

GPF meeting, 6 November 2018  
Agenda Paper 2

# Primary Financial Statements

Contacts: Karlien Conings, [kconings@ifrs.org](mailto:kconings@ifrs.org), 020 7246 6410  
Nick Barlow, [nbarlow@ifrs.org](mailto:nbarlow@ifrs.org), 020 7246 6499  
Aida Vatrenejak, [avatrenejak@ifrs.org](mailto:avatrenejak@ifrs.org), 020 7246 6456

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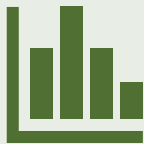
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# Purpose of the session

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- The purpose of this session is to provide GPF members with an **updated overview** of the Primary Financial Statements project and **seek feedback** on proposals.
- We would like members to identify which proposals:

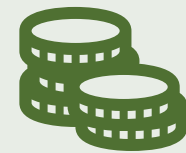
Result in better  
**economic  
decision-making**  
by investors



result in **change  
in current  
practice**



be **costly** to  
implement



# Before the GPF meeting

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- Please review the slides in advance of the meeting, in particular illustration on slide 16
- Please consider the effect you think the proposals would have on the financial statements of your entity and complete the matrix on next slide
- If you have time prepare illustration of:
  - Profit or loss statement
  - Note on management performance measures, if any
  - Note on unusual and infrequent itemsfor your entity, based on your understanding of the Board's proposals

The staff will gratefully receive such illustrations by Friday  
2<sup>nd</sup> November.

# Before the session – effects analysis matrix

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Key proposals	economic decision-making by investors	change in practice	costs of implementation
Subtotals	Better/No impact/Worse/Don't know	Change/no change/not applicable	Costly/not costly/Not applicable
Business profit from consolidated entities			
Profit before investing, financing and income tax			
Profit before financing and income tax			
Management performance measures			
Inclusion of management performance measures in the financial statements			
Reconciliation to closest IFRS-defined subtotal			
Tax and NCI for each adjustment			
Explanation of why measure is useful and how it has been calculated			
Disaggregation			
Disaggregation of expenses in business profit by function or by nature			
Disclosure of unusual and infrequent items			
Disaggregation principles and factors to consider			
Separate presentation of share of profit or loss from JVs and associates			

# Agenda

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# Project background & overview

