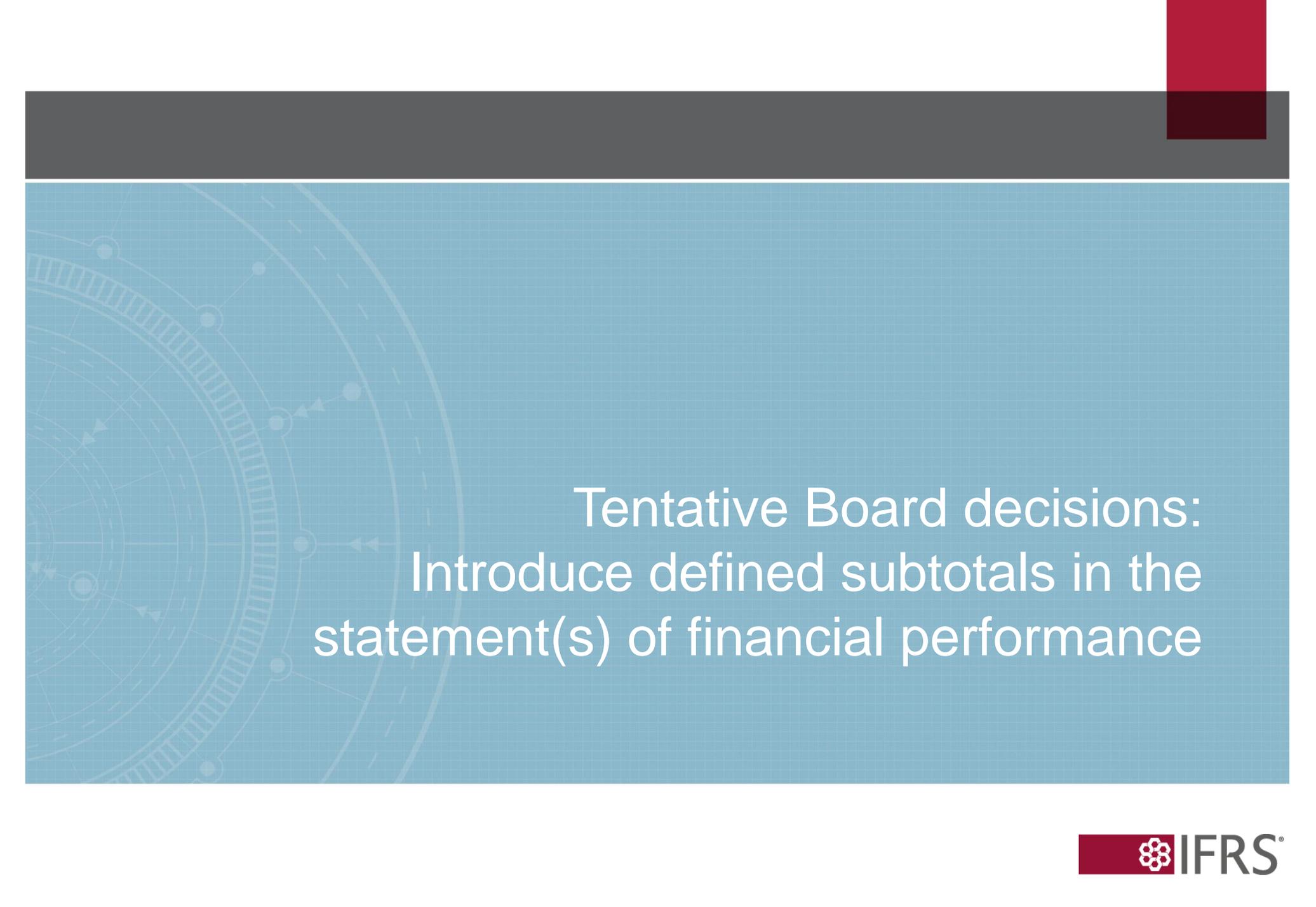


There is insufficient disaggregation in financial statements

# Full scope of the project

Statement(s) of financial performance	Statement of cash flows
Subtotals & categories facilitating comparisons between entities: <ul style="list-style-type: none"><li>• Operating, investing and financing categories</li><li>• Presentation of associates/JVs</li></ul>	Eliminating classification options (interest/dividends)
Management performance measures	Consistent starting point for the indirect method
Better ways to communicate OCI	Prescribing classification of cash flows related to associates/JVs

Improving disaggregation in financial statements
Principles of disaggregation in financial statements
Disaggregation by nature or by function in the statement(s) of financial performance
Disclosure of unusual or infrequent items
Minimum line items in the primary financial statements
Illustrative examples of primary financial statements for a small number of industries



Tentative Board decisions:  
Introduce defined subtotals in the  
statement(s) of financial performance

