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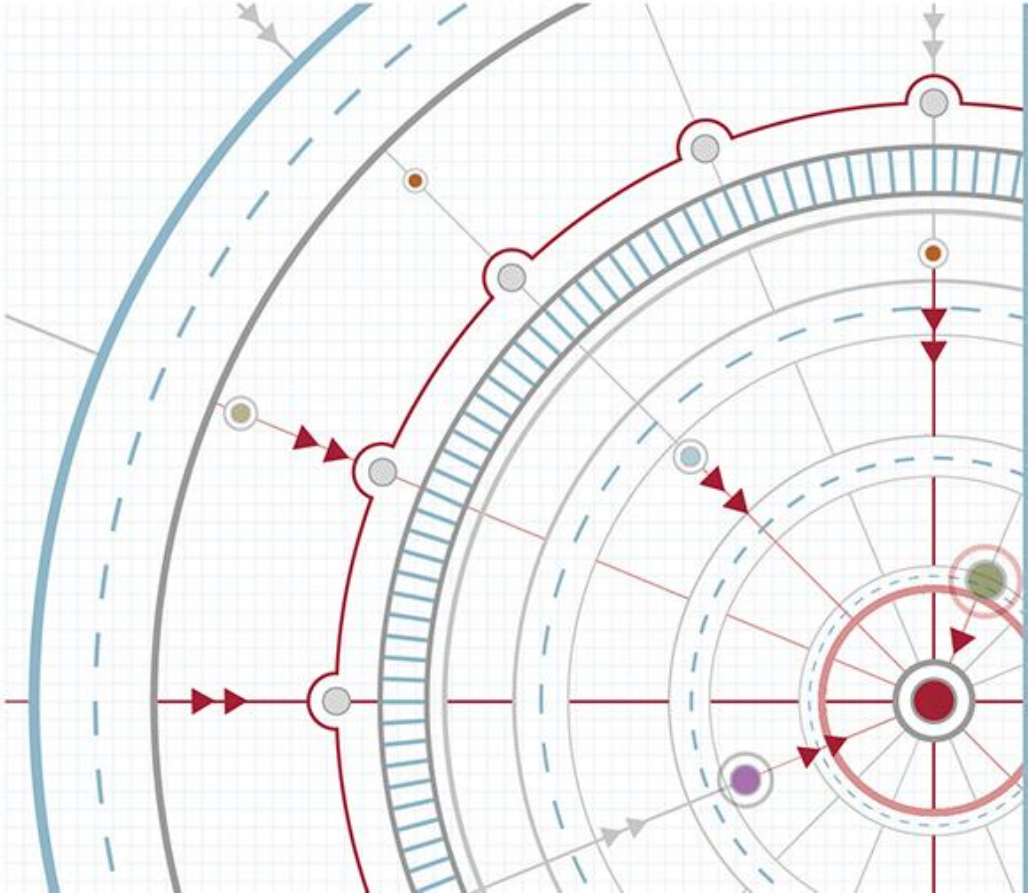

Primary Financial Statements Project

Exposure Draft
General Presentation and Disclosures

EFRAG TEG and User Panel
March 2020

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Objective of this session

Help you prepare response to the consultation by:

- providing an overview of the consultation
- providing an opportunity for Q&A

Contents

Primary Financial Statements project

objective

To improve how information is communicated in the financial statements, with a focus on information included in the statement of profit or loss

2015	2016-2019	Q4 2019	H1 2020	H2 2020
Agenda Consultation identified the project as a priority	Board discussions to develop Exposure Draft	Exposure Draft published for public comment	Comment period (ends 30 June)	Board starts redeliberations

Project responds to investor needs

What investors say	Board's main proposals
Subtotals in the statement of profit or loss need to be comparable between different companies.	❶ Require companies to present additional **defined subtotals** in the statement of profit or loss.
Companies should provide more granular information and information grouped in a way that provides better inputs for our analysis.	❷ Strengthen requirements for **disaggregating information**
Performance measures defined by management can provide useful information, but should be used in a more transparent and disciplined way.	❸ Require companies to disclose information about **management performance measures** in the notes.

