PRIMARY FINANCIAL STATEMENTS

EFRAG OUTREACH ACTIVITIES

EFRAG CFSS-TEG meeting
23 September 2020

EFRAG
European Financial Reporting Advisory Group

Purpose of the session

EFRAG would like to inform you to the feedback received during various outreach events and the field test

National Standard Setters might have received different or similar feedback. We would be interested to hear especially about different feedback received

Do you have any comments or suggestions?

EFRAG INITIAL POSITION

EFRAG due process and general position

- EFRAG published its Draft Comment Letter on 24 February 2020
- Comment letters are **welcome by 28 September 2020**.
- Final position after considering the input from outreaches, field-test and comment letters
- EFRAG welcomes the IASB's proposals on improving how information is communicated in the financial statements
- This project responds to a strong demand from users of financial statements and respondents to the IASB 2015 *Agenda Consultation* to undertake a project on primary financial statements. EFRAG considered that the IASB's proposals in this ED would properly address this request
- EFRAG also agrees with the IASB's proposal to update current requirements through issuing a new IFRS Standard, even if the IASB focused mainly on information about performance in the statement of profit or loss. Such an approach has the benefit of highlighting the importance and impact of the proposed changes

EFRAG CONSULTATION AND JOINT FIELD-TEST

Outreach with different types of European stakeholders, including users, preparers and NSS, and different European jurisdictions (public webinars and online events):

- *Input on the IASBs Exposure Draft General Presentation and Disclosures*: Online joint outreach event hosted by EFRAG, FSR – Danish Auditors, the Confederation of Danish Industry (DI) and the IASB (14 May 2020). For more details, please click here.
- *Time for a facelift? A new look for the income statement (Presentation)*: Online users joint outreach event hosted by EFRAG, EFFAS, BVFA/ABAF and the IASB (19 May 2020). For more details, please click here.
- *Time for a facelift? A new look for the income statement (Disclosures)*: Online users joint outreach event hosted by EFRAG, EFFAS, BVFA/ABAF and the IASB (26 May 2020). For more details, please click here.
- *Changing the Income Statement – Norwegian perspectives*: Online joint outreach event hosted by EFRAG, NASB, the NFF and the IASB (17 June 2020). For more details, please click here.
- *Outreach event on PFS with Accounting Standards Committee of Germany (ASCG) on 7 September and 11 September 2020. For more details please click* here.
- *Joint outreach event PFS with Dutch Accounting Standards Board (DASB) on 16 September 2020. For more details please click* here.

EFRAG CONSULTATION AND JOINT FIELD-TEST

Field test with preparers in coordination with European National Standard Setters and the IASB:

- Field-Test Workshop on 7 July with preparers of financial statements – 5 corporates -For more details, please click here.
- Field-test workshop on 7 July with preparers of financial statements – 4 Financial Institutions - For more details, please click here.
- Field-test workshop on 24 August with preparers of financial statements – 2 Financial Institutions and 4 Corporates
- *Preparers roundtable on Primary Financial Statements* (webinar): Online joint outreach event hosted by EFRAG, BusinessEurope and the IASB (1 September 2020). For more details, please click here.

New subtotals and categories

EFRAG INITIAL POSITION

New subtotals and categories

- ‘Operating profit or loss’ is one of the most used subtotals and currently there is a lack of consistency in its use, labelling and definition. EFRAG supports the IASB's proposals to present an operating, investing and financing category in the statement of profit or loss to improve comparability and reduce diversity in practice. However, EFRAG expressed some concerns:
  - the newly created categories in the statement of profit or loss are not aligned with the presentation of cash flows in the statement of cash flows, however, they have the similar labelling
  - clear guidance is needed on the notion of 'entity's main business activity' to distinguish between categories in the statement of profit or loss
  - the ED proposals should consider the interaction with existing regulatory frameworks on presentation of financial statements
- Useful to also define EBIT and EBITDA as they are among the most used performance measures.