# Central theme of the Board's work

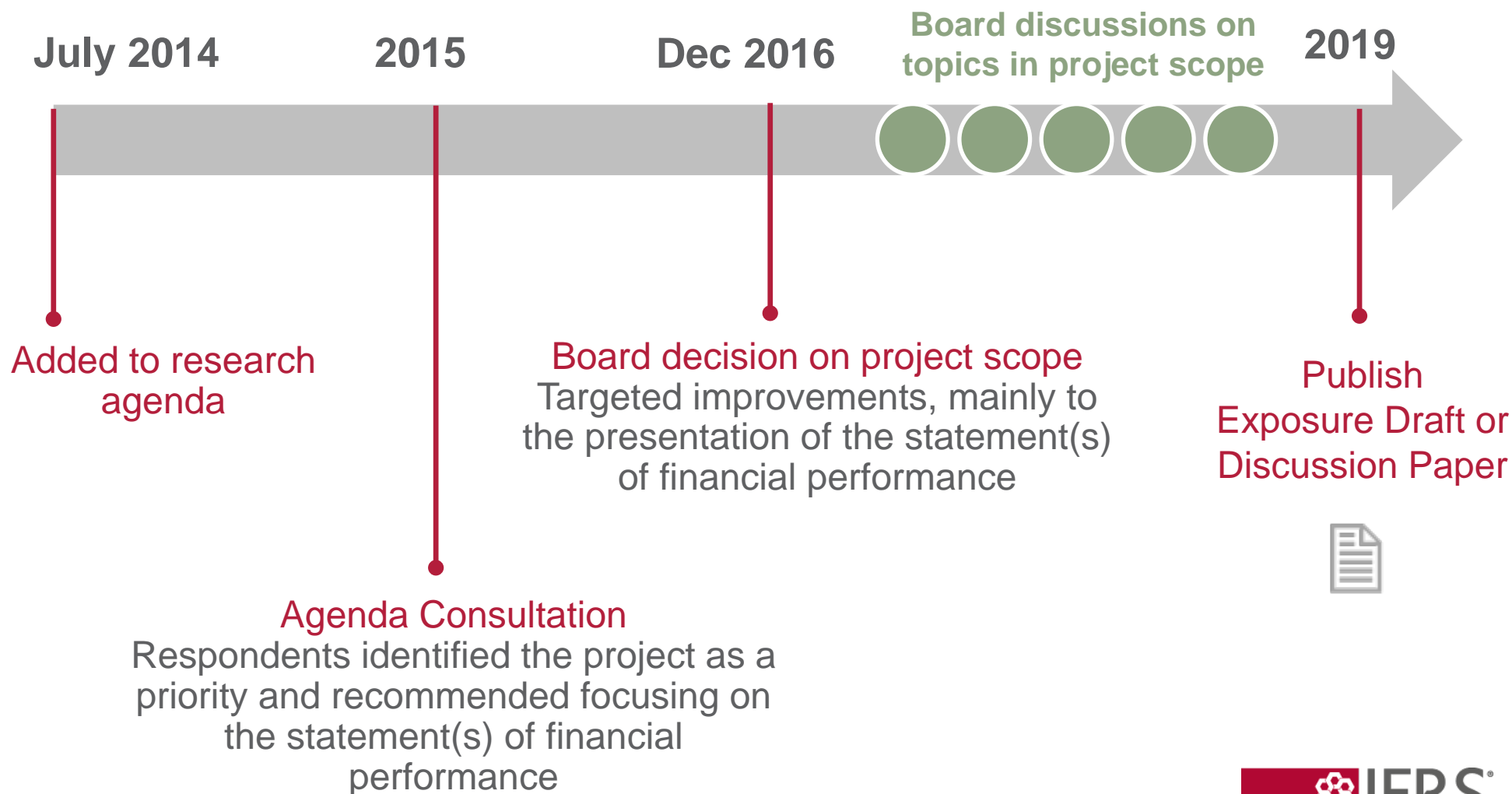
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## Better Communication in Financial Reporting



# Project timeline

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# Overall project objective

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## Primary Financial Statements

Statement(s)  
of financial  
performance

Statement of  
financial  
position

Statement of  
cash flows

Statement of  
changes in  
equity



## Objective of the Primary Financial Statements project

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

# Stakeholder feedback and key project proposals

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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

