

Joint CMAC-GPF meeting, 15-16 June 2017  
Agenda Paper 3

# Primary Financial Statements

Comparability and flexibility  
in performance reporting

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# Purpose of the session

- To receive input from the CMAC and GPF members on possible introduction of the following subtotals in the statement(s) of financial performance.
- The slides are structured as follows:
  - background – slides 3-6;
  - profit before finance income/expense and tax (EBIT) – slides 7-12;
  - management operating performance measure – slides 13-17;
  - questions to GPF and CMAC members – slides 18-20

# Background



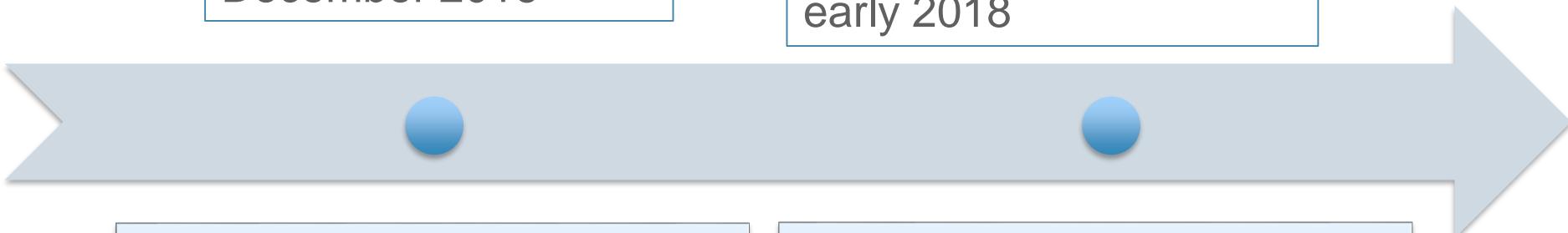
# Project background

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- The Primary Financial Statements project is an early-stage research project examining potential targeted improvements to the structure and content of the primary financial statements

December 2016

Target publication date—  
early 2018



The Board tentatively decided to focus on targeted improvements to:

- statement(s) of financial performance; and
- statement of cash flows.

The Board will decide whether it will issue:  
- Discussion Paper; or  
- Exposure Draft  
as the first due process output of the project.

# Stakeholders' opposing views about reporting performance

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*Comparability*

VS

*Flexibility*

Lack of comparability negatively affects usefulness of IFRS financial information

Because of the lack of comparability, users prefer financial statements 'standardised' by data aggregators

Recognition and measurement should be principle based but presentation should be more structured

Flexibility allows preparers to tell their own story

As long as necessary information is available in the notes, primary financial statements can be concise

