IFRS® Accounting

Staff paper

Agenda reference 4

Global Preparers Forum

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Project	**Primary Financial Statements**
Topic	Targeted feedback
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Purpose of this session

The purpose of this session is to obtain feedback from GPF members on whether the tentative decisions on the following selected topics will achieve the related objectives and the intended balance of costs and benefits:

1. Classification of income and expenses in the financing category (slides 4-8)
2. Entities with financing as a main business activity (slides 9-13)
3. Aspects of the disclosure requirements for management performance measures (slides 14-22)
4. Disclosure of operating expenses by nature in the notes when an entity presents operating expenses by function in the statement of profit or loss (sides 23-28)

We will also provide an update on unusual income and expenses (slides 29-31)

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**

Classification of income and expenses in the financing category

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What are the new subtotals and categories?

Revenue	Operating
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	Investing
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	Financing
Unwinding of discount on provisions	
Profit before tax	
Income tax	
Profit for the year	

Line items illustrate what is included in each category and do not necessarily denote specified line items.
An entity would present line items that provide an understandable overview of the entity's income and expenses

Exposure Draft proposal for the financing category

Income and expenses on liabilities arising from **financing activities**

Financing activities involve the receipt or use of a resource from a provider of finance with the expectation that:

- the resource will be returned to the provider of finance; and
- the provider of finance will be compensated through a finance charge

Interest income and expenses on other liabilities

Includes items such as unwinding of the discount on provisions and net interest on net defined benefit liabilities

Respondents to the Exposure Draft raised questions to clarify the definition of 'financing activities' such as:
- Who qualifies as a provider of finance and what compensation qualifies as a finance charge?
- Does the resource returned need to be the same as the resource received?

Revised proposal for 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, a 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 IFRS 16, IAS 19 or IAS 37)

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

- The revised approach is intended to make the proposals easier to apply and is not expected to result in a change in the income and expenses classified in the financing category
- However, lease liabilities and amounts payable for goods or services will be captured by 'specified income and expenses from other liabilities'

Questions for GPF members

1. Is the revised proposal for classifying income and expenses within the financing category clearer and easier to apply than the proposal in the Exposure Draft?
2. Are you aware of any issues that may arise from the expected change in outcome from the Exposure Draft for lease liabilities and amounts payable for goods and services received discussed on slide 7?
3. Does the revised proposal for classifying income and expenses in the financing category result in a change from the proposals in the Exposure Draft for the classification of any income and expenses from liabilities other than lease liabilities and amounts payable for goods and services received?

Entities with financing as a main business activity

Entities with financing as a main business activity

For entities that provide financing to customers as a main business activity (eg banks) the Exposure Draft proposed an accounting policy choice to classify in the operating category*, either:

a) income and expenses from financing activities, and from cash and cash equivalents, that relate to the provision of financing to customers; or

b) all income and expenses from financing activities and all income and expenses from cash and cash equivalents

The Exposure Draft also proposed to classify in the operating category income and expenses from cash and cash equivalents if an entity, in the course of its main business activities, invests in financial assets that generate a return individually and largely independently of other resources held by the entity

*In the redeliberations, the IASB has tentatively decided that an entity classify income and expenses from cash and cash equivalents in the investing category, rather than the financing category.

Withdrawing accounting policy choice

The IASB tentatively decided to explore withdrawing the accounting policy choice for classifying income and expenses from cash and cash equivalents proposed for entities that provide financing to customers as a main business activity

It expects that many entities that provide financing to customers as a main business activity will also invest in financial assets as a main business activity

For such entities, the requirement to classify in the operating category all income and expenses from cash and cash equivalents would be triggered by their investments in financial assets and no requirement in relation to providing financing to customers as a main business activity would be needed

If the IASB decides to withdraw the accounting policy choice, entities that provide financing to customers as a main business activity that do not also invest in financial assets as a main business activity would classify income and expenses from cash and cash equivalents in the investing category

*In the redeliberations, the IASB has tentatively decided to confirm the proposed accounting policy choice for classifying income and expenses from liabilities that arise from transactions that involve only the raising of finance. An entity that provides financing to customers as a main business activity would either classify all of these income and expenses or the portion related to providing financing to customers as a main business activity in the operating category.

Entities that may be impacted

There may be entities that provide financing to customers as a main business activity for which income and expenses from cash and cash equivalents are part of net interest income

However, without retaining the accounting policy choice these entities would be required to classify income and expenses from cash and cash equivalents in the investing category

These could be entities like a bank that:

a) provides financing to customers as a main business activity;

b) does not invest in financial assets, such as bonds and shares, as a main business activity; and

c) is required to hold large amounts of cash for regulatory and operational purposes

Question for GPF members

1. Are you aware of any entities that provide financing to customers as a main business activity that do not also invest in financial assets as a main business activity that would be impacted by the possible change to the Exposure Draft explained in slide 11?

Aspects of the disclosure requirements for management performance measures (MPMs)

What are MPMs?

