Primary Financial Statements

Summary and analysis of the comment letters received

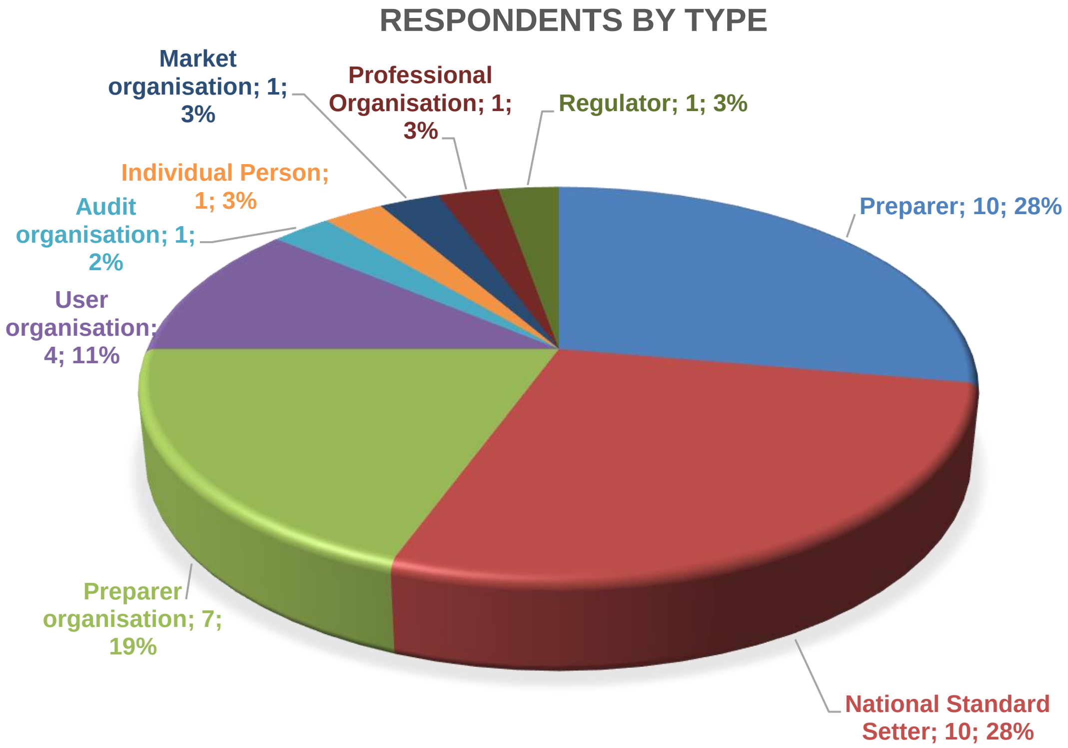
Objective of the session

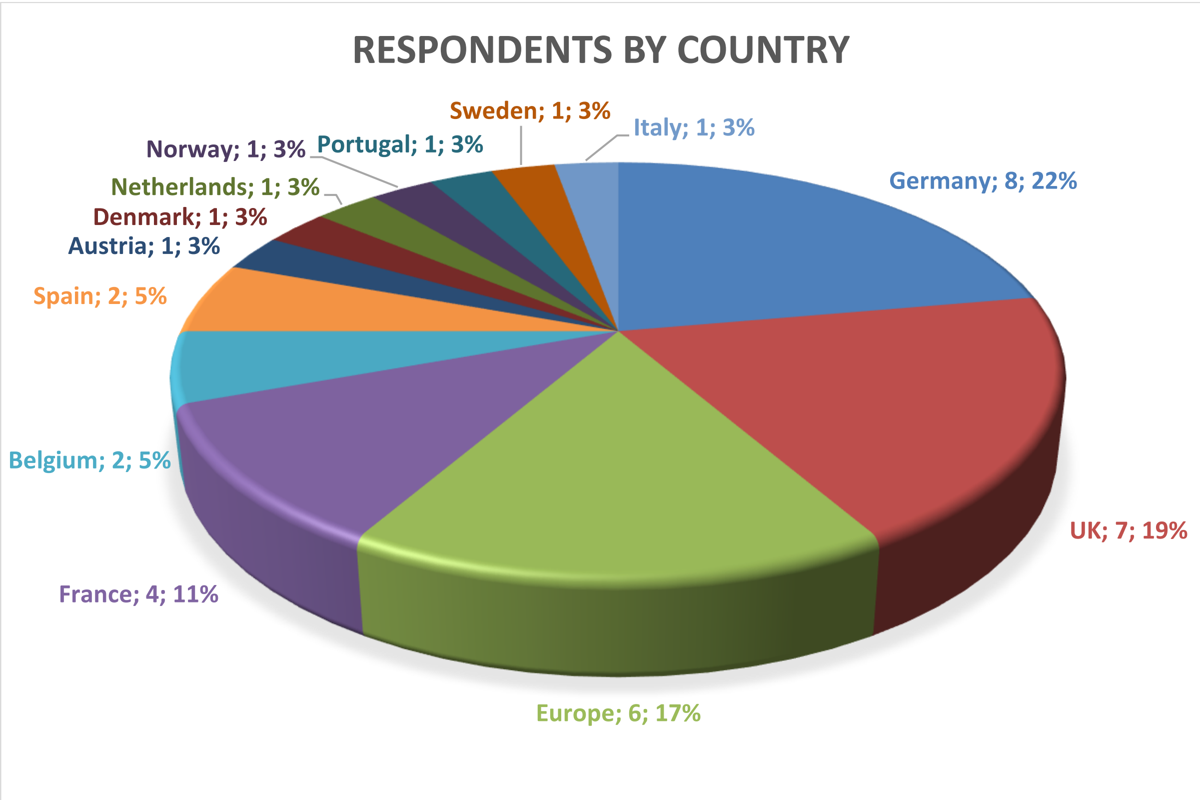
1 The objective of this agenda paper is to provide EFRAG TEG members a summary and analysis of the comment letters received.

Structure of the paper

Summary of respondents

2 At the time of writing, 36 comment letters have been received. The letters are summarised below by type and country of respondent.





3 When summarising and analysing the comment letters received, the EFRAG Secretariat uses the following terminologies:

Term	Extent of response among respondents
Almost all	90%-100% (32-36 comment letters)
Most	80%-90% (29-31 comment letters)
Majority	50% to 80% (18-28 comment letters)
Many, significant	20% to 50% (7-17 comment letters)
Some, others	10%-20% (4-6 comment letters)
A few	0%-10% (0-3 comment letters)

Executive summary of respondents' views

General

4 The majority of the respondents welcomed the IASB initiative to improve communication of the information in the financial statements with a focus on the statement of profit or loss.

5 Nonetheless, most of the respondents expressed concerns on, or did not agree with, some of the IASB's proposals. These respondents called for the IASB to further improve or discuss alternatives to its proposals (including cost-benefit trade-off as the cost of some proposed requirements might exceed their expected benefits) before issuing a new IFRS Standard.

6 One respondent even considered that the IASB should consider re-exposure of topics that may require further significant development.

7 One Corporate European industry association expresses concerns that the proposals reduce primary financial statements to the status of a compliance document and will lead to performance reporting being communicated by other ways.

Question 1 to 6 New subtotals and categories

8 Many respondents expressed support for the IASB's proposals to add new defined subtotals in the statement of profit or loss, particularly operating profit or loss, as it would reduce diversity in practice and improve comparability.

9 Nonetheless, some respondents expressed concerns on the IASB's proposals to require new subtotals and categories on the face of the financial statements as it would:

(a) impose uniformity (increasing the use of MPMs);

(b) would require the use of non-relevant categories. For example, it would require:

(i) an investing category which his currently not used, even if allowed by IAS 1 *Presentation of Financial Statements*; and

(ii) an operating category for financial institutions when most of their income and expenses would be presented within operating profit.

10 Many respondents expressed concerns that both the statement of financial performance and the statement of cash flows would have three different categories with similar labelling (operating, investing, and financing) even though they would not be aligned. This could create confusion for users and preparers.

<u>*Operating profit or loss*</u>

11 The majority of the respondents generally supported the IASB's proposal to require and define 'operating profit or loss'. Nonetheless, many respondents also highlighted the importance of having additional guidance on the definition of operating profit or loss, particularly on the notion of the ‘entity’s main business activity’ or ‘in the course of the entity’s main business activity’ as the lack of guidance might give rise to significant diversity in practice. There were also some other concerns. For example:

(a) mixed views on having a definition of 'operating profit or loss' that contains both a positive and a residual element;

(b) it is key to clarify the relation to the definition of operating segments under IFRS 8 *Operating Segments*;

(c) mixed views on whether there is a need to separate returns from investments made in the course of an entity’s main business activities from those that are not;

(d) no support for the accounting policy option in paragraph 51 of the ED for entities that provide financing to customers as described in the ED. Nonetheless respondents provided different views on their disagreement (either considered that 51(b) should not be available for non-financial institutions or not available at all circumstances) and provided different suggestions on how to move forward;

(e) concerns on the definition of operating category when applied to the insurance industry (e.g. interaction with IFRS 9 *Financial Instruments* and IFRS 17 *Insurance Contracts*); and

(f) concerns on definition of operating category when applied to banks (e.g. most income and expenses would be presented within operating profit).

(g) questions on the classification of specific items such as contingent consideration from business combinations, goodwill impairments, etc.

<u>*Investing category*</u>

12 Many respondents supported the proposal to create a new separate category in the profit or loss statement for ‘investing’ income and expenses, as it will provide useful information to users of financial statements about the returns from investments that are not part of the entity’s main business activities.

13 By contrast, a similar number of respondents expressed significant concerns on, or were even against the introduction of the investing category as, for example, it would create implementation complexities, result in diversity in practice and would not provide useful information (entities are not currently presenting an investing category even if it is possible under IAS 1).

14 Finally, many respondents called for more guidance on the definition of an investing category. In particular, respondents called for further guidance on:

(a) what constitutes ‘investments made in the course of the entity’s main business activities’ (including examples of investments that are not part of the entity’s main business activities);

(b) what constitutes “a return individually and largely independently of other resources held by the entity”;

(c) classification of foreign exchange differences (due to complexity and related costs);

(d) classification on fair value gains and losses on derivatives and hedging instruments, particularly the guidance in paragraph 57 of the ED on financial instruments designated as hedging instruments (e.g. whether derivatives can be classified in the operating category on a net basis, when the hedged net exposure is referred to items related to the main business activity); and

(e) incremental expenses incurred generating income and expenses from investments.

Financing category

15 Many respondents welcomed the IASB proposal to require and define a subtotal for "profit or loss before financing and income tax". Some of these noted that this subtotal would serve the purpose of allowing users of financial statements to analyse on a consistent and comparable basis an entity's performance independently of how that entity is financed. Respondents also provided a number of suggestions to help implementation.

16 Nonetheless, respondents provided mixed views on the presentation of cash and cash equivalents and interest income and expenses on liabilities that do not arise from financing activities.