The Exposure Draft

New IFRS Standard	Proposed **new** presentation and disclosure requirements **+**	Related requirements brought forward from **IAS 1** with limited wording changes
Amendments to other Standards	• IAS 7—statement of cash flows • IFRS 12—associates and JVs • IAS 33—earnings per share • IAS 34—interim reporting	Other requirements of **IAS 1**—moved to IAS 8 and IFRS 7

Withdraw IAS 1

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Proposals in the Exposure Draft *General Presentation and Disclosures*

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➊ Subtotals in the statement of profit or loss

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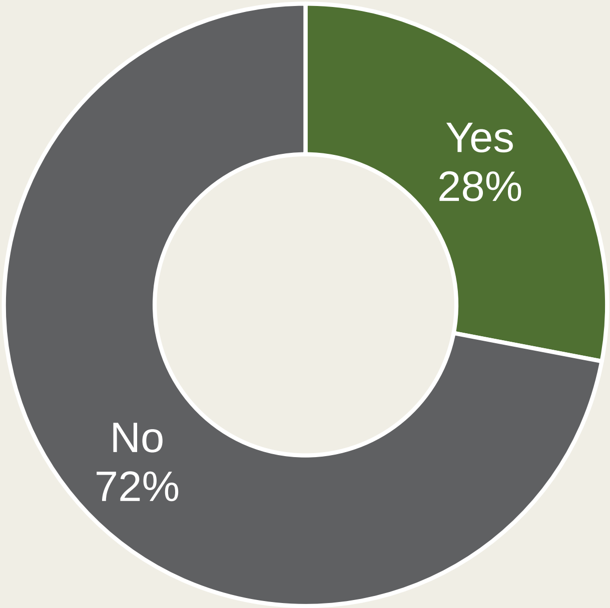
❶ What is the issue?

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

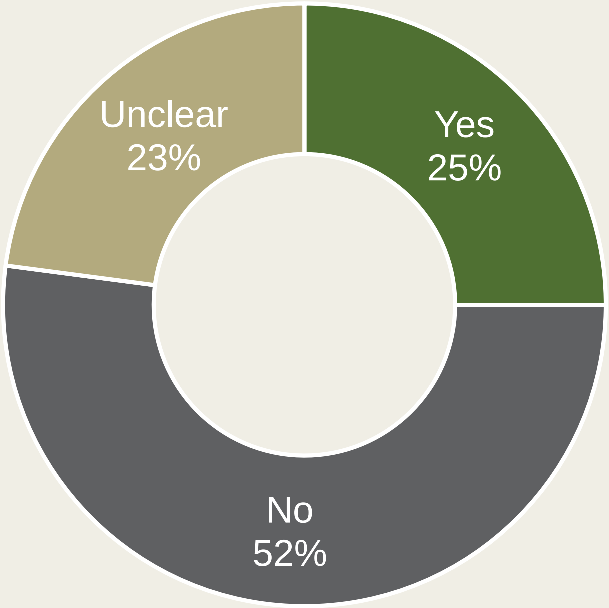
Companies calculate subtotals in different ways

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?



❶ Board proposals—subtotals and categories

Revenue	347,000
Other income	3,800
Changes in inventories of finished goods and work in progress	3,000
Raw materials used	(146,000)
Employee benefits	(107,000)
Depreciation	(37,000)
Amortisation	(12,500)
Professional fees and other expenses	(10,030)
Operating profit	**41,270**
Share of profit or loss of integral associates and joint ventures	(600)
Operating profit and income and expenses from integral associates and joint ventures	**40,670**
Share of profit or loss of non-integral associates and joint ventures	3,380
Dividend income	3,550
Profit before financing and income tax	**47,600**
Expenses from financing activities	(3,800)
Unwinding of discount on pension liabilities and provisions	(3,000)
Profit before tax	**40,800**
Income tax	(7,200)
Profit for the year	**33,600**

Operating

Integral associates and joint ventures

Investing

Financing

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❶ Application to financial entities

Operating profit is intended to include income and expenses from companies' main business activities.