IFRS Standards should keep their principle-based nature

# Proposed subtotals to address the tension between flexibility and comparability

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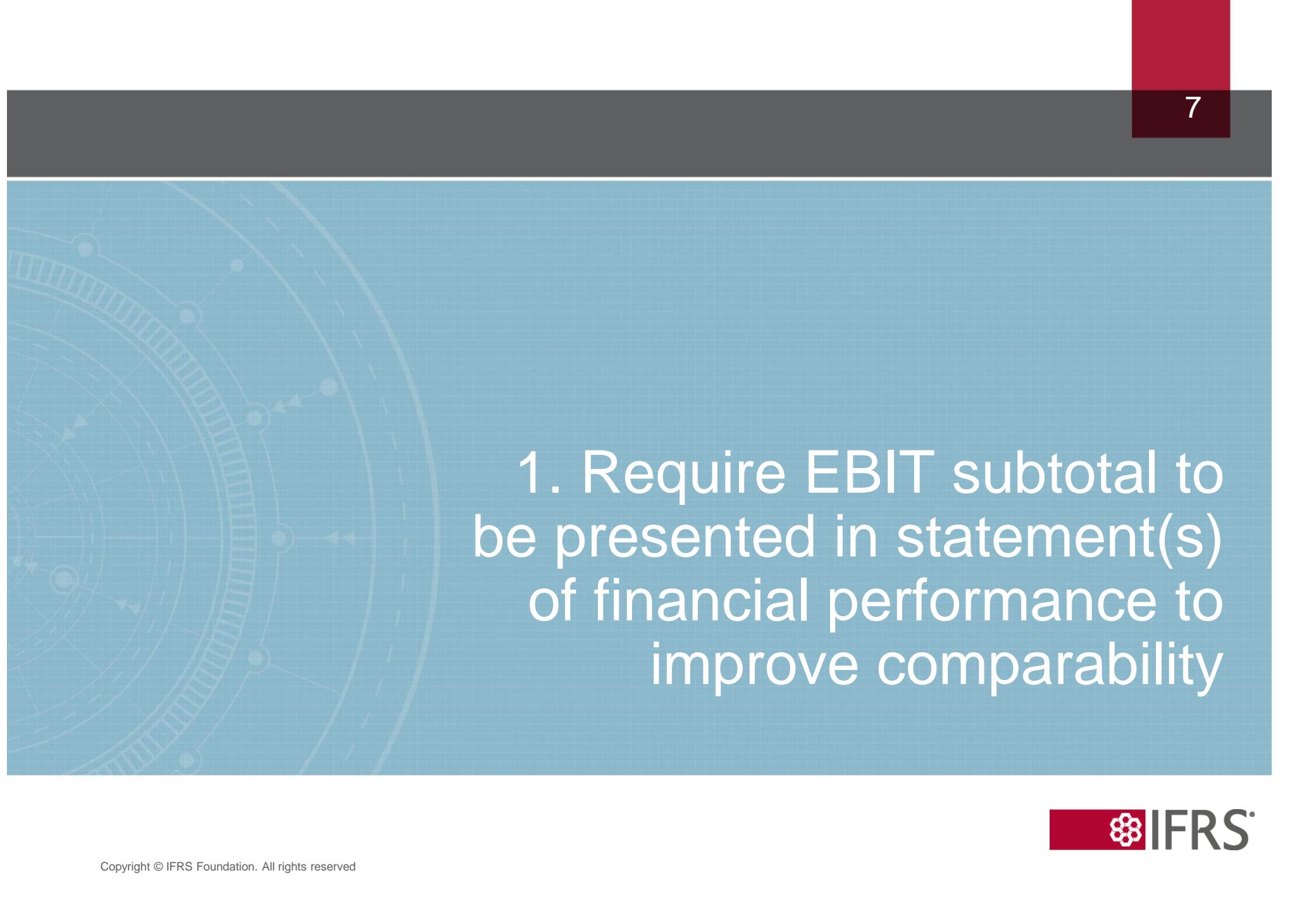
- We propose introducing two subtotals to better communicate entities' performance

**Flexibility** - Performance measure that management uses to communicate progress towards its business objective or strategy

Items between two subtotals show how an entity's Management Operating Performance Measure is different from EBIT

**Comparability** - Introducing a comparable performance measure among different entities as an 'anchor'

Proposed subtotals	
Revenue	10,000
Cost of goods sold	-4,000
Gross profit	6,000
SG&A	-2,500
<b>Management Operating Performance Measure</b>	3,500
2	
Infrequent operating income and expenses, etc	-500
EBIT	3,000
1	
Finance income	200
Finance expense	-1,200
Pre-tax profit	2,000
Taxation	-600
Profit	1,400



1. Require EBIT subtotal to be presented in statement(s) of financial performance to improve comparability

# Require 'EBIT' (profit before finance income/expense and tax) subtotal

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Concerns raised	Possible solutions	Example
<ul style="list-style-type: none"><li>Users need a comparable subtotal as a starting point for their analysis</li><li>Many companies present an EBIT-type subtotal, but it varies and is not comparable</li></ul>	<ul style="list-style-type: none"><li>Require presentation of comparable EBIT subtotal</li></ul>	<p><b>Revenue</b> All income and expenses excluding finance income/expense and tax *</p> <p><b>EBIT</b> <i>Finance income</i> <i>Finance expense</i></p> <p><b>Pre-tax profit</b> Taxation</p> <p><b>Profit</b></p> <p><b>OCI items</b> <b>Comprehensive income</b></p>
<ul style="list-style-type: none"><li>Presentation of finance income and expense varies, even among entities in the same industry (eg net interest on net defined benefit pension liabilities)</li></ul>	<ul style="list-style-type: none"><li>Provide principles-based definition of finance income and expense</li><li>Prescribe treatment for some items (eg net interest on net defined benefit pension liabilities)</li></ul>	<p>* Financial institutions will be considered separately.</p>

