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IFRS Alert

IASB proposes major changes to the primary statements and notes

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Executive summary

In December 2019 the International Accounting Standards Board (IASB) published an Exposure Draft 'General Presentation and Disclosures' (General Presentation ED). The General Presentation ED proposes to replace IAS 1 'Presentation of Financial Statements' with a new IFRS and amend several other IFRS Standards. The impact of the proposals would include:

- Changes to the structure of the Statement of Profit and Loss
- More minimum subtotals, including a subtotal for Operating Profit
- New requirements on disaggregating information in the financial statements
- New disclosures about unusual items, management performance measures and the analysis of expenses
- Limited changes to the Statement of Cash Flows and Statement of Financial Position

The ED is open for comment until 30 June 2020.

Background

The General Presentation ED is an important milestone in the IASB's 'Better Communication' initiative. The IASB undertook this project in response to concerns from investors about the current comparability and transparency of companies' performance reporting.

The proposals

The proposals aim to address the identified concerns by introducing new requirements in three main areas:

- The structure of the statement of profit or loss
- Disaggregation of information in the financial statements
- Disclosures concerning financial performance.

While the main focus is on reporting financial performance, the General Presentation ED also proposes limited changes to the Statement of Cash Flows and Statement of Financial Position.

The proposals would replace IAS 1 and amend some other IFRS Standards. While the proposals are extensive, many aspects of IAS 1 would be retained. For example, IAS 1's requirements on the components of a complete set of financial statements and the option to present single statement of comprehensive income or separate sections for profit or loss and other comprehensive income would be carried forward unchanged. The structure below the profit before tax subtotal, including the presentation of results of discontinued operations, would also be unaffected.

The main changes proposed are summarised below.

Statement of profit or loss

The main proposals affecting the Statement of Profit or Loss are:

Area	Summary
Basic structure	The Statement of Profit or Loss, above the existing profit before tax subtotal, would be organised into four sections: • Operating • Integral associates and joint ventures (see below) • Investing • Financing The types of income and expense included in each section are prescribed, with adaptations for particular entities (see below).
New subtotals	The following new, minimum subtotals would be required: • Operating profit • Operating profit and income and expenses from integral associates and joint ventures • Profit before financing and income tax
Operating profit or loss	Income and expenses would be included in arriving at operating profit or loss unless they are specifically classified in another category (i.e. operating, investing, financing, integral associates and joint ventures, income tax or discontinued operations). In other words, operating profit or loss is the 'default category'. As a result, it would not be permissible to present an operating profit or loss subtotal that excludes 'unusual' items such as restructuring costs and impairments of non-financial assets. The proposals would also restrict the use of columns to present management performance measures in the statement(s) of financial performance.
Associates and joint ventures	The ED defines 'integral associates and joint ventures' and 'non-integral associates and joint ventures', and proposes to require an entity to provide information about integral associates and joint ventures separately from that for non-integral associates and joint ventures.
Expenses by nature or by function	In presenting its expenses within the operating section an entity would select whichever of the 'by nature' or 'by function' that provides the most useful information to users. A mixed approach would not be permitted. Entities applying the 'by function' method would (i) present cost of sales separately from other expenses; and (ii) disclose an analysis of total operating expenses by function in the notes.
Adaptations for particular entities	The requirements on what is included/excluded in the categories and subtotals would be adapted for certain entities. Adaptations would apply to insurers and to entities that provide financing to customers (e.g. banks) and/or make investments as a main business activity.

Disaggregation

The General Presentation ED contains several proposals aimed at improving how entities disaggregate information both in the primary financial statements and in the notes. These include the proposals of the presentation of expenses ‘by nature’ or by ‘function’ (see above) and on disclosing unusual items (see below). In addition, the ED proposes more general guidance on when to combine or separate items of income or expense. This includes a description of the purpose of the primary statements and the notes and a three-step approach to aggregation and disaggregation. The three steps are:

- identify assets, liabilities, equity, income and expenses that arise from individual transactions or other events
- classify those items into groups based on shared characteristics, so that line items in the primary financial statements comprise items that share at least one characteristic; and
- separate those line items based on further characteristics, resulting in the separate disclosure of material items in the notes.

New guidance is also proposed on the aggregation of individually immaterial items.

Disclosures

Management performance measures

The IASB has observed that many companies provide performance measures defined by management (sometimes referred to as ‘non-GAAP’ or ‘alternative performance’ measures) in communications with investors outside the financial statements. The IASB believes that such measures can be useful but have heard concerns about the quality of disclosures provided about them.

In response the ED includes proposals to define ‘management performance measures’ (MPMs) and require entities to disclose information about them. The proposals are summarised below:

Area	Summary
Definition	MPMs would be defined as measure that are: • are used in public communications outside financial statements • complement totals or subtotals specified by IFRS Standards • communicate management’s view of an aspect of a company’s financial performance
Scope	The proposals focus on MPMs that are subtotals of income and expenses (e.g. adjusted operating profit). Other measures such as free cash flow, adjusted revenue and growth rates are not affected.
Requirements	The following information about MPMs would be provided in a single note: • a reconciliation between each measure and the most directly comparable subtotal or total specified by IFRS Standards • the effect on tax and non-controlling interests for each reconciling item • a description of why each measure communicates management’s view of performance and how it is calculated • an explanation of any changes in how a company calculates its management performance measures or which measures it provides

Unusual items

The IASB believes that Information about income and expenses that are not expected to recur in the near future is useful to investors. However, IFRS Standards do not explicitly require entities to provide such information and the IASB has observed inconsistency in current disclosure practices.

In response the ED includes proposals to define 'unusual' income and expenses and require entities to disclose them. The proposals are summarised below:

Area	Summary
Definition	'Unusual' income and expenses would be defined as those with a 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.
Requirements	For each unusual item, entities would be required to disclose, in a single note: • a narrative description of how it arose and why it meets the definition of an unusual item • in which line item(s) in the statement of profit or loss it is included • an analysis by nature, if the company presents operating expenses by function in the statement of profit or loss.

Other primary statements

Although the main focus is on the statement of profit and loss, the General Presentation ED also include proposals for more limited improvements to cash flow reporting, which would amend IAS 7 'Statement of Cash Flows'. The key proposals:

- require operating profit as the single starting point for the indirect method for reporting cash flows from operating activities
- require a split between cash flows from investments in integral and non-integral associates and joint ventures, consistent with its proposed approach for the statement of profit or loss
- remove the classification choice for interest and dividend cash flows for most entities.

The proposals would also expand the list of minimum line items in the Statement of Financial Position to include goodwill and to present 'integral' and 'non-integral' associates and joint ventures separately.

What will it look like?

Structure of the statement of profit and loss

Under the proposals in the General Presentation ED, the basic structure of a statement of profit or loss (for entities other than banks, insurers and those that make investments in the course of their main activities), down to the profit before tax subtotal, would be organised as follows:

Revenue	x	Operating
Operating expenses	(x)	
Operating profit or loss	**x**	
Share of profit of integral associates and joint ventures	x	Integral associates and joint ventures
Operating profit or loss and income and expenses from integral associates and joint ventures	**x**	
Share of profit or loss of non-integral associates and joint ventures	x	Investing
Income from investments	x	
Profit or loss before financing and income tax	**x**	
Interest revenue from cash and cash equivalents	x	Financing
Expenses from financing activities	(x)	
Unwinding of discount on pension liabilities and provisions	(x)	
Profit or loss before tax	**x**	

It should be noted that:

- Additional line items, headings and subtotals would be required when relevant (consistent with IAS 1 today)
- The above illustration does not include various line items that are required in accordance with other IFRS Standards such as IFRS 9 'Financial Instruments' and IFRS 17 'Insurance Contracts'
- Different presentations apply to the particular types of entities referred to in the table on page 2.

Next steps

The ED is open for comment until 30 June 2020.

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The IASB's proposals in the General Presentation and Disclosure ED are not a complete reinvention of the primary financial statements but would still bring about substantial changes to current practices. The more notable impacts include changes to the reporting of operating profit, a prohibition on the use of columns to report adjusted profit measures, new disclosures about unusual income and expense and a distinction between integral and non-integral associates and joint ventures. The proposals on management performance measures (MPMs) are similar to existing regulatory requirements in some jurisdictions but represent a first attempt by the IASB to anchor MPMs in the financial statements.

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