Proposals on **Management Performance Measures**



I need flexibility to tell my company's story

Proposals to **improve disaggregation**



There is insufficient disaggregation in financial statements

# Scope of the project

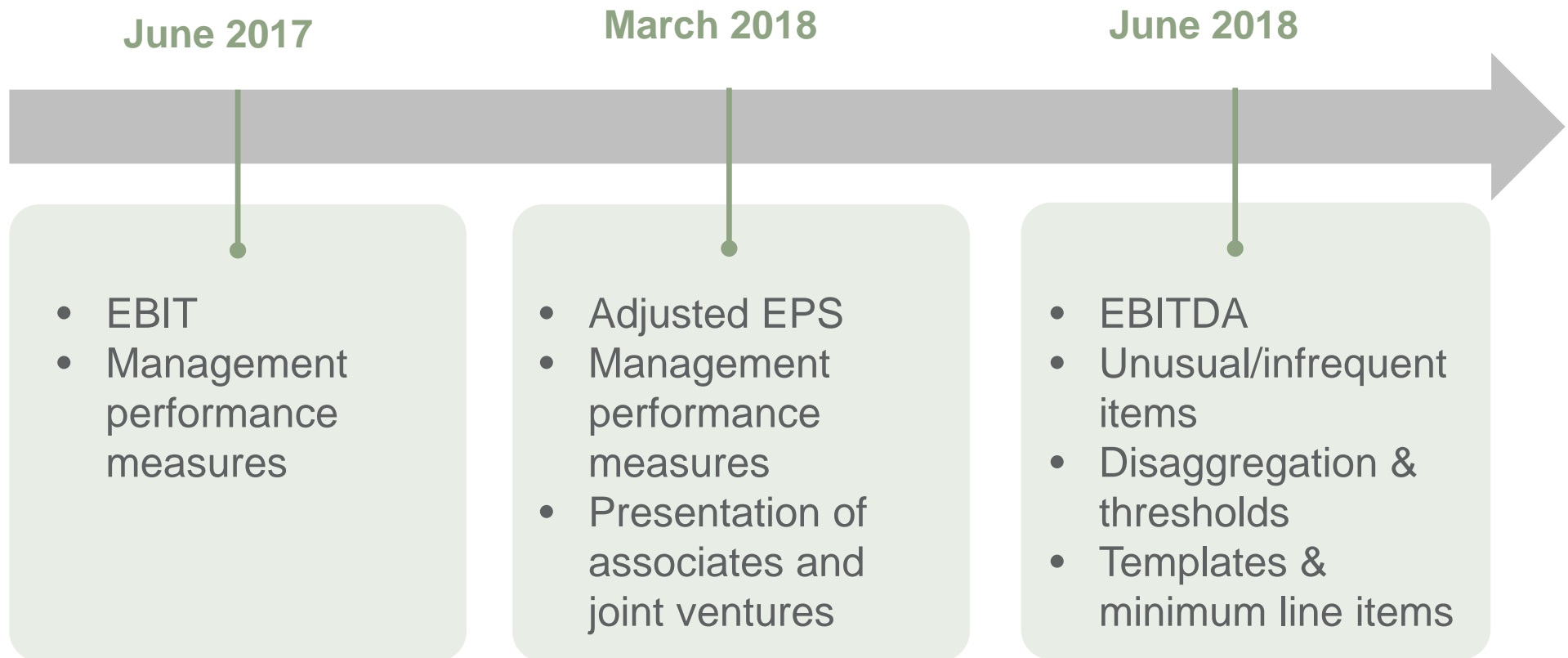
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Statement(s) of financial performance	Statement of cash flows
Subtotals & categories facilitating comparisons between entities:	Eliminating classification options (interest/dividends)
<ul style="list-style-type: none"> <li>• Finance income/expense</li> <li>• Income/expenses from investments</li> <li>• Presentation of associates/JVs</li> </ul>	Consistent starting point for the indirect method
Management performance measures	Cash flows related to associates/JVs
Better ways to communicate OCI	
Improving disaggregation in financial statements	
Principles of disaggregation in financial statements	
Disaggregation by nature and by function in the statement(s) of financial performance	
Disclosure of unusual and infrequent items	
Minimum line items in the primary financial statements	
Templates for primary financial statements for a small number of industries	

# Previous GPF meetings

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- We discussed the project with GPF on several occasions, focussing on selected individual topics:



- Slides 31–33 provide a summary of feedback from these three meetings



# Tentative Board decisions: statement(s) of financial performance

# Three defined subtotals in the statement of profit or loss

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## 1 Profit from consolidated entities, before investing, financing and income tax (business profit)

Excludes share of profit from ALL joint ventures and associates

## 2 Profit before investing, financing and income tax

- Excludes income/expenses from investments, which are defined as 'income/expenses from assets that generate a return individually and largely independently of other resources held by the entity'
- Excludes share of profit from non-integral joint ventures and associates

## 3 Profit before financing and income tax

Excludes finance income and expenses which include:

- expenses on liabilities arising from financing activities (definition based on existing definition of financing activities for the statement of cash flows)
- unwinding of discount on other liabilities (see illustrative example)

**Defined  
bottom-up**

# Presentation of associates and JVs

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Preparer A

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 B

## Tentative Board decisions

Requirement to 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 determine classification: generate returns largely independently of other resources.

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

# Defined subtotals —illustration for general corporates

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Revenue	10,000
Cost of goods sold	-4,000
Gross profit	6,000
Selling, general and admin costs (SG&A)	-3,000
<b>Business profit (from consolidated entities)</b>	<b>3,000</b>
Share of profit of <b>integral</b> joint ventures and associates	500
<b>Profit before investing, financing and income tax</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>Profit before financing and income tax (EBIT)</b>	<b>3,900</b>
Interest income from cash and equivalents calculated using the effective interest rate method	80
Other income from cash and cash equivalents and financing activities	20
Expenses from financing activities	-1,000
Other finance income	50
Other finance expenses	-350
Profit before tax	2,700

Income/  
expenses from  
investments

Finance  
income/  
expenses



# Subtotals – finance income/expenses

17

## Finance income/expenses

Interest income from cash and cash equivalents calculated using effective interest method

