

Review of fundamental relationships

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Fundamental calculation relationships being reviewed today

1. **Statement of cash flows** (continuation of June ITCG discussions)

Slides 3 - 11

Net cash flows from (used in) operating activities (A)	NA
Net cash flows from (used in) investing activities (B)	Debit
Net cash flows from (used in) financing activities (C)	Debit
Net increase (decrease) in cash and cash equivalents before effect of exchange rate changes (D) = (A+B+C)	Debit
Effect of exchange rate changes on cash and cash equivalents (E)	Debit
Net increase (decrease) in cash and cash equivalents (F) = (D+E)	Debit

2. **Gross profit** (new: resulting from stakeholder feedback)

Slides 12 - 37

Revenue (A)	Credit
Cost of sales (B)	Debit
Gross Profit (C) = (A-B)	Credit

Review of fundamental relationships—

Statement of cash flows

Summary of our review

The calculation relationship generally works fine. However, there are some exceptions:

Category	Description	Number of companies	Proposed improvements?
Incorrect use of an element	Incorrect use of the IFRS Taxonomy element 'Increase (decrease) in cash and cash equivalents'.	Common Around 12%	Yes, label change [See slides 5-11]
Extensions	A few extension elements break the calculation relationship.	Less than 5%	No , not common
Incorrect use of signs	A small number of filers used an incorrect sign.	Less than 1%	No , not common

Incorrect use of the IFRS Taxonomy element

5

IFRS Taxonomy presentation

Cash flows from (used in) operating activities (A)	5
Cash flows from (used in) investing activities (B)	7
Cash flows from (used in) financing activities (C)	3
Net increase (decrease) in cash and cash equivalents before effect of exchange rate changes (D) = (A+B+C)	15
Effect of exchange rate changes on cash and cash equivalents (E)	2
Net increase (decrease) in cash and cash equivalents (F) = (D+E)	17
Cash and cash equivalents at beginning of period (G)	1
Cash and cash equivalents at end of period (H) = (F+G)	18

Common reporting practice

Cash flows from (used in) operating activities (A)	5
Cash flows from (used in) investing activities (B)	7
Cash flows from (used in) financing activities (C)	3
Net increase (decrease) in cash and cash equivalents (D) = (A+B+C)	15
Cash and cash equivalents at beginning of period (G)	1
Effect of exchange rate changes on cash and cash equivalents (E)	2
Cash and cash equivalents at end of period (H) = (D+G+E)	18

Some companies incorrectly use the element 'Net increase (decrease) in cash and cash equivalents' to tag the amount of 15. The correct element to use is: 'Net increase (decrease) in cash and cash equivalents before effect of exchange rate changes'

- The label of the element ‘Net increase (decrease) in cash and cash equivalents’ **exactly matches the wording used in the Illustrative Examples of IAS 7 *Statement of Cash Flows***
- The **presentation context of this example and of the IFRS Taxonomy makes it clear** that the element should only be used to tag an ‘amount after exchange rate differences’
- However, we think some preparers **may mainly (or solely) rely on label searches** to find the correct element. In this case, the label of the element does not precisely define the accounting meaning and confusion may arise

Staff proposal

The staff is proposing to change the label of the element ‘Net increase (decrease) in cash and cash equivalents’ to clarify that this element should only be used to reflect the net increase (decrease) in cash and cash equivalents after effect of exchange rate differences.

Net increase (decrease) in cash and cash equivalents before effect of exchange rate changes
Effect of exchange rate changes on cash and cash equivalents (E)
Net increase (decrease) in cash and cash equivalents <u>after effect of exchange rate changes</u>

Underlined text shows the proposed label changes

Existing documentation label	Proposed documentation label
The increase (decrease) in cash and cash equivalents. [Refer: Cash and cash equivalents]	The increase (decrease) in cash and cash equivalents <u>after the effect of exchange rate changes on cash and cash equivalents held in foreign currencies</u> . [Refer: Cash and cash equivalents; <u>Effect of exchange rate changes on cash and cash equivalents</u>]

Consistency of the proposed label change with the IFRS Taxonomy policy

Policy for element labels in the IFRS Taxonomy

‘The standard label of an element **normally matches** the wording used in IFRS Standards or its accompanying materials*’.

