

STAFF PAPER

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IASB® Meeting

| Project | Primary Financial Statements | | |
|-------------|---|--|---------------------|
| Paper topic | Ten possible approaches presented during outreach | | |
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Purpose of paper

1. As discussed in Agenda Paper 21D *Summary of outreach on scope of project*, the Board Advisors and staff considered the 2015 Agenda Consultation feedback and other input from stakeholders to develop a list of 10 possible approaches to improving the structure and content of the primary financial statements.
2. The presentation of these suggested approaches to stakeholders provided structure for some of our discussions about the scope of the project. The suggested approaches were not presented as solutions researched in detail.
3. This paper reproduces the materials that were used to describe the 10 possible approaches during the outreach activities. These materials are provided for information purposes only.

Ten possible approaches

1. Require 'EBIT' subtotal

| Concerns raised | Possible solutions | Example |
|---|---|--|
| <ul style="list-style-type: none"> Users need comparable subtotals as a starting point for their analysis Many companies present EBIT-type subtotal but it varies and is not comparable | <ul style="list-style-type: none"> Require presentation of comparable EBIT-type subtotal | <p>Revenue All income and expenses excluding finance income/expense and tax</p> <p>EBIT</p> <p style="padding-left: 20px;">Finance income Finance expense</p> <p>Pre-tax profit Taxation</p> <p>Profit</p> |
| <ul style="list-style-type: none"> Presentation of financing income and expense varies, even among peers (eg interest cost of pension) | <ul style="list-style-type: none"> Provide principles-based definition of 'financing' activities Prescribe treatment for some items (eg interest cost of pension) | <p style="text-align: center;">OCI items</p> <p style="text-align: center;">Comprehensive income</p> |

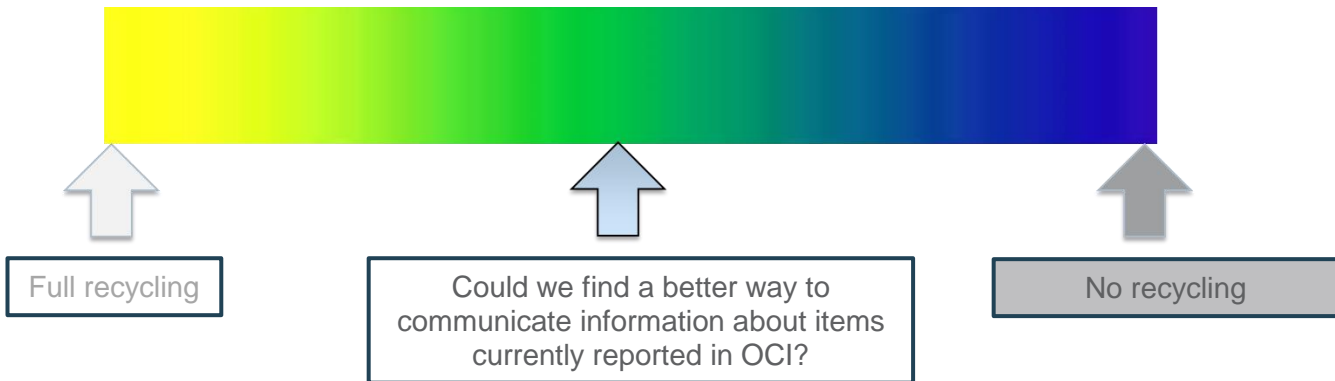
2. Require 'operating profit' subtotal

| Concerns raised | Possible solutions | Example |
|--|---|---|
| <ul style="list-style-type: none"> Many companies present operating profit subtotal but it is not comparable | <ul style="list-style-type: none"> Require presentation of operating profit subtotal | <p>Revenue All income and expenses excluding non-operating income/expense, finance income/expense and tax</p> <p>Operating profit</p> <p style="padding-left: 20px;">Non-operating income and expense</p> <p>EBIT Finance income Finance expense</p> <p>Pre-tax profit Taxation</p> <p>Profit</p> |
| <ul style="list-style-type: none"> Distinction between operating and non-operating income/expense varies, even among peers (eg result of associate) | <ul style="list-style-type: none"> Provide principles-based definition of operating income and expense Prescribe treatment for some items (eg result of associates) | <p style="text-align: center;">OCI items</p> <p style="text-align: center;">Comprehensive income</p> |