+

Other income from cash and cash equivalents and **financing activities**

+

Expenses from **financing activities**

+

Other finance income

Other finance expenses



### 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 (dependent on amount/duration of credit)

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

# Scope of subtotals (see illustrations in appendix)

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	Business profit from consolidated entities Includes...		Profit before investing, financing and tax	Profit before financing and tax (EBIT)
General corporates	✓	no income or expenses relating to financing or investing activities	✓	✓
Entities whose main business activity is providing financing to customers (eg traditional banks)	✓	all income/expenses from financing activities and cash and cash equivalents	✓	✗
Entities who invest in the course of their main business activity (eg investment property companies)	✓	income/expenses from investments made in the course of their main business activity	✗	✓
Entities whose main business activities are <u>both</u> investing* and provision of financing to customers	✓	<ul style="list-style-type: none"> <li>income/expenses from financing activities and cash and cash equivalents</li> <li>income/expenses from investments made in the course of main business activity</li> </ul>	✗	✗
Entities with more than one main business activity incl. investing <u>and/or</u> provision of financing to customers	✓	<ul style="list-style-type: none"> <li>income/expenses from financing activities and cash and cash equivalents related to the provision of financing to customers</li> <li>income/expenses from investments made in the course of their main business activity</li> </ul>	✓	✓

# Management performance measures (1)

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Preparers

I need flexibility to tell my company's story

## Tentative Board decisions

Separate requirements for unusual and infrequent items - see slide 27

Entities are **required** to identify a measure of profit that, in management's view, communicates the financial performance of the entity – this could be a subtotal or total specified by IFRS Standards

Entities are **allowed** to present 'Management performance measures' in the **notes**

MPM **complement** subtotals or totals specified by IFRS Standards

**No specific constraints** on the calculation of MPM

# Management performance measures (2)

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Users

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

## Tentative Board decisions

Disclose a **reconciliation** in the **notes** between the MPM and the most directly comparable subtotal or total specified by IFRS Standards

**Describe why** the MPMs provide management's view of performance and **how** they have been **calculated**

Explain **differences** between MPMs and **segment** measures

Disclose the **effect of tax and non-controlling interests** separately for each reconciling item

**Label** MPMs in a **clear** and **understandable** way

# Management performance measures (3)

## Example of reconciliation

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

### Management performance measure reconciliation (extract from notes)

Management performance measure	4,900	Tax impact	NCI impact
Restructuring expenses for the closure of Factory A	(1,000)	200	50
Litigation settlement related to court case B	(400)	80	
Profit before investing, financing and income tax	3,500		



# Tentative Board decisions: statement of cash flows

# Statement of cash flows

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- Eliminating **classification options** (interest/dividends):

Cash flows	Classification
Interest incurred on financing activities	Financing cash flows
Interest paid that is capitalised as part of the cost of an asset	Financing cash flows
Dividends paid	Financing cash flows
Dividends received	Investing cash flows
Interest received	Investing cash flows

- Consistent starting point** for **indirect method** for reporting operating cash flows: 'profit before investing, financing and income tax'
- Separate presentation** of cash flows from integral and non-integral associates and JVs within investing cash flows

# Statement of cash flows – illustration (indirect method)

24

Profit before investing, financing and income tax	X
Adjustments for:	
Depreciation	X
Share of profit from integral associate A	(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





# Tentative Board decisions: disaggregation

# Disaggregation (1)

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Users

Some entities present large, unexplained  
'other' balances

## Extract from the notes—Other expenses

(In million €)

Losses on asset disposals	(200)
Foreign exchange losses	(100)
Other expenses	(700)
<b>Total 'Other expenses' presented in P&amp;L</b>	<b>(1,000)</b>

A large part of 'other expenses' remains unexplained

# Disaggregation (2)

27



There is insufficient disaggregation in financial statements

Principles of disaggregation in the financial statements

Proposals to improve disaggregation of expenses by nature / by function

Guidance on unusual/infrequently occurring items

Consider expanding the list of required minimum line items in the primary financial statements

Consider templates for the primary financial statements for a small number of industries

# Unusual or infrequent items

28



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

## **Tentative Board decisions**

Requirement for all entities to disclose information about unusual or infrequent items in the notes irrespective of whether an entity discloses an MPM.

Note disclosure required to attribute unusual or infrequent items to line items in the statement(s) of financial performance.