# Defined subtotals

## —illustration for general corporates (by nature)

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Revenue	16,500
Changes in inventories of finished goods and work in progress	(1,000)
Raw material and consumables used	(6,000)
Employee benefits expense	(4,000)
Impairment of property, plant and equipment	(500)
Depreciation expense	(1,200)
Amortisation expense	(800)
<b>1 Operating profit</b>	<b>3,000</b>
Share of profit of <b>integral</b> joint ventures and associates	500
<b>2 Operating profit and share of profit or loss of integral associates and joint ventures</b>	<b>3,500</b>
Changes in the fair value of financial assets	250
Dividend income	50
Share of profit of <b>non-integral</b> joint ventures and associates	100
<b>3 Profit before financing and income tax</b>	<b>3,900</b>
Interest income from cash and cash equivalents	100
Expenses from financing activities	(1,000)
Unwinding of discount on pension liabilities and provisions	(100)
Profit before tax	2,900

# Three defined subtotals in the statement of profit or loss

1

Operating profit

Excludes share of profit from **all** associates and joint ventures

2

Operating profit and share of profit of integral associates and joint ventures

Excludes:

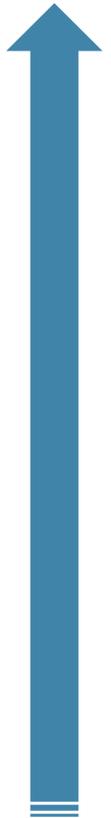
- **income (expenses) from investments**
- share of profit from **non-integral** associates and joint ventures

3

Profit before financing and income tax

Excludes:

- expenses (income) arising from **financing activities**
- income from **cash and cash equivalents**
- **unwinding of discount** on liabilities that do not arise from financing activities



Defined bottom-up

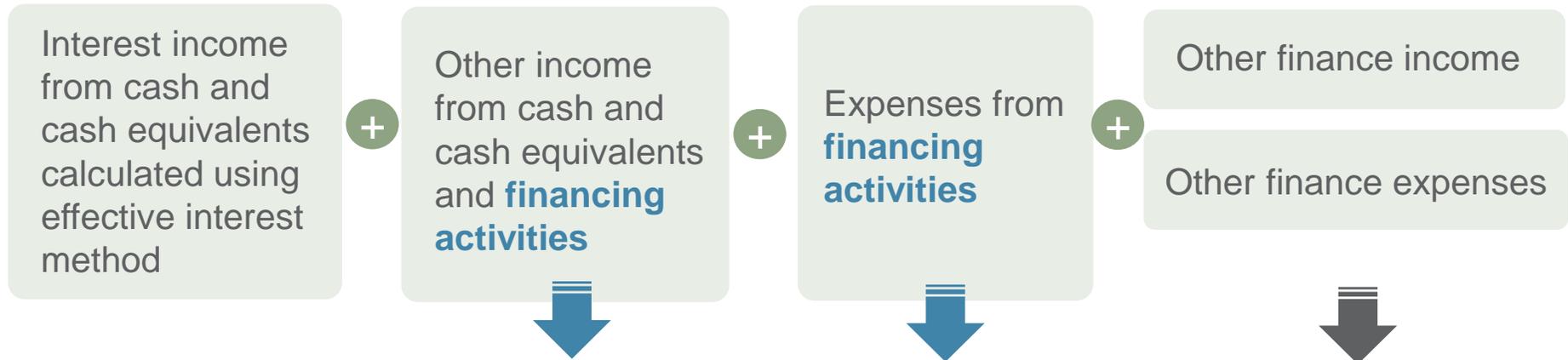
# Profit before financing and income tax

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**Objective:** enable comparison of entities with different capital structures

## Items excluded from profit before financing and income tax



### Financing activities (proposed clarification to IAS 7 definition)

- receipt or use of a resource from a provider of finance (or provision of credit)
- expectation: resource returned to provider of finance
- expectation: provider of finance appropriately compensated through finance charge

Includes specified items such as unwinding of the discount on liabilities that do not arise from financing activities (eg provisions)

# Income (expenses) from investments

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**Objective:** enable investors to separate operations from investments

## Definition

‘income (expenses) from assets that **generate a return individually and largely independently** of other resources held by the entity’

## Presentation

required to be presented between the ‘operating profit and share of profit of integral associates and joint ventures’ subtotal and the ‘profit before financing and income tax’ subtotal

## Examples

(for entities that do not invest in the course of their main business activities\*)

- fair value changes and rental income on investment property
- interest income on financial assets, other than cash and cash equivalents
- dividends and fair value changes on non-consolidated equity investments

\* eg for an investment property company, income from investment properties would be included in operating profit, as illustrated in the appendix.

# Presentation of associates and JVs

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Preparer

My associates and JVs are a part of my main business, so I want to include my share of their results in my key performance measures.

The share of associates' and joint ventures' profit is after financing and after tax so I want to analyse them separately.



User

## Tentative Board decisions

Separately present 'integral' and 'non-integral' associates and joint ventures in statements of financial performance and cash flows.

Use definition of income/expenses from investments to classify as 'integral' or 'non-integral': generate returns largely independently of other resources.

Definition supplemented with indicators for determining whether a joint venture or associate is 'integral' or 'non-integral'.