Question 7 Integral and non-integral associates and joint ventures

Definition of integral and non-integral

17 Many respondents welcomed the IASB’s proposal to require entities to identify “integral associates and joint ventures” and “non-integral associates and joint ventures”, however the majority of them expressed concerns about the high level of judgement and subjectivity of the new definition, which would impede comparability, its contingency on the definition of the term “main business activity”, its applicability to different business models, etc.

18 These respondents proposed several changes to the IASB definition and asked for clarifications, further guidance, and more illustrative examples to be able to apply the definition in practice.

19 However, approximately the same number of respondents did not support the new definition. These respondents argued that: there was too much judgement involved; the condition of the generation of “a return individually and largely independently of other assets was confusing; the interaction with other IFRS Standards should be considered; for some preparers the costs of implementation would outweigh the benefits, etc.

20 Several suggestions were made to improve the IASB definition, such as to explore the concept of interdependency; to consider interrelationships between the proposed indicators, to clarify the treatment in the separate financial statements and in the group reporting, etc.

21 Approximately one third of the respondents did not express a clear view or opinion on the proposed definition.

Separate presentation and disclosures

22 The majority of respondents who expressed a view on this topic did not support the separate presentation of integral associates and joint ventures as a sub-total on the face of the profit or loss.

23 Half of respondents who supported the IASB definition of integral and non-integral, did not support the separate presentation requirements.

24 Several arguments were mentioned, among which that the IASB proposal gives too much emphasis and undue prominence on this sub-total making the structure of the statement of profit or loss unduly complicated, damaging comparability and that implementation would be costly and might not reflect how the entities manage their business, etc.

25 Many suggested (all respondents representing insurance industry and some others) that it should be permitted to report the results of associates and joint ventures as a separate line item in the operating section (with or without a split between integral and non-integral).

26 Many, however preferred, to provide a split between "integral" and "non-integral" in the notes to the financial statements and not on the face.

27 A few respondents recommended the IASB to align the presentation in the statement of cash flows with the new proposed categories of the statement of profit or loss and to undertake a more extensive project to meet user needs and to identify potential improvements.

28 A little less than one third of the respondents did not express a clear view or opinion on the topic.

Question 8: Roles of the primary financial statements and the notes, aggregation, and disaggregation

29 Many respondents agreed with the IASB's proposal to describe the roles of primary financial statements and the notes, aggregation, and disaggregation. Some of the comments related to:

(a) Additional guidance is needed (i) to reduce the judgement required to group different items belonging to the same transaction into one single line item; (ii) address the topic of reverse factoring;

(b) Clarification is necessary (i) to apply the aggregation principles over time, including when using comparatives; to clarify the request of paragraph 28 to present details of "other items";

(c) Additional guidance is useful to avoid that the proposals in the ED lead to presentation and disclosure of immaterial items.

30 Two standard setters suggest to amend the definition of role of PFSs and notes, one suggests referring to prospects of cash flows and management's stewardship; the other suggest referring to overall position, performance, cash flows and stewardship of an entity, rather than the elements (assets, liabilities, equity, income, expenses) included in those financial statements. One of these to standard setters suggests considering explicitly the incorporation by reference of contents of other reports to comply with the requirements and to consider specifying that understandability should have the same importance as consistency overtime and comparability between entities.

Question 9: Analysis of operating expenses

<u>Presenting by function or by nature</u>

31 Many of the respondents support presentation by function or by nature.

32 Many object to the option for the two methods, including European users, that would prefer by nature on the face.

33 Users are split: international association, international users consider that both methods are useful and that presentation by nature is not superior, while European users consider by nature is superior.

34 Some users (and one standard setter) do not consider one method superior to another. Both have different roles.

35 IASB failed to clarify in which cases the method currently selected by entities has failed to deliver the most useful information, hence the objective itself is unclear.

36 The predictive value of some expense items under the nature of expense method might be low such as 'reversal of inventory write downs', 'impairment of property,

plant and equipment", 'impairment losses on trade receivables', 'gains (losses) on derivatives', and 'other miscellaneous expenses'. The IASB is to investigate further which information about operating expenses by nature is needed by users of financial statements.

Additional disclosure by nature when presenting by function

37 Many noted the requirement to present expenses by nature in the notes when a presentation by function was used in the profit or loss could/would result in significant additional costs for preparers. In some cases, the costs would exceed the benefits.

38 But to some extent a mixed message about costs: based on information from one national standard setter and an investment association, a few preparers are able to deliver the information (do it already); based on inputs from preparers and their representative bodies, for most others it requires significant costs.

39 Generally, preparers and preparers organisations disagreed with the requirement to disclose by nature when presenting on the face by function, while users, some national standard setters and one regulator agreed with the requirement

Mixed presentation

40 Some respondents are in favour of a mixed format, a few are against. The ED itself is unclear about the purity of methods.

41 Some respondents are in favour of allowing the mixed presentation, including financial conglomerates and two national standard setters.

(a) One national standard setter recommends more analysis by the IASB, to investigate more which information about operating expense is needed by nature (similar to a preparers association and another national standard setter that ask or more field test);

(b) the other national standard setter recommends that an entity present additional line items when such presentation is relevant to an understanding of its financial performance, regardless of the analysis of operating expenses retained. In this case, the statement of profit or loss would mix by-function and by-nature methods. In their view, the main users' information needs could be met by requiring an entity to disclose only some expense amounts such as the employee benefits expenses, depreciation and amortisation expenses and impairment losses.

Financial conglomerates

42 Respondents from the finance industry noted that presentation either by nature or by function was not appropriate for financial conglomerates. They support retaining the mixed approach.

43 Additional guidance

44 The following were suggested:

(a) a clear definition of "by function" is missing, more examples are needed;

(b) define costs of sales;

(c) split of operating expenses by business lines and linkage to IFRS 8;

(d) clarify par. B65 in combination with B47, clarify par. B15;

(e) impairment of GW should be a separate line on the face;

(f) concerns with some of the indicators of B45; and

(g) address the change in estimates (retrospective).

Question 10 Unusual income and expenses

45 The majority of respondents supported the IASB's proposals regarding disclosing unusual items. Many disagrees and justify their disagreement because they believe the proposals are ambiguous, leave room for interpretation and are highly judgemental.

46 Many consider the scope too narrow (like EFRAG); two (including a regulator) consider that the scope should be even narrower (different from EFRAG's view). The regulator believes that income and expenses which have arisen in past annual reporting periods or that are expected to arise in future reporting periods (such as restructuring costs or impairment losses) should generally not be considered as "unusual").

47 International users and two standard setters prefer "unusual line item" on the face.

48 One standard setter suggests more discipline in specific guidance for disclosure including accounting policies applied, neutral unbiased approach.

49 Most of the respondents raised concerns regarding the clarity of the definition. The following suggestions were made, rather than defining unusual items, the IASB should base its requirements on:

(a) the management's view;

(b) identify a list of items;

(c) less emphasis to the future (one national standard setter);

(d) use core/non-core category;

(e) unusual for the entity's main activity rather than with limited predictive value;

(f) fair value changes on loan loss impairments at list partially should be unusual in situations like the Covid crisis. Refer to an "unusual event";

(g) Recurring/non-recurring.

50 Some of the respondents also requested clarifying how to report the figures, i.e. whether to report full amounts or excess of the usual levels.

Question 11 Management performance measures

51 The respondents presented mixed views regarding the IASB's proposals to disclose information on management performance measures.

52 Many disagree, including associations of corporates and insurers, but also international users. The latter consider that indicators on the face are more relevant (due to the use of data aggregators) and suggest to they propose to require companies to disclose MPMs just below the bottom line of the statement of profit or loss.

53 Many agree, including audit profession, regulator, four national standard setters and European users.

54 The opponents justified their disagreement and explained that:

(a) the proposals may not bring the expected discipline in reporting outside of financial statements;

(b) in Europe there is already existing regulation concerning performance measures and the issues should rather be addressed by the regulators; and

(c) the cost of implementation is not justified by the benefits.

55 Moreover, majority of the respondents considered the that the scope of the MPMs in respect to their use in public communication is too broad. Some respondents also considered that it is not clear how the term public communication itself should be understood. Auditors suggests the public communication could be limited to be limited to regulatory information or to the examples provided in paragraph B79 of the ED.

56 Furthermore, many respondents considered that the scope of the IASB proposals in terms of types of measures was too narrow and would expect other measures as ratios or measures containing financial position or cash flow items to be included in the scope (similar to EFRAG DCL).

57 Many respondents considered that IASB's proposal on the calculation of the income tax effect and the effect on non-controlling interests for each item disclosed in the reconciliation would be burdensome.

58 A few respondents raised an issue of the increased audit risk related to the completeness of the disclosures.

59 The following comments were received with reference to the list of indicators that are not MPM in paragraph 104:

(a) one NSS would like to see the list extended, as the IASB's proposals should aim to narrow the use of MPMs in practice by increasing the number of subtotals specified by IFRS Standards;

(b) international users suggest deleting paragraph 104 (Subtotals specified by IFRS Standards that are not management performance measures) so to have broader scope;

(c) one regulator considers that only subtotals which are calculated from IFRS figures and are defined in IFRSs should be exempted from MPM requirements. Unless a requirement is introduced for issuers to disclose separately "depreciation" and "amortisation", either in the face of the financial statement or in the Notes, "operating profit or loss before depreciation and amortisation" should be considered an MPM;

(d) one standards setter considers that subtotal that is presented in the statement of profit or loss should not be considered as an MPM.

60 Of those respondents that answered the question in EFRAG DCL (Scope 1 versus Scope 2), some preferred scope Alternative 2 i.e. restriction of MPMs to communication released jointly with the annual or interim report. A few preferred Alternative 1, i.e. MPMs in the financial statements and guidance in the MCPS, the rest did not answer the question.

61 Two respondents including one standard setter would prefer MPM disclosure in the management commentary instead than in the notes.

62 Those that provided an answer to the question in paragraph 190 of EFRAG DCL had mixed views about the possible increase or decrease of the number of MPM.

Question 12 EBITDA

63 The respondents presented mixed views regarding EFRAG's request to define EBITDA (+/- 50%). Those that thought that the definition is not needed explained that EBITDA does not serve clear purposes in the context of IFRS, or that the IASB should not venture into the area of regulating performance indicators but instead leave this to the regulator in each jurisdiction.

Question 13: Statement of cash flows

64 Many respondents welcomed the IASB proposal to require the 'operating profit or loss' as a starting point for the indirect reconciliation of cash flows from operating activities in the statement of cash flows.

65 Many respondents agreed with the classification of interest and dividends in the statement of cash flows for non-financial entities, however, it was observed that this prescribed classification could lead to some unintended inconsistencies due to the lack of alignment between the categories in the statement of profit or loss and the statement of cash flows.

66 Respondents from the financial industry called for the statement of cash flows to be fundamentally reviewed as it was not providing relevant information for the financial sector.

67 Many respondents commented that the inconsistent usage of the terms 'operating', 'investing' and 'financing' across the statement of profit or loss and the statement of cash flows could be confusing and reduce understandability. Respondents suggested that the IASB start a separate project on IAS 7 *Statement of Cash Flows* to comprehensively review the challenges that arise in practice.

