IFRS Accounting

Primary Financial Statements

Introduction

In March 2021, the IASB began redeliberating the proposals in response to feedback received on the Exposure Draft *General Presentation and Disclosures*

The IASB has made key decisions in relation to key topics of subtotals and management performance measures and is progressing work on disaggregation

The IASB is seeking stakeholder feedback on targeted aspects of its tentative decisions to date

The following slides detail the main proposals in the Exposure Draft updated to reflect the IASB's tentative decisions to September 2022

Project overview

Q4 2019	Q1–Q3 2020	Q4 2020	2021–2023
Exposure Draft published	Consultation period	Discussion of feedback summary	IASB redeliberations

Objective

- Improve communication in financial statements
- Focus on information included in the statement of profit or loss

Main proposals

1. Require additional **defined subtotals** in statement of profit or loss
2. Require disclosures about **management performance measures**
3. Strengthen requirements for **disaggregating information**

Subtotals

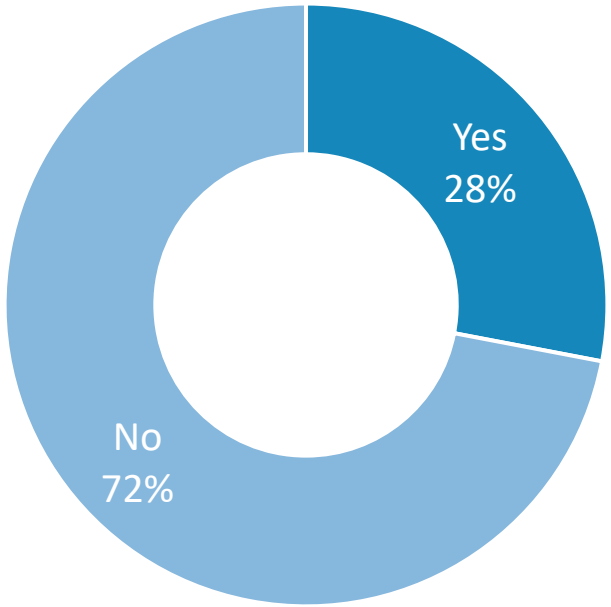
What is the issue?

No subtotals defined by IFRS Accounting Standards between ‘revenue’ and ‘profit or loss’

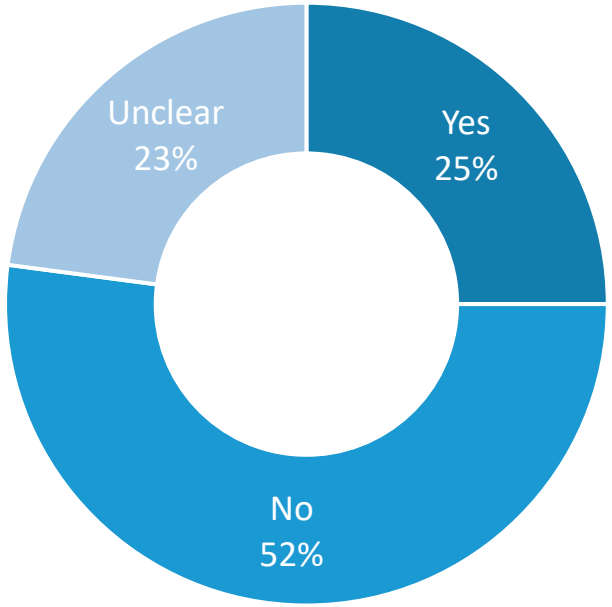
Companies calculate subtotals in different ways

- In a sample of 100 companies, we found that 63 companies reported operating profit in the financial statements, **using at least nine different definitions**

Share of profit or loss of associates and joint ventures included in operating profit?



Interest cost on defined benefit pension liabilities included in operating profit?