‘Each element in the IFRS Taxonomy has a standard label that provides a concise human-readable description **reflecting the accounting meaning of the element**. Labels should be concise, **follow the terminology in the IFRS Standards** and avoid being excessively descriptive**’.

*Source: [Using the IFRS Taxonomy- A preparer’s guide](#)

**Source: [Using the IFRS Taxonomy- The Taxonomy architecture 2019](#)

Consistency of the proposed label change with the IFRS Taxonomy policy (cont'd)

The proposed change applies as an exception to the normal policy of using the label of the Illustrative Examples. The staff think the exception is justified as it ensures that the accounting meaning of the element is clear outside the presentation context of the Illustrative Examples.

The staff considered changing the documentation label only but rejected this option as documentation labels:

- are not translated by all jurisdictions using the IFRS Taxonomy;
- are not included with the PDF version of the IFRS Taxonomy Illustrated; and
- may be less prominent within tagging tools.

Consequential label amendments?

- The staff reviewed whether the IFRS Taxonomy includes other elements **where the label does not clearly identify** whether the element depicts a disclosure before or after the effect of exchange rate differences
- This review did **not highlight any such elements**



Do you agree with the staff proposal outlined on Slide 7? If not, what improvements would you suggest and why?

Are you aware of other IFRS Taxonomy elements where you think the label is not sufficiently clear, causing a common practice error to occur?

Review of fundamental relationships—

Gross Profit

- One of the fundamental calculation relationships for the statement of profit or loss by function of expenses is:

$$\text{Revenue} - \text{Cost of sales} = \text{Gross profit}$$

- The staff **received feedback that this relationship does not always work** for the XBRL filings of foreign private issuers, making it difficult for investors to use the tagged data.
- The staff **has reviewed the use of the IFRS Taxonomy elements** ‘Revenue’, ‘Cost of sales’ and ‘Gross profit’ for the 2017 annual reports of 458 companies that file with the SEC using IFRS Standards (foreign private issuers) to understand why the relationship may not work and to evaluate whether **any IFRS Taxonomy improvements are required**.

Use of IFRS Taxonomy elements

- X indicates that the IFRS Taxonomy element is used. Matching (not matching) means that the value of 'Gross Profit' equals (does not equal) 'Revenue' minus 'Cost of Sales'

Pattern	A	B	C	D	E	F	G	H	Total
Revenue	X	X	X	-	-	-	X	-	
Cost of sales	X	X	-	X	X	-	-	-	
Gross profit	X	-	X	X	-	X	-	-	
Matching	181	-	-	-	-	-	-	-	181
Not matching	17	42	18	17	2	8	119	54	277
Total	198	42	18	17	2	8	119	54	458

Relationship works fine for 181 companies

173 companies out of scope (see slide 15)

Relationship does not work for 104 companies (focus of our analysis)

Companies out of scope

- Companies that use neither 'cost of sales' nor 'gross profit' (patterns G and H on slide 14).
- These are companies that:

Present a statement of profit or loss by nature of expenses



Are still in the research or development phase



Are engaged in banking, insurance and other financing related activities



In the slides that follow, we will:

1. Provide an overview **of the main reasons** why the relationship does not always work (slides 17 to 20)
2. Explore in detail a common reason, ie **the different presentation patterns for cost of sales** (slides 21 to 28) and our staff proposals to address the issues we have observed
3. Review common reporting practice **relating to the attribution of expenses by nature to cost of sales** and our staff proposals to add new IFRS Taxonomy elements (slides 29 to 34)



Main reasons why the
relationship does not work

The main reasons why the gross profit relationship does not always work are:

1. Tagging errors
[Slides 19]

2. Inclusion of another
line item [Slide 20]

3. Use of a more
specific IFRS
Taxonomy element
[Slide 20]

4. Disaggregation into
different businesses
[Slide 20]

5. Different
presentation patterns
for cost of sales



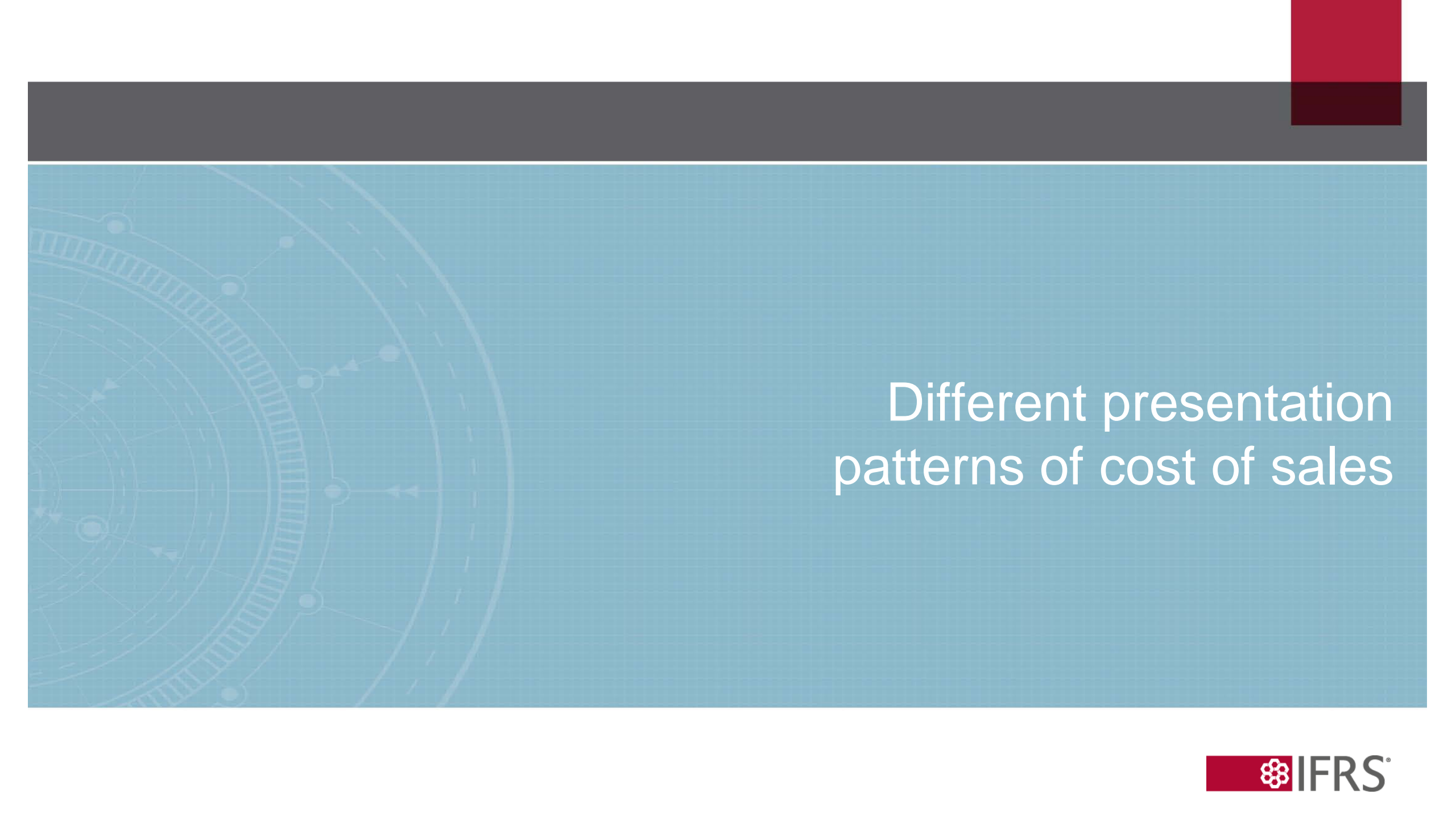
Common

1. Tagging errors

- A few companies (less than 10%) use **the wrong IFRS Taxonomy element to tag line items and subtotals in the statement of profit or loss**
 - For example, use of the IFRS element ‘total operating expenses’ to tag cost of sales.
 - Appendix A provides other illustrations of incorrect tagging
- The staff thinks that these are clear errors that cannot be addressed by **IFRS Taxonomy improvements** (including new guidance)