# Classification by financial entities

Revenue	X
Operating expenses	(X)
Operating profit	X
Share of profit of integral joint ventures and associates	X
Operating profit and share of profit or loss of integral associates and joint ventures	X
Share of profit of non-integral joint ventures and associates	X
Income (expenses) from investments (eg fair value changes in financial assets)	X
Profit before financing and income tax	X
Interest income from cash and cash equivalents	X
Expenses from financing activities	(X)
Unwinding of discount on pension liabilities and provisions	(X)
Profit before tax	X

*Appendix includes more details on the model for financial entities as well as illustrations*

Included in operating profit for entities that invest\* in the course of their main business activities

But only to the extent income (expenses) arise from investments made in the course of main business activities

Included in operating profit for entities that provide financing to customers as a main business activity

Accounting policy choice whether to include all expenses (income) or only those related to the provision of financing to customers

\*in assets that generate a return individually and largely independently of other entity resources



# Tentative Board decisions: Proposals on management performance measures

# Management performance measures (1)



Users

Non-GAAP measures can provide useful information

## Tentative Board decisions

Entities are **required** to identify a measure (or measures) of profit that, in management's view, communicates to users the financial performance of the entity.

This measure will often be a subtotal or total specified by IFRS Standards, but could be a **management performance measure** (MPM) that complements those subtotals or totals.

If entities identify MPMs, they will usually be disclosed in the **notes**, because few will fit in the structure of the statement(s) of financial performance.

**No specific constraints** on the calculation of MPMs.

# Management performance measures (2)

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Users

Transparency of non-GAAP measures needs to be improved

## Tentative Board decisions

- Disclose a **reconciliation** in the **notes** between the MPM and the most directly comparable subtotal/total specified by IFRS Standards (*not* as a column on the face)
- Disclose the **effect on tax and non-controlling interests** separately for each reconciling item
- **Describe why** the MPMs provide management's view of performance and **how** they have been **calculated**
- **Label** MPMs in a **clear** and **understandable** way
- Explain any **changes over time** in calculation of MPMs
- Explain any **differences** between MPMs and **segment** measures

# Management performance measures (3)

## Example of reconciliation

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The management performance measure is disclosed in a separate reconciliation in the **notes**:

Adjusted operating profit	4,400	Tax impact	NCI impact
Restructuring expenses for the closure of Factory A	(1,000)	200	50
Impairment of asset B	(400)	80	-
<b>Operating profit</b>	<b>3,000</b>		



**Most directly comparable subtotal/total specified by IFRS Standards** can be:

- any of the subtotals required by para 81A of IAS 1;
- any of the three subtotals proposed in this project;
- profit before tax, profit from continuing operations or gross profit; or
- operating profit before depreciation and amortisation—this means entities are unlikely to be required to disclose tax and NCI for depreciation and amortisation.

# Implications for EBITDA



Users

EBITDA is one of most commonly used non-GAAP measures. Diversity in calculation is unhelpful.

## Tentative Board decisions

- The Board has not defined EBITDA, ie it has not prescribed how measures labelled 'EBITDA' should be calculated.
- If an entity calculates EBITDA as operating profit + D&A then MPM disclosures need not be provided.



# Tentative Board decisions: improving disaggregation



Users

Quality of disaggregation in financial statements needs improving

## Tentative Board decisions

Improved principles, definitions and guidance on aggregation and disaggregation.

Guidance on immaterial aggregations resulting in material balances to address **large residual or 'other' balances**.

Entities are **required** to present their primary analysis of expenses by nature **or** by function in the statement(s) of financial performance.

When primary analysis of expenses is presented **by function**, entities are **required** to disclose a full analysis of expenses **by nature** in the **notes**.



Users

Information about unusual items is useful but transparency needs to be improved.

## Tentative Board decisions

**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.

Gains or 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.

**Disclose** information about unusual items in the **notes**:

- an attribution of unusual items to line items in the statement(s) of financial performance
- an attribution of unusual expenses to natural expense categories
- a narrative description of the transactions/other events that gave rise to unusual items

# Required minimum line items



How do required minimum line items in the statement of financial performance relate to the project proposals?

## Tentative Board decisions

Minimum line items required to be presented separately regardless of the method of analysis of expenses in the operating profit section.

Minimum line items could be presented in more than one section of the statement of financial performance.

'Finance costs' to be removed from the existing requirement for minimum line items (Para 82 of IAS 1).

Add goodwill, investments in integral associates and joint ventures, and investments in non-integral associates and joint ventures, to the list of minimum line items in the statement of financial position.