What are the new subtotals and categories? (1/2)

To address diversity in subtotals presented in the statement of profit or loss the IASB is proposing to introduce two new subtotals:

- Operating profit; and
- Profit before financing and income tax

To enhance comparability of information provided in the statement of profit or loss, the IASB also proposes to introduce three categories for classifying income and expenses:

- Operating;
- Investing; and
- Financing

The following slide is an example of the statement of profit or loss including the proposed subtotals and categories

What are the new subtotals and categories? (2/2)

Revenue

Other income

Changes in inventories of finished goods and work in progress

Raw materials used

Employee benefits

Depreciation

Amortisation

Professional fees and other expenses

Operating profit

Income and expenses from associates and joint ventures

Income and expenses from investments

Income and expenses from cash and cash equivalents

Profit before financing and income tax

Income and expenses from liabilities that arise from transactions that involve only the raising of finance

Unwinding of discount on provisions

Profit before tax

Income tax

Profit for the year

Operating

Investing

Financing

Line items illustrate what is included in each category and do not necessarily denote specified line items.

What is in the operating category?

Includes, **but is not limited to**, income and expenses from an entity's main business activities

Defined as a default—includes income and expenses not classified in other categories

- Works for **different business models**
- A direct definition would require **significant judgement** which may result in operating profit not being comparable
- Avoids creation of a **'non-operating' category** that is neither operating, investing or financing, which may be used opportunistically

Includes volatile and unusual income and expenses arising from an entity's operations

- The category is intended to provide a **complete** picture of the entity's operations for the period

What is in the investing category?

- Income and expenses from associates and joint ventures accounted for using the equity method
- Income and expenses from assets that generate a return individually and largely independently of other resources held by an entity, including cash and cash equivalents

Examples (classified in the operating category when investing as a main business activity)

- rental income and remeasurements of investment property
- interest income and fair value changes on financial assets
- dividends and fair value changes on non-consolidated equity investments

What is in the financing category?

All income and expenses from liabilities that involve only the raising of finance

A transaction that involves only the raising of finance is a transaction that involves:

- The receipt by the entity of cash, an entity's own equity instruments or a reduction in a financial liability; and
- The return by the entity of cash or an entity's own equity instruments

For example, typical loan contract involves only the receipt of cash and the return of cash

Interest expense and the effects of changes in interest rates from other liabilities

For other liabilities, including lease liabilities, **interest expense and the effect of changes in interest rates** are classified in the financing category when such amounts are identified applying the requirements of IFRS Accounting Standards (eg IAS 19 or IAS 37)

For example, a lease liability involves the receipt of a right-of-use asset and the return of cash

★ *Change in classification of income and expenses within the financing category included in targeted outreach topics*

How will FX gains or losses be classified?

FX gains and losses are classified in the same category as income or expenses giving rise to gain or loss, unless it results in undue cost or effort

Exchange differences not classified in other categories and cases that involve undue cost or effort	Operating category
Exchange differences on cash and cash equivalents	Investing category
Exchange differences on investments (eg on foreign currency denominated bonds)	Investing category
Exchange differences related to financing activities (eg on foreign currency denominated debt)	Financing category

How will gains or losses from derivatives and risk management be classified?

		Derivatives	Non-derivative financial instruments
Used for risk management	Designated as a hedging instrument	Include in the category affected by the risk the entity intends to manage, except when it would involve grossing up gains and losses—then include in the operating category	
	Not designated	Classify as above except when it involves undue cost or effort—then include in the operating category	Apply definitions for categories
Not used for risk management		Include in the operating category, unless it relates to financing and not used in main business activities	

How will income and expense from hybrid instruments be classified?