Question 14: Other

68 Many respondents agreed with EFRAG proposal (paragraph 249 of the DCL) that for entities operating in different business industries the IASB should consider providing 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 judgment applied in the allocation process.

69 Some respondents considered that the proposed changes to the statement of other comprehensive income in paragraph 74 were minor changes in wording and are unlikely to significantly improve understandability. Thus, recommended that the proposed wording and its extent are reviewed more fully as part of a separate project.

70 Some respondents recommended that consideration is given to the practicalities and timescales of implementation of IFRS 17 together with any new standards or amendments arising from the ED and noted that the proposed time of 18 to 24 month for a retrospective first-time application was not sufficient.

71 Respondents also raise a number of other comments such as taxonomy, illustrative examples, and interim financial statements.

Question to EFRAG TEG

72 Does EFRAG TEG has any comments or questions on the EFRAG Secretariat's summary and analysis in *Appendix 1: Analysis and Summary of Comments* received?

Appendix 1 - Detailed analysis of responses to EFRAG's draft comment letter, EFRAG Secretariat recommendations and questions to EFRAG TEG

General comments

<u>*IASB Exposure Draft General Presentation and Disclosures*</u>

73 The majority of the respondents welcomed the IASB initiative to improve communication of the information in the financial statements with a focus on the statement of profit or loss (in line with EFRAG DCL).

74 Nonetheless, most of the respondents expressed concerns on, or did not agree with, some of the IASB's proposals. These respondents called for the IASB to further improve or discuss alternatives to its proposals (as described in detail within the different questions) before issuing a new IFRS Standard.

75 One respondent even considered that the IASB should consider re-exposure of topics that may require further significant development. This would enable stakeholders to fully understand the impact of the final proposals and ensure a smooth implementation.

76 By contrast, one individual respondent did not welcome changes to IFRS Standards that would increase complexity and increase the reporting burden. (not in line with EFRAG DCL).

77 Finally, one respondent (European corporate industry association) expressed concerns that the IASB's proposals may have the counterproductive effect of reducing the primary financial statements to the status of a compliance document (e.g. due to the rules-based nature of the proposals missing key concepts such as main business activity or by nature/by function presentation of expenses) and leading to performance reporting being communicated by other ways; this respondent consider that the proposals are developed following the users' perspective, without considering the need of the management to covey a presentation of performance aligned with their business approach.

Question 1 Operating profit or loss

> Paragraph 60(a) of the Exposure Draft proposes that all entities present in the statement of profit or loss a subtotal for operating profit or loss.
>
> Paragraph BC53 of the Basis for Conclusions describes the Board's reasons for this proposal.
>
> Do you agree with the proposal? Why or why not? If not, what alternative approach would you suggest and why?

EFRAG's tentative position

> In general, EFRAG supports the IASB's efforts to improve the structure and content of primary financial statements, particularly the statement of profit or loss.
>
> EFRAG highlights that '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. Thus, EFRAG supports the IASB's proposal to require all entities to present on the face of the statement of profit or loss the subtotal 'operating profit or loss' (with its consequent labelling), to reduce diversity in practice and improve comparability of financial statements.

Summary of constituents' comments

Improvements to the structure and content of the statement(s) of financial performance in general

78 Many respondents expressed support for the IASB's proposals to add new defined subtotals in the statement of profit or loss as it would reduce diversity in practice and improve comparability. Some of these respondents detailed that:

(a) currently only a few measures are defined or specified in IFRS Standards. Thus, defining more subtotals or measures will have a positive impact on financial information provided, both inside and outside the financial statements, by improving comparability between issuers and the understandability of their performance for users (in line with EFRAG DCL);

(b) the IASB's proposals will improve consistency and will assist in the implementation of electronic reporting format initiatives such as the European electronic reporting format (ESEF) and other technology advances.

79 Two respondents encouraged the IASB to go further and:

(a) develop specific subtotals for entities that provide financing to customers. One of these respondents noted that for entities whose main business activities include provide financing to customers and to make investments (e.g. banks), most of their income and expenses would be presented in the operating profit or loss. To tackle this concern, one of these two respondents encouraged the IASB to develop specific subtotals for entities that provide financing to customers. For example, it would be relevant to define a "gross income" including 'net interest income', 'dividend income', 'fees and commissions' and gains and losses from financial instruments excluding loan impairment losses;

(b) explicitly require that all line items included in the statement of profit or loss should be part of the calculation of a subtotal and of the total profit or loss (i.e. all line items should be allocated to categories).

80 Nonetheless, some respondents expressed concerns on the IASB's proposals to require new subtotals and categories on the face of the financial statements:

(a) two respondents expressed concerns on having stronger uniformity in the presentation of the statement of profit or loss (when considering the subtotals altogether). This could lead to 'a greater recourse to other channel of financial communication and an increasing consideration that the IFRS financial statements are a mere exercise in compliance';

(b) three respondents expressed reservations on the introduction of an investing category (please see more details in Question 5):

(i) the introduction of an investing category could give rise to challenging assessments, create implementation complexities and result in diversity in practice without significantly improving the usefulness of the information provided to users of financial statements;

(ii) currently entities do not present an investing category, even if it is possible under IAS 1;

(iii) it is problematic to use the same terms in the statement of profit or loss and the statements of cash flows when the definitions of these concepts for the purposes of these statements differ.

(c) one respondent from the automotive industry did not agree with the differentiation between an investing and financing category as such distinction would not result in a fair presentation of their business model. This respondent considered that the IASB should focus on issues that are key for users: 'operating income' and 'share of the result of equity accounted investments'.

81 Finally, one respondent would prefer narrow amendments to IAS 1.

Labelling of the new categories (operating, investing and financing)

82 Many respondents expressed concerns that both the statement of financial performance and the statement of cash flows would have three different categories with similar labelling (operating, investing, and financing) even though they would not be aligned. This could create confusion for users and preparers (in line with EFRAG DCL).

83 Some of these respondents suggested that the IASB:

(a) should align these categories to the extent possible (not full alignment, which had been discussed in the past in the context of the Discussion Paper on Financial Statements Presentation in 2009 and was not deemed achievable);

(b) this could have a separate project reviewing IAS 7 in light of the new proposals on the statement of profit or loss. One respondent considered that the IASB should align, for example, the definition of 'investing activities' with the 'investing category'. This would mean that in accordance with the new proposed definition of the investing category, cash flows from investing activities should comprise only cash payments and cash receipts related to 'investments in assets that generate a return individually and largely independently of other resources held by the entity'. Conversely, cash payments to acquire (and cash receipts from sales of) property, plant and equipment and intangible assets should be classified as cash flows from operating activities, as corresponding income and expenses from these assets (such as depreciation, amortisation and gains/losses on disposals) are classified in the operating category in the statement of profit or loss;

(c) different labels could be used for the categories in the profit or loss statement and the cash flow statement to avoid confusion;

(d) the IASB needs to explain why there is no alignment between the three categories (operating, investing and financing) in the income statement and the cash flow statement.

84 In addition, two respondents considered that:

(a) considered that the entities should not have the option to use different labels for the same concept (e.g. use of 'net income' to describe 'profit or loss') to avoid inconsistency of the labelling of the subtotals;

(b) the IASB should include the definitions of any new categories (e.g. 'operating', 'investing' and 'financing') in Appendix A of the new IFRS Standard.

Presentation of the subtotal operating profit or loss

85 Many respondents, particularly users of financial statements, expressed support for the introduction of the subtotal "operating profit or loss" as it would reduce diversity in practice, improve comparability and provide relevant information to users of financial statements.

86 However, some of these respondents:

(a) noted that main business activities are so diverse that analysts tend to look to the segment reporting under IFRS 8 as their primary source of information;

(b) would prefer changes to the requirement for segment reporting in IFRS 8 rather than the statement of profit or loss. More specifically, considered that it is better to maintain and improve segmentation of activities as part of the IFRS 8 (not mentioned in our DCL);

(c) IASB should look for more cohesiveness between what is required regarding the primary financial statements, particularly the statement of profit or loss, and what is laid down in IFRS 8. More specifically, IFRS 8 should require entities to present the operating profit - as defined - of each separate operating segment. It would create a direct link between the consolidated operating profit or loss and the operational performance of the segments. The amounts that are operating because they did not belong in the investing nor in the financing category, could then be disclosed separately. This interaction between the proposal in the ED and IFRS 8 would solve the concerns of some users that the operating profit is not defined directly.

87 One respondent did not object to the proposal to require the presentation of the subtotal 'operating profit or loss' and noted that such a requirement would not be a major change as most companies already present operating profit in the statement of profit or loss. To increase comparability, the definition of operating profit or loss is the critical issue.

Presentation of the subtotal operating profit or loss for financial institutions

88 A few respondents, particularly from the financial industry noted that the introduction of the 'Operating profit or loss' subtotal would only be relevant for entities that have a significant part of income and expenses in other categories (i.e. financing and investing). For banks and financial conglomerates, most of the income and expenses would be, in accordance with the IASB's proposals, presented within operating profit or loss. Thus, this subtotal would be artificial and would formally improve comparability without contributing to the relevance of the information (for more details please see questions 3 and 4).

89 In addition, a few respondents from the insurance industry highlighted the challenges that would be raised with the introduction of the subtotal 'operating profit'. In particularly, these respondents noted that insurers report on a fair value through profit and loss basis for their financial assets and insurance liabilities and considered that operating profit or loss would replace a well understood existing measures of financial performance and in reduce comparability with insurers which report using other comprehensive income. The proposal would result in short-term volatility being reported in operating profit in a way which both does not help the management's reporting on their stewardship of the entity's resources and has limited predictive value from the user's perspective. This would reinforce, rather than reduce, the need for extra management performance measure reporting (for more details please see questions 2).

Question 2 The operating category

Paragraph 46 of the Exposure Draft proposes that entities classify in the operating category all income and expenses not classified in the other categories, such as the investing category or the financing category.

Paragraphs BC54–BC57 of the Basis for Conclusions describe the Board's reasons for this proposal.

Do you agree with this proposal? Why or why not? If not, what alternative approach would you suggest and why?

EFRAG's tentative position

EFRAG supports the IASB's proposal to define the 'operating category' as described in paragraph 46 of the ED. EFRAG notes that in paragraphs 46 and B25-B31 of the ED the IASB starts by defining the operating category positively and then introduces a residual element in its definition. This residual element is further explained in paragraphs BC54 and BC55 of the Basis for Conclusions.

In this context, EFRAG highlights the importance of having clear guidance on the notion of the "entity's main business activity" or "in the course of the entity's main business activity".

Summary of constituents' comments

Definition of operating category: positive vs residual approach

90 The majority of the generally supported the IASB's proposed definition of 'operating profit or loss'.

91 Nonetheless, many respondents provided comments on the fact that the IASB's definition of 'operating profit or loss' includes both a positive and a residual element.

