PRIMARY FINANCIAL STATEMENTS

FIELD TEST

24 August 2020

EFRAG

European Financial Reporting Advisory Group

IFRS®

OVERVIEW

OBJECTIVE OF THE FIELD TEST

NEW SUBTOTALS & CATEGORIES

INTEGRAL / NON-INTEGRAL

ANALYSIS OF EXPENSES

MANAGEMENT PERFORMANCE MEASURES

UNUSUAL

AGGREGATION AND DISAGGREGATION

STATEMENT OF CASH FLOWS

OBJECTIVE OF THE FIELD TEST

- The fieldwork is designed to provide the IASB with evidence of:
  - how the proposals would be implemented in practice;
  - any need for further guidance; and
  - the extent of process or system changes that may be needed.

Resulting feedback will be a valuable resource to the IASB and EFRAG discussions on the project Primary Financial Statements

PARTICIPANTS

WORKSHOP - 24 AUGUST 2020 – FROM 12:00h to 15:30h

Company	Country	Industry
Fraport AG	Germany	Airport Services
Merck Group	Germany	Pharma
Deutsche Post DHL	Germany	Postal Services
DSM	The Netherlands	Chemicals
ABN AMRO Bank NV	The Netherlands	Bank
Banca Monte dei Paschi di Siena	Italy	Bank

INCOME STATEMENT

NEW SUBTOTALS & CATEGORIES

BACKGROUND: QUESTIONS FROM THE QUESTIONNAIRES

- *What were the main changes to the structure of the income statement?*
- *Were the proposed requirements clear?*
- *Any significant judgements required?*
- *Were the proposed requirements clear when providing financing to customers or making investments?*
- *Were you able to separate the returns from investments made in the course of an entity's main business activities from those that are not?*
- *Is it difficult or costly to allocate income and expenses from financing activities and from cash and cash equivalents to those that do or do not relate to the provision of financing to customers?*
- *Is it difficult to track whether exchange differences relate to the entity's main business activities, investing activities or financing activities?*

NEW SUBTOTALS & CATEGORIES

KEY THEMES IDENTIFIED: CORPORATES

- In general, participants rearranged the structure of their income statement
- Overall, the different categories and subtotals are well understood. However, calls for clearer guidance in some areas. For example:
  - **definition of the investing category -** more guidance and examples would be useful - this new category will require reclassification of items currently in the operating and financing category
  - **classification of specific items**: more guidance on specific items such as ‘exchange rate differences’ related to subsidiaries, ‘interest on tax receivables’, ‘contingent consideration’ and ‘interest expense on trade payables’, reclassification of financing items
  - **guidance on how to deal with items recycled from OCI -** the lack of categorization in the OCI leads to inaccuracy of the operating result
  - **positive definition of the operating category** - defining operating profit as a residual is difficult, particularly when having multiple business activities. Need to improve the notion of ‘entity’s main business activity’

NEW SUBTOTALS & CATEGORIES

KEY THEMES IDENTIFIED: CORPORATES

- Other specific observations:
  - **Exchange differences – mixed experiences:**
    - already making allocations to different categories
    - not possible to make a clear allocation to the different categories - allocation must be decided for each individual case – thus adjustments in the accounting system will be costly and time-consuming
  - **Entities with multiple business activities**: the IASB should provide more guidance for the presentation of revenues and costs when they are allocated to different business activities on the face of the statement of profit or loss, including consistency with IFRS 8 and disclosure on judgement applied in the allocation process
  - **Investing category**: there were cases where pure cash investments of surplus liquidity were classified as investments – Is this in line with the requirements of paragraphs 49 and B34 of the ED?

NEW SUBTOTALS & CATEGORIES

KEY THEMES IDENTIFIED: FINANCIAL INSTITUTIONS

- Proposed requirements for classification were clear and information is available but different experiences on the changes to the presentation:
  - **No significant changes in presentation** - mainly related to new subtotals and line items on integral and non-integral associates and joint-ventures and the new definition of operating profit
  - **Significant changes in presentation** – use of the 4 new categories, reclassification of line items and deletion of some subtotals
- Final impact on presentation may depend on local regulators’ guidelines
- On the accounting policy choice provided by paragraph 51 of the ED, financial institutions are expected to apply paragraph 51(b)
- Separating returns from investments made in the course of an entity’s main business activities from those that are not can involve significant judgement
- For a bank, derivatives used to manage risks (designated and non-designated) expected to be presented in the operating category. Similarly, exchange differences classified within the entity’s main business activities
- Guidance needed for entities with multiple business activities

NEW SUBTOTALS & CATEGORIES

POINTS FOR DISCUSSION

Clarity of requirements

- Please discuss what guidance was helpful. Those that would want more guidance, please discuss what kind of guidance would be helpful

Classification of hedging and forex

- Please discuss how you considered the classification of hedging and forex

Materiality

- Please discuss how you considered materiality

Providing financing to customers or making investments

- Please discuss the accounting policy options used and the distinction of investments made in the course of an entity's main business activities from those that are not

Are there any other relevant points you would like to discuss?