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

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*

Exposure Draft definition of MPMs

Disclosure in the notes of subtotals of income and expenses that:

Are used in public communications outside financial statements	Complement totals or subtotals specified by IFRS Accounting Standards	Communicate management's view of an aspect of an entity's financial performance

Accompanied by disclosures in a singe note to enhance transparency

- Some respondents said that the requirement that an MPM communicate management's view of an aspect of an entity's financial performance may be too subjective to capture all intended measures
- Other respondents were concerned that not all measures used in public communications outside financial statements reflect management's view

Revised definition of MPMs

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)

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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

The rebuttable presumption is intended to:

- reduce the subjectivity involved in identifying the subtotals that represent management's view; and
- avoid requiring entities to include as management performance measures, subtotals of income and expenses that do not represent management's view of an aspect of the entity's performance

Questions for GPF members

1. Do you think that establishing the rebuttable presumption that a subtotal of income and expense included in public communications outside financial statements represents management's view of an aspect of the entity's financial performance will achieve the objectives described in slide 18? Why or why not?
2. If not, what alternative approach would you suggest and why?

What might a reconciliation look like?

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

Simplified approach to calculating the tax effect

Simplified approach to tax on reconciling items

In response to feedback that calculating tax on reconciling items may be complex the IASB tentatively decided to revise the requirement specifying how to calculate the income tax effect. The revised requirement allows an entity to either:

a) calculate the tax effects of the underlying transaction(s) at the statutory tax rate(s) applicable to the transaction(s) in the relevant jurisdiction(s); or

b) calculate the tax effects as described in a) and allocate any other tax effects related to the underlying transaction(s) based on a reasonable pro rata allocation of the current and deferred tax of the entity in the jurisdictions concerned, or other method that achieves a more appropriate allocation

The revised requirement is intended to reduce the complexity of the proposal in the Exposure Draft by specifying a simplified calculation of the tax effects of reconciling items that an entity can choose when a full calculation would be too complex—the calculation in a)

As a simplified calculation, the information provided may be less than would be provided by a full calculation but is intended to respond to user feedback that high-level information on these tax effects would meet their needs. For example, the effect when the transaction(s) occur in a jurisdiction with a tax rate materially different to the effective tax rate for the consolidated entity

Question for GPF members

1. Does the IASB's tentative decision to revise the method used to calculate the tax effect in slide 21 provide a better balance of costs and benefits than the proposal in the Exposure Draft?

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Disclosure of operating expenses by nature

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	Disclosure of amounts included in each line item of statement of profit or loss for depreciation, amortisation and employee benefits ★	Present operating expenses by nature and by function (mixed presentation permitted)

★ Aspects of proposal to be redeliberated in a future IASB meeting

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

★ Aspects of proposal to be redeliberated in a future IASB meeting

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*

Comparison of Exposure Draft and revised proposal

Statement of profit or loss	202X[1]
Revenue	3000
Cost of goods sold	(600)
Gross profit	**2400**
Other income	500
Selling expenses	(400)
Research and development expenses	(300)
General and administrative expenses	(200)
Impairment losses on trade receivables	(100)
Operating profit (loss)	**1900**

[1] Comparative reporting period not depicted in example for simplification purposes

Exposure Draft proposal	202X[1]
Changes in inventories of finished goods and work in progress	200
Raw material used	(400)
Reversal of inventory write-downs	50
Depreciation	(500)
Employee benefits	(400)
Amortisation	(100)
Impairment of property, plant and equipment	(100)
Impairment losses on trade receivables	(100)
Property taxes	(25)
Litigation expenses	(100)
Gains (losses) on derivatives	(25)
Other miscellaneous expenses	(100)
Operating expenses total	**(1600)**

Revised proposal (illustrating depreciation and employee benefits)[2]	202X[1]
Depreciation	**(500)**
Cost of goods sold	*(250)*
Selling expenses	*(150)*
Research and development expenses	*(50)*
General and administrative expenses	*(50)*
Employee benefits	**(400)**
Cost of goods sold	*(200)*
Selling expenses	*(100)*
Research and development expenses	*(50)*
General and administrative expenses	*(50)*

[2] Amortisation not illustrated. Additional specified nature expenses may be required in the final proposal

Questions for GPF members

1. Does disclosing the amounts of depreciation, amortisation and employee benefits included in each line item in the statement of profit or loss provide a better balance of costs and benefits than the proposal in the Exposure Draft (see slide 27)?
2. Do you think the list of line items included in question 1 should also include impairments and write-downs of inventories? Why or why not?
3. Do you think requiring an entity to disclose, for all other operating expenses disclosed in the notes, the amounts included in each line item in the statement of profit or loss would provide a similar balance between costs and benefits as the revised proposal described in question 1? Why or why not?
4. Do you think an undue cost or effort relief to the proposed requirement in question 3 is required to achieve the right balance between improving disclosures provided by entities and ensuring that entities do not incur excessive costs to provide information? Why or why not?

Unusual income and expenses

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

Question for GPF members

1. Do you have any comments on the IASB tentative decision to withdraw the proposals for unusual income and expenses?

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