(a) Many respondents expressed concerns that the definition of 'operating profit or loss' included a residual element, particularly when considering that 'operating profit or loss' is a key measure. These respondents noted that:

(i) such an approach raised the risk of turning 'operating profit or loss' into a 'dumping ground' (e.g. it would include restructuring costs, disposals or impairment of individual non-current assets, impairment of goodwill, etc;

(ii) a residual approach would fail to increase comparability as it would not reflect the income and expenses from the 'main business activities' for all entities;

(iii) if many preparers find the residual figure misleading, the proposed definition is likely to be a driver for presenting alternative measures outside the financial statements and thus not lead to the desired comparability and would create confusion;

(iv) a residual category approach works only if the other categories are well and independently defined (i.e. no circularity). This is not the case in the ED. For example, paragraph BC49 states that the objective of the investing category is to 'identify returns from investments that are not part of the entity's main business activities';

(v) there should be a definition for the results achieved by company's core and recurrent operations. For that purpose, the results generated by extraordinary or one-off transactions should be separately presented and not included in operating profit, investment profit or financing result line items;

(vi) detailed that if operating profit or loss is defined as a residual category, entities will include minor and auxiliary business activities in operating profit. This would conflict with the notion stated in paragraph 46 of the ED that the operating category includes information about income and expenses from an entity's main business activities.

(b) By contrast, many respondents agreed with having an operating category that includes a residual element. In addition, these respondents:

(i) encouraged the IASB to better explain the concept of the investing and financing categories to ensure that the operating category is comprised of all income and expenses of an entity except for those that belong in the narrowly defined other categories respondents;

(ii) considered that if there are other amounts that materially influence the operating income and that for some reason cannot be linked to the main business activities, the entity is likely to comment on that (to the extent that the amounts are material). In addition, an improved interaction between the proposal in the ED and IFRS 8 could solve the concerns of some users that the operating profit is not defined directly;

(iii) acknowledged that if operating profit or loss is defined as a residual category, entities will include minor and auxiliary business activities in operating profit (e.g. disposal of non-current assets, impairment loss of goodwill, gains or losses on loss of control of subsidiary, etc). This would conflict with the notion stated in paragraph 46 of the ED that the operating category includes information about income and expenses from an entity's main business activities;

(iv) acknowledged that developing a principle-based definition of the operating category would have been the best approach from a conceptual perspective. However, supported the practical way forward retained by the IASB in this respect.

92 One respondent asked the IASB to further discuss the classification of the following items, which raised often in practice and did not considered them to be operational (more related to investments or divestments decisions):

(a) impairment loss for goodwill;

(b) gains and losses related to non-current assets held for sale as part of continuing operations (i.e. not eligible to a separate presentation as a discontinued operation in the statement of performance applying IFRS 5 Non-current Assets held for Sale and Discontinued Operations3);

(c) the gain or loss arising from the loss of control of a subsidiary as specified in paragraphs B98–B99A of IFRS 10 Consolidated Financial Statements; and

(d) the gain or loss related to the remeasurement of the previously held equity interest in an acquiree when the entity obtains control of that acquiree in steps in accordance with paragraphs 41–42A of IFRS 3 Business Combinations.

<u>Definition of operating category: associates and joint ventures</u>

93 Respondents also provided mixed views on whether associates and joint ventures should be presented within operating profit or loss.

(a) a few respondents considered that associates and joint ventures, in particular those that are integral, should be presented within the operating category:

(i) two respondents, including one respondent from the insurance industry considered that investments in associates and joint ventures were made in the course of an entity's main business activities and should also be displayed in the operating category (e. g reconsidering the scope of the requirement in paragraph 48 to include income and expenses from associates and joint ventures). Further, income and expenses related to associates and joint ventures displayed separately in two-line items in operating profit or loss (i.e. separately for integral vs. non-integral associates and joint ventures). This would better reflect insurers' investment business while users would still be able to extract the respective information on income and expenses from associates and JVs from the separate line items;

(ii) one respondent noted that integral associates and joint ventures are defined as being 'integral to the main business activities of an entity'. If so, they should be included in the operating category.

(b) one respondent suggested that the IASB require classification of income and expense from non-integral associates and joint ventures as operating for entities that invest in associates and joint ventures in the course of their main business activities;

(c) by contrast, one respondent welcomed that 'operating profit or loss' did not reflect income and expenses from associates and joint ventures. This respondent considered that the operating margin to make sense, as a general rule, it should only include revenue and expenses which are fully consolidated.

94 Finally, one respondent from the automotive industry did not agree with the IASB definition of operating profit as the term 'main business' activities is misleading, and the definition is circular, difficult to read and ambiguous. This respondent preferred to have two main categories: 'Main activities' (including income of main activities gained by fully consolidated companies and income from investments where the investments are directly connected to the main activities) and 'financing the main activities' (i.e. which would not be a main activity).

Definition of operating category when applied to the insurance industry

95 A few respondents from the insurance industry expressed concerns about the IASB proposed definition of operating profit or loss when applied to the insurance industry. More specifically:

(a) expressed concerns about the implications of the proposal on the insurance industry who typically apply a fair value through profit or loss ('FVTPL') approach in the valuation of insurance liabilities under IFRS 17 and financial assets under IFRS 9. Currently the impact of investment variances, economic assumption changes and short-term market fluctuations in the return of investments are recognised outside of operating profit;

(b) noted that the proposed definition of the operating category would reduce comparability for insurance companies. This is because the operating result would significantly depend on insurer's accounting policy choices made under IFRS 9 and IFRS 17. More specifically, two identical insurers could report significantly different operating profits: an insurance company that reports FVTPL under IFRS 9 and IFRS 17 (general market practice in the UK, Australian and Canada) will present an operating profit significantly more volatile (with limited options to present an appropriate disaggregation to explain the performance in the period) compared to an insurance company that reports FVOCI under IFRS 9 and IFRS 17. Further work is needed here to ensure the objective of improved comparability is achieved.

96 These respondents from the insurance industry provided the following suggestions:

(a) operating profit as defined by the ED without disaggregation of fair value investment variances would not provide a fair reflection of the financial performance in a given period. Disaggregation of the fair value investment variances and economic assumption changes, which are often large and not predictive of performance, is necessary to gain an understanding of the operating performance in the period and reflect the buy and hold investment model. Without this disaggregation, the ED does not meet the objective of providing relevant financial information such that the users of the financial statements can assess "management's stewardship of the entity's resources";

(b) additional non-GAAP disclosures will be necessary to enable users of the accounts to understand the underlying profitability. For example, the measure Group Adjusted Operating Profit that excludes fair value investment variances and economic assumption changes is essential for management's decision making and internal performance management;

(c) the IASB should consider allowing a transfer of investment variance from operating to investing, with suitable disclosure of the approach applied, to facilitate a more useful and more comparable income statement presentation for insurers, and to avoid the propagation of additional performance measures.

<u>*Definition of operating category: need for additional guidance*</u>

97 Many respondents highlighted the importance of the notion of the ‘entity’s main business activity’ or ‘in the course of the entity’s main business activity’ and called for more guidance (i.e. guidance that illustrates how an entity determines its main business activities) as the lack of guidance might give rise to significant diversity in practice (in line with EFRAG DCL). In addition, respondents noted that:

(a) the allocation of income and expenses to the operating category and other categories (e.g. integral associates and joint ventures) significantly relies on these notions and the use of such concepts might involve significant judgement (in line with EFRAG DCL);

(b) further guidance is needed regarding the notion of ‘an entity’s main business activities’, especially when considering different levels of reporting entities in a group context. For example, if an activity is identified as a main business activity on a subsidiary level in its separate statements, it may or may not remain so on a group level, and we do not see that the ED provides enough guidance;

(c) the ED does not clearly articulate the link between the ED and IFRS 8 *Operating Segments*. For example, the ED does not clarify the interaction between the notion of ‘entity’s main business activity’ in the ED and the notion of ‘main business activities’ used in IFRS 8 *Operating Segments.* In particular, whether ‘main business activity’ assessment should be done at a segment level or lower (in line with EFRAG DCL);

(d) guidance is needed on when an entity is permitted or even required to reassess what constitutes its main business activities as entities can have several main business activities and the main business activities may alter over time;

(e) entities could be required to provide ‘a description of the nature of the entity’s operations and its main business activities to help users understand the classification of income and expenses in the different categories;

(f) the IASB needs to clarify that income and expenses arising from ‘ancillary’ business activities (its ‘non-core’ or ‘supplementary’ activities) should be also presented in the operating category. That is, an entity’s main business activities and its ‘supplementary’ or ‘non-core’ business activities (e.g. non-core, supplementary, investing and financing to customers) would be presented in the operating category and separately presented in the notes;

(g) called for the IASB to consider using the concept more broadly as a determining factor in categorisation issues;

(h) lacks guidance as to the circumstances under which a change in the classification of an item of income and expense is allowed or required;

(i) more guidance or examples on how entities with different business activities related to different industries (i.e. conglomerates) should present their disaggregated performance within the operating category;

(j) called for the IASB fine-tune the definition of the operating category to clarify about the presentation of income and expenses that are not related to an entity’s main business activities are necessary (e.g. and do not meet the definition of items to be presented in the investing and financing categories (e.g. impairment loss for goodwill, gains and losses related to non-current assets held for sale as part of continuing operations, the gain or loss arising from the loss of control of a subsidiary).

98 In addition, some respondents provided comments on the wording used by the IASB to define operating profit or loss:

(a) not clear why the wording in paragraphs 48 and 51 of the ED is different (i.e. “in the course of its main business activities” and “as a main business activity” respectively);

(b) other terms similar to ‘main business activity’ are used in other IFRSs such as income arising “in the course of an entity’s ordinary activities” (IFRS 15 Revenue from Contracts with Customers, IFRS 3 Business Combinations) potentially resulting in confusion. It would be useful to clarify the interaction (not mentioned in EFRAG DCL);

(c) not clear whether the examples provided in paragraphs B33 (operating category), B32 (investing category) and B34-B37 (financing category) are exhaustive/required or whether these paragraphs only illustrate items that typically would be classified in each of the categories.

(d) improve the wording used. For example:

(i) amending the phrase, “generated in the course of its main business activities” in paragraph 48 of the ED to “arising from its main business activities”;

(ii) ‘income and expenses arising from an entity’s activities in executing its business model’ would be a clearer articulation for items to be classified in the operating category.

99 Finally, one respondent called for more guidance on specific items such as:

(a) hedging instruments (e.g. where to classify the ineffective hedging portion);

(b) acquisition-related costs incurred in a business combination;

(c) gains or losses arising from disposals of businesses and consolidated subsidiaries; and

(d) remeasurements of previously held interest in associate and JV due to the obtaining of control over.

Question 3 The operating category: income and expenses from investments made in the course of an entity’s main business activities

> Paragraph 48 of the Exposure Draft proposes that an entity classifies in the operating category income and expenses from investments made in the course of the entity’s main business activities.
>
> Paragraphs BC58–BC61 of the Basis for Conclusions describe the Board’s reasons for this proposal. Do you agree with the proposal? Why or why not? If not, what alternative approach would you suggest and why?

EFRAG’s tentative position

> EFRAG agrees with the proposal as it will enhance the comparability between entities and provide relevant information to users of financial statements.
>
> Nonetheless, EFRAG calls upon the IASB to closely communicate with regulators on the interaction of the IASB proposals with existing regulatory frameworks, particularly those that exist across Europe (e.g. on the use of additional subtotals).