QUESTIONS TO CONSTITUENTS

New subtotals and categories

- EFRAG is also seeking constituents' views on the presentation of specific line items:
  - Income and expenses from cash and cash equivalents - please see paragraph 55 of the DCL
  - time value of money, please see paragraph 76 of the DCL

Application to conglomerates (operating different lines of business)

- EFRAG is seeking views on whether more guidance is needed for the presentation of revenues and costs when they are allocated to different business activities on the face, including consistency with IFRS 8 Operating Segments and disclosure on judgement on the allocation process

FEEDBACK FROM FIELD-TESTS

New subtotals and categories

- In general, participants rearranged the presentation of their income statement (e.g. introduction of new subtotals and reallocation of line items). However, we observed different experiences:
  - For some participants, the proposed classification requirements are clear
  - For others, there is a need for clearer guidance in some areas. In particular, more guidance on:
    - the definition of the operating category (e.g. importance of having clear guidance on the notion of the 'entity's main business activities')
    - the definition of the investing category (e.g. more examples of incremental expenses incurred generating income and expenses from investments);
    - the classification of other very specific line items such as:
      - foreign exchange differences and hedging instruments
      - interest from extended payment terms to customers and interest on trade payables
      - contingent consideration from business combination

FEEDBACK FROM FIELD-TESTS

New subtotals and categories

- There were also different experiences in terms of level of judgement involved:
  - For some, no significant judgements were required
  - For others, it would involve a high degree of judgement, particularly on hedging instruments and foreign exchange differences. Participants also referred to the judgement used to reallocate the existing line items to the new categories (e.g. cash investments)
- When referring to the cost, some referred to the high degree of costs related to the classification of gains and losses from hedging instruments and foreign exchange differences. Nonetheless, there were also participants that were already making this allocation
- Participants discussed materiality considerations when presenting the operating, investing and financing categories. Participants noted that, for the purposes of the field-test, some items were presented even if they were close to zero
- There were also questions on whether a separate subtotal is needed if, for example, investments are immaterial

OUTREACH ACTIVITIES

New subtotals and categories

- Many welcomed the IASB efforts to improve the content and structure of the primary financial Statements, in particular welcomed the new subtotal “Operating profit or loss” (good anchor point)
- Most users of financial statements welcomed the fact that associates and joint-ventures did not impact the ‘Operating profit or loss’ subtotal
- Many welcomed having more granular information on the face of the financial statements
- Some stakeholders discussed the definition of operating profit or loss. For example:
    - the definition of operating profit having a positive, default category and residual element
    - some called for the IASB to focus on the core profit of an entity
- Not useful to have the same labelling for the different categories in the statement of profit or loss and statement of cash flows when the different categories were not aligned
- Mixed view on the presentation of cash and cash equivalents and unwinding of discount

QUESTION TO EFRAG TEG-CFSS MEMBERS

Have National Standard Setters received different feedback?

Do you have any different comments or suggestions?

Integral and non-integral associates and JVs

EFRAG INITIAL POSITION

Integral and non-integral associates and JVs

- EFRAG's research has shown that there is diversity in practice on the presentation of the share of profit or loss of associates and joint ventures
- EFRAG considers that separate presentation of integral and non integral associates and joint ventures will result in relevant information for users of financial statements and enhance comparability
- However, EFRAG highlights that such presentation will involve significant judgement and needs to be tested in practice
- EFRAG seeks views on:
  - the needs to expand the new paragraph 20 D of IFRS 12 for example to include additional indicators, to reduce the level of judgement involved when making a distinction between integral and non integral entities
  - whether it would be useful to separately present or disclose the income tax related to associates and joint ventures accounted for under the equity method

FEEDBACK FROM FIELD-TESTS

Integral and non-integral associates and JVs

- This was one of the most debated topics where participants provided had many comments and expressed some concerns
- ‘Operating profit or loss and income and expenses from integral associates and joint ventures’ is a new subtotal not used before. None of the participants had made this distinction of the face of the financial statements before
- The information needed was available (subject to judgements) and no significant changes to the systems were required
- In general, companies made the split, even if some presented line items with amounts equal or close to zero
- Nonetheless, the classification of investments in general is becoming complex: subsidiaries, different types of associates and joint ventures, investment entities, joint arrangements, financial instruments, etc)