For hybrid contracts with host liabilities and embedded derivatives

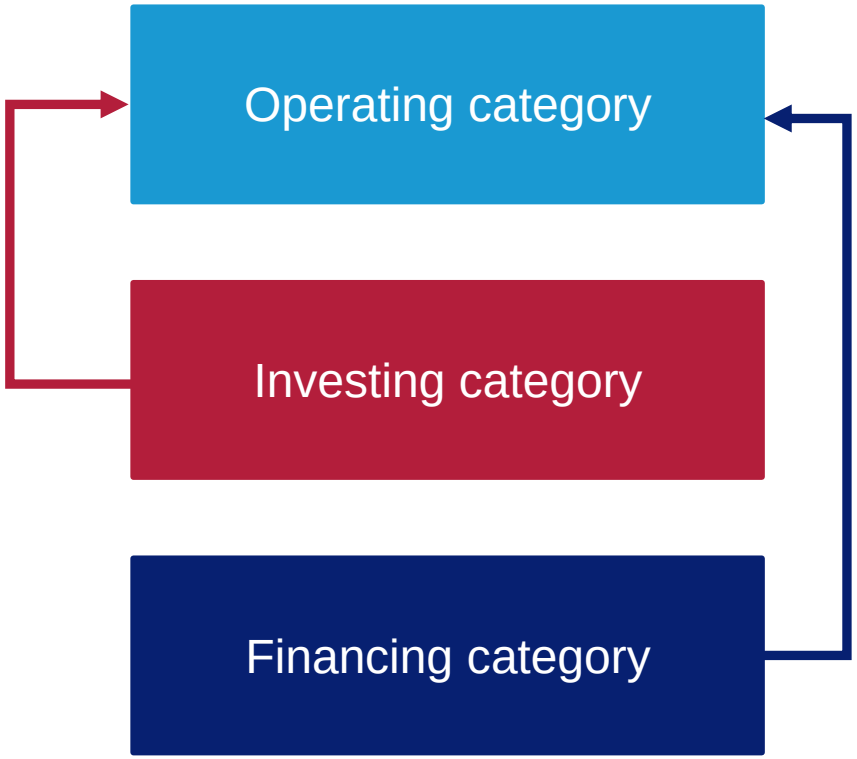
Income and expenses related to contracts that are not separated ★	Classify in the same way as income and expenses related to other liabilities
Income and expenses related to separated host liabilities	
Income and expenses related to separated embedded derivatives	Classify in the same way as income and expenses related to stand-alone derivatives

★ *The IASB will discuss at a future meeting the disclosure requirements when an entity designates an entire hybrid contract as at fair value through profit or loss*

Entities with specified main business activities

Operating profit is intended to include, but is not limited to, income and expenses from an entity's main business activities

The IASB proposes requirements for some entities, such as banks, to classify income and expenses in the operating category that would otherwise be classified in the investing or financing categories



Entities that provide financing to customers as a main business activity

Operating

Income and expenses from transactions that involve only the raising of finance

- Classified in the operating category by entities that provide financing to customers as a main business activity, such as banks and entities that provide financing to customers to purchase the entity's products
- Accounting policy choice whether to classify in the operating category ***all*** such income and expenses or ***only*** those related to providing financing to customers

Financing

Specified income and expenses from other liabilities classified in the financing category (same approach for all entities)

Entities that invest as a main business activity

Operating

Income and expenses from assets that generate a return individually and largely independently of other resources held by an entity

- Classified in the operating category by entities that invest in those assets as a main business activity, such as insurers, investment entities and investment property companies
- Applies to cash and cash equivalents if invest in financial assets as a main business activity ★

Investing

Income and expenses from associates and joint ventures accounted for using the equity method classified in the investing category (same approach for all entities)

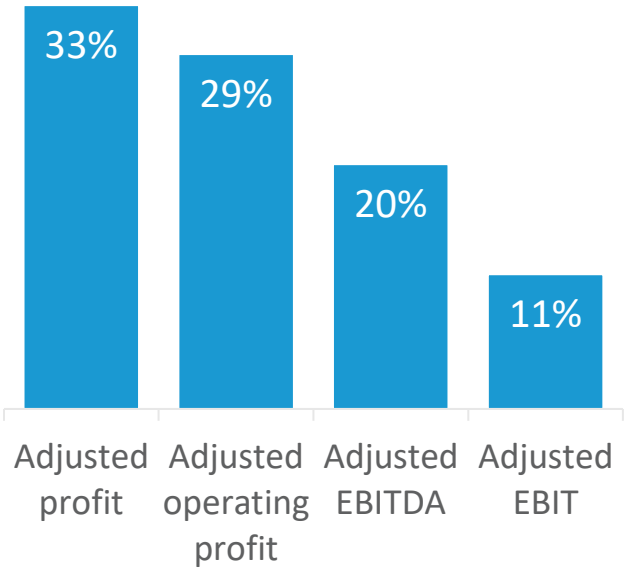
★ *Withdrawal of the proposal in the Exposure Draft for entities that provide financing to customers as a main business to be explored in targeted outreach*

Management performance measures

What is the issue?