INTEGRAL AND NON-INTEGRAL

BACKGROUND: QUESTIONS FROM THE QUESTIONNAIRES

- *Were the proposed requirements for classifying associates and joint ventures as integral or non-integral clear?*
- *Did you have all of the information required to apply the proposed requirements or was it easily obtained?*
- *What would need to change in your current systems or processes to obtain the required information on an ongoing basis*
- *Do you consider that the IASB needs to expand the new paragraph 20D of IFRS 12?*
- *What would need to change in your current systems or processes to obtain the required information on an ongoing basis?*
- *Do you anticipate a possible impact on governance processes other than on the reporting systems and processes?*

INTEGRAL AND NON-INTEGRAL

KEY THEMES IDENTIFIED: CORPORATES

- Many comments on the definition of integral and non-integral associates and joint ventures. For example:
    - definition of integral is narrow (e.g. might exclude companies that generate revenues independently but are active in the same business area as the parent company, associates or joint ventures in a start-up phase, or research and development collaborations)
    - judgement is needed for the distinction (e.g. as it is discretionary)
    - shared company name or brand is not a strong indicator of significant interdependency between the company and the joint venture
    - the classification as non-integral and other investments is unclear and difficult to perform
- Call for clearer guidance: for example, meaning of ‘generate returns independently’ and to expand the list of examples
- **One-time expense** for the categorization of existing associates and joint ventures – not significant changes to the IT systems

INTEGRAL AND NON-INTEGRAL

KEY THEMES IDENTIFIED: FINANCIAL INSTITUTIONS

- Also many comments on the definition of integral and non-integral associates and joint ventures. For example:
  - The subtotal ‘operating profit or loss and income and expenses from integral associates and joint ventures’ is a new subtotal - not used before
  - The distinction between integral and non-integral JVs and associates is not always clear and will be judgemental.
  - Many different distinctions (related parties, associates, unconsolidated structured entities, etc) lead to more complex IT systems
- Suggested the IASB to expand the new paragraph 20D of IFRS 12: for example to include additional indicators and examples

INTEGRAL AND NON-INTEGRAL

POINTS FOR DISCUSSION

- Please discuss what guidance was helpful in making the split and what judgements were you able to make in the process. Please comment on specific factors considered and on whether it was easier to classify joint ventures or associates. Are there any factors that could be useful which are not included in the Exposure Draft?
- For those of you that thought some associates and JVs you viewed as integral would not meet the definition, please discuss why you see those as integral and why you concluded they did not meet the proposed definition?
- Those that would want more guidance in paragraph 20D and more illustrative examples, please discuss what kind of indicators and examples would be helpful for your company and what kind of judgements could you not make in the absence of such additional guidance
- In your opinion, to what extent can additional guidance help with judgement required?

Are there any other relevant points you would like to discuss?

ANALYSIS OF EXPENSES

BACKGROUND: QUESTIONS FROM THE QUESTIONNAIRES

- *Were the proposed requirements for the presentation and disclosures of an analysis of operating expenses clear?*
- *Were any significant judgements required in applying the proposed requirements?*
- *Did you have all of the information required to apply the proposed requirements or was it easily obtained?*
- *What, if anything, would need to change in your current systems or processes to obtain the required information on an ongoing basis?*

ANALYSIS OF EXPENSES

KEY THEMES IDENTIFIED: CORPORATES

- Questions on whether practice will change based on the proposed indicators for the selection of most appropriate method to present analysis of expense by function and by nature
- Disclosures of expenses by nature on a consolidated level might be difficult to present in the notes when an entity analyses its expenses by function in the financial statements - considerable costs would be incurred in implementing this requirement
- not clear whether a ‘pure presentation’ is required – can by nature items be included in ‘other operating expenses’? (e.g. impairment losses, restructuring expenses, litigation expenses) – if not, allocation of these expenses to functions would create volatile line items across reporting periods

ANALYSIS OF EXPENSES

KEY THEMES IDENTIFIED: FINANCIAL INSTITUTIONS

- No significant changes or concerns from those presenting operating expenses by nature (banks typically present by nature)
- When presenting one or two line items by function (administrative expenses), consider that additional disclosures by nature are not necessary

ANALYSIS OF EXPENSES

POINTS FOR DISCUSSION

- What kind of guidance would be helpful for determining which method provides the most useful information?
- If you currently report by function, how do you classify restructuring expenses and impairment losses?
- What are main cost drivers for reporting expenses by nature when your primary method of analysis is by function? What system changes would be required? What kind of reliefs could be considered?

Are there any other relevant points you would like to discuss?

DISCLOSURES

MANAGEMENT PERFORMANCE MEASURES

BACKGROUND: QUESTIONS FROM THE QUESTIONNAIRES

- *Were the proposed definition and disclosure requirements for MPMs clear?*
- *Were any significant judgements required in identifying MPMs or providing the required disclosures?*
- *Were there any performance measures which you concluded did not to meet the definition of MPMS which required significant judgements?*
- *If you identified MPMs, which public communications were the source of your MPMs?*
- *Did you have all of the information required to apply the proposed requirements or was it easily obtained?*
- *What would need to change in your current systems or processes to obtain the required information on an ongoing basis?*
- *What is your assessment of the overall costs on the calculation of the income tax effect and the effect on non-controlling interests?*

MANAGEMENT PERFORMANCE MEASURES

KEY THEMES IDENTIFIED: CORPORATES

In general, companies were able to easily identify the sources of public communication and the MPMs (from 0 to 4 MPMs identified)

Some of the MPMs identified were EBIT, adjusted operating profit, EBITDA pre, adjusted EBITDA and adjusted net profit

Definition

Comments received include:

- Definition of MPMs is clear but narrow - limited to subtotals of income and expenses - definition only captures a subset of APMs (e.g. not EBIT, Ratios and Free Cash Flows)
- The term "management's view" to identify relevant measures is unclear
- Public communications is a broad term and would require entities to analyse all possible communications
- Questions on whether additional key figures (i.e. that do not meet the definition of MPM) may be explained voluntarily

MANAGEMENT PERFORMANCE MEASURES

KEY THEMES IDENTIFIED: CORPORATES

Presentation and disclosures

Comments received include:

- Calculation of income tax and NCI effect for each adjustment to each jurisdiction is burdensome and costly. Also questions on the benefits
- Unclear how the effects of income tax and non-controlling interests for each item disclosed in the reconciliation should be disclosed
- Considering using IFRS defined subtotals (e.g. operating profit) as key KPIs in the future - related costs would be lower
- The link to and interaction with the ESMA Guidelines on APMs is unclear - encourage the IASB to investigate the interrelation

MANAGEMENT PERFORMANCE MEASURES

KEY THEMES IDENTIFIED: FINANCIAL INSTITUTIONS

- The definition of MPMs and the scope is not always clear:
  - questions on whether metrics required by regulators would be considered as MPMs. If so, large number of MPMs expected
  - questions on interaction between MPMs and non-defined subtotals on the face
- Compiling the single note regarding MPMs can be challenging
- Overall costs of the IASB’s proposal on the calculation of the income tax and non-controlling interest effect will be significant and difficult to provide
- Information that is required to be disclosed is not always directly/ easy available from the IT systems (e.g. income tax effect)
- Increase of reporting work and audit cost due to more and more comprehensive disclosure notes

MANAGEMENT PERFORMANCE MEASURES

POINTS FOR DISCUSSION

Definition

- How did the inclusion of public communications in the definition of MPMs affect your assessment of the non-GAAP measures you included? Where do you disclose non-GAAP measures currently? Are there measures currently disclosed you think would be captured by 'public communications' that should not be?

Labelling and disclosures

- How did you determine labels for MPMs, did you use the same labels as used for current APMs? Were requirements on labelling and faithful representation difficult to apply?
- Please explain challenges with providing tax and NCI information for reconciling items? Did you attempt to prepare these calculations?

Are there any other relevant points you would like to discuss?

UNUSUAL ITEMS

BACKGROUND: QUESTIONS FROM QUESTIONNAIRES

- *Were the proposed definition and disclosure requirements for unusual income and expenses clear?*
- *Were any significant judgements required in identifying unusual income and expenses or providing the required disclosures?*
- *Did you have all of the information required to apply the proposed requirements or was it easily obtained?*
- *What, if anything, would need to change in your current systems or processes to obtain the required information on an ongoing basis?*

UNUSUAL ITEMS

KEY THEMES IDENTIFIED: CORPORATES

- Some already disclose unusual items in the notes but definition may lead to changes
- Some participants identified unusual items – between 2 and 3 unusual items
- Some expressed concerns on the definition of unusual items:
  - it is too narrow – might exclude items that have limited predictive value (e.g. restructuring). Consider a combined approach for MPMs and unusual items
  - focuses on the future perspective ("predictive value") and not on items occurred in the current annual reporting period
  - The assessment of unusual can change over time
- Unclear to some whether the definition of unusual income and expenses requires both criteria (in type and amount) to be met

UNUSUAL ITEMS

KEY THEMES IDENTIFIED: CORPORATES

- Assessing whether an item is unusual requires significant judgment:
  - the term “several future annual reporting periods” and ‘predictive value’ will involve significant judgement
  - judgement is required in connection with restructuring programs
  - judgement on what is unusual vs ‘under normal circumstances’
  - judgement on the allocation of unusual income and expenses to their nature when by function presentation is used
  - management has to determine which revenues and costs are "unusual" in the individual and consolidated accounts - difficult to make sure that all subsidiaries make the same assessment as the parent company
- One time expenses expected

UNUSUAL ITEMS

KEY THEMES IDENTIFIED: FINANCIAL INSTITUTIONS

- One participant identified unusual items (3)
- Different experiences on the clarity of the definition:
    - The proposed definition is clear
    - The proposed definition and disclosure requirements for unusual income and expenses are not clear
        - does a new (legal) provision meet the definition unusual income and expense? Whereas do existing (legal) provisions not meet the definition unusual income and expense?
- significant judgements required in identifying unusual income and expenses

UNUSUAL ITEMS

POINTS FOR DISCUSSION

- For those that thought that the definition of unusual income and expenses was difficult to apply in practice, what additional guidance would be helpful in making the required judgements?
- For those that found the requirements clear, could you share how you approached the judgements required?
- For companies that currently disclose unusual items (or an equivalent e g non recurring, not indicative of future performance etc) can you share how you identify these items and how the process would need to differ for the proposed definition?
- In your view, how do you consider to consolidate unusual items when preparing the consolidated accounts when an assessment check on an entity level is needed?

Are there any other relevant points you would like to discuss?

OTHERS

AGGREGATION AND DISAGGREGATION – GENERAL GUIDANCE

BACKGROUND: QUESTIONS FROM QUESTIONNAIRES

- *Was the additional proposed guidance on the roles of the financial statements and aggregation and disaggregation clear?*
- *Were any significant judgements required in aggregating or disaggregating information presented in the primary financial statements or disclosed in the notes?*
- *Did your approach to, or the level of, aggregation and disaggregation of information in the financial statements change as a result of the proposed guidance?*
- *Did you have all of the information required to apply the proposed requirements or was it easily obtained?*
- *What, if anything, would need to change in your current systems or processes to obtain the required information on an ongoing basis?*

AGGREGATION AND DISAGGREGATION

KEY THEMES IDENTIFIED: CORPORATES

- Requirements for aggregation and disaggregation are generally clear and well understood
- However, these requirements did not lead to further disaggregation of operating expenses presented by entities in their statement of profit or loss
- The additional paragraphs did not alter current practice significantly

KEY THEMES IDENTIFIED: FINANCIAL INSTITUTIONS

- Requirements for aggregation and disaggregation are generally clear well understood
- Final impact on aggregation and disaggregation may depend on regulators' guidelines

OTHER KEY THEMES IDENTIFIED

- Segment reporting note will be more comprehensive

AGGREGATION AND DISAGGREGATION

POINTS FOR DISCUSSION

- What additional guidance would you find helpful for aggregation and disaggregation?
- Do you disagree with any of the proposed guidance for aggregation and disaggregation?
- How do you currently approach aggregation and disaggregation and do you have challenges with applying the current guidance?

Are there any other relevant points you would like to discuss?

STATEMENT OF CASH FLOWS

STATEMENT OF CASH FLOWS

KEY THEMES IDENTIFIED: CORPORATES

- There were cases where classification of interest and dividend cash flows were already in line with proposal

Comments received include:

- The different categorisation of “operating”, “investing” and “financing” in the statement of profit or loss and the statement of cash flows could be misleading to users
- no information is currently available for the proceeds from disposal of integral associates and joint ventures and other investments as well as cash paid to acquire integral associates and joint ventures and other investments

STATEMENT OF CASH FLOWS

KEY THEMES IDENTIFIED: FINANCIAL INSTITUTIONS

- Changes mainly related to line items on integral and non-integral associates and joint ventures
- Interest paid and interest received presented in more than one category
- No significant issues raised by banks

STATEMENT OF CASH FLOWS

POINTS FOR DISCUSSION

- Were there any challenges applying the proposals for the statement of cash flows?
- Would different labelling of the categories in the statement of profit or loss resolve possible confusion over the categories in the statement of cash flows? Are there suggestions for how to address the issue?

Are there any other relevant points you would like to discuss?

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THANK YOU

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