Summary of constituents' comments

<u>*Classification of income and expenses from investments in operating profit or loss*</u>

100 Many respondents agreed that income and expenses from investments made in the course of the entity's main business activities should be classified in the operating category (in line with EFRAG DCL).

101 Nonetheless, some respondents provided different views on whether there is a need to separate returns from investments made in the course of an entity's main business activities from those that are not:

(a) a few respondents from the financial sector considered that there was no need to separate returns from investments made in the course of an entity's main business activities from those that are not as most or even all investments were made in the course of their main banking business. It would also be difficult without adding relevant useful information to users;

(b) one respondent added that challenges may arise when an entity invests in an investment property and has to determine whether investments in investment properties are part of entity's main business activities (not mentioned in EFRAG DCL);

(c) one respondent noted that it is useful for users to separate returns from investments made in the course of an entity's main business activities from those that are not.

<u>*Additional guidance on the classification of income and expenses from investments*</u>

102 Many respondents considered that the IASB proposals need further consideration and called for additional guidance. In particular, these respondents considered that it would be important that the IASB:

(a) provides more guidance on the notion of 'entity's main business activity' or 'investments made in the course of the entity's main business activity' to enable consistent application. For instance, would welcome more 'positive' and 'negative' examples in paragraph B27 of the ED and examples of when a main business activity is not a business segment;

(b) provides more guidance on investments in subsidiaries accounted for under IAS 27 *Separate Financial Statements*. For example, when using the equity method on subsidiaries in the separate financial statements, the IASB could clarify whether the parent company should classify the share of profit or loss from subsidiaries in the operating or investing category;

(c) requires explicitly, in a future IFRS Standard, that transactions of financial instruments made by non-financial companies should not normally be regarded as part of the company's main business activities. This is because a preparer may define the company's main business activities as broadly as possible to recognise income and expenses from investing activities in the operating category;

(d) provides more guidance on the reclassifications of investments (and, thus, related income and expenses). For example, clarifications about how paragraph 48 of the ED would apply when the investing activity funds existing or new main business activities or becomes itself one of the entity's main business activity;

(e) clarifies how to deal with income and expenses from investments made in the course of an entity's main business activities other than investments in associates and joint arrangements. For example, whether the depreciation, impairment and amortisation of a non-current asset used in industrial production be classified as operating or as investing expenses (not mentioned in EFRAG DCL);

(f) expands paragraph B30 of the ED to make reference to investment entities (as defined in IFRS 10 *Consolidated Financial Statements*). This will further improve consistency in presentation between investment entities regardless of whether investing in financial instruments and or non-financial instruments such as property;

(g) clarifies that for investment funds fair value measurement gains/losses from financial instruments shall also be presented within the operating category;

(h) expands paragraph 64 of the ED so that an entity does not have to present the subtotal 'profit or loss before financing and income tax' if applying paragraph 52 of the ED it classifies all income and expenses from financing activities and all income and expenses from cash and cash equivalents in the operating category;

(i) clarifies the presentation of investments in start-up entities developing specialised technology that the reporting entity may wish to make use of later. Such investments might be considered to have an operating nature and therefore would appropriately be classified in the operating category. However, the degree of influence held by the reporting entity may be such that equity-accounting might be required, thus excluding the (negative) returns from the main body of the operating category;

(j) improve the wording used. For example, amending the phrase, "generated in the course of its main business activities" in paragraph 48 of the ED to "arising from its main business activities";

(k) includes banks as an example of entities that invest in the course of their main business activities (in paragraph B27 of the ED) (not mentioned in EFRAG DCL);

(l) the IASB should clearly distinct between 'investments made as part of the entity's main business activity' and 'investments made in the course of the entity's main business activities' as such distinction may lead to different conclusions. For example, if a paper company that takes a minority stake in another paper group active in another part of the world where the paper company itself is not yet active: is that an investment made in the course of the entity's main business activities? Should it be presented within operating profit?

Question to constituents

103 *Paragraph 32 of EFRAG DCL: For those in a regulated industry, would the IASB proposals in paragraph 48, for entities that invest in the course of the entity's main business activities, result in significant changes in practice that would be in conflict with regulation in your industry? Do you expect any additional challenges or significant costs?*

Do not expect additional challenges, conflicts or costs

104 Some respondents did not expect additional challenges, conflicts with regulations or significant costs:

(a) one respondent from the banking industry explained that currently the structure used in the financial statements presented under IFRS were already different from the one used for statutory requirements (banks are subject to FINREP regulatory reporting requirements);

(b) one national standard setter did not expect significant changes or conflicts in Denmark;

(c) one respondent from the insurance industry did not expect conflicts, additional challenges or significant costs. Only one-off implementation costs for setting up the IT systems / processes as well as with costs related to the classification of income and expenses.

May lead to additional challenges, conflicts, and costs

105 One respondent suggested that the IASB closely communicates with regulators on this topic to avoid having to prepare two or three different templates/presentations for the profit and loss statement (and any other financial statement) to be provided to ECB, Insurance Supervisor, markets supervisor and to main stakeholders (in line with EFRAG DCL).

106 This respondent noted that financial conglomerates, banking and insurance businesses are highly regulated industries, therefore the implementation of the new ED may lead to a conflict with specific requirements for both industries in terms of how to report and communicate public financial information. For example, the Spanish banking requirements to communicate public information to the local supervisor of the stock exchange market is based on FINREP templates. The same happens with public presentation for the financial statements which are prescribed by the National Bank and for the templates used to provide on-going information to the ECB. The following situations have been identified:

(a) paragraphs 60 (a) and 61 of the ED propose that all entities present a subtotal for operating profit or loss. Nonetheless, the income statement according to requirements based on FINREP for banks and the public template prescribed by the local National Bank use the subtotals lines “Gross Income” and “Profit/ (Loss) before tax from continuing operations” but not the subtotal “Operating Profit”. There are some lines presented after “Gross Income” such as administrative expenses, amortisation, depreciation that they will need to be moved inside the Operating Profit. In a similar way FINREP uses the subtotal “Total operating income, net”, however it is presented well above the IASB’s “Operating Profit”. E.g. it excludes administrative expenses, depreciation, impairment on both financial instruments and non-financial assets, provisions;

(b) Paragraph 60(b) of the ED proposes to present the subtotal ‘operating profit or loss and income and expenses from integral associates and joint ventures’ while current local requirements do not distinguish between integral and non-integral associates and joint ventures.

Focus on whether financial information is relevant for users

107 One respondent considered that the IASB should continue to focus on financial information that is relevant to primary users and that provides a faithful representation, rather than focus on avoiding differences with such frameworks. While liaising with constituents like regulators might help to ensure that IFRS Standards result in useful information (e.g., by learning about common industry practices), other frameworks might have different objectives and, therefore, should not predominate the IASB’s decisions.

Question to constituents

108 Paragraph 33 of EFRAG DCL: Do you consider that separating returns from investments made in the course of an entity’s main business activities from those that are not will be difficult to make in practice? Please explain.

No difficulties in separating returns from investments made in the course of an entity’s main business activities from those that are not

109 Two respondents did not consider that separating returns from investments made in the course of an entity’s main business activities from those that are not made in the course of an entity’s main business activities would be difficult in practice.

110 One of these respondents recalled that the proposals would only be applicable to entities making investments that generate a return individually and largely independently of other resources held by an entity in the course of their main business activities in the first place.

111 Nonetheless, one of these respondents expected the following costs/risks:

(a) entities will incur one-off implementation costs and for setting up the IT systems / processes as well as for the respective classification of investments on an ongoing basis;

(b) at initial application of the proposals, there may be a risk of strategic classification, i.e. (currently) low-performing investments may be less likely to be classified as 'investments made in the course of an entity's main business activities'. As such, clear principles are needed to ensure that the classification is made on a consistent basis within and across entities.

<u>*Difficulties in separating returns from investments made in the course of an entity's main business activities from those that are not*</u>

112 Two respondents replied that in practice it will be difficult to separate the returns from investments made in the course of an entity's main business activities from those that are not. One of these respondents stated that if the result is arbitrary, it would not result in helpful information to users.

<u>*No need for separating returns from investments made in the course of an entity's main business activities from those that are not*</u>

113 A few respondents from financial industry noted that investing is a main business activity for banks. Thus, most, or even all investments, are made in the course of their main banking business. Considering this, there is no need to separate returns from investments made in the course of an entity's main business activities from those that are not. This is the case even for financial assets and investment properties.

114 Nonetheless, one of these respondents noted that making the split would be costly if required and would not provide useful information to users of financial statements, in particular when considering that investment activities that are not obtained in the course of the entity's main business activities are not material.

Question 4 The operating category: an entity that provides financing to customers as a main business activity

Paragraph 51 of the Exposure Draft proposes that an entity that provides financing to customers as a main business activity classify in the operating category either:

- income and expenses from financing activities, and from cash and cash equivalents, that relate to the provision of financing to customers; or
- all income and expenses from financing activities and all income and expenses from cash and cash equivalents.

Paragraphs BC62–BC69 of the Basis for Conclusions describe the Board's reasons for the proposals.

Do you agree with the proposal? Why or why not? If not, what alternative approach would you suggest and why?

EFRAG's tentative position

EFRAG agrees with the IASB's proposal for entities that provide financing to customers as a main business activity, as it provides relevant information to users of financial statements. However, EFRAG questions the IASB's proposal to provide a 'free' accounting policy choice in paragraph 51(b) to non-financial institutions (e.g. manufacturer providing financing to customers).

Summary of constituents' comments

Support for the presentation of and classification in the operating profit or loss

115 Many respondents agreed with the IASB's proposal that entities whose main business activity is providing financing to customers should classify in the operating income category income and expenses from financing activities and from cash and cash equivalent (in line with EFRAG DCL).

116 In particular, one respondent highlighted the fact that such requirements would improve comparability, particularly for non-financial institutions. For example, currently a manufacture of retail goods that provides financing to customers as a main business activity may present the results of the provision of financing to customers either in the operating category or in the financing category.

117 One respondent also agreed that entities that provide financing to customers as a main business activity shall be required to classify income and expenses from cash and cash equivalents that relate to the provision of financing to customers in the operating category.

No support for the presentation of and classification in the operating profit or loss

118 A few respondents, particularly from the financial industry did not consider it was relevant to require banks to present the subtotal 'Operating profit or loss' when almost all income and expenses would belong to the operating category (only exclude results from associates and joint ventures and unwinding of discount on pension liabilities and provisions).

119 These respondents considered that requiring the presentation of the subtotal operating profit or loss for banks would not bring much added value for the statement of profit or loss and would be an artificial subtotal which formally improves comparability without contributing to relevance of the information.

120 These respondents, including a banking association, argued that the proposed requirements would force banks to present the subtotal 'operating profit or loss' while management considered that the operating performance was better reflected by another subtotal which would exclude some volatile items such as:

(a) impairment result from financial instruments, result from IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*; and

(b) impairment on non-financial assets including goodwill or gains/losses from disposal of non-financial assets.