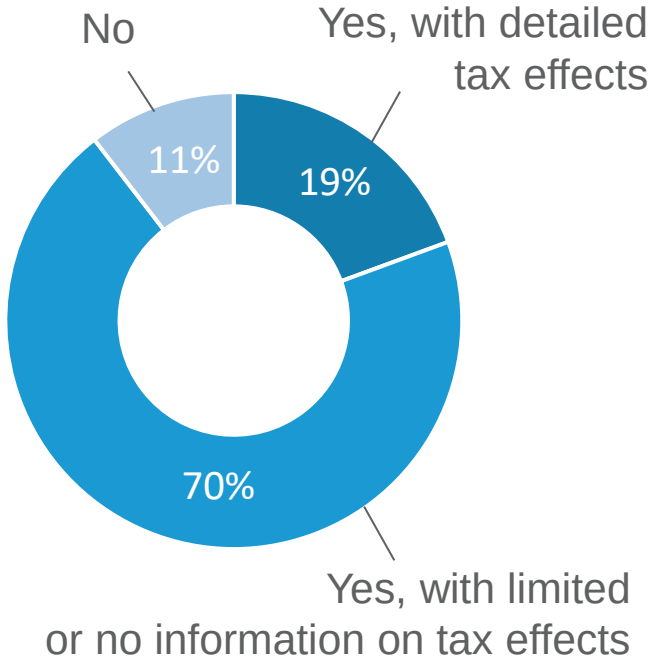
- Many companies provide performance measures defined by management in communications with investors
- Investors have said such measures can provide useful information, but should be used in a more transparent and disciplined way

Common management-defined performance measures



% of companies using measure in annual report

Is a reconciliation provided to a measure specified by IFRS Accounting Standards?



What are MPMs? (1/2)

The IASB is proposing to define a subset of non-GAAP measures as management performance measures (‘MPMs’) and require their disclosure in the financial statements along with disclosure requirements that will improve the transparency and discipline in their reporting

Management performance measures are a subset of non-GAAP measures consistent with the project focus on improving reporting of financial performance in the statement of profit or loss and the related notes

Many commonly reported non-GAAP measures and measures specified in IFRS Accounting Standards will not be management performance measures as demonstrated in the following slide

What are MPMs? (2/2)

Performance measures

Non-Financial performance measures

For Example:

- Number of subscribers
- Customer satisfaction score
- Store surface

Financial performance measures

(Sub)totals of income and expenses

IFRS-Specified

For example:

- Operating profit
- Operating profit before depreciation amortisation and specified impairments

MPMs

For example:

- Adjusted profit or loss
- Adjusted operating profit
- Adjusted EBITDA

Other measures that are not subtotals of income/expenses

For example:

- Free cash flow
- Return on equity
- Net debt
- Same-store sales

How will MPMs be defined?

Subtotals of income and expenses not specified by IFRS Accounting Standards that:

Are used in public communications outside financial statements (excluding oral communications, transcripts and social media posts)

=

Communicate management's view of an aspect of an entity's financial performance

Rebuttable presumption that a subtotal used in public communications represents management's view of an aspect of an entity's financial performance—rebutted with reasonable and supportable evidence ★

★ *Included in targeted outreach topics*

What disclosures will be required for MPMs?

Reconciliation	Reconciliation between MPM and the most directly comparable subtotal or total specified by IFRS Accounting Standards, including the income tax effect and effect on non-controlling interests ★★
Why an MPM communicates management's view	Includes an explanation of how the MPM is calculated and how the measure provides useful information about the entity's performance. Explanation should refer to individual reconciling items where necessary
Not necessarily comparable with other entities	A statement that MPM provides management's view of an aspect of the entity's financial performance and is not necessarily comparable with measures provided by other entities
Changes in calculation	Explanation of any changes in how the entity calculates its MPMs or which MPMs it provides ★

★ *To be discussed at a future IASB meeting*

★ *Included in targeted outreach topics*

What might a reconciliation look like?

		Tax	NCI
Adjusted operating profit (MPM)	**52,870**		
Restructuring in Country X (incl. in employee benefits)	(5,400)	900	(1,020)
Revenue adjustment (incl. in revenue)	(6,200)	1,550	-
Operating profit (IFRS-specified)	**41,270**		

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

- operating profit, profit before financing and income tax;
- gross profit and subtotals similar to gross profit;
- profit before tax, profit from continuing operations, profit or loss;
- total other comprehensive income, comprehensive income;
- operating profit before depreciation, amortisation and specified impairments
- operating profit and income and expense from investments accounted for using the equity method

Simplified approach to calculating the tax effect ★★

★ *To be discussed at a future IASB meeting*

★ *Included in targeted outreach topics*

How does EBITDA fit in the proposals?