Proposals to develop principles-based guidance for identifying unusual or infrequent items.



# Remaining topics for Board discussion

# Remaining topics for Board discussion

30

## Not discussed yet

Industry-specific illustrative examples/templates

Minimum line items

Guidance on the disclosure and definition of EBITDA

First due process document—  
Discussion Paper or  
Exposure Draft?

## Further discussion of outstanding issues on:

Application of project proposals to financial entities

Disaggregation of information

Subtotals (incl. review of labelling)

Unusual/infrequent items



# Feedback from previous GPF meetings

# Feedback June 2018 CMAC/GPF meeting

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EBITDA	<p>Mixed views on:</p> <ul style="list-style-type: none"><li>• the usefulness of EBITDA as a performance measure</li><li>• whether the Board should define EBITDA</li></ul>
Unusual or infrequent items	<ul style="list-style-type: none"><li>• Support for developing proposals for unusual/infrequent items separately from MPM proposals.</li><li>• Many said developing a practicable definition will be challenging for the Board.</li><li>• Some suggested developing principle-based guidance instead.</li></ul>
Disaggregation and quantitative thresholds	<ul style="list-style-type: none"><li>• Most did not think the Board should require additional information of functional line items by nature, because it would require significant and costly changes to accounting systems.</li><li>• Most supported the tentative decision not to require quantitative thresholds for disaggregation of large 'other' balances.</li></ul>
Templates	Generally not supported



Management performance measures	<ul style="list-style-type: none"><li>• General support for including MPMs in financial statements.</li><li>• Mixed views on whether MPMs should be presented in the statement(s) of financial performance or the notes.</li><li>• Debate over use of a columnar approach.</li></ul>
Adjusted EPS	<ul style="list-style-type: none"><li>• Mixed views on proposals for consistency of adjusted EPS with MPMs.</li><li>• Some supported requiring adjusted EPS because such measures are useful for users.</li><li>• Others said providing adjusted EPS and reconciliation (including allocation of tax and NCI) would require significant additional effort.</li></ul>
Presentation of results of associates and joint ventures	<ul style="list-style-type: none"><li>• Many members did not support the distinction between integral and non-integral associates and JVs due to the significant judgement required and the perceived irrelevance of the 'non-integral' category.</li><li>• Some preferred a single location for all associates and JVs, but there were mixed views on what that location should be.</li></ul>

# Feedback June 2017 CMAC/GPF meeting

34

Management performance measures	<ul style="list-style-type: none"><li>• 3 of 4 groups* supported including MPM in financial statements:<ul style="list-style-type: none"><li>• merits include scope of audit, transparency, consistency over time and additional disclosures</li><li>• the Board should limit constraints on MPM so it reflects management's view of performance</li></ul></li><li>• Other group opposed proposal because in their view MPMs do not belong in financial statements<ul style="list-style-type: none"><li>• instead supported greater disaggregation, including separate presentation of infrequent items</li></ul></li></ul>
Profit before financing and tax	<ul style="list-style-type: none"><li>• General support for the Board requiring and defining a profit before financing and tax subtotal.</li><li>• Some concerns about using cash and cash equivalents as a proxy for cash and temporary investments of excess cash.</li><li>• Some concerns about application to financial entities.</li></ul>

\*These groups included both CMAC and GPF members.



# Questions for GPF members

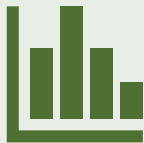
# Questions to GPF

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- Please refer to the proposals relating to:
  - Presenting subtotals in the statement of profit or loss;
  - Disclosures of management performance measure(s); and
  - Improving disaggregation.
- Which of the Board's tentative proposals do you think will:

## Question 1

result in better  
**economic**  
**decision-making**  
by investors?