121 These respondents noted that in order to properly capture their operating performance, banks would have to consider introducing own developed subtotal(s) in the statement of profit or loss. However, this may not be straightforward as noted in BC165 of the Basis for Conclusions.

122 These respondents suggested that the IASB does not require the presentation of the subtotals in the statement of profit or loss if (substantially) all income and expenses, other than from coming from associates and joint ventures, relate to main business activities. Alternatively, the IASB could consider keeping this subtotal but dropping the requirement to use the attribute 'operating' in labelling this subtotal.

The suggest 'Profit or loss before associates and joint ventures and income tax', or alternatively entities could use other appropriate labels.

123 One respondent explained that in order to properly capture the operating performance in the statement of profit or loss from the management perspective, he would have to consider introducing own developed subtotal(s). These would be also communicated externally and thus would meet the definition management performance measure(s). However, adding such subtotals which also are MPMs would not be straightforward because as noted in BC165 of the ED: "…the Board expects that few management performance measures would meet the requirements for presentation as a subtotal in the statement(s) of financial performance."

Additional guidance

124 Some respondents considered that it would be important to provide additional guidance on determining what are the "main business activities" of an entity, a key term in the IASB's proposals for entities to assess whether providing financing to customers is a main business activity.

125 In addition, respondents provided the following comments:

(a) one respondent, audit association, suggested that the IASB includes more examples: include an example of a car manufacturer that provides financing to customers and discloses its financing in a separate segment (not mentioned in EFRAG DCL) and a telecommunications company providing financing (e.g. when including products equipment in offerings) but does not disclose it in a separate financing segment;

(b) one respondent considered that the link between the proposals of the ED and the requirement to separately account for a significant financing component in accordance with paragraphs 60 seq. of IFRS 15 is not addressed in the ED. In addition, suggest that interest income and expenses from financing activities that are closely linked to a manufacturing activity (or another business activity that is presented within the operating category) be classified in the operating category;

(c) two respondents suggested the IASB to clarify if paragraph 51 of the ED could be applied on a segment level in the case of producers providing financing to customers;

(d) one respondent highlighted that the IASB proposals in paragraphs 51-52 of the ED for classifying income and expenses from cash and cash equivalents in the operating category did not capture all the scenarios. In particular, for one Italian participant to the field test, it was not clear if one of its main business (which consists, according to the Italian law, in collecting cash from customers and investing in European government bonds, without providing financing to customers and without investing in individually and largely independent financial assets1) could be classified in the operating category. It should be clarified that income and expenses from cash and cash equivalents should be classified in the operating category, when the entity provides financial services to customers as its main business activity, even if it is not providing finance to customers, like in the example de-scribed above.

Accounting policy option in paragraph 51 of the ED

126 Many respondents did not agree with the accounting policy choice described in paragraph 51 of the ED. Some of these respondents noted that an accounting choice would hinder comparability (in line with EFRAG DCL).

127 Nonetheless, respondents provided different views supporting their disagreement:

(a) some respondents did not agree with the IASB's proposal to provide a the 'free' accounting policy choice in paragraph 51(b) of the ED for non-financial institutions (in line with EFRAG DCL). This is because the accounting policy choice in 51(b), combined with the lack of clarity on how the notion of "main business activity" applies to preparers with several business lines, could potentially create the risk that non-financial institutions who provide financing to customers as one of their main business activities (for example, a car manufacturer that provides financing to their customers to buy cars) would withhold from investors useful information; (in line with EFRAG DCL);

(b) some respondents did not agree with the accounting option in paragraph 51(b) in all circumstances. These respondents did not see a strong argument for permitting some entities to allocate all income and expenses from financing activities and from cash and cash equivalents to the operating category;

(c) a few respondents, particularly from the financial industry considered that all income and expenses from financing activities and all income and expenses from cash and cash equivalents should be accounted for in the financing category.

128 These respondents provided different suggestions on how to move forward:

(a) require entities to undertake the allocation unless this would involve undue cost or effort. For entities for which the allocation would involve undue cost or effort, a set of additional disclosures in a single note could be required to provide further information in this regard;

(b) entities that provide financing to customers as a main business activity should classify in the operating category income and expenses from financing activities and from cash and cash equivalents that relate to the provision of financing to customers (i.e. should apply paragraph 51(a)), except when these entities are unable to distinguish its financing activities related to providing financing to customers. In such cases, entities should include all income and expenses related to its financing activities as part of financing activities and all income and expenses from cash and cash equivalent in investing activities;

(c) the 'free' accounting policy choice should not be applicable to entities that provide financing to customers although it is not their key main business activity (i.e. should not be applicable to non-financial institutions);

(d) when an entity only has one main business activity, which is providing finance to customers, this entity should be required to present all income and expenses from financing activities, all income and expense from cash and cash equivalents, and all interest income and expenses on other liabilities (as set out in proposed paragraph B37) in the operating category;

(e) entities should be required to make those allocations on a reasonable and consistent basis, supported by disclosure of the basis used;

(f) Instead of offering a free choice, we suggest constraining the choice by referring to the management approach, that is, binding the classification to the policy used in the entity;

(g) the IASB should specify the method an entity should use to allocate financial income and expenses in the operating category when the entity applies paragraph 51(a) of the ED;

(h) classify all income and expenses from financing activity and all income and expenses from cash and cash equivalents in the operating category only if the activity of providing financing to its customers is its major business activity.

129 Some respondents, particularly from the financial industry highlighted that financial institutions were likely to use the accounting option in paragraph 51(b) to classify all income and expenses from financing activities in the operating category. These respondents explained that:

(a) it would be artificial, difficult and costly to make the distinction for banks and financial conglomerates; and

(b) the net interest income is a key revenue item at the very top of the statement of income; separating a small part of interest expenses (allegedly unrelated to customer financing activities) would be very confusing.

130 However, one of these respondents added that introducing the accounting policy choice is likely to result in both a loss of comparability between entities and less transparency for entities that do not undertake the allocation.

131 Finally, one respondent considered that the IASB should state more clearly, that when a company has more than one main business, rules only apply to the specific parts of the company (e.g. segment that provides financing to customers).

Question to constituents

132 Paragraph 42 of EFRAG DCL Do you consider that it is 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? Please explain.

Allocation of income and expenses from financing activities and from cash and cash equivalents for entities that provide financing to customers

133 Three respondents did not think it would be difficult or costly to make the allocation. One respondent detailed that usually companies have systems that would allow them 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.

134 By contrast, two respondents considered that it would be artificial, difficult and 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. One respondent further noted that:

(a) the borderline between the customer financing and other activities would not be clear;

(b) the distinction would be very disproportionate since more than 90% of the balance sheet of a bank may consist of loans and debt securities, which are typical financing instruments.

135 One respondent had no clear indications that it would be too difficult or costly to allocate income and expenses from financing activities and from cash and cash equivalents to those that do relate to the provision of financing to customers and those that do not.

Question to constituents

136 Paragraph 43 of EFRAG DCL: For those that provide financing to customers as a main business activity and are in a regulated industry, would the IASB's proposals in paragraph 51 of the ED be in conflict with regulation in your industry? Do you expect any additional challenges or significant costs?

137 One respondent replied that the IASB proposals in paragraph 51 of the ED were not in conflict with banking regulation (FINREP reporting). This respondent detailed that in the FINREP structure of the statement of profit or loss all items of interest income and interest expenses are included as part of 'Total operating income, net' subtotal.

138 One other respondent did not expect conflict with regulation in their jurisdiction.

Question 5 The investing category

Paragraphs 47–48 of the Exposure Draft propose that an entity classifies in the investing category income and expenses (including related incremental expenses) from assets that generate a return individually and largely independently of other resources held by the entity, unless they are investments made in the course of the entity's main business activities. Paragraphs BC48–BC52 of the Basis for Conclusions describe the Board's reasons for the proposal. Do you agree with the proposal? Why or why not? If not, what alternative approach would you suggest and why?

EFRAG's tentative position

EFRAG supports the IASB's proposal to require the presentation of an investing category subject to materiality considerations (in accordance with paragraph 24 of the ED). Nonetheless, EFRAG considers that the IASB should better explain the interaction of paragraphs 45 and 60 (on the new requirements related to the categories and subtotals) with paragraph 24 of the ED which refers to the notion of materiality. EFRAG notes that the IASB's approach to consider income and expenses that arise from cash and cash equivalents being related to the entity's financing allows the reflection of managements' intention in managing debt and equity financing. However, there might be considerable relevance in another possible approach where the financing category is linked to the management of liabilities that arise from financing activities (as described in IAS 7) and the investing category is linked to the management of investments in assets. EFRAG is seeking views of the constituents on this topic. Finally, EFRAG is concerned about presenting gains and losses on derivatives in the investing category under certain conditions, particularly when referring to financial institutions. EFRAG is also seeking views on the costs of the proposal for presentation of exchange differences.

Summary of constituents' comments

Presentation of an investing category

139 Many respondents supported the proposal to create a new separate category in the profit or loss statement for "investing" income and expenses, as it will provide useful information to users of financial statements about the returns from investments that are not part of the entity's main business activities (in line with EFRAG DCL). One respondent noted that currently there is diversity in practice, and this limits the usefulness of information on both operating and investing activities for users.

140 Nonetheless, these respondents noted that the investing category in the statement of profit or loss is defined more narrowly than cash flow from investing activities in IAS 7. Although both are primary statements and prominently report on investing, they are non-comparable. If these two concepts cannot be reconciled, it may be useful to consider different labels to avoid confusion.

141 By contrast, a similar number of respondents expressed significant concerns on, or were even against to, the introduction of the investing category. These respondents explained that:

(a) it will be a challenge for entities to assess which assets generate an individual and independent return that should be reported in the investing category. Thus, it would create implementation complexities and result in diversity in practice;

(b) entities are not currently presenting an investing category even if it is possible under IAS 1;

(c) definition of investing would give rise to challenging assessments, without necessarily adding to the information usefulness for the users of financial statements;

(d) the amounts classified within this category are rarely expected to be significant on a recurring basis, hence limiting its value relevance;

(e) this category gives the false impression that it is mirroring the investing category of the statement of cash flows, while the underlying transactions are not the same;

(f) alignment with IAS 7 should be considered to make this category relevant;

(g) the principle for classifying income and expenses in the investing category is unclear and requires reconsideration. For example, it is not clear whether income and expenses on investment property should always be presented in the investing category, or whether an entity may classify income and expenses on investment property in the operating category (even if the entity does not operate a business model under which it invests in assets in the course of its main business activities);

(h) entities may use the investing category to clear operating profit or loss from unwanted items;

(i) the definition of income and expenses that should be presented in the investing category is similar to the definition of a cash generating unit which may also be a source of some confusion;

(j) the differentiation between investing and financing will not result in a fair presentation of its business model;

(k) the definition of the investing category is not sufficiently clear to ensure consistent and comparable application by the different entities applying IFRS;

(l) it would have been far more relevant to put in the same category all the income and expenses related to the net financial debt, and to define this metric (in practice entities present net cost of gross financial debt less income on cash and cash equivalents and other financial assets, such as marketable securities, held for financing rather than investing purposes);

(m) it is difficult to draw a line between investing and financing.