3. Require ‘recurring operating profit’ subtotal

| Concerns raised | Possible solutions | <i>Example</i> |
|--|--|---|
| <ul style="list-style-type: none"> Users need information about persistency of income and expenses to develop forecast | <ul style="list-style-type: none"> Require presentation of recurring operating profit subtotal | <div style="border: 1px solid #2c5e8c; padding: 5px; margin-bottom: 5px;"> <p style="text-align: center;"><i>Example</i></p> </div> <div style="border: 1px solid #2c5e8c; padding: 5px;"> <p>Revenue <b style="background-color: yellow;">Recurring operating profit <b style="background-color: yellow;">Non-recurring operating income and expense</p> <p>Operating profit Non-operating income and expense</p> <p>EBIT Finance income Finance expense</p> <p>Pre-tax profit Taxation</p> <p>Profit</p> </div> <div style="border: 1px solid #2c5e8c; padding: 5px; margin-top: 5px;"> <p style="text-align: center;">OCI items Comprehensive income</p> </div> |
| <ul style="list-style-type: none"> Items classified as non-recurring vary and are not transparent Adjustments may not be consistent period to period Some non-recurring items occur regularly | <ul style="list-style-type: none"> Require detailed disaggregation of components Require disclosure of 5 or 10 year historical record of adjustments Require explanation of adjustments | |

4. Introduce new category that reduces the need for OCI



| Concerns raised | Possible solutions | Example |
|--|---|--|
| <ul style="list-style-type: none"> • Users do not understand amounts presented in OCI • Current OCI category includes items with different nature • Some think all items reported in OCI should be recycled; others disagree. | <ul style="list-style-type: none"> • Require all OCI items to be recycled • Or, abolish OCI and report all OCI items in profit or loss • Or, restrict use of OCI to items that will be recycled and introduce new category below profit or loss subtotal for non-recycled OCI items (see examples) | <p style="text-align: center;"><i>Example</i></p> <p>Revenue ...</p> <p>Recurring operating profit Non-recurring operating income and expense</p> <p>Operating profit Non-operating income and expense</p> <p>EBIT Finance income Finance expense</p> <p>Pre-tax profit Taxation</p> <p>Profit for continuing operations Loss from discontinued operation</p> <p>Profit Specified long term revaluations (OCI items not reclassified) Profit after specified long term revaluations</p> <hr/> <p>Income and expense to be recognised in profit in the future* (OCI items that will be reclassified)</p> <p>Comprehensive income</p> |

*Achieves 'full-recycling'

5. Introduce alternative ‘earnings per share’

| Concerns raised | Possible solutions | Example | | | | | | | | |
|---|---|--|--|-----------|----------------------------|---|-------------------|---|---|---|
| <ul style="list-style-type: none"> Alternative earnings per share are widely used for communication with users of financial statements | <ul style="list-style-type: none"> Allow presentation of alternative earnings per share (eg recurring earnings per share) | <table border="1"> <thead> <tr> <th></th> <th style="background-color: #ffff00;">Per share</th> </tr> </thead> <tbody> <tr> <td style="background-color: #ffff00;"><i>Recurring earnings*</i></td> <td style="text-align: center;">X</td> </tr> <tr> <td>Earnings (profit)</td> <td style="text-align: center;">X</td> </tr> <tr> <td style="background-color: #ffff00;"><i>Earnings (profit) after specified long term revaluations</i></td> <td style="text-align: center;">X</td> </tr> </tbody> </table> | | Per share | <i>Recurring earnings*</i> | X | Earnings (profit) | X | <i>Earnings (profit) after specified long term revaluations</i> | X |
| | Per share | | | | | | | | | |
| <i>Recurring earnings*</i> | X | | | | | | | | | |
| Earnings (profit) | X | | | | | | | | | |
| <i>Earnings (profit) after specified long term revaluations</i> | X | | | | | | | | | |
| <ul style="list-style-type: none"> Calculation of these figures are often not transparent | <ul style="list-style-type: none"> Require disclosure of the calculation (including a 5 year historical record of the items excluded) and the reason for presenting it | <p>* <i>‘Recurring earnings’ represent profit before post-tax non-recurring operating income and expense on page 3</i></p> | | | | | | | | |