# Non-mandatory illustrative examples

25

Statement(s)  
of financial  
performance

+

Statement of  
cash flows

+

Any notes that are introduced or amended by the project

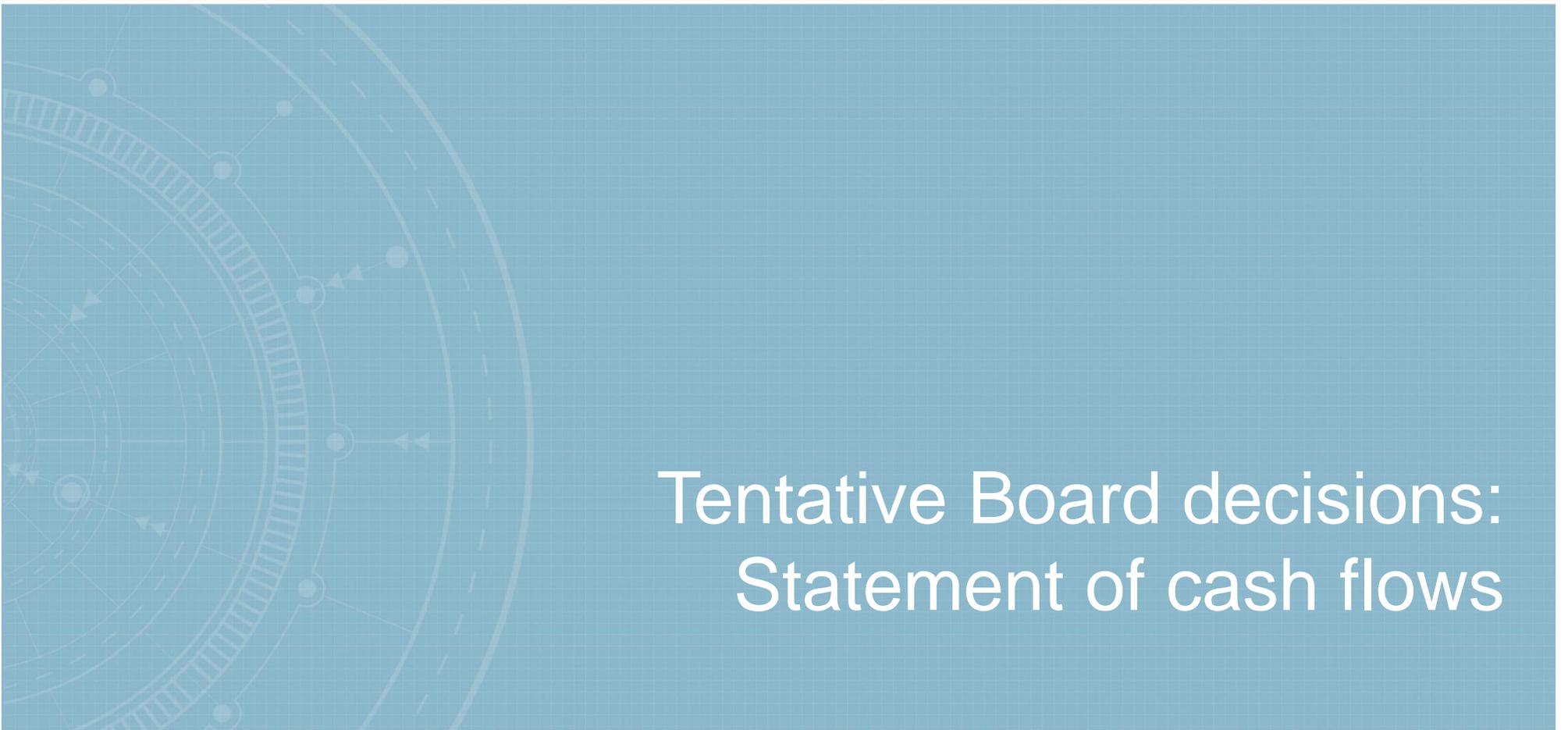
## Types of entities

- a non-financial entity (both by function and by nature)
- an investment property company
- a traditional bank with no material investing activities
- a bank engaged in both investing and customer financing activities
- a bank-insurer
- a manufacturer that conducts investing activities
- a manufacturer that provides financing to customers

## Types of entities\*

- a financial entity
- a non-financial entity

\*based on the current illustrative examples in IAS 7



# Tentative Board decisions: Statement of cash flows

# Statement of cash flows—illustration (indirect method)

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Operating profit	X
Adjustments for:	
Depreciation	X
[...]	
Income taxes paid	(X)
<b><u>Net cash from operating activities</u></b>	<b><u>X</u></b>
Acquisition of integral joint venture X	(X)
Acquisition of non-integral associate Y	(X)
Dividends received from integral associate A	X
Dividends received from non-integral associate B	X
Purchase of property, plant and equipment	(X)
[...]	
<b><u>Net cash used in investing activities</u></b>	<b><u>(X)</u></b>
[...]	
<b><u>Net cash used in financing activities</u></b>	<b><u>(X)</u></b>
<b><u>Net increase in cash and cash equivalents</u></b>	<b><u>X</u></b>

Consistent starting point for indirect method for operating cash flows

Separate presentation of cash flows from integral and non-integral associates and joint ventures within investing cash flows