FEEDBACK FROM FIELD-TESTS

Integral and non-integral associates and JVs

- When referring the definition of integral and non-integral, participants expressed different experiences:
  - Some considered that the classification of integral and non-integral was clear, all required information was available and low level of judgement
  - Others considered that
    - it would be useful to expand paragraph 20D of IFRS 12 to ease implementation (e.g. is the supplier or customer relationship critical for the investor only or also for the investee)
    - significant and professional judgements may be required
    - the definition of integral associate and joint venture was narrow as some of their associates and JV would be classified as non-integral while management considered them as integral
    - importance of having clear guidance on the notion of the ‘entity’s main business activities’
- Some called for the IASB to further discuss how its proposals in general would apply to the separate financial statements

OUTREACH ACTIVITIES

Integral and non-integral associates and JVs

- This was one of the most controversial issues discussed by stakeholders with many:
  - questioning the relevance of the IASB proposal to require the split of integral and non-integral associates and joint-ventures (“is it worth to make the distinction?”)
  - questioning the need for a separate subtotal on integral associates and joint ventures (providing too much prominence to associates and joint-ventures), particularly users
  - questioning how the IASB proposals should be applied when considering immaterial associates and joint-ventures
  - expressing concerns about the level of judgement involved and supporting additional guidance to decrease the level of judgement.
  - suggesting having this information presented in the disclosures, others proposed alternative ways of defining integral and non-integral.
  - stating that there is room to improve the equity method but agreed that this should be addressed in a different project (e.g. presentation of income tax separately)

QUESTION TO EFRAG TEG-CFSS MEMBERS

Have National Standard Setters received different feedback?

Do you have any different comments or suggestions?

Analysis of expenses

EFRAG INITIAL POSITION

Analysis of operating expenses

- EFRAG is sympathetic towards the IASB's proposal to continue requiring entities to present an analysis of expenses using either by function or by nature method, based on whichever method provides the most useful information to the users of financial statements
- However, EFRAG suggests that the IASB clarifies that paragraph B 47 of the ED allows, or even requires, a mixed basis of presentation when an entity presents line items under paragraphs 65 and B15 of the ED

Questions to constituents

- EFRAG seeks views on:
    - usefulness of having disclosures by nature in a single note when an entity assesses that presentation by function provides the most useful information and whether it will be costly to provide this additional info
    - usefulness of having in the statement of profit or loss a strict presentation either by nature or by function or a mix presentation basis

FEEDBACK FROM FIELD-TESTS

Analysis of operating expenses

- No significant changes or concerns from those presenting operating expenses by nature. The observations came mainly from those that present an analysis of their expenses by function:
  - called for more guidance on the presentation by function (e.g. no clear definition of items such as ‘cost of sales’ and ‘administrative expenses’) and on the use of the line item ‘other expenses’
  - judgments to allocate some income and expenses by nature to the by function presentation (e.g. restructuring expenses and goodwill impairment losses)
  - referred to the high costs (IT systems auditing) related to the disclosures of total operating expenses by nature when presenting by function on the face and duplication of some items as current IFRS Standards already require disclosures by nature (e g amortisation and depreciation)
  - clarify the link between paragraphs B46 and B15 of the ED

QUESTION TO EFRAG TEG-CFSS MEMBERS

Have National Standard Setters received different feedback?

Do you have any different comments or suggestions?

Management Performance Measures

EFRAG INITIAL POSITION

Management performance measures

- EFRAG welcomes the IASB's efforts to provide guidance on management performance measures (MPMs) which are often used in practice and additional guidance on non-IFRS measures could bring more transparency and consistency on their use
- EFRAG suggests to apply the MPM requirements also to the non-GAAP performance measures, presented within financial statements, that may not satisfy the proposed criteria of MPMs (e.g. adjusted revenues and ratios)
- EFRAG highlights a number of challenges in regard to the ED proposals

Questions to constituents

- Seeking views of its constituents on a possible alternative narrower scope: **Scope 1** (MPM in the financial statements and guidance in the MCPS) or **Scope 2** (MPM in communications released jointly with the annual or interim report, including earning releases)?
- Costs and benefits of splitting income tax effect and NCI for each item in the reconciliation as required by paragraph 106(b)?
- Will the IASB’s proposals on the statement of P&L lead to an increased number of MPMs?