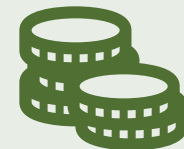
## Question 2

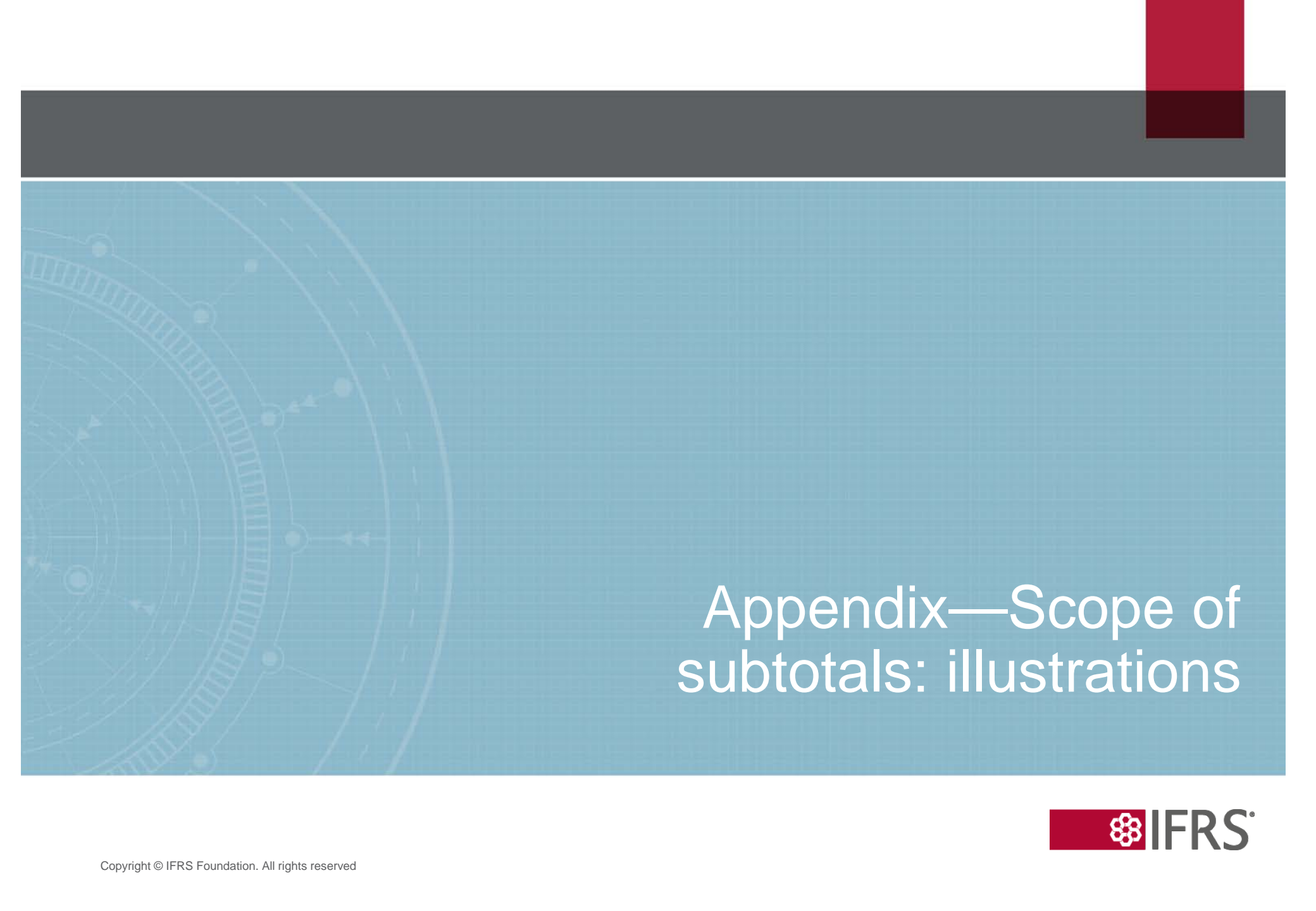
result in **change**  
**in current**  
**practice**



## Question 3

be **costly** to  
implement





# Appendix—Scope of subtotals: illustrations

# 1 Investment property company

## —P&L as per staff's proposals

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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/loss on disposal of investment properties	X
Business profit from consolidated entities	X
Share of profit of integral associates and joint ventures	X
Share of profit of non-integral associates and joint ventures	X
Profit before financing and income tax (EBIT)	X
Interest income from cash and cash equivalents calculated using effective interest method	X
Other income from cash and cash equivalents and financing activities	X
Expenses from financing activities	(X)
Other finance income	X
Other finance expenses	(X)
Profit before tax	X

Presentation of rental income, changes in fair value and gains/losses on investment properties **in business profit** (although we expect entities to disclose management performance measures that exclude changes in fair value)

We think separate presentation of results from associates/JVs outside business profit is as useful as for non-financial entities.

Income (or expenses) from investments made outside the course of the entity's main business activities would be presented outside business profit (assumed to be immaterial in this illustration).

## ② Insurer

### —possible P&L as per staff's proposals

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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)
Net financial result	X
<b>Business profit from consolidated entities</b>	<b>X</b>
Share of profit of integral associates and joint ventures	X
Share of profit of non-integral associates and joint ventures	X
<b>Profit before financing and income tax (EBIT)</b>	<b>X</b>
Interest income from cash and cash equivalents calculated using effective interest method	X
Other income from cash and cash equivalents and financing activities	X
Expenses from financing activities	(X)
Other finance income	X
Other finance expenses	(X)
Profit before tax	X

Presentation of investment returns and insurance finance expenses in business profit

We think separate presentation of results from associates/JVs outside business profit is as useful as for non-financial entities.

Income (or expenses) from investments made outside the course of the entity's main business activities would be presented outside business profit (assumed to be immaterial in this illustration).

We assume this entity does not provide financing to customers in the course of its main business activities and therefore it presents an EBIT subtotal.

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

### ③ Traditional bank

#### —possible P&L as per staff's proposals

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Extract from statement(s) of financial performance	
Interest income*	X
Interest expense	(X)
<b>Net interest income</b>	<b>X</b>
Credit impairment losses	(X)
Employee benefit expenses	(X)
General and administrative expenses	(X)
[other operating expenses]	(X)
<b>Business profit from consolidated entities</b>	<b>X</b>
Share of profit of integral associates and joint ventures	X
Other finance income	X
Other finance expenses	(X)
<b>Profit before tax</b>	<b>X</b>

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

Interest expense is incurred in the course of the entity's main business activities, so should be presented **in business profit**. This allows the presentation of **net interest income** as a subtotal.

We think separate presentation of results from associates/JVs outside business profit is as useful as for non-financial entities.

Income (or expenses) from investments made outside the course of the entity's main business activities would be presented outside business profit (assumed to be immaterial in this illustration).



## ④ Entities with more than one main business activity, including both investing and financing —possible P&L as per the staff’s proposals

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Extract from statement(s) of financial performance	
Interest income*	X
Interest expense	(X)
<b>Net interest income</b>	<b>X</b>
Fee and commission income	X
Fee and commission expense	(X)
<b>Net fee and commission income</b>	<b>X</b>
Net trading income	X
Net investment income*	X
Credit impairment losses	(X)
Employee benefit expenses	(X)
General and administrative expenses	(X)
[other operating expenses]	(X)
<b>Business profit from consolidated entities</b>	<b>X</b>
Share of profit of integral associates and joint ventures	X
Share of profit of non-integral associates and joint ventures	X
Other finance income	X
Other finance expenses	(X)
<b>Profit before tax</b>	<b>X</b>

- **Example:** A bank with investing and customer financing activities

Interest income, interest expense, net trading income and net investment income are earned (incurred) in the course of the entity’s main business activities, so should be presented **in business profit**

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

## 5 Entities with more than one main business activity, including investing or financing —possible P&L as per the staff’s proposals

42

- An entity that sells goods and has a customer financing business:

Extract from statement(s) of financial performance	
Revenue from sale of goods	X
Cost of goods sold	(X)
<b>Gross profit from sale of goods</b>	<b>X</b>
Interest income from customer financing (calculated using effective interest method)	X
Interest expense related to customer financing business	(X)
<b>Gross profit from customer financing business</b>	<b>X</b>
Selling, general and admin expenses (SG&A)	(X)
<b>Business profit (from consolidated entities)</b>	<b>X</b>
Share of profit of integral associates and joint ventures	X
<b>Profit before investing, financing and income tax</b>	<b>X</b>
Share of profit of non-integral associates and joint ventures	X
Other income (expenses) from investments	X
<b>Profit before financing and income tax (EBIT)</b>	<b>X</b>
Interest income from cash and cash equivalents calculated using effective interest method	X
Other income from cash and cash equivalents and financing activities	X
Expenses from financing activities	(X)
Other finance income	X
Other finance expenses	(X)
<b>Profit before tax</b>	<b>X</b>

Sale of goods

Customer  
financing

Sale of goods +  
customer  
financing

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