# Classification of interest and dividends

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User A

I want each type of interest and dividend cash flows in a single location

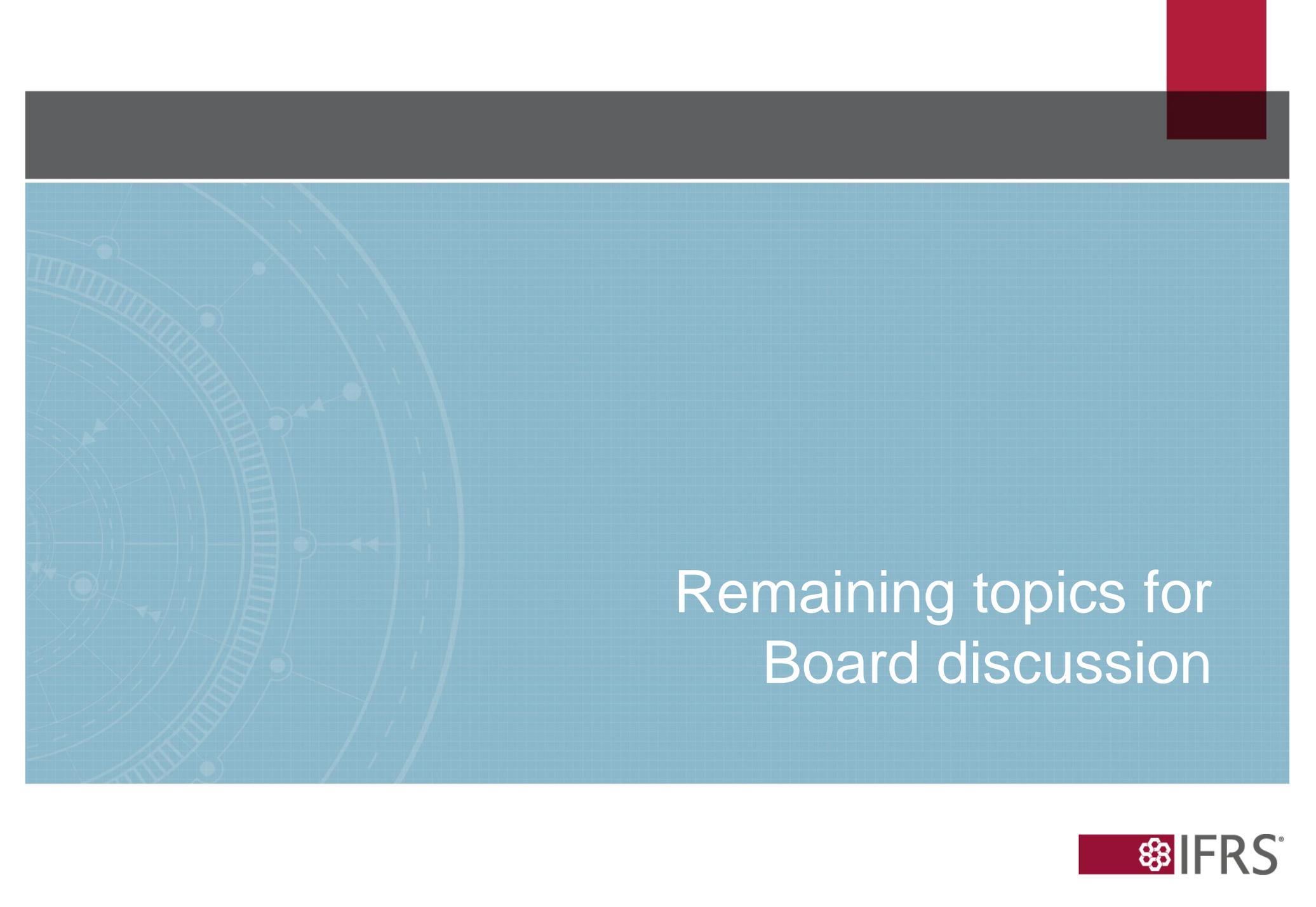
Classification should be aligned between the statements of financial performance and cash flows



User B

Cash flow item	IAS 7 classification	Tentative Board decision— non-financial entities	Tentative Board decision— financial entities
Interest paid	Operating or financing	Financing	Operating or financing*
Dividends paid	Operating or financing	Financing	Financing
Interest received	Operating or investing	Investing	Operating, investing or financing*
Dividends received	Operating or investing	Investing	Operating or investing* (always investing for equity-accounted investments)

\* Aligned with P&L, except if in more than one category in P&L, choose a single category in the statement of cash flows



# Remaining topics for Board discussion

# For discussion in Q2 2019

**April 2019  
see next slide**

Application of project proposals to financial entities

Amending proposals for MPMs

**Not discussed  
yet:**

Interaction with IFRS Taxonomy

First due process document—  
Discussion Paper or Exposure Draft?