2. Other reasons why the relationship does not work

Reason	For example:	Number of companies	Any improvements to the IFRS Taxonomy
1. Inclusion of a line item other than 'revenue' and 'cost of sales' within the relationship	Gains (losses) in fair value adjustments, biological assets [IFRS]	A few (less than 10%)	No, <ul style="list-style-type: none">Not common: each reason only applies to a few (less than 10%) of companies. A user would need to review the XBRL calculations to understand how gross profit has been derived.
2. Use of a more specific IFRS Taxonomy element to tag 'revenue'	Revenue from rendering of services [IFRS]	A few (less than 10%)	
3. Disaggregation into different businesses	Cost of sales relating to business A and cost of sales relating to business B [EXT]	A few (less than 10%)	



Different presentation patterns of cost of sales

What is the issue?

- The relationship **works well** when a company **presents a single line item for cost of sales** and **does not combine** an analysis of expenses by nature and function in the statement of profit or loss. This presentation pattern is the most common.

Revenue	1000
Cost of sales	<u>(650)</u>
Gross profit	350
General and administrative expenses	<u>(100)</u>
Operating profit	250

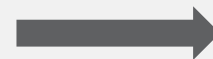
- The relationship **does not work (or may not always work)** when a company presents a cost of sales that excludes a specific expense classified by the company as cost of sales:
 - see slide 23 for an example

Example—cost of sales excluding a specific expense

Presentation pattern	Number of companies	Why may the relationship not work?
<p>Presentation of a statement of profit or loss by function of expenses. Presentation of line items for ‘significant expenses allocated to cost of sales’ and ‘cost of sales excluding a significant expense(s)’. The aggregate value for cost of sales may or may not be reported.</p>	<p>Common (more than 10% for companies engaged in extractive activities)</p>	<ul style="list-style-type: none"> • Use of extensions that are not linked to the IFRS Taxonomy element ‘Cost of sales’ when this line item is not explicitly presented • The IFRS Taxonomy element ‘Cost of sales’ is used to tag the line item ‘cost of sales excluding a significant expense(s)’. This is incorrect.

Example:

Revenue	1000
Cost of sales excluding depreciation	(400)
Depreciation included within cost of sales	<u>(250)</u>
Gross profit	350



Tagged using an extension or the IFRS Taxonomy element ‘Cost of sales’)

Staff analysis—new common reporting practice? (1/1)

- There is variety in practice as to which expense(s) are excluded and presented separately from cost of sales. The staff **did not observe any common reporting practice**. For example:

	Number of companies
Cost of sales excluding depreciation and amortisation	Between 5 to 10%
Cost of sales excluding depreciation and impairment	Between 5 to 10%
Cost of sales excluding depreciation, amortisation and royalty expenses	Less than 5%
.....	

Staff analysis—new common reporting practice? (2/2)

- The staff **considered the addition of a new ‘anchor’ element:**
 - ‘Cost of sales, excluding expenses separately presented’
- However, we **rejected this approach** as:
 - this element would not have a defined accounting meaning;
 - companies can use extensions, and could link these extensions to the IFRS Taxonomy element ‘Cost of sales’; and
 - the use of an anchor element is a new IFRS Taxonomy feature (introduction of such as feature may result into other taxonomy amendments that have to be reviewed, any such review is outside the scope of this project).

Staff analysis—additional guidance?

- The staff holds the view that the labels and references of the IFRS Taxonomy element ‘Cost sales’ already clarify that this element should not be used to tag a line item that represents a ‘Cost of sales excluding a specific expense(s)’ :

Cost of sales	
IFRS Standard reference	Documentation label
IAS 1.103 Disclosure	The amount of costs relating to expenses directly or indirectly attributed to the goods or services sold, which may include, but are not limited to, costs previously included in the measurement of inventory that has now been sold, unallocated production overheads and abnormal amounts of production costs of inventories.
IAS 1.99 Disclosure	

Documentation label is based on paragraphs 10,12 and 38 of IAS2 *Inventories*

- Nevertheless, the staff thinks that the addition of a guidance label may further clarify the intended use of the element. For staff proposals, see next slide.


Cost of sales

New guidance label

- The IFRS Taxonomy element ‘Cost of sales’ should NOT be used for a disclosure that represents a ‘Cost of sales, excluding a specific expense(s) classified by the company as cost of sales’. For example, the element should not be used when a company presents a line item ‘Cost of sales, excluding depreciation’ and the depreciation amount reflects an expense which the company considers part of cost of sales.



Do you agree with the staff proposal to add a new guidance label for the IFRS Taxonomy element 'Cost of sales'? (see slide 27). If not, what would you suggest and why?



Attribution of expenses by nature to cost of sales

Attribution of expenses by nature to cost of sales in the notes (1/3)

- The staff also reviewed the disclosures relating to cost of sales in the notes
- Paragraph 104 of IAS 1 *Presentation of Financial Statements* requires an entity that presents its statement of profit or loss by function of expenses to disclose additional information on the nature of expenses, including depreciation and amortisation expenses and employee benefits expense.
- IFRS Standards do not require a company to attribute the expenses by nature to line items depicting expenses by function presented in the statement of profit or loss.
- However, the staff observed that such an attribution is commonly reported (see next slide)

Attribution of expenses by nature to cost of sales in the notes (2/2)

The attribution is disclosed in two ways:

1) a breakdown of a single (or multiple) functional line item(s) into expenses by nature



For example:

Cost of sales	
Raw materials and goods for resale	x
Employment costs	x
Repairs and maintenance	x
Depreciation, amortisation and impairment	x
Change in inventory	x
Other production expenses	x

2) an attribution of only a single (or a few) expenses by nature to a single (or multiple) functional expenses



Depreciation and impairment of Property, plant and equipment is included in:	
Cost of sales	x
Distribution expenses	x
Sales and marketing expenses	x
Administrative expenses	x

Attribution of expenses by nature to cost of sales in the notes (3/3)

The staff observed that companies have used **three main approaches to tag the information:**

	Description	For example:
1	Use of extension line items	<i>Line item:</i> Depreciation and amortisation expenses included within cost of sales [EXT]
2	Use of a line item depicting an expense by nature combined with an extension axis indicating the expense by function (which has been presented in the statement of Profit or Loss)	<i>Line item:</i> Depreciation and amortisation expense [IFRS] <i>Axis:</i> Profit or Loss location [EXT] <i>Member:</i> Cost of sales [EXT]
3	Use of a line item depicting an expense by function combined with an extension axis indicating the expense by nature	<i>Line item:</i> Cost of sales [IFRS] <i>Axis:</i> Expenses by nature [EXT] <i>Member:</i> Depreciation and amortisation expense [EXT]

This lack of consistency makes it difficult for a user to consume the data.
For staff proposal, see next slide

Staff proposal—new table for the attribution of expenses by nature to a functional line item

The staff is proposing to **include a new table** in the IFRS Taxonomy **to ensure consistent tagging of the note disclosure**:

Table	Attribution of expenses by nature to line items depicting expenses by function presented in the statement of profit or loss
Axis	Location in the statement of profit or loss
Default member	'Not applicable' (Default member has no meaning)
Members	Members representing P&L line items, for example: 'Cost of sales', 'General and Administrative expenses', ...
Line item	Existing IFRS Taxonomy line items representing expenses by nature, for example: 'Depreciation and amortisation expenses', 'Employment benefits expense', ...

This new axis has also been proposed for the attribution of unusual items (see Agenda Paper 1)



Do you agree with the staff proposal outlined on slide 33? If not, what would you suggest and why?



Based on your experience of using tagged financial statements, do you have any suggestions for new calculation relationships the staff should consider for review? If so, what problems have you noticed that could be addressed through improvements to the IFRS Taxonomy?



Appendix A

Tagging errors

Tagging errors—examples

The IFRS Taxonomy element ...	is used to tag a disclosure depicting ...
Revenue	Revenue and other operating income
Revenue and other operating income	Revenue
Gross profit	Revenue
Gross profit	Profit (loss) from operating activities
Profit (loss) from operating activities	Gross profit
Profit (loss) from operating activities	Revenue and other operating income
Cost of sales	Total operating expenses
Total operating expenses	Cost of sales
Cost of sales	Purchase of goods and services
Cost of sales	Increase (decrease) in inventories of finished goods and work in progress

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