The IASB is proposing to define
'**operating profit before depreciation, amortisation and specified impairments**'

- If used, no MPM disclosures would be required for this measure
- The IASB will not explicitly prohibit 'EBITDA' as a label for 'operating profit before depreciation, amortisation and specified impairments', but will explain in the Basis for Conclusions that such a label would rarely be a faithful representation of it

Disaggregation overview

What is the issue?

Entities sometimes provide information that is too aggregated or incomplete so investors don’t get the information they need for their analysis

What will be the disaggregation requirements?

General requirements and specified line items	Roles of the primary financial statements (PFS) and the notes	Principles for aggregation and disaggregation ★
	Specified line items	Grouping dissimilar immaterial items, avoiding 'other' labels ★
Specific requirements	Present operating expenses by nature and by function (mixed approach permitted) Disclosure of amounts included in each line item of profit or loss for depreciation, amortisation and employee benefits ★★	Disclosure of unusual income and expenses (***proposal withdrawn***)

★ *To be discussed at a future IASB meeting*

★ *Included in targeted outreach topics*

What would be the general requirements?

Roles of PFS and the notes	• Describe the roles of PFS and the notes and refer to understandability in the description of the role of PFS
Principles for aggregation and disaggregation	• Single dissimilar characteristic can be enough to disaggregate if resulting information is material • Application guidance on when disaggregation in the notes would result in material information and when disaggregation in the PFS would result in a more understandable overview ★
Specified line items	• New specified line items, including goodwill in the statement of financial position
Grouping dissimilar immaterial items, avoiding 'other' labels	• Use meaningful labels for groups of immaterial items, avoiding line items such as 'other expenses' • If that is not possible, entities required to provide information in the notes about the content of such groups of items ★

★ *To be discussed at a future IASB meeting*

Understandable overview and specified line items

The IASB has tentatively decided to provide guidance on disaggregation in the notes and in the primary financial statements

Primary financial Statements

- Disaggregate when it results in a more **understandable overview**
- **Specified line items** are presented in primary financial statements when it does not detract from providing an understandable overview

Disclosure in the notes

- Disaggregate when it results in **material information**
- **Specified line items** not presented in the primary financial statements are disclosed in the notes when material

Disclosure of operating expenses by nature in the notes

The Exposure Draft proposed that an entity that reports expenses by function in the statement of profit or loss discloses in the notes an analysis of total operating expenses by nature

Some respondents (users, standard-setters and accountancy bodies) agreed

Some respondents (preparers and their representative bodies) disagreed

To achieve a more balanced outcome between costs for preparers and benefits for users the IASB has tentatively decided to:

- require an entity to disclose the amounts of depreciation, amortisation and employee benefits included in each line item in the statement of profit or loss; and
- explore in targeted outreach an approach that would require an entity to disclose, for all operating expenses disclosed in the notes, the amounts included in each line item in the statement of profit or loss (‘a general requirement’) ★★

★ *To be discussed at a future IASB meeting*

★ *Included in targeted outreach topics*

Unusual income and expenses

The Exposure Draft proposed a definition of unusual income and expenses and disclosure requirements (for example, an entity would disclose the line item(s) in the statement of financial performance in which unusual income and expenses are included and narrative information)

Most agreed with the IASB developing a definition, but also said the definition was too subjective, that it included income and expenses that some did not view as unusual, and that more application guidance was required

- The IASB has been working on a revised definition of unusual items – focusing on reducing the subjectivity and limiting the population of items captured by the definition
- Discussions with stakeholders and IASB members over the last nine months have not led to a consensus on what the population of unusual income and expenses should be

The IASB tentatively decided not to proceed with the specific requirements for unusual income and expenses as part of this project

Other issues

Changes to the statement of cash flows

Operating profit or loss subtotal to be the starting point for the indirect method of reporting cash flows from operating activities

Dividends received	Investing category
Dividends paid	Financing category
Interest paid	Financing category
Interest received	To be discussed at a future IASB meeting ★

★ *Classification of dividends and interest paid and received by entities with specified main business activities to be discussed at a future IASB meeting*

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