# April meeting—staff recommendations

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## MPMs

State that entities can only identify a measure as a management performance measure if they use the same measure in their **communications with users** outside financial statements

In providing a reconciliation of the management performance measures to the closest IFRS-specified subtotal, separately identify adjustments for **unusual** items

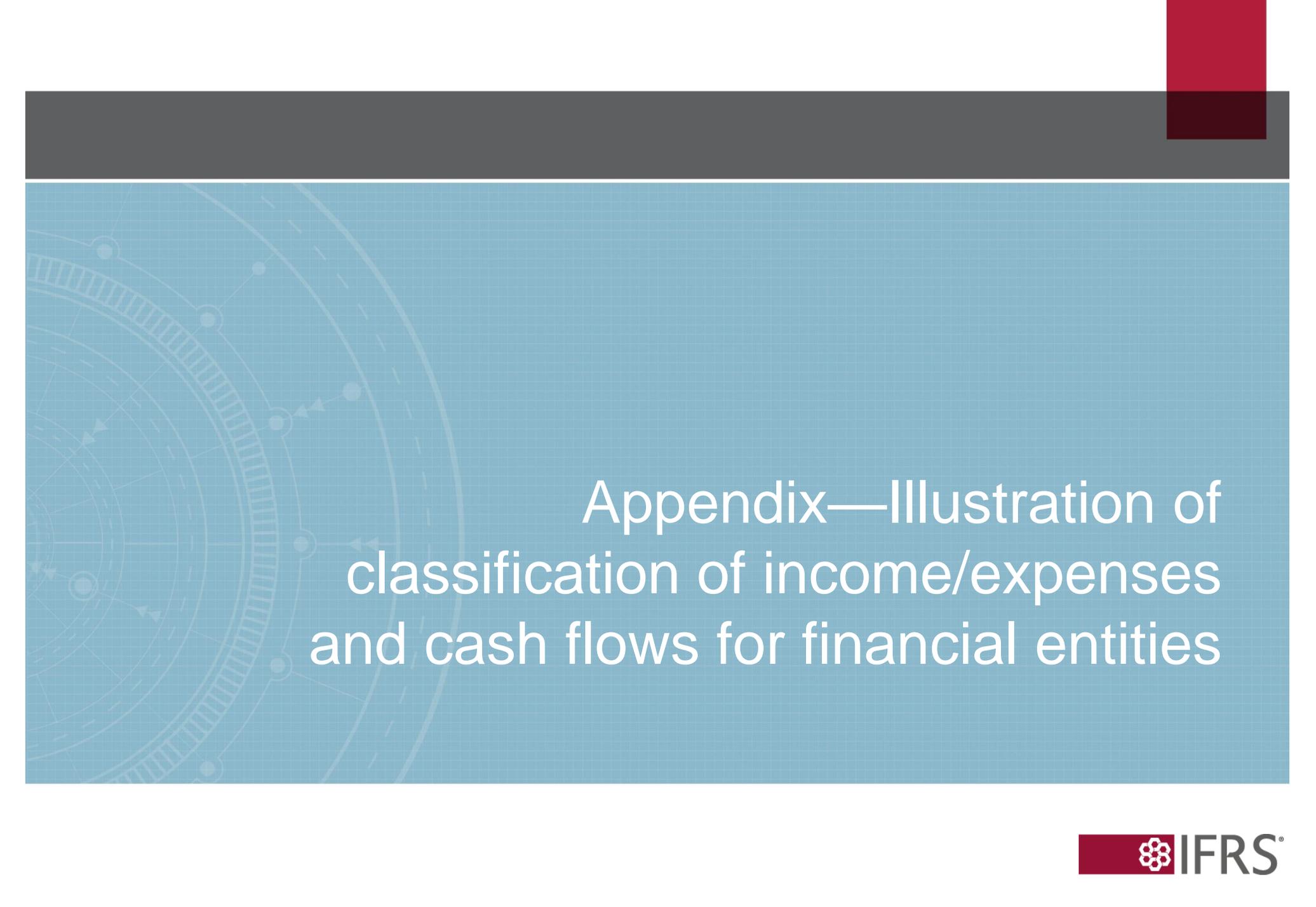
Clarify that MPM is subject to general requirement for **faithful representation**

## Financial entities

Entities that invest in financial assets in course of their main business activities – include interest on cash and cash equivalents in operating profit

Entities that invest in course of their main business activities – include expenses directly related to any investment contracts with participation features in operating profit

Clarify what is meant by main business activities



# Appendix—Illustration of classification of income/expenses and cash flows for financial entities

# Classification of income/expenses for financial entities

## Starting point

(Tentative Board decisions for non-financial entities)

Present all 3 subtotals

All expenses from financing activities and income from cash & cash equivalents:

Financing

All income (expenses) from investments:

Investing

Share of profit of equity-accounted investments and unwinding of discount below operating profit

## Tentative Board decisions for financial entities

If providing financing to customers is a main business activity, make accounting policy choice:

Allocate expenses from financing activities and income from cash & cash equivalents:

- Related to provision of financing to customers
- Not related to provision of financing to customers

Operating

Financing

OR

Present all expenses from financing activities and income from cash & cash equivalents in:

Operating

If the entity invests in the course of its main business activities:

Allocate income/ expenses from investments:

- Investments in course of main business activities
- Investments not in course of main business activities

Operating

Investing

If no expenses from financing activities or income from cash & cash equivalents in financing category:

No 'profit before financing & tax' subtotal

Insurance finance expenses (income):

Operating

# Illustrative examples for financial entities

- The examples in this slide deck are intended to illustrate the proposals for *classification* of income and expenses related to investments and financing and cash flows from interest and dividends.
- Presentation of other line items is simplified and thus the examples do not present a complete illustration of the statements of financial performance and cash flows.

Types of entities	Invests in the course of its main business activities?	Provides financing to customers as a main business activity	Slide # P&L, SCF
① Investment property company	✓	x	35, 39
② Insurer	✓	x (but applies exception for insurance finance expenses (income))	36, 40
③ Bank with multiple business activities	✓	✓ (example illustrates an entity that has chosen to move all in operating)	37, 41
④ Entity with a captive finance subsidiary	x	✓ (example illustrates an entity that has chosen to split between operating and financing)	38, 42

## Example 1—Investment property company

Extract from statement(s) of financial performance	
Gross rental income	X
Property operating expenses	(X)
Net rental income	X
Administrative expenses	(X)
Changes in fair value of investment properties	X
Gain on disposal of investment properties	X
Operating profit	X
Share of profit of integral associates and joint ventures	X
Operating profit and share of profit of integral associates and JVs	X
Share of profit of non-integral associates and joint ventures	X
Dividends from investments in equity instruments at FVOCI	X
Profit before financing and income tax	X
Interest income from cash and cash equivalents	X
Expenses from financing activities	(X)
Unwinding of discount	(X)
Profit before tax	X

Income (expenses) from **investments** that are made in the course of the entity's **main business activity** are included in operating profit.

Income (expenses) from **investments not** made in the course of the entity's **main business activity** are presented below operating profit.

## Example 2—Insurer

Extract from statement(s) of financial performance	
Insurance revenue	X
Insurance service expenses	(X)
Insurance service result	X
Investment income*	X
Impairment of investments	(X)
Insurance finance expenses	(X)
<b>Net financial result</b>	<b>X</b>
<b>Operating profit</b>	<b>X</b>
Share of profit of integral associates and joint ventures	X
<b>Operating profit and share of profit of integral associates and JVs</b>	<b>X</b>
Share of profit of non-integral associates and joint ventures	X
<b>Profit before (non-customer) financing and income tax</b>	<b>X</b>
Interest income from cash and cash equivalents**	X
Expenses from financing activities	(X)
<b>Profit before tax</b>	<b>X</b>

Income (expenses) from **investments** that are made in the course of the entity's **main business activity** are included in operating profit \*\*\*

**Insurance finance expenses** included in operating profit, applying exception

Expenses from financing activities (eg interest on financial debt) below operating profit, applying model for general corporates

\*Interest revenue calculated using the effective interest method would be presented separately (IAS 1.82(a)(i))

\*\* classification of income from cash and cash equivalents to be discussed at a April 2019 Board meeting.

\*\*\* in this example, the entity only has investments made in the course of its main business activity.

## Example 3—Bank with multiple business activities

A bank with multiple business activities, including investing, customer financing activities and other services

Extract from statement(s) of financial performance	
Interest income*	X
Interest expense	(X)
Net interest income	X
Fee and commission income	X
Fee and commission expense	(X)
Net fee and commission income	X
Net trading income	X
Net investment income*	X
Credit impairment losses	(X)
Employee benefit expenses	(X)
General and administrative expenses	(X)
Operating profit	X
Share of profit of integral associates and joint ventures	X
Operating profit and share of profit of integral associates and JVs	X
Share of profit of non-integral associates and joint ventures	X
Income from investments outside main business activities	X
Unwinding of discount	(X)
Profit before tax	X

In this example, the entity has chosen to present **all expenses from financing activities in operating profit**, instead of splitting them between its different business activities.

Income (expenses) from **investments** that are made in the course of the entity's **main business activity** are included in operating profit. Income (expenses) from other investments are presented below operating profit.

Entity does not present 'profit before financing and income tax' subtotal applying exception.

\*Interest revenue calculated using the effective interest method would be presented separately (IAS 1.82(a)(i))

## Example 4—Entity with captive finance subsidiary

An entity that manufactures and sells goods and has a customer financing business (eg car manufacturers)

Extract from statement(s) of financial performance	
Revenue from sale of goods	X
Cost of goods sold	(X)
Gross profit from manufacturing and sale of goods	X
Interest income from customer financing	X
Expenses from financing activities related to customer financing business	(X)
Gross profit from customer financing business	X
Selling, general and admin expenses (SG&A)	(X)
Operating profit	X
Share of profit of integral associates and joint ventures	X
Operating profit and share of profit or loss of integral associates and joint ventures	X
Share of profit of non-integral associates and joint ventures	X
Income from investments	X
Profit before financing of manufacturing business and income tax	X
Interest income from cash and cash equivalents related to manufacturing business	X
Expenses from financing activities related to manufacturing business	(X)
Unwinding of discount	(X)
Profit before tax	X

In this example, the entity has chosen to **split expenses from financing activities and income from cash and cash equivalents** between its different business activities, instead of presenting all in operating profit.

# Example 1—Investment property company

Cash flows from operating activities	
Receipts in the course of operations	X
Payments in the course of operations	(X)
Income taxes paid	(X)
<b>Net cash from operating activities</b>	<b>X</b>

Cash flows from investing activities	
Purchase of investment properties	(X)
Proceeds from sale of investment properties	X
Dividends received from integral associates and JVs	X
Dividends received from non-integral associates and JVs	X
Dividends received from non-equity-accounted investments	X
<b>Net cash from investing activities</b>	<b>(X)</b>

Cash flows from financing activities	
Proceeds from issue of share capital	X
Proceeds from long-term borrowings	X
Payment of lease liabilities	(X)
Interest received	X
Interest paid	(X)
Dividends paid	(X)
<b>Net cash from financing activities</b>	<b>(X)</b>

➔ **Dividends received** from non-equity-accounted investments classified as investing cash flows because the related income is included in investing in P&L

➔ **Interest received** classified as financing cash flows, assuming the only interest received is from cash and cash equivalents, which is classified in financing in P&L

➔ **Interest paid** classified as financing cash flows, because the related interest expense is classified in financing in P&L

## Example 2—Insurer

<b>Cash flows from operating activities</b>	
Premiums received	X
Claims paid	(X)
Interest received	X
Dividends received from non-equity-accounted investments	X
Income taxes paid	(X)
<hr/>	
Net cash from operating activities	X
<b>Cash flows from investing activities</b>	
Proceeds from sale of subsidiary, net of cash acquired	X
Acquisition of subsidiary, net of cash acquired	(X)
Dividends received from integral associates and JVs	X
Dividends received from non-integral associates and JVs	X
<hr/>	
Net cash from investing activities	(X)
<b>Cash flows from financing activities</b>	
Proceeds from issue of share capital	X
Proceeds from long-term borrowings	X
Dividends paid	(X)
Interest paid	(X)
<hr/>	
Net cash from financing activities	X

Accounting policy choice—this entity has chosen to classify **interest received** as operating cash flows (interest income is included in operating and financing in P&L)

**Dividends received** from non-equity-accounted investments classified as operating cash flows because the related income is included in operating in P&L

**Interest paid** classified as financing cash flows, because the related interest expense is classified in financing in P&L

## Example 3—Bank with multiple business activities

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<b>Cash flows from operating activities</b>	
Dividends received (from non-equity method investments)	X
Interest received	X
Interest paid	(X)
Income taxes paid	(X)
Cash flows from operating activities before changes in operating assets and liabilities	X
<i>Net change in operating assets and liabilities:</i>	
Deposits	X
Loans	(X)
<b>Net cash from operating activities</b>	<b>X</b>
<b>Cash flows from investing activities</b>	
Proceeds from sale of subsidiary, net of cash acquired	X
Acquisition of subsidiary, net of cash acquired	(X)
Dividends received from integral associates and JVs	X
Dividends received from non-integral associates and JVs	X
<b>Net cash from investing activities</b>	<b>X</b>
<b>Cash flows from financing activities</b>	
Proceeds from issue of share capital	X
Dividends paid	(X)
<b>Net cash from financing activities</b>	<b>X</b>

Accounting policy choice—this entity has chosen to classify **dividends received** as operating cash flows

**Interest received** is classified as an operating cash flow because all interest income is included in operating profit in P&L.

**Interest paid** is classified as an operating cash flow because the entity uses the proposed exemption in P&L and presents all expenses from financing activities in operating.

## Example 4—Entity with captive finance subsidiary

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Cash flows from operating activities	
Receipts from customers	X
Payments to suppliers and employees	(X)
Interest received	X
Income taxes paid	(X)
<hr/>	
Net cash from operating activities	X



Accounting policy choice—this entity has chosen to classify **interest received** as operating cash flows

Cash flows from investing activities	
Acquisition of subsidiaries, net of cash acquired	(X)
Purchase of property, plant and equipment	(X)
Proceeds from sale of property, plant and equipment	X
Dividends received (from non-equity method investments)	X
Dividends received from integral associates and JVs	X
Dividends received from non-integral associates and JVs	X
<hr/>	
Net cash from investing activities	(X)



**Dividends received** from non-equity-accounted investments classified as investing cash flows because the related income is included in investing in P&L

Cash flows from financing activities	
Proceeds from issue of share capital	X
Proceeds from long-term borrowings	X
Interest paid	(X)
Dividends paid	(X)
<hr/>	
Net cash from financing activities	(X)



Accounting policy choice—this entity has chosen to classify **interest paid** as financing cash flows

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