# How to define EBIT?

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## Staff's tentative approach in the March Board paper

Objective of EBIT	Comparable performance measure that is independent of an entity's capital structure and income tax situation
Definition of EBIT	Profit before finance income/expenses and tax
Finance income/expenses	Income/expenses related to the entity's capital structure
Net interest on the net defined benefit liability	The policy choice in IAS 19 for the presentation of the expense should be eliminated because this reduces comparability

### Feedback received in March Board meeting:

1. Capital structure should be defined
2. Consider additional guidance for particular items

# How to define capital structure?

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Warranty/onerous  
contract/legal/  
restructuring  
provisions

Net defined benefit  
liabilities

Trade payables  
with significant  
financing  
component

Bank loans  
Bonds/notes issued

Not part of  
capital  
structure

Where to draw  
the line?

More clearly  
part of capital  
structure

Trade payables  
without significant  
financing  
component

Decommissioning  
provisions

Liabilities for deferred  
consideration in a  
business combination

Lease  
liabilities

# How to define EBIT?

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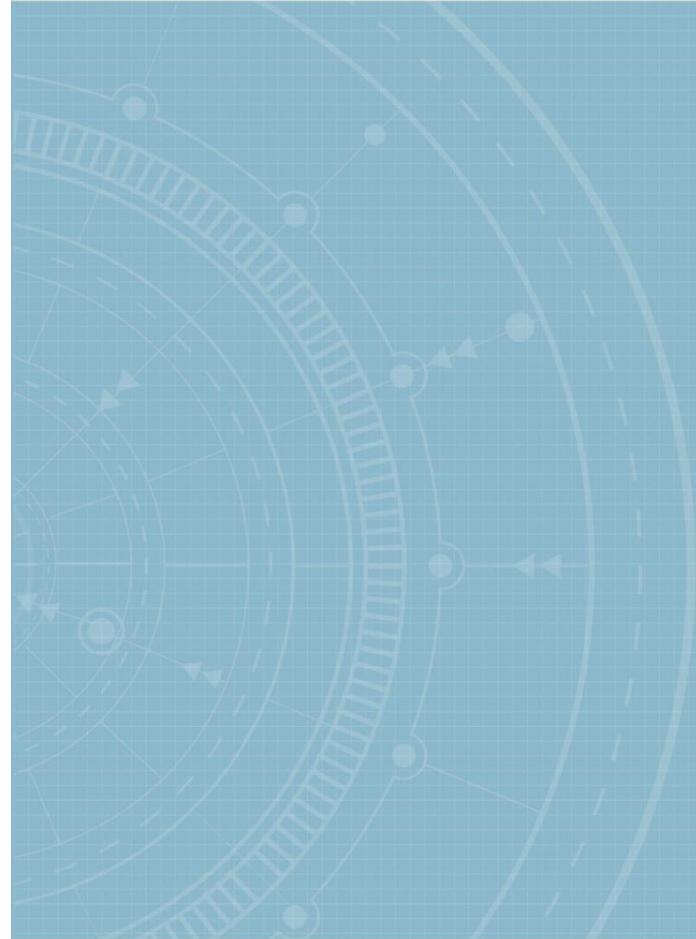
## Staff's tentative proposals for the June Board meeting (not yet discussed by the Board)

- |  |   |
|--|---|
| 1. Tentative approach to determining capital structure/ finance income and expense | Proposal to <b>develop clear principles/definitions</b> , to achieve objective of a <b>comparable</b> measure, rather than allowing a management view |
| 2. Tentative definition of capital structure                                       | <b>Equity + assets and liabilities arising from financing activities + excess cash and temporary investments of excess cash</b>                       |
| 3. Financing activities  | IAS 7 <i>Statement of Cash Flows</i> definition may need to be <b>clarified</b>   |
| 4. Excess cash and temporary investments of excess cash                            | Consider using <b>cash and cash equivalents</b> as defined in IAS 7 as proxy  |
| 5. Interest on items that are not part of capital structure                        | <b>Separately presented below EBIT</b>  |

# How to define EBIT— comparability vs flexibility

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Approaches	Advantages	Implications
Management view of what should go in finance income/expense and capital structure	<ul style="list-style-type: none"><li>Provides flexibility for preparers</li><li>Provides users with management's view of finance income/expense and capital structure</li></ul>	<ul style="list-style-type: none"><li>Limited changes to the statement(s) of financial performance.</li><li>We expect to require disclosure of a breakdown of what management considers to be finance income/expense and capital structure.</li></ul>
Clear principles/definitions for finance income/expense and capital structure	<ul style="list-style-type: none"><li>Would provide more comparable information for users</li><li>Would provide more guidance for preparers</li></ul>	<ul style="list-style-type: none"><li>Reduction in diversity in which income and expenses are classified as finance income and expense, eg net interest on net defined benefit liability</li><li>Could result in changes to entity's EBIT subtotal if already presented</li><li>Disclosure of breakdown of finance income/expense and capital structure would be standardised.</li></ul>



2. Allow/require a Management Operating Performance Measure to provide flexibility

# Allow/require entities to present management operating performance measure

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Concerns raised	Possible solutions	Example
<ul style="list-style-type: none"><li>Users need information that shows progress towards management's business objective or strategy</li></ul>	<ul style="list-style-type: none"><li>Require/allow presentation of management operating performance measure, rather than defining operating profit</li></ul>	<p>Revenue</p> <p>...</p> <p>...</p> <p><b>Management operating performance measure (eg core operating profit)</b></p> <p><b>Items excluded from management operating performance measure</b></p> <p>EBIT</p> <p>Finance income</p> <p>Finance expense</p> <p>Pre-tax profit</p> <p>Taxation</p> <p>Profit</p>
<ul style="list-style-type: none"><li>Users need information about persistency of income and expenses to develop forecasts</li><li>Currently items classified as 'infrequently occurring' vary and are not transparent</li><li>Some infrequently occurring items seem to occur regularly</li></ul>	<ul style="list-style-type: none"><li>Require additional transparency about management operating performance measure and whether items excluded were infrequently occurring items</li></ul>	<p>OCI items</p> <p><b>Comprehensive income</b></p>

# Characteristics of adjustments

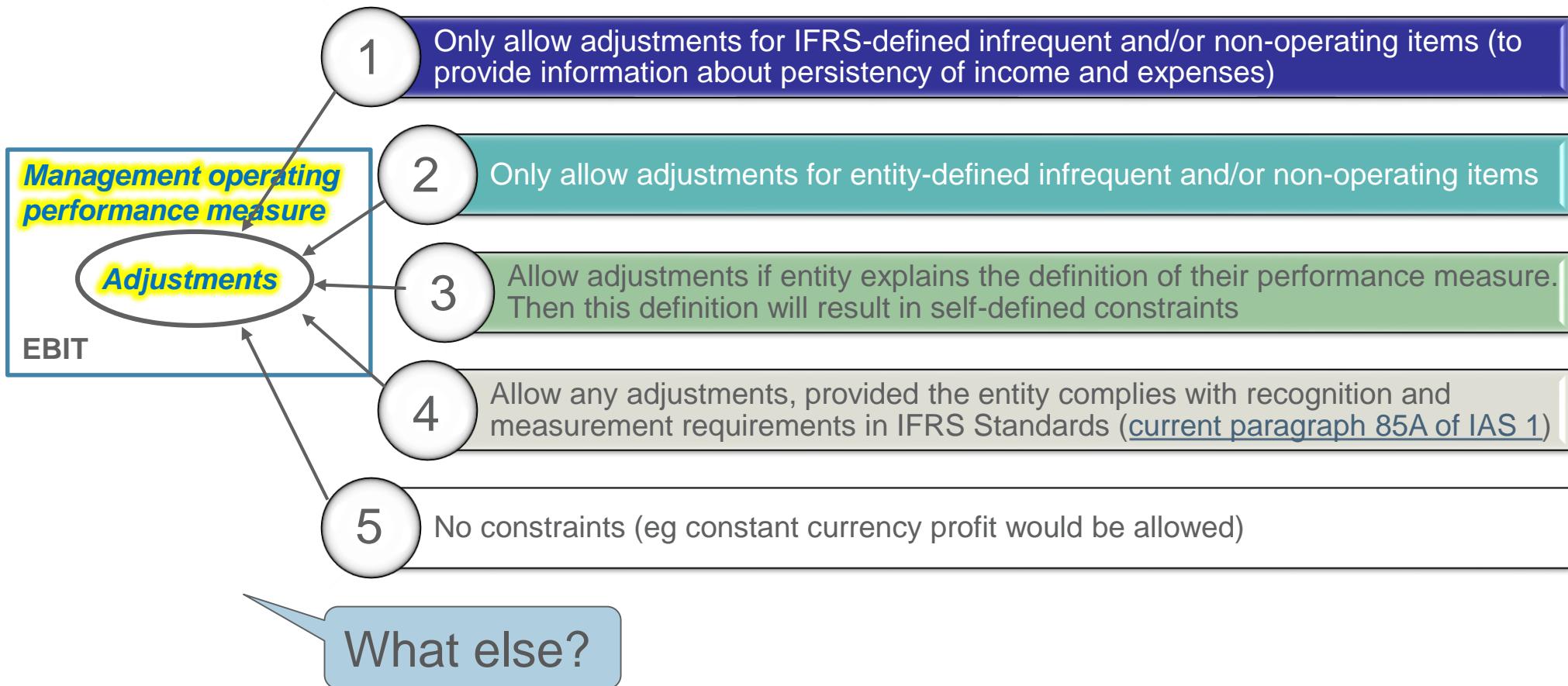
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- Adjustments made between management operating performance measure and EBIT have different characteristics:

	<b>Operating</b>	<b>Non-operating</b>
<b>Infrequent</b>	- Impairment of goodwill - One-time restructuring cost	- Impairment loss of investment property
<b>Frequent</b>	- Amortisation of intangible assets - Share-based payment	- Dividend income

# Which constraints should we impose on a management operating performance measure?

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# Possible approaches to enhance the transparency of the performance measure

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Separate presentation of infrequent items

- require separate presentation of both infrequently occurring items and frequently occurring items, for the items presented between management operating performance measure and EBIT, based on management's judgement

Disclose why an entity uses the measure

- require disclosure of why an entity believes the performance measure used reflects its performance
- require entities to define the nature of the performance measure (eg. 'excluding infrequently occurring items', together with their definition of 'infrequent') and apply that definition consistently from period to period

Require subtotal if used outside of F/S

- if an entity uses a management operating performance measure outside of financial statements (eg management commentary), it could be required to present the measure in the statement(s) of financial performance

Historical adjustments

- require disclosure in the notes of a historical summary (eg five years) of infrequently occurring items excluded from the management operating performance measure

## Question 1: EBIT

- Do you agree that our objective for an EBIT subtotal should be to provide a comparable starting point for users' analysis that facilitates comparisons of entities with different capital structures?
- Do you agree with having clear definitions and principles about what constitutes capital structure and finance income/expenses to achieve comparability rather than allowing a management view?

## Question 2: management operating performance measure

- Do you agree with the presentation of a management operating performance measure in the statement(s) of financial performance?
- Should it be allowed or required?
- Which constraints should we impose on a management operating performance measure?
- How could we enhance the transparency of the performance measure?

## Question 3: address the needs for comparability and flexibility

- Do you think the introduction of EBIT and management operating performance measure in the statement(s) of financial performance would meet the need for both comparability and flexibility expressed by users and preparers?
- If not, do you have any other suggestions?

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