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

➊ Example—investment and retail bank

Interest revenue calculated using the effective interest method	356,000
Interest expense	(281,000)
Net interest income	75,000
Fee and commission income	76,800
Fee and commission expenses	(45,300)
Net fee and commission income	31,500
Net trading income	9,100
Net investment income	11,600
Credit impairment losses	(17,300)
Employee benefits	(55,100)
[other line items not shown in this illustration]	(11,800)
Operating profit	43,000
Share of profit or loss of integral associates and joint ventures	(2,400)
Operating profit and income and expenses from integral associates and joint ventures	40,600
Share of profit or loss of non-integral associates and joint ventures	4,200
Profit before tax	44,800
Income tax expense	(11,200)
Profit for the year	33,600

all expenses from financing activities are classified in the operating category rather than the financing category

income (expenses) from investments made in the course of main business activities are classified in the operating category, rather than the investing category

no ‘profit before financing and income tax’ subtotal

❷ Disaggregation

② Analysis of operating expenses

Statement of profit or loss	Notes
Use method for analysis of operating expenses (by nature or by function) that provides the **most useful information**	Disclose analysis by **nature** in the notes if analysis by function is presented in the statement of profit or loss

Statement of profit or loss

- **Not a free choice**—the Board proposes to provide a set of indicators to help companies select a method.
- Companies should **not mix** the two methods.
- Would **remove option** to present analysis of expenses in the **notes only.**

Notes

- Analysis of **total** operating expenses—no requirement to analyse each functional line item by nature.

② Unusual income and expenses

Definition

Income and expenses with **limited predictive value**.
Income and expenses have limited predictive value when it is reasonable to expect that income or expenses that are similar in type and amount will not arise for several future annual reporting periods.

Income and expenses from the recurring remeasurement of items measured at a current value would not normally be classified as unusual.

Disclosures

Amount & narrative description	Amount disaggregated by: • line items presented in statement of profit or loss; and • line items disclosed in analysis of operating expenses by nature, if the entity analyses expenses by function in the statement of profit or loss

❷ Disaggregation—other proposals

Roles of the primary financial statements and the notes

- **Role of the primary financial statements** is to provide a structured and comparable summary of a reporting entity's recognised assets, liabilities, equity, income, expenses and cash flows.
- **Role of the notes** is to:
  - provide further information necessary for users of financial statements to understand the items included in the primary financial statements; and
  - supplement the primary financial statements with other information that is necessary to meet the objective of financial statements.

Required line items

New required line items would include:

- Goodwill (statement of financial position)
- Separate line items for integral and non-integral associates and joint ventures (statement of profit or loss, cash flows and financial position)
- Income or expenses from financing activities

❷ Disaggregation—other proposals

Principles for aggregation & disaggregation

1. Identify assets, liabilities, equity, income and expenses that arise from individual transactions or other events
2. Classify items into groups based on shared characteristics, resulting in line items in the primary financial statements that share at least one characteristic
3. Separate those line items based on further characteristics, resulting in the separate disclosure of material items in the notes

Grouping dissimilar immaterial items

- Companies should use **meaningful labels** for groups of immaterial items, avoiding line items such as ‘other expenses’.
- If that is not possible, companies would be required to provide information in the **notes** about the **content** of such groups of items.