FEEDBACK FROM FIELD-TESTS

Management performance measures

- Participants did not raise significant issues when identifying MPMs, which could be found in the notes, management commentary, presentation to analysts, guidance for the year and mid-term plan
- Many participants noted that the definition seemed to be narrow, with some also disclosing other APMs that did not meet the definition of an MPM. These participants explained that they had presented other APMs because providing only a narrow number of MPMs would provide an incomplete picture of the entity's performance
- In general, information was readily available, except for the effects of income tax and non-controlling interest. Some participants noted that the computation of income tax effect can be complex, particularly when there are many different tax jurisdictions and when using constant currency performance measures
- Many participants also called for the IASB to clarify what public communication is
- There were also many questions on the interaction of MPMs with several other regulatory requirements (e.g. ESMA guidelines and local management report requirements) given their different scope
- Finally, some participants noted that they might revisit their performance measures considering the new proposed subtotals

OUTREACH ACTIVITIES

Management performance measures

- Support for the IASB's efforts to introduce discipline and transparency on the use of MPMs - important that such measures are audited
- Stakeholders expressed mixed views on the scope:
  - some considered appropriate to go for the indicators presented in all the communications issued jointly with the annual or interim results, particularly users of financial statements.
  - some would prefer disclosures only for the indicators that the entity presents in the financial statements, particularly preparers
  - many called for the IASB to clarify the meaning of 'public communication'

QUESTION TO EFRAG TEG-CFSS MEMBERS

Have National Standard Setters received different feedback?

Do you have any different comments or suggestions?

Unusual income and expenses

EFRAG INITIAL POSITION

Unusual income and expenses

- EFRAG welcomes the IASB’s proposals as they would result in useful information and reduce diversity in practice
- EFRAG suggests the IASB to refine definition of unusual to include items that presently occur in the business, but only for a limited period (e.g. those identified in paragraph B15 of the ED such as restructuring costs)
- EFRAG notes that the translation of term ‘ may raise issues in some jurisdiction EFRAG considers that it would be useful to clarify whether entities can present unusual items on the face of the financial statements by specifically referring to ‘unusual line items’ and ‘unusual subtotals’ within the categories defined by the IASB or with the use of columns

FEEDBACK FROM FIELD-TESTS

Unusual income and expenses

- Some participants already provided information about non-recurring or unusual items; however they noted that the IASB proposed definition would change current practice.
- The proposed requirements were often considered clear, the information available and no significant changes to the IT systems. However, some concerns have been expressed:
  - it would involve a significant degree of judgement and discretion to determine whether an item is unusual (e.g. the term ‘several future annual reporting periods’ and ‘predictive value’ will involve significant judgement)
  - questions on how to report the unusual amounts (part that is usual and the excess that is unusual) and how unusual items would be monitored and considered by the auditors
  - the definition would restrict the number of unusual items identified and, consequently, disclosures will have limited added value. For example, the definition excludes expenses caused by a restructuring program which takes two years

FEEDBACK FROM FIELD-TESTS

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OUTREACH ACTIVITIES

Unusual items

- Stakeholders provided mix views on how unusual items should be defined:
  - some considered that the IASB definition is too narrow
  - some considered it too wide
  - some considered that there should be a list of line items for which entities have to provide disclosures (e.g. restructurings, impairments, litigations, etc)
  - some considered that it was difficult to agree on a common definition and management should provide its own definition of unusual items (particularly when considering that this would not impact the presentation of the income statement)
- Many questioned the applicability and iteraction/addded value in conjunction with the IASB proposals on MPMs (likely to capture the same items)

QUESTION TO EFRAG TEG-CFSS MEMBERS

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