142 One respondent agreed with EFRAG that the IASB should better explain the interaction between paragraphs 45 and 60 of the ED on the one hand (requiring the use of predefined categories and subtotals in the statement of profit or loss) and paragraph 24 of the ED on the other (referring to the notion of materiality). Nonetheless, no need to refer the phrase ‘subject to materiality considerations’ necessary” as it applies to any proposed requirement.

More guidance on the definition of an investing category

143 Many respondents called for more guidance on the definition of an investing category. In particular, respondents:

(a) called for further guidance on what constitutes ‘investments made in the course of the entity’s main business activities’ as it would be helpful to avoid diversity in practice (in line with EFRAG DCL);

(b) considered the use of the notion of generating “a return individually and largely independently of other resources held by the entity” is potentially confusing;

(c) recommended the IASB to include a definition of investment in appendix 1, and this definition should be aligned with the stated objective for the investing category;

(d) considered that it is not clear from the current ED how entities should classify the interests paid on investments, negative interest payments, FX gains/losses on trade payable, or impairments of goodwill. In order to address this concern, the list in paragraph B32 and B33 could be expanded and the principles guiding this judgement further explained (not mentioned in EFRAG DCL);

(e) called for more guidance on incremental expenses as current practices in determining what is incremental or not as per other IFRS/IAS standards (e.g. IFRS 16 *Leases*, IFRS 15, IFRS 9, IAS 32 *Financial Instruments: Presentation*) have resulted in inconsistent or inadequate reporting disclosures. For example, it remains unclear whether labour costs of employees engaging only in investing activities are incremental. In addition, different interpretations exist as to whether, for example, legal and advisory fees for activities including due diligence, negotiating terms, preparing legal documents, etc. are incremental, considering that often (part of) these fees would still have been due even if the transaction had not been closed;

(f) suggested stating explicitly that transactions of financial instruments by a non-financial company would not normally be regarded as part of a company's main business activities;

(g) improves the definition of the investing category. The 'investment' category seems largely to be about returns from financial instruments. This is not the same as 'investment' in the cash flow statement. Nor is it the same as 'investment' in, for example, intangibles which are now a hugely important contributor to a company's future performance. Another example is the notion of "assets that generate a return individually and largely independently of other resources held by the entity" which is unclear;

(h) referred to the practical difficulties in applying the definition of 'investing category' to some common transactions, events or conditions. For example, entities happen to dispose of, or impair, their trade receivables applying the requirements in IFRS 9 or the costs related to that failed capital expenditure;

(i) more guidance on entities that implement asset-liability management strategies. For example, some entities invest in financial assets or equity instruments to secure the funding of long-term liabilities that arise as part of their main business activities (such as decommissioning liabilities). In the absence of any specific presentation requirement in this respect, an entity would have to present in separate categories items of income and expenses that are, from management's perspective, intertwined ('presentation mismatch'). This would result in presentation 'mismatches' between the investing and financing categories;

(j) clarifies the presentation of investments in start-up entities (operating or investing?).

144 In addition, one respondent was concerned about the proposal that the investing category includes only incremental expenses related to investment (paragraph 47(b) of the ED). This implies that profit or loss from investing is overstated in relation to profit or loss from operating activities, which by default includes all fixed expenses.

145 Finally, one respondent considered that the definition of the investing category was too narrow and needed to be amended so as to include income or expenses related to changes in the consolidation scope (e.g. impairment loss for goodwill, contingent consideration from business combination, etc). Else, the investing category as defined in this ED is expected to include non-material amounts.

Classification of foreign exchange differences

146 Two respondents welcomed the IASB's proposals. Nevertheless, they noted that:

(a) the costs are likely to vary depending on an entity's main business activity / activities;

(b) suggested that the IASB clarifies the presentation of foreign exchange differences when income and expenses from the items that gave rise to the foreign exchange differences are classified in more than one category.

147 One respondent considered that the IASB should provide further guidance on the interaction of the classification with the chosen presentation of operating expenses (by nature or by function) (not mentioned in EFRAG DCL).

148 One respondent recommended a separate disclosure of foreign exchange differences included in operating profit, either in the income statement or in the notes, for instance by amending paragraph 52(a) of IAS 21 *The Effects of Changes in Foreign Exchange Rates*.

Classification of fair value gains and losses on derivatives and hedging instruments

149 One respondent welcomed the IASB's proposal. Nonetheless, this respondent expressed concerns regarding the proposal that fair value gains and losses on derivatives and hedging instruments shall be classified in the investing category (as a default category),if a classification in the category affected by the risk the entity manages would involve grossing up gains and losses and for derivatives that are not used for risk management. This could result in entities being required to present an investing category simply due to their hedging and risk management activities which will be difficult to explain to users of financial statements. It is unlikely that entities use derivatives for purposes other than risk management. Therefore, we recommend the IASB to redeliberate whether:

(a) an accounting policy choice should be permitted to classify fair value gains and losses on derivatives and hedging instruments in a single category; or

(b) the operating or financing category should be designated as the default category, as they usually entail activities that are typically related to risk management.

150 The new presentation requirements should apply to both, embedded derivatives and stand-alone derivatives.

151 One respondent considered that the IASB should provide further guidance on the interaction of the classification with the chosen presentation of operating expenses (by nature or by function). (not mentioned in EFRAG DCL).

152 Finally, one respondent asked the IASB to clarify the guidance on grossing up related to the classification of derivatives. In particular, paragraphs 57-59 of the ED and the example in paragraph B42 refer to derivatives used to hedge risks arising from items classified in different categories. Such circumstances are very rare in practice and the guidance for avoiding the "grossing up" effect on gains and losses could be misleading in other more frequent fact patterns. More specifically, entities could enter into derivatives for hedging net exposure of income and expenses, so that gains or losses on derivatives cannot be attributed to a specific line item (because they refer to a net exposure). Therefore, the IASB should clarify that such derivatives can be classified in the operating category on a net basis, when the hedged net exposure is referred to revenues and costs related to the main business activity (i.e. when the hedged items are all in the operating category).

Question to constituents

153 Paragraph 57 of EFRAG DCL: Do you consider income and expenses from cash and cash equivalents (i.e. short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value) as part of the entity's financing (paragraph 54 above) or investing activities (paragraph 55 above)? Please explain.

<u>Classification of income and expenses on cash and cash equivalents</u>

154 Some respondents, particularly from the financial industry (i.e. entities that invest in the course of their main business activities) agreed with the IASB's proposal and noted that for banks, insurance companies and financial conglomerates income and expenses from cash and cash equivalent are naturally part of operating activities (in line with EFRAG DCL).

155 For entities that do not invest in the course of their main business activities, respondents provided mixed views:

(a) some respondents agreed with the IASB proposals to classify income and expenses from cash and cash equivalents as part of the entity's financing activities. One respondent added that the IASB should (more clearly) require separate presentation (or disclosure) of the main financing category items;

(b) one respondent acknowledged that there are arguments for presenting both as investing and as financing. Considering this, it supported EFRAG's suggestion of linking the financing category to the management of an entity's liabilities that arise from financing activities and the investing category to the management of investments in assets. Including income and expenses from cash and cash equivalent as part of investing activities has the merit of including in the same category income and expenses from cash equivalents and from other very liquid investments that share many characteristics with, but fail the narrow definition of, cash equivalents;

(c) two respondents, including a users' association, considered that if is cash and cash equivalents allocated to working capital (cash and cash equivalents used for operating needs), then any related income and expenses should be within operating profit. If it is large cash balances in excess of their operating needs, then income and expenses should be within financing category (i.e. linked to net debt). It was also noted that there may be some restrictions on the use of cash and cash equivalents (e.g. restrictions imposed by banks);

(d) two respondents did not agree with the separation of income and expenses from cash and cash equivalents from other interest income and expense;

(e) two respondents questioned the need for a separate presentation of interest income of cash and cash equivalents, particularly when considering that they may not be material on their own (particularly in a low interest rate environment). The additional cost of a separate recognition for each of their subsidiaries would not be justified;

(f) one respondent noted that in practice entities present, in a financing category, the net cost of gross financial debt less income on cash and cash equivalents and other financial assets (such as marketable securities) held for financing rather than investing purposes.

Question to constituents

156 Paragraph 63 of EFRAG DCL How costly would it be to track whether exchange differences relate to the entity's main business activities, investing activities or financing activities? Please explain.

<u>*Costs related to exchange differences*</u>

157 Some respondents did not expect excessive costs as companies usually have systems that would allow them to track whether exchange differences relate to the entity's main business activities, investing activities or financing activities. One respondent detailed that entities would have one-off implementation costs to set up the IT systems and processes and some ongoing costs. While the initial one-off implementation costs might be significant for various entities, the ongoing costs would be minor.

158 Some respondents considered that it would be burdensome and costly to track whether exchange differences relate to the entity's main business activities, investing activities or financing activities. These respondents explained:

(a) this is especially true when entities steer the overall foreign currency position and use the system of position accounts whereby the gains and losses on foreign currency transactions are calculated on an aggregated level;

(b) the costs of tracking the exchanges differences relating to operating, investing and financing activities derive mainly from changing IT systems and workflows.

159 Three respondents from the financial industry noted that for banks the concerns related to the costs of tracking exchange differences will be mitigated by the fact that most income and expenses will be presented within the operating category. In addition, it was noted that the items presented outside of the operating category were not likely to give raise to exchange differences (associates and joint ventures and liabilities and unwinding of discount on pension liabilities and provisions). Thus, all their foreign exchange differences seem to relate to the operating category.

160 One respondent from the insurance industry noted that for entities making investments in the course of their main business activities the majority of exchange differences would arise in the operating category as well. For entities making investments in the course of their main business activities, a scenario in which no income and expenses and, thus, no exchange differences would need to be classified in the investing category is also possible. Under these circumstances, exchange differences could only relate to two rather than three categories (operating and financing). Therefore, for such entities, the tracking should also be less costly and more straightforward.

161 One respondent had no clear indications on whether tracking exchange differences relate to operating, investing or financing activities, would be too difficult or costly.

162 Finally, one respondent expected the proposed changes regarding the structure of the statement of profit and loss, in particular on the classification fair value gains and losses on derivatives and hedging instruments, to lead to significant increases in costs and efforts.

Question 6 Profit or loss before financing and income tax and the financing category

(a) Paragraphs 60(c) and 64 of the Exposure Draft propose that all entities, except for some specified entities (see paragraph 64 of the Exposure Draft), present a profit or loss before financing and income tax subtotal in the statement of profit or loss.

(b) Paragraph 49 of the Exposure Draft proposes which income and expenses an entity classifies in the financing category.

Paragraphs BC33–BC45 of the Basis for Conclusions describe the Board's reasons for the proposals.

Do you agree with the proposals? Why or why not? If not, what alternative approach would you suggest and why?

EFRAG's tentative position

EFRAG supports the IASB's proposal to require and define 'Profit or loss before financing and income tax' and the 'financing category'. EFRAG highlights that the outcome of IASB's proposals is, to some extent, similar to the concept of Earnings Before Interest and Tax ('EBIT') and that there is a strong demand from users of financial statements to define and require the presentation of a subtotal equal or similar to EBIT. However, as already mentioned above, EFRAG highlights the challenges of the IASB's proposals to make the distinction between the investing and financing category.