6. Revise the definition of operating cash flows

| Concerns raised | Possible solutions | Example |
|--|---|---|
| <ul style="list-style-type: none"> Because of the options permitted to present interests and dividends in different cash flow categories, operating cash flows are not comparable | <ul style="list-style-type: none"> Eliminate the options for presenting interest and dividend | <p>Cash flows from operating activities</p> <p style="padding-left: 20px;">Profit before taxation</p> <p style="padding-left: 20px;">Adjustments for:</p> <p style="padding-left: 40px;">Depreciation</p> <p style="padding-left: 40px;">Interest expense</p> <p style="padding-left: 40px;">Increase in trade and other receivables</p> <p style="padding-left: 40px;">...</p> <p style="padding-left: 40px; background-color: #ffff00;">Interest paid</p> <p style="padding-left: 40px; background-color: #ffff00;">Income taxes paid</p> <p>Net cash from operating activities</p> <p>Cash flows from investing activities</p> <p style="padding-left: 40px;">...</p> <p>Cash flows from financing activities</p> <p style="padding-left: 40px; background-color: #ffff00;"><i>Interest paid</i></p> <p style="padding-left: 40px;">...</p> <p style="padding-left: 40px; background-color: #ffff00;"><i>Income taxes paid</i></p> <p>Net increase in cash</p> <p>Cash at beginning of period</p> <p>Cash at end of period</p> |
| <ul style="list-style-type: none"> Operating profit in the statement of financial performance and operating cash flow in the statement of cash flows are disconnected | <ul style="list-style-type: none"> Require consistency between how an entity defines operating profit in the statement of financial performance and operating cash flow in the statement of cash flows | |

7. Align presentation among different primary financial statements

| Concerns raised | Possible solutions |
|--|--|
| <ul style="list-style-type: none"> It is difficult to separate the profitability of business itself (Return on Net Operating Assets (RNOA)) from the effect of financing activity | <ul style="list-style-type: none"> Require better alignment across different primary financial statements |

| <i>Example</i> | | |
|--|--|--|
| Statement of financial performance | Statement of financial position | Statement of cash flows |
| <ul style="list-style-type: none"> Operating income and expenses Non-operating income and expenses | <ul style="list-style-type: none"> Operating assets and liabilities Non-operating assets and liabilities | <ul style="list-style-type: none"> Operating cash flows Investing cash flows |
| <ul style="list-style-type: none"> Finance income and expense | <ul style="list-style-type: none"> Finance assets and liabilities | <ul style="list-style-type: none"> Financing cash flows |
| Income taxes | Income taxes | Income taxes |
| Profit | Equity | |
| <ul style="list-style-type: none"> Specified long term revaluation Income and expense to be recognised in profit in the future | | |
| Comprehensive income | | |

8. Provide illustrative examples for the primary financial statements

| Concerns raised | Possible solutions | Example (non-financial) |
|---|--|--|
| <ul style="list-style-type: none"> Financial statements are not comparable even among peer companies | <ul style="list-style-type: none"> Provide illustrative examples of structure and format for different industries (eg, non-financial, bank, insurance and property) | <p>Revenue <i>Cost of goods sold</i></p> <p>Gross profit <i>Selling costs</i> <i>General and administrative costs</i> <i>R&D costs</i></p> <p>Recurring operating profit <i>Non recurring operating income and expense</i></p> <p>Operating profit <i>Non operating income and expense</i></p> <p>EBIT <i>Finance income</i> <i>Finance expense</i></p> <p>Pre tax profit <i>Taxation</i></p> <p>Profit <i>Specified long term revaluations</i></p> <p>Profit after specified long term revaluations</p> |
| <ul style="list-style-type: none"> In many jurisdictions, entities create entity-specific taxonomy items which hinder comparability and reduces usefulness of the taxonomy | <ul style="list-style-type: none"> Define core elements of financial statements and core taxonomy | <p><i>Income and expense to be recognised in profit or loss in the future</i></p> <p>Comprehensive income</p> |

Example (bank)

Interest income
Interest expense

Net interest income

Fee and commission income
Fee and commission expense

Net fee and commission income

Net income from instruments held for trading
Net income from other instruments at FVTPL
Operating expenses

Recurring operating profit

Non-recurring operating income and expense

Operating profit

Non-operating income and expense (including results of associates)

(EBIT)*

(Finance income)
(Finance expense)

** For banks, most interest income and expense are operating and hence above EBIT. However interest paid on liabilities classified as capital for regulatory purposes (ie Tier 2 liabilities) could be regarded as financing and hence EBIT would be before these items.*

Pre-tax profit

Taxation

Profit

Specified long term revaluations

Profit after specified long term revaluations

OCI items that will be reclassified
Comprehensive income

Example (property)

Rental income
Service charge income
Service charge expense

Net rental income

Sales of inventory property
Cost of sales of inventory property

Profit on sale of inventory property

Profit on disposal of investment property
Valuation gain from investment property

Net gains on investment property

Administrative expense

Recurring operating profit

Non-recurring operating income and expense

Operating profit

Non-operating income and expense (eg results of associates)

EBIT

Finance income
Finance expense

Pre-tax profit

Taxation

Profit

Specified long term revaluations

Profit after specified long term revaluations

OCI items that will be reclassified
Comprehensive income

9. Extend segment reporting and align with revised performance statement

| Concerns raised | Possible solutions | <i>Example</i> | | | |
|---|---|--|-----------|-------|--|
| | | Segment A | Segment B | Total | |
| <ul style="list-style-type: none"> Companies need to present only those items that management regularly review Disaggregation of line-items in segment reporting is not sufficient to analyse performance | <ul style="list-style-type: none"> Align segment reporting with a revised statement of financial performance | Revenue | | | |
| | | Cost of goods sold | | | |
| | | Gross profit | | | |
| | | SG&A | | | |
| | | Recurring operating profit | | | |
| | | Non-recurring operating income and expense | | | |
| | | Operating profit | | | |
| | | EBIT | | | |
| | | Finance income | | | |
| | | Finance expense | | | |
| Pre-tax profit | | | | | |
| Taxation | | | | | |
| Profit | | | | | |

10. Eliminate 'discontinued operations' and present it in segment reporting

| Concerns raised | Possible solutions | <i>Example</i> | | | |
|--|---|--|---|------------------------|-------|
| | | A | B | Discontinued operation | Total |
| <ul style="list-style-type: none"> Net presentation of discontinued operations is not sufficient to assess management's stewardship | <ul style="list-style-type: none"> Eliminate discontinued operations Income, expense items and any impairments would be reported in gross basis Require separate presentation in segment reporting | Revenue | | | |
| | | Cost of goods sold | | | |
| | | Gross profit | | | |
| | | SG&A | | | |
| | | Recurring operating profit | | | |
| | | Non-recurring operating income and expense | | | |
| | | Operating profit | | | |
| | | EBIT | | | |
| | | Finance income | | | |
| | | Finance expense | | | |
| Pre-tax profit | | | | | |
| Taxation | | | | | |
| Profit | | | | | |

Illustrative example—before and after proposed changes

| <i>Before</i> | <i>After</i> | | | | | | | | |
|--|---|--|-----------|--------------------|---|-------------------|---|--|---|
| <p>Revenue All income and expense items excluding tax</p> <p>Pre-tax profit Taxation</p> <p>Profit for continuing operations Loss from discontinued operations</p> <p>Profit</p> | <p>Revenue Cost of goods sold</p> <p>Gross profit Selling costs General and administrative costs R&D costs</p> <p>Recurring operating profit Non-recurring operating income and expense</p> <p>Operating profit Non-operating income and expense</p> <p>EBIT Finance income Finance expense</p> <p>Pre-tax profit Taxation</p> <p>Profit Specified long term revaluations</p> <p>Profit after specified long term revaluations</p> | | | | | | | | |
| <p>OCI items not reclassified OCI items that will be reclassified</p> <p>Comprehensive income Basic EPS Diluted EPS</p> | <p style="text-align: center;">Income and expense to be recognised in profit or loss in the future*</p> <p>Comprehensive income</p> | | | | | | | | |
| | <table style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th style="width: 80%;"></th> <th style="width: 20%; text-align: center;">Per share</th> </tr> </thead> <tbody> <tr> <td>Recurring earnings</td> <td style="text-align: center;">X</td> </tr> <tr> <td style="border-top: 1px dashed black;">Earnings (profit)</td> <td style="text-align: center; border-top: 1px dashed black;">X</td> </tr> <tr> <td style="border-top: 1px dashed black;">Earnings (profit) after specified long term revaluations</td> <td style="text-align: center; border-top: 1px dashed black;">X</td> </tr> </tbody> </table> | | Per share | Recurring earnings | X | Earnings (profit) | X | Earnings (profit) after specified long term revaluations | X |
| | Per share | | | | | | | | |
| Recurring earnings | X | | | | | | | | |
| Earnings (profit) | X | | | | | | | | |
| Earnings (profit) after specified long term revaluations | X | | | | | | | | |

* Achieves 'full-recycling'

Questions

Question 1

Do you think we should explore:

1. Requiring 'EBIT' subtotal
2. Requiring 'operating profit' subtotal
3. Requiring 'recurring operating profit' subtotal
4. Introducing new category that reduces the need for OCI
5. Introducing alternative 'earnings per share'
6. Revising the definition of operating cash flows
7. Aligning presentation among different primary financial statements
8. Providing illustrative examples for the primary financial statements
9. Extending segment reporting and align with revised performance statement
10. Eliminating 'discontinued operations' and present it in segment reporting

Question 2

Are there any other changes to the structure and content of the primary financial statements that we should explore as part of this project?

- statement of financial performance
- statement of cash flows
- statement of financial position