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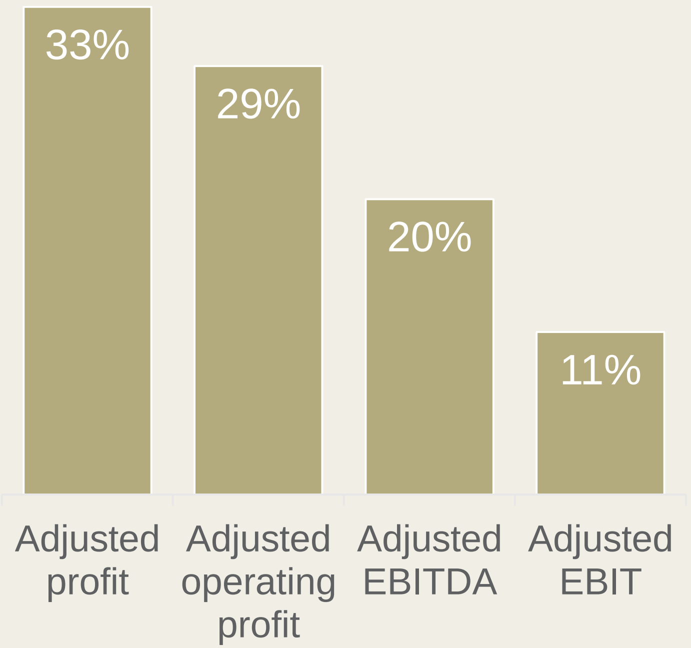
❸ Management performance measures

❸ What is the issue?

Many companies provide performance measures defined by management in communications with investors.

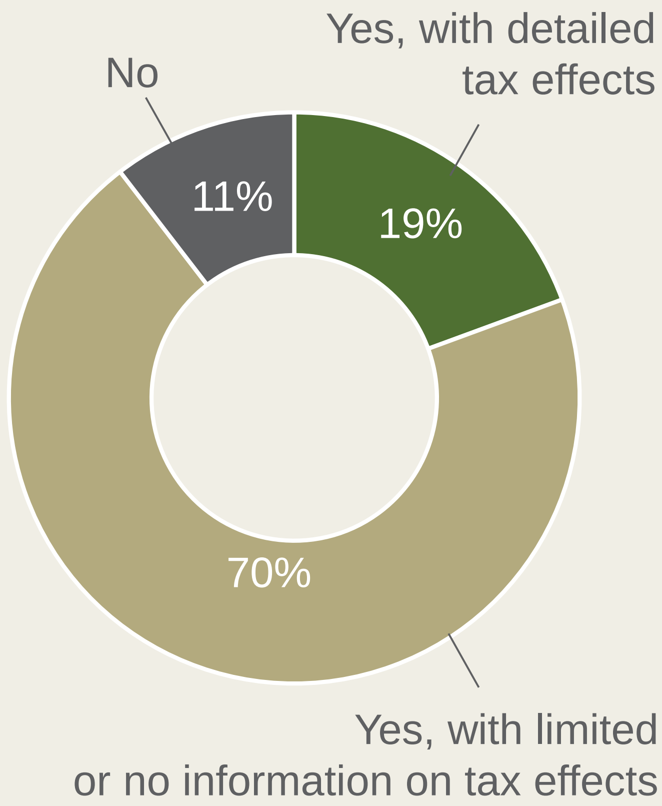
Investors have said such measures can provide useful information, but should be used in a more transparent and disciplined way.

Common management-defined performance measures



% of companies using measure in annual report

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



❸ Management performance measures (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 Standards	Communicate management's view of an aspect of an entity's financial performance

Accompanied by disclosures in a **single note** to **enhance transparency**

❸ MPMs—proposed disclosures in the notes

A **reconciliation** between the MPM and the most directly comparable subtotal or total specified by IFRS Standards

A description of why the MPM communicates management’s view of performance, including an explanation of:
- **how** the MPM is **calculated**
- **how** the measure provides **useful information** about the entity’s financial performance

A statement that the 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

The **income tax** effect and effect on **non-controlling interests** separately for each item disclosed in the reconciliation, and how the entity determined the income tax effect

An explanation of any **changes** in how the entity calculates its MPMs or which MPMs it provides

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❸ Not all performance measures 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:
- Profit or loss
- Operating profit
- Operating profit before depreciation and amortisation

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

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Other proposals

Statement of cash flows

Proposals

Single starting point for the indirect reconciliation: **Operating profit**

Removal of classification options for interest and dividends

Cash flow item	IAS 7 classification	Proposed approach	
		Most entities	Entities with particular business activities incl. banks
Interest paid	Operating or financing	Financing	Depends on the classification of the related income and expenses in the statement of profit or loss (mostly operating)
Interest received	Operating or investing	Investing	
Dividends received	Operating or investing	Investing	
Dividends paid	Operating or financing	Financing	Financing

EBITDA

The Board is proposing not to define EBITDA

This is because the Board could not identify a single underpinning concept—there is no consensus among users about what EBITDA represents, other than it being a useful starting point for various analyses. Its calculation is diverse in practice.

The Board is proposing to define 'operating profit before depreciation and amortisation' as a measure that entities can provide in the financial statements without having to provide the MPM disclosures.

The Board decided not to label this measure 'EBITDA' because its content does not match what the acronym 'EBITDA' stands for.

Recap—proposals in the ED & expected benefits

Key proposals	User feedback	Expected benefits of proposals
❶ Introduce defined **subtotals and categories** in the statement of profit or loss	Structure and content of statements of profit or loss varies between different entities, making it difficult to compare entities' performance	Additional relevant information and a P&L structure that is more comparable between entities
❷ Introduce requirements to improve **aggregation** and **disaggregation**	Level of disaggregation does not always provide the information they need	Additional relevant information and material information not being obscured
❸ Introduce **Management Performance Measures (MPMs)** and accompanying disclosures in financial statements	Non-GAAP measures can provide useful information, but transparency and discipline need to be improved	Transparency & discipline in use of such measures Disclosures in a single location
❹ Introduce targeted improvements to the **statement of cash flows**	Classification and presentation options make it more difficult to compare entities	Improved comparability between entities

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Questions in the Exposure Draft

Subtotals

Operating category and operating profit

- Do you agree with the Board's proposal to require all entities to present an operating profit or loss subtotal in the statement of profit or loss?
- Do you agree with the way the Board has defined the operating category?
- If not, what alternative approach would you suggest and why?

Investing and financing categories and profit before financing and income taxes

- Do you agree with how the Board has defined the investing category?
- Do you agree with how the Board has defined the financing category?
- Do you agree with the proposal to require (most) entities to present a 'profit before financing and income tax' subtotal?
- If not, what alternative approach would you suggest and why?

Subtotals (continued)

- Do you agree with the Board’s proposed distinction between integral and non-integral associates and joint ventures?
- Do you think the proposed set of indicators would provide sufficient guidance for entities to identify integral ands non-integral associates and joint ventures?
- Do you agree with the proposed presentation of income and expenses from integral and non-integral associates and joint ventures in the statement of profit or loss?
- If not, do you prefer any of the alternative approaches on the previous slide?

- Do you agree with the Board’s proposed approach to operating profit for financial entities?
- If not, what alternative approach would you suggest and why?

Disaggregation

- Do you agree with the Board's proposed approach to the analysis of operating expenses?
- If not, what alternative approach would you suggest and why?

- Do you agree with the Board's proposed principles and general requirements on aggregation and disaggregation?
- If not, what alternative approach would you suggest and why?

- Do you agree with the Board's proposed approach to defining and requiring the disclosure of unusual income and expenses?
- If not, what alternative approach would you suggest and why?

MPMs

- Do you agree with the Board's proposed approach to defining and requiring the disclosure of management performance measures?
- Do you agree with the Board's proposed approach for adjusted EPS?
- If not, what alternative approach would you suggest and why?

Other proposals

- Do you agree with the Board's proposal to require operating profit or loss as the starting point for the reconciliation of operating cash flows under the indirect method?
- Do you agree with the Board's proposed approach for classification of interest and dividend cash flows?
- If not, what alternative approach would you suggest and why?

- Do you agree with the Board's proposed approach not to define EBITDA?
- If not, what alternative approach would you suggest and why?

- Do you agree with the Board's proposed approach to relabelling the categories in other comprehensive income?
- Do you think the Board's proposed selection of illustrative examples to illustrate the project proposals is appropriate?

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