IFRS

STAFF PAPER

July 2018

Accounting Standards Advisory Forum

Project	Primary Financial Statements		
Paper topic	Moving from the research agenda to Standard-setting		
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Purpose

1. The purpose of this paper is to ask Accounting Standards Advisory Forum (ASAF) members' advice on moving the *Primary Financial Statements* project from the research agenda to the standard-setting agenda.

2. The *Due Process Handbook* requires the Board to consult with ASAF before making a decision to add a project to its standard-setting agenda.[1]

Question for ASAF members

Question
What are ASAF members' views on moving the Primary Financial Statements project from the research agenda to the standard-setting agenda?

[1] *Due Process Handbook*, paragraph 5.6.

Background

3. The objective of the Primary Financial Statements Project is to explore targeted improvements to the primary financial statements with a focus on the statement(s) of financial performance.

4. The project is part of the Board's research agenda. It is not possible to publish an Exposure Draft for a project that is on the research agenda; however, it is possible to publish a Discussion Paper for a project that is on the Board's standard-setting agenda.[2]

5. The Board has not yet decided whether to publish an Exposure Draft or a Discussion Paper as its first due process document for this project. The staff plan to ask the Board to decide whether to publish an Exposure Draft or a Discussion Paper later in the year. However, ahead of that decision, the staff are planning to ask the Board whether it wishes to move the project from its research agenda to the standard-setting agenda.

6. The following sections:

   (a) describe the criteria in the *Due Process Handbook* that have to be met before a project is added to the standard-setting agenda (paragraphs 8-9); and

   (b) explain why the staff are of the view that those criteria have been met (paragraphs 10-22).

7. Appendix A provides a summary of the tentative decisions to date on this project.

Criteria for adding a project to the standard-setting agenda

8. The *Due Process Handbook* states that when adding a standard-setting project to its agenda or making major amendments to existing Standards, the Board evaluates the merits of adding the project primarily on the basis of the needs of

[2] Paragraph 4.12 of the *Due Process Handbook* states that the main output of the research programme is expected to be Discussion Papers and research papers. However, paragraph 5.5 of the *Due Process Handbook* states that the Board is not required to publish a Discussion Paper before adding a standard-setting project to its agenda if the Board is satisfied that it has sufficient information and understands the problem and the potential solutions well enough.

users of financial reports, while also taking into account the costs of preparing the information. When deciding whether a proposed agenda item will address users' needs, the Board considers:

(a) whether there is a **deficiency** in the way particular types of transactions or activities are reported in financial reports;

(b) the **importance** of the matter to those who use financial reports;

(c) the **types of entities** likely to be affected by any proposals, including whether the matter is more prevalent in some jurisdictions than others; and

(d) how **pervasive** or acute a particular financial reporting issue is likely to be for entities.[3]

9. The *Due Process Handbook* also states the Board should only add a standard-setting project if it considers that the benefits of the improvements to financial reporting will outweigh the costs.[4]

Staff analysis of the Primary Financial Statements project

10. The following sections describe the work the Board and staff have undertaken to assess:

(a) whether there is a deficiency in current reporting and the importance of any deficiency to users of financial statements (paragraphs 11-16);

(b) the types of entity likely to be affected by the proposals (paragraph 17);

(c) the pervasiveness of the problem (paragraph 18); and

(d) the costs and benefits of the proposals (Paragraph 19-22).

[3] *Due Process Handbook*, paragraph 5.4.

[4] *Due Process Handbook*, paragraph 5.7.

Deficiencies in current reporting and importance to users

11. The project was added to the Board's research agenda in July 2014 in response to the strong demand from users of financial statements to undertake a project on performance reporting. The Board observed that, in order to answer questions about the structure and content of the statement(s) of financial performance, it would also need to think about the structure and content of the other primary financial statements.

12. Feedback received on the Board's 2015 Agenda Consultation reinforced the view that the Primary Financial Statements project should be a high priority for the Board. Users in particular identified the project as important. Respondents to the Agenda Consultation suggested that the project should focus on performance reporting issues.

13. Consequently, during 2016, the staff undertook research and outreach activities to gather evidence about perceived problems with the presentation of the primary financial statements in order to understand stakeholders'—and in particular users'—views on the areas of the primary financial statements that need improvement.

14. In November 2016 the staff presented an overview of its research and outreach activities to the Board.[5] Some of the major findings on the presentation of financial statements were as follows:

    (a) the structure and content of the statement(s) of financial performance vary even among entities in the same industry.

    (b) users of financial statements would like more comparability in the structure and content of the statement(s) of financial performance and would welcome more defined subtotals and line items in that statement.

    (c) users of financial statements would like to see greater disaggregation of information in the primary financial statements and the notes.

[5] Agenda Papers 21A-21E from November 2016.

(d) alternative performance measures can provide relevant information to users. However, users find that there is often a lack of transparency around how these measures are calculated or why they are disclosed.

(e) users find the permitted presentation alternatives for the statement(s) of financial performance and the statement of cash flows unhelpful as they reduce comparability.

(f) electronic reporting of financial information is facilitated if there are more required line items and subtotals and greater disaggregation of the information provided.

(g) users expressed few concerns about the presentation of the statement of financial position.

15. The research and outreach seemed to indicate that the main area of concern for most users of financial statements was presentation of information in the statement(s) of financial performance. Consequently, at its December 2016 meeting the Board tentatively decided to focus on targeted improvements, mainly to the statement(s) of financial performance, rather than a fundamental revision of the presentation of all the primary financial statements. Appendix B describes the scope of the project in more detail.

16. Based on the feedback, research and outreach described in paragraphs 11-15, the staff are of the view that there are deficiencies in the way that information is presented in the primary financial statements and these deficiencies are important to users of financial statements.

Types of entity affected

17. It is likely that this project will have a pervasive effect. Although our initial focus has been on presentation in the financial statements of non-financial entities, it is likely that at least some of our proposals (for example the proposals on disaggregation and management performance measures) will affect all entities.

Pervasiveness of the problem

18. Our research has indicted that problems with presentation in the primary financial statements, and the statement(s) of financial performance in particular, are pervasive. For example:

    (a) the structure and content of the statement(s) of financial performance vary even among entities in the same industry.

    (b) there are significant variations in the presentation of information across jurisdiction. The structure and content of the primary financial statements appears to depend significantly on the former accounting requirements in the jurisdiction or guidance from individual regulators.

    (c) the use of alternative performance measures and the quality of the disclosures about such measures vary across jurisdiction and are dependent on the approach taken by individual regulators.

Cost benefit

19. It is difficult to be certain about the likely costs and benefits of the proposed improvements to the presentation of information in the primary financial statements at this stage of the project. A detailed effects analysis will be conducted before publication of an Exposure Draft. However, our outreach and research has highlighted that users think that improvements to the structure and content of the primary financial statements would be beneficial.

20. We have discussed the project several times with the Global Preparers' Forum (GPF).[6] Feedback from GPF members, including concerns raised about the potential costs of some proposals, has been considered by the Board when making tentative decisions.

21. Two factors are likely to mitigate the costs of implementing the proposals in this project:

[6] The project was discussed by the GPF at its meeting in March 2018 and at joint meetings with the Capital Markets Advisory Committee in June 2017 and June 2016.

(a) The proposals affect presentation and disclosure requirements only; they do not affect recognition and measurement. Consequently, the proposals are less likely than other major projects to have significant systems implications for preparers.

(b) We are proposing targeted improvements rather than a fundamental revision of the presentation of all primary financial statements.

22. Consequently, the staff's preliminary assessment, subject to a more detailed effects analysis before issuing an Exposure Draft, is that the benefits of the improvements to financial reporting from this project are likely to outweigh the costs.

Appendix A – Summary of the Board's tentative decisions to date on the project

Topic	Staff condensed summary of Board's tentative decisions (focus on non-financial entities)
	A full record of the Board's tentative decisions is available from the December 2016-May 2018 IASB updates.
General	The Board tentatively decided to focus on targeted improvements to the statement(s) of financial performance and to the statement of cash flows. The Board will decide at a later stage of the project whether to publish a Discussion Paper or an Exposure Draft as the first due process output of the project.
Statement(s) of financial performance—project scope	The Board tentatively decided, to explore the following topics in this project: 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 (eg 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 other comprehensive income (OCI). The Board tentatively decided to prioritise introducing into the statement(s) of financial performance subtotals that facilitate comparisons between entities, such as EBIT, over introducing a management-performance measure subtotal.
Statement(s) of financial performance—EBIT and finance income and expenses	The Board agreed (by consensus) to explore: a. requiring the presentation of an EBIT subtotal in the statement(s) of financial performance; and b. defining EBIT as profit before finance income/expenses and tax. The Board tentatively decided that, if it introduces both an investing category and an EBIT (or profit before financing and income tax) subtotal, 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'; c. 'expenses from financing activities'; d. 'other finance income'; and e. 'other finance expenses'. 'Cash and cash equivalents' is used in the definition of 'finance income/expenses' as a proxy for cash and temporary investments of excess cash. The Board also noted that a separate line item for impairment of cash and cash equivalents may be needed, if material. Other finance income/expenses comprises 'interest' income/expenses on liabilities that do not arise from financing activities (unwinding of a discount), The Board tentatively decided to clarify the description of 'financing activities' in IAS 7 *Statement of Cash Flows* by indicating that a financing activity involves:

<table>
<tr><th>Topic</th><th>Staff condensed summary of Board’s tentative decisions (focus on non-financial entities)</th></tr>
<tr><td></td><td>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.
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.</td></tr>
<tr><td>Statement(s) of financial performance—investing category</td><td>The Board agreed (by consensus) to explore the introduction of an investing category into the statement(s) of financial performance.

The Board tentatively decided:

a. to relabel the ‘investing’ category as ‘income/expenses from investments’.
b. to 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. to 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’.
d. not to label the subtotal before the ‘income/expenses from investments’ category as ‘operating profit’.

The Board tentatively decided that:

a. entities should be required to present the results of ‘integral’ associates and joint ventures separately from those of ‘non-integral’ associates and joint ventures.
b. the project’s first due-process document should:
i. use the Board’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.
ii. 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 and require a new subtotal above that line item.
iii. discuss all of the alternative approaches considered by the Board 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 Board’s reasons for rejecting those approaches.</td></tr>
<tr><td>Statement(s) of financial performance—other comprehensive income (OCI)</td><td>The Board 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’)

but not to introduce a new subtotal between these two categories called ‘income after remeasurements reported outside profit or loss’.

The Board tentatively decided:

a. the staff should explore whether there is demand to remove the following presentation options in IAS 1 Presentation of Financial Statements for OCI:
i. presenting items of OCI either net of related tax effects, or before related tax effects (paragraph 91 of IAS 1); and
ii. presenting reclassification adjustments in the statement(s) of financial performance or in the notes (paragraph 94 of IAS 1).
b. not to develop separate guidance or educational material on the presentation of OCI for entities, but to consider both profit or loss and OCI when developing proposals for better aggregation/disaggregation and additional minimum line items.</td></tr>
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<table>
<tr><th>Topic</th><th>Staff condensed summary of Board's tentative decisions (focus on non-financial entities)</th></tr>
<tr><td></td><td>c. not to develop educational material for investors in the form of case studies that illustrate why it is important for users of financial statements to consider items of OCI in their analysis of companies.</td></tr>
<tr><td>Management performance measure

Management performance measure (continued)</td><td>The Board tentatively decided:
a. 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:
i. often only be a subtotal or total specified by paragraph 81A of IAS 1.
ii. 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.
b. the following requirements apply to management performance measures described in paragraph a(ii):
i. 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;
ii. that there should be no specific constraints on management performance measures;
iii. the measure would be labelled in a clear and understandable way so as not to mislead users; and
iv. the following information is required to be disclosed:
1. a 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;
2. a description of why the management performance measure provides management's view of performance, including an explanation of
• how the management performance measure has been calculated and why; and
• how the measure provides useful information about an entity's financial performance
3. 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.

c. 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.

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 Board 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, and gross profit, defined as revenue less cost of sales. The Board 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.</td></tr>
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Topic	Staff condensed summary of Board's tentative decisions (focus on non-financial entities)
	The Board 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 Board tentatively decided to require the reconciliation described in paragraph b(i) to be disclosed in the notes rather than be provided below the statement(s) of financial performance.
Adjusted earnings per share (EPS)	The Board 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. b. it will not be required to disclose in the notes adjusted EPS calculated consistently with the management performance measure. The Board also tentatively decided that a. an entity would continue to be permitted to disclose adjusted EPS. b. an entity would be prohibited from presenting adjusted EPS in the statement(s) of financial performance.
Statement of cash flows—project scope	The Board tentatively decided to explore the following topics in this project: c. elimination of options for the classification of the cash effects of interest and dividends in the statement of cash flows; d. alignment of the operating section across the statement of cash flows and the statement(s) of financial performance; and e. requiring a consistent starting point for the indirect reconciliation of cash flows.
Statement of cash flows—general	The Board tentatively decided to: a. remove from IAS 7 options for the classification of interest and dividends paid and of interest and dividends received and prescribe a single classification for each of these items. b. clarify that: i. cash flows arising from interest incurred on financing activities should be classified as financing cash flows. ii. cash flows arising from interest paid that is capitalised as part of the cost of an asset should be classified as financing cash flows. iii. cash flows arising from dividends paid should be classified as financing cash flows. c. amend the definition of 'investing activities' in IAS 7 to clarify that interest and dividends received should be classified as investing cash flows. The Board tentatively decided: a. to require a consistent subtotal as the starting point for the indirect reconciliation of cash flows from operating activities. This subtotal should be 'profit before investing, financing and income tax'. b. not to align the operating section of the statement of cash flows with a corresponding section in the statement(s) of financial performance. c. not to make other further improvements to the statement of cash flows, besides those mentioned above.

Topic	Staff condensed summary of Board's tentative decisions (focus on non-financial entities)
Statement of cash flows—associates and joint ventures	The Board tentatively decided to propose: a. separate presentation of (i) the investing cash flows that arise between an entity and its 'integral' associates and joint ventures and (ii) the investing cash flows that arise between an entity and its 'non-integral' associates and joint ventures. The split between 'integral' and 'non-integral' associates and joint ventures would be the same for the statement of cash flows as for the statement(s) of financial performance. b. the separate presentation of the investing cash flows of 'integral' and 'non-integral' associates and joint ventures should be within the 'investing activities' section of the statement of cash flows.
Other topics—project scope	The Board 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. b. development of a principle for aggregating and disaggregating items in the primary financial statements. The Board tentatively decided not to consider targeted improvements to the statement of financial position unless work on other areas of the primary financial statements identifies possible improvements to that statement. Additionally, the Board tentatively decided that segment reporting and the presentation of discontinued operations should not be part of the scope of the project.
Principles of aggregation and disaggregation	The Board tentatively decided to develop: a. principles for aggregation and disaggregation in the financial statements; b. definitions of the notions 'classification', 'aggregation' and 'disaggregation; and c. guidance on the steps involved in applying 'classification', 'aggregation' and 'disaggregation' when preparing financial statements. d. guidance on disaggregation by nature and by function in the statement of financial performance The Board 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 Board discussed whether to introduce numerical thresholds or rebuttable presumptions for aggregating or disaggregating financial information but decided not to introduce such thresholds. Instead, the Board decided to explore whether principle-based guidance could be developed to encourage further disaggregation of large residual balances or 'other' balances. The Board will explore further ways to improve disaggregation in the financial statements, which may include illustrating how different characteristics could be used to aggregate or disaggregate financial information. The Board clarified that any further guidance developed in this respect would not override specific aggregation or disaggregation requirements in individual IFRS Standards.

Topic	Staff condensed summary of Board's tentative decisions (focus on non-financial entities)

	The Board 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 to determine whether a by-function or by-nature methodology provides the most useful information to users. These are:
	    a. which method provides the best information about the key components or drivers of profitability;
	    b. which method most closely matches how management reports internally to the board or key decision makers and the way the business is run;
	    c. peer industry practice; and
	    d. whether the allocation of expenses to functions would be so arbitrary that it would not provide a sufficiently faithful representation of the 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 to:
	    i. present its primary analysis of expenses in the statement(s) of financial performance; and
	    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.

Appendix B—Scope of the Primary Financial Statements Project

B1. The scope of the Primary Financial Statements project is designed to address the concerns about financial statement presentation identified by the research and outreach conducted in 2016 (see paragraph 13).

B2. For the statement(s) of financial performance, the Board is exploring the following topics:

(a) requiring additional subtotal(s) in the statement(s) of financial performance—earnings before interest and tax (EBIT) and/or operating profit;

(b) removing some of the alternatives for presentation of income and expenses in existing IFRS Standards (for example, presentation of net interest cost on a net defined benefit liability);

(c) providing guidance on the use of performance measures, including separate presentation of non-recurring, unusual or infrequently occurring items.

B3. The Board has tentatively decided not to attempt to positively define an operating profit subtotal. Although many users supported the idea, the Board's initial research suggested that it would be difficult to reach a consensus on what should be included in operating profit.

B4. The Board tentatively decided not to develop guidance on which items of income or expense should be reported in other comprehensive income or when such items should be recycled as it has developed high-level guidance on this topic as part of its *Conceptual Framework*. However, the Board is exploring better ways of communicating information about other comprehensive income.

B5. For the statement of cash flows the Board is exploring the following topics:

(a) elimination of options for the classification of the cash effects of interest and dividends in the statement of cash flows;

(b) alignment of the operating section across the statement of cash flows and the statement(s) of financial performance; and

(c) requiring a consistent starting point for the indirect reconciliation of cash flows.

B6. The Board is also exploring:

(a) the development of templates for the primary financial statements for a small number of industries; and

(b) the development of a principle for aggregating and disaggregating items in the primary financial statements.

B7. In light of the feedback from users which suggested that they had fewer concerns about the presentation of information in the statement of financial position, the Board has tentatively decided not to consider targeted improvements to that statement unless work on other areas of the primary financial statements identifies possible improvements.

B8. In addition, the Board decided not to consider changes to the following as part of this project:

(a) the statement of changes in equity. The Board has a separate project on Financial Instruments with the Characteristics of Equity which may consider changes to that statement.

(b) segment reporting. The Board decided not to consider segment reporting as part of this project because it would significantly increase the scope of the project, potentially delaying improvements to the structure and content of the primary financial statements.

(c) the presentation of discontinued operations.