EFRAG notes that in accordance with paragraph BC44 of the Basis for Conclusions, time value of money on liabilities that do not arise from financing activities can be seen either as a component of the operating category or of the financing category. EFRAG is seeking views from the constituents on this topic.

EFRAG notes that it would be useful to consider whether incremental expenses related to financing activities should also be in the financing activities in symmetry with the treatment of expenses relating to investing activities.

Summary of constituents' comments

163 Many respondents welcomed the IASB proposal to require and define "profit or loss before financing and income tax". Some of these respondents noted that this subtotal would serve the purpose of allowing users of financial statements to analyse on a consistent and comparable basis an entity's performance independently of how that entity is financed (in line with EFRAG DCL).

164 Nonetheless, respondents provided mixed views on the presentation of cash and cash equivalents (please see above paragraph 154) and interest income and expenses on liabilities that do not arise from financing activities (please see below paragraph 170).

165 In addition, some respondents considered that:

(a) the label could be misleading because the definition of "financing activities" currently provided in paragraph 50 of the ED seems to be oriented towards debt, even if issuing equity is also normally considered a financing activity. Furthermore, the current definition seems not to take into account instruments where the resource will not be returned to the provider of finance (perpetual debt) or where a different resource is returned to the provider (convertible debt) (not mentioned in EFRAG DCL);

(b) financing category should encompass not only the income and expenses related to the gross financial debt and cash and cash equivalents but also the income or loss related to financial assets held for financing purposes and treated as part of the net financial debt;

(c) the presentation of associates and joint ventures (after tax) before this subtotal (before tax) raises a major concern in terms of relevance of the information presented;

(d) recommended the IASB to clarify the scope of “other liabilities” in paragraph 49 (c). For example, whether provisions for uncertain tax positions are within the scope of other liabilities. The IASB should also clarify whether interest income and expenses on uncertain tax amounts are included in the same category;

(e) recommended that the IASB clarifies the categorisation of interest income and expenses related to assets;

(f) incremental expenses relating to financing should be included in the financing category in the statement of profit or loss;

(g) until the issues for insurance companies that include insurance finance expenses within the operating category are resolved, this section is unlikely to meet the objective of providing a useful basis for comparing an entity’s performance independently of how that entity is financed;

(h) clarify the meaning of “negotiated on extended credit terms”. Suggest adding as an example expenses related to trade liabilities for which discounting at initial recognition was required (i.e. usually liabilities with a maturity at inception of more than one year);

(i) entities should be allowed to label the new defined subtotal as ‘EBIT’ or ‘operating profit or loss’, provided that the performance measure does not contain any significant amounts of interest income or expense (for financial institutions for whom interest income and expense are the most significant items of income and expense, the IASB’s prohibition to use ‘EBIT’ is relevant and suggest using ‘operating profit or loss’ instead);

(j) questioned whether the IASB intended a similar meaning regarding the definition of ‘financing activities’ in the ED and the SPPI criterion in IFRS 9. For example, whether a finance charge that is not a compensation that depends solely on the amount of the loan and its duration (e.g. in the case of an embedded derivative) would be covered by the definition of financing activities;

(k) Considered that changes in the fair value of contingent consideration that are not measurement period adjustments (in accordance with paragraph 58 of IFRS 3), remeasurements of a financial liability arising from an entity’s obligation to purchase is own equity instruments, and transaction costs incurred that are not attributable to issuing new capital or new shares (e.g. costs attributable to listing existing shares, share splits or secondary offerings) should be presented in the financing category (paragraph B36).

166 Three respondents did not object to the requirement to present a profit or loss before financing and income tax in the statement of profit or loss.

(a) one of these respondents noted that if the investment category is not introduced, then the returns from financial investments should belong to this financing category;

(b) the other did not agree with the way financing had been defined in the ED, particularly on time value of money (which is included) and cash and cash equivalents (which excludes other than cash and cash equivalents);

(c) an entity should be permitted to present ‘income from other financial assets or equity instruments’ (i.e. long-term investments that fund long-term liabilities) in the financing category together with the unwinding effect computed on the liabilities. This would ensure that subtotal of profit or loss before financing and income tax is unaffected by the nature of the underlying items used to fund the liabilities.

167 One respondent did not consider this subtotal relevant.

168 Finally, a few respondents referred to other specific issues:

(a) two respondents considered that banks should have flexibility to include immaterial items from financing and investing activities within the operating category (e.g. other income and expenses' line item;

(b) one respondent expressed concerns that the IASB intended to split income and expenses on trade payables into different categories – financing category in case of extended credit terms and operating category in case of "regular" trade payables. The classification of a payable as "trade" payable indicates that the operational background is considered as main driver for its existence. Hence, income and expenses on trade payables should not be split into different categories.

Question to constituents

169 Paragraph 76 of EFRAG DCL: Do you consider income and expenses that reflect the effect of the time value of money on liabilities that do not arise from financing activities (as in paragraph B47 of the ED) as part of the entity's financing or operating activities? Please explain.

<u>Income and expenses that reflect the effect of the time value of money on liabilities that do not arise from financing activities</u>

170 When referring the allocation of income and expenses that reflect the effect of the time value of money a slight majority of those responding considered that those income and expense should be part of the entity's operating activities. Respondents provided the following views:

(a) some respondents agreed with the IASB proposal that income and expenses that reflect the effect of the time value of money on liabilities that do not arise from financing activities should be classified in the financing category. Nonetheless, one respondent believed that the IASB should (more clearly) require separate presentation (or disclosure) of the main financing category items;

(b) one respondent considers that income and expenses that reflect the effect of the time value of money on liabilities that do not arise from financing activities should be part of the financing category to the extent that such items do not arise from an entity's main business activity;

(c) some respondents considered that income and expenses that reflect the effect of the time value of money on 'liabilities that do not arise from financing activities' should be classified in the operating category;

(d) two respondents from the financial industry considered that the income and expenses that reflect the effect of the time value of money on liabilities that do not arise from financing activities should be part of the entity's operating activities. (e.g. income or expense of the provisions and liabilities (under the scope of IAS 19 *Employee Benefits*, IAS 37 or IFRS 16 are classified in the operating section, in this sense the time value of money on these liabilities should be treated consistently in a similar way). These respondents also noted that these items were currently presented in the net interest income and that the regulatory FINREP reporting as set out by the EBA also applied this approach;

(e) one representative of users considered that if the actual cost is accounted for in the operating category, then the unwinding of any discount should also be in the operating category;

(f) three respondents considered that there are arguments to support both the presentation in the financing and operating. For example:

    (i) provisions for restoration, where it seems arguable that the time value of money is more linked to the operating category;

    (ii) provisions where an entity could choose to settle the provision now but has the option to defer is more linked to the financing category.

(g) One respondent considered that when an entity only has one main business activity, which is providing finance to customers, this entity should be required to present all income and expenses from financing activities, all income and expense from cash and cash equivalents, and all interest income and expenses on other liabilities (as set out in proposed paragraph B37) in the operating category.

(h) One respondent; considered when an entity has more than one main business activity, of which one is providing financing to customers, only the income and expenses arising from financing activities and cash and cash equivalents that relate to the provision of financing to customers should be classified in the operating category. In this case, interest income and expenses on other liabilities (as set out in paragraph B37) would continue to be classified in the financing category.

(i) One respondent replied that currently there is diversity in practice and that the IASB should further consider this issue.

Additional comments from financial institutions

171 One respondent suggested that the accounting policy choice included in paragraph 51 of the ED PFS should be extended to income and expenses that reflect the effect of the time value of money on liabilities that do not arise from financing activities. That is, to allow including in operating profit and loss all income and expenses from financing activities, all income and expenses from cash and cash equivalents and the time value on these liabilities.

172 One respondent from the financial industry questioned whether the IASB proposals on time value of money were useful for financial entities, including banks and insurance companies. The caption proposed in the new ED focuses only on the unwinding of provisions, whereas financial entities are very much used to discount many of the figures that are recognised in their balance sheets (both assets and liabilities). It is quite strange for a financial conglomerate to report in a separate line the unwinding of provisions whereas the unwinding of the insurance liabilities will be separately presented in the profit and loss statement.

173 A few respondents from the financial industry questioned how such amounts should be treated when not material. These respondents assumed that entities will be able to report them under the Operation category by application of paragraph 24 of the ED. One respondent noted that in accordance with paragraphs 49 and 51 of the ED, it appears that banks might be required to present the financing category as a separate line on the face of the statement of profit or loss even if such a line item would be immaterial (more specifically ‘other interest income and expenses on other liabilities), thus providing limited value to the users of financial statements. This respondent considered that preparers should have flexibility to include immaterial items from financing and investing activities within the operating category (e.g. other income and expenses’ line item.

Question 7 Integral and non-integral associates and joint ventures

(a) The proposed new paragraphs 20A–20D of IFRS 12 would define ‘integral associates and joint ventures’ and ‘non-integral associates and joint ventures’; and require an entity to identify them.

(b) Paragraph 60(b) of the Exposure Draft proposes to require that an entity present in the statement of profit or loss a subtotal for operating profit or loss and income and expenses from integral associates and joint ventures.

(c) Paragraphs 53, 75(a) and 82(g)-82(h) of the Exposure Draft, the proposed new paragraph 38A of IAS 7 and the proposed new paragraph 20E of IFRS 12 would require an entity to provide information about integral associates and joint ventures separately from non-integral associates and joint ventures.

Paragraphs BC77–BC89 and BC205–BC213 of the Basis for Conclusions describe the Board’s reasons for these proposals and discuss approaches that were considered but rejected by the Board.

Do you agree with the proposals? Why or why not? If not, what alternative approach would you suggest and why?

EFRAG’s tentative position

EFRAG considers that providing a distinction between integral and non-integral associates and joint ventures will help users of financial statements to easily distinguish between associates and joint ventures that are closely related to the entity's main business activities and those that are not. However, EFRAG highlights that such changes to the presentation requirements would involve significant judgement and need to be tested in practice.

EFRAG notes that the IASB's proposals would also apply to associates and joint ventures in the separate financial statements, which may in some cases raise questions about the applicability of the proposed definitions.

Summary of constituents’ comments

Support of the definition of integral and non-integral

174 Several respondents welcomed the IASB’s proposal to require entities to identify “integral associates and joint ventures” and “non-integral associates and joint ventures” as it will give users of financial statements more insights in the way the reporting entity sees its own business model.

175 However, the majority of the above respondents highlighted the shortcomings in the IASB definition, such as:

(a) subjectivity and judgement involved, hindering the comparability. In their view, assessments required to make the distinction are likely not be performed on a consistent basis within and across entities and entities would often not come to the conclusion that an associate or joint ventures qualify as integral based on the indicators of the proposed paragraph 20D of IFRS 12 *Disclosure of Interests in Other Entities* although the associate or joint venture and the reporting entity have the same main business activities;

(b) the distinction will be contingent on how the term ‘main business activity’ is defined and might exclude many associates and joint ