STAFF PAPER

May 2018

IASB® Meeting

Project	**Primary Financial Statements**
Paper topic	Cover note

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Purpose of the meeting

1. At this meeting, we will:
   (a) discuss staff's preliminary analysis of which of the tentative decisions made to-date for non-financial entities could apply, with little or no change, to financial entities;
   (b) discuss staff's preliminary analysis of alternative approaches we could consider for those project areas in which the tentative decisions made to-date would have to be adjusted for financial entities; and
   (c) provide the Board with a summary of our research on reporting practices for a sample of financial entities.
2. We are not asking the Board to make any decisions at this meeting. However, the papers for this meeting include questions that are intended to help us to identify what further analysis we need to bring to the Board.
3. This cover note includes the following:
   (a) proposed approach to discussing financial entities in the project (paragraphs 4 – 5);
   (b) list of papers that will be discussed during this meeting (paragraph 6);
   (c) our planned next steps in this project (paragraph 7);

(d) a summary of feedback on financial entities received from the Board's consultative bodies (Appendix A); and

(e) a summary of the Board's tentative decisions to date (Appendix B).

Proposed approach to discussing financial entities in the project

4. The Board has reached tentative decisions in most areas in the project scope. In reaching those decisions the Board has initially focused on the primary financial statements of non-financial entities. The Board needs to consider whether and how those proposals would apply to financial entities. Some of these proposals might be useful for financial entities and some might not. Also, some of the proposals are related. For example, if the proposed subtotals in the statement of financial performance are not useful for financial entities then the proposed reconciliation of a management performance measure to the closest subtotal might need to be revised. Finally, the usefulness of proposals may differ depending on the type of financial entity – for example a proposal might not be useful for a bank but might be useful for an investment property company.

5. The staff have devised a three-phased approach to address financial entities in the project:

   (a) **Phase 1** – preliminary analysis of approaches for financial entities, which includes the following steps:

      (i) preliminary identification of project areas in which tentative decisions made to-date for non-financial entities could apply, with little or no change, to financial entities; and

      (ii) preliminary identification of alternative approaches for those project areas in which the tentative decisions made to-date would have to be adjusted for financial entities.

   (b) **Phase 2** –explore and address priority areas for financial entities. This phase considers the project proposals which need adjusting for financial entities, and involves the following steps:

      (i) assess inter-relationships between different project areas and decide which project areas need to be addressed first because decisions on those areas will affect decisions in other areas (identify priority project areas). This is likely to include the areas of focus in the project, such as presentation in the statement(s) of financial performance.

(ii) explore alternative approaches in priority project areas.

(iii) decide on most useful approach(es) in priority project areas.

(c) **Phase 3 –** address remaining areas and check overall model. This phase involves the following steps:

(i) review the remaining project areas that might need addressing; and

(ii) review the overall model for financial entities and make sure it works for all project areas.

Papers for this meeting

6. Agenda papers for this meeting address Phase 1 of the approach to financial entities:

(a) **Agenda Paper 21A** discusses staff's preliminary analysis of approaches for financial entities, including assessment of which of the tentative decisions made to-date for non-financial entities could apply, with little or change, to financial entities.

(b) **Agenda Paper 21B** provides a summary of our research on key reporting practices for a sample of financial entities.

Next steps

7. At future Board meetings, we plan to discuss:

(a) phases 2 and 3 of our planned approach for financial entities (see paragraph 5);

(b) the feedback on Section 5 of the Discussion Paper *Disclosure Initiative—Principles of Disclosure*—Use of performance measures in the financial statements, including whether to define EBITDA, allow or require presentation or disclosure of infrequently occurring items, and allow or require use of columns in presenting financial performance;

(c) outstanding issues on subtotals in the statement(s) of financial performance —including a review of the categories, subtotals and labelling (for example, reviewing the decision not to use the term operating profit and the decision to present integral associates and joint ventures separately from non-integral associates and joint ventures);

(d) proposals to develop templates for financial statements, including the status and location of such templates;

(e) the identification of minimum line items to present on the face of the statement(s) of financial performance;

(f) outstanding issues on disaggregation of information;

(g) outstanding issues on aggregation in presentation of other comprehensive income;

(h) moving the project from the research to the standard-setting agenda; and

(i) deciding which type of consultative document to publish to obtain feedback on the Board's tentative decisions (ie an Exposure Draft or a Discussion Paper).

Appendix A: Summary of feedback on financial entities received from IASB consultative bodies

A1. Whether the Board's tentative decisions to date could be applied to financial entities was discussed with the following consultative bodies:

(a) The Accounting Standards Advisory Forum (ASAF) in April 2018—see paragraphs A2-A9; and

(b) The Capital Markets Advisory Group (CMAC) in October 2017—se paragraphs A10-A11)

ASAF meeting, 17 April 2018: Approach for financial entities

A2. ASAF members (ASBJ, NZASB, AcSB, FASB, ANC, CASC, EFRAG) said that the subtotals the Board has tentatively decided to require for non-financial entities—ie 'profit before investing, financing and income tax' and 'profit before financing and income tax' (EBIT)—would not provide useful information for financial entities, because investing and financing activities are usually part of their core activities.

A3. A Board member said that some stakeholders had suggested requiring an EBIT-type subtotal for financial entities, in which the 'I' consists only of interest expenses on debt included in regulatory capital. The AASB/NZASB member said she understood the rationale behind such an approach, but questioned how easy it would be to implement.

A4. The AcSB, EFRAG and FASB members suggested the Board could instead explore defining and requiring alternative subtotals that are commonly used in practice by financial entities, such as net interest margin and operating profit. The EFRAG and AcSB members said that entities define some of these measures inconsistently.

A5. The ASBJ, AASB/NZASB and FASB members said that if the Board provides specific requirements or exemptions for 'financial entities', it will need to define 'financial entities', which will be difficult. For example, they said any definition would be difficult to apply to conglomerates that have both non-financial and financial activities.

A6. The ASBJ and AASB/NZASB members suggested that instead the Board should allow entities not to present the proposed subtotals if an alternative approach is more useful. These members referred to a similar approach in IAS 1 *Presentation of Financial Statements*, paragraph 60, which requires entities to use a current/non-current distinction in the statement of financial position except when a presentation based on liquidity provides information that is reliable and more relevant.

A7. ASAF members made the following additional comments about the application of the Board's tentative decisions to financial entities:

(c) the ANC and AOSSG members said that the statement of cash flows is not useful for financial entities. The ANC member also referred to the EFRAG Discussion Paper *The Statement of Cash Flows—Issues for Financial Institutions* on this subject.

(d) the AcSB member reported the views of preparers in Canada, who did not support including management performance measures in banks' financial statements, because it would lead to duplication with the management commentary, nor did they support developing guidance on disaggregation. However, the AcSB member did not necessarily agree with these views.

A8. The AASB/NZASB member said another issue the Board may want to address is excessive offsetting of income and expenses by financial entities.

A9. ASAF members also shared examples of research available to help the Board in its decision-making.

CMAC meeting, 20 October 2017: Financial institutions and performance reporting

A10. The purpose of this session was to gain CMAC members' views about useful subtotals for the presentation of financial performance for banks, focusing on:

(a) whether the metrics users need for analysing financial performance of banks are readily available and reported consistently.

(b) whether any defined performance measures above profit before tax in banks' statement(s) of financial performance would be useful for users.

(c) whether such measures could be consistent with measures that the staff proposed for non-financial institutions, such as ‘profit before investing, financing and tax’; and ‘profit before financing and tax’ (EBIT).

A11. CMAC members supported the Board researching this area, and thought that there are problems today with how banks present their statement(s) of financial performance. Key issues and suggestions highlighted by CMAC members included:

(a) Many banks are conglomerates, which some CMAC members analyse by looking at their different activities separately, ie banking (lending and deposit taking), providing services (such as transaction advisory and underwriting) and trading. The segment note and other notes, rather than the consolidated primary financial statements, provide the most useful information for this purpose.

(b) There are inconsistencies in how line items and subtotals—such as net interest margin (NIM)—are calculated. For example, a mix of ‘by nature’ and ‘by function’ presentation is used when presenting interest and there is diversity in practice. However, one member said the notes included the inputs they needed to calculate two interest measures they are interested in, ie ‘banking NIM’ and ‘total NIM’. Some CMAC members said that requiring presentation by function would be an improvement to the statement(s) of financial performance, because it would allow investors to distinguish banking from other activities, with information by nature provided in the notes.

(c) A clear linkage between the statements of financial performance and financial position is important to their analysis, eg for calculating key performance metrics such as return on assets, return on equity and return on risk weighted assets. In their view, this linkage is not clear at present and the project should explore improving this linkage.

(d) Some CMAC members said that investors do not use EBIT for banks and many said that defining an EBIT subtotal would not be useful for banks, as interest income and expenses are part of a bank’s core business and should be analysed together. However, some CMAC members asked for additional information about the cost of banks’ regulatory capital.

Appendix B: Summary of the Board's tentative decisions to date in 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 issue 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),

Topic	Staff condensed summary of Board's tentative decisions (focus on non-financial entities)
	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: 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.
Statement(s) of financial performance—investing category	The Board agreed (by concensus) 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.

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<tr><th>Topic</th><th>Staff condensed summary of Board’s tentative decisions (focus on non-financial entities)</th></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.
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.
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<tr><td>Management performance measure</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.
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Topic	Staff condensed summary of Board's tentative decisions (focus on non-financial entities)
Management performance measure (continued)	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 Segment*s. 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. 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.

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

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

and disaggregation	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.
	
	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.