Proposed amendments to the way in which we present financial information in the financial statements – Part 1

Over the recent months, the IASB has issued two exposure drafts (ED) which propose amendments to the manner in which information is presented in the financial statements. These both form part of the boards initiative for Better Communication in Financial Reporting – an attempt to reduce diversity and improve comparability of financial statements.

This article considers the ED titled 'General Presentation and Disclosures' which is expected to replace IAS 1 *Presentation of Financial Statements.*

Some of the changes the exposure draft proposes include the following:

- A new income statement structure,
- the disaggregation of information and
- required disclosures for non-GAAP measures

This article is the first instalment of a 3 part series on the ED, and focuses on the first bullet above.

Firstly, the ED requires a preparer to categorise items of income and expenditure on the face of the Income Statement, which consequently introduces three new subtotal line disclosures. The proposed amendments will require a preparer to classify items similar to how the Statement of Cash Flows requires a preparer to separate between operating, investing and financing activities. Guidance is provided to assist a preparer in performing this allocation exercise – however some of the requirements may be considered to be quite 'interesting', such as:

- the terminology used to classify items of income and expenditure differs slightly to terminology used in IAS 7 *Statement of Cash flows* to classify cash flows, yet the definitions are somewhat similar
- interest income or expense on cash and cash equivalents is to be included in the financing category and not the operating category, even though one may have assumed cash balances may form part of the day to day operating activities or working capital of an entity

- and the operating activity appears to be the “bucket” (default) category

IAS 1 previously gave the preparer discretion as to whether to present expenses by nature or function – although the ED still allows for both, it provides factors to be considered when determining which analysis provides the most useful information. It requires however, that where disclosure is by function on the face of the primary statement, disclosure by nature is also required to be presented in the notes. Could this perhaps be interpreted that disclosure by nature provides more meaningful information to a user?

In addition to the above classification , there needs to be a separation of equity accounted results from *integral* and *non-integral* investments in associates or joint ventures. This will require significant judgement to be applied in determining what is integral vs non-integral. Some have expressed concerns as to whether there is sufficient guidance to aid a preparer in applying these judgements, and to ensure these judgements would be applied consistently across preparers in the same industry.

The proposal which may be the most surprising however, is the introduction of a note disclosure for “unusual items”.

Prior to 2002, there was a requirement for extraordinary items to be disclosed. An extraordinary item was defined as being “*income or expenses that arise from events or transactions that are clearly distinct from the ordinary activities of the enterprise and therefore are not expected to recur frequently or regularly*”.

In 2002, disclosure of extraordinary items was prohibited. The reason why this change was made was because the board felt that the nature or function of a transaction or other event, rather than its frequency, should determine its presentation within the income statement. This eliminated arbitrary segregation of expenses.

Interestingly though, the ED proposes separate disclosure of what the board terms to be “unusual” items. An unusual item is said to be something unusual by type (nature) or amount and if it has limited predictive value – based on expectations about the future, rather than the past. How does one assess the predictive value of an item, and does this imply there is some forecasting that would be required by management in assessing whether an item is unusual or not?

The requirement is also to disclose ***all*** unusual items – does this mean the normal requirements of materiality are not applicable? Or are unusual items deemed to be qualitatively material by virtue of them being unusual? This may be a question relevant to the auditors out there – how would one satisfy themselves as to whether something is in fact unusual, and whether *all* items have been disclosed?

Although there is a fair amount of application guidance which supports the unusual item disclosure requirement, some feel this may be difficult to apply in practice, and its intriguing that disclosure of *extraordinary items* was prohibited – but disclosure of *unusual items* may now be required.

In closing, both users and preparers should expect the way in which information around income and expenditure is presented

going forward to be different to the way in which it has been presented and consumed in the past.

Change always brings about mixed views.

There is no set date for when these amendments would be effective, the comment letter period for the ED ended on 30 September 2020. It is still very much a work-in-progress.

My opinion is however, assuming more clarity is provided around some of the grey areas, the replacement of IAS 1 may largely reduce diversity, and give rise to more meaningful and comparable reporting – although we may expect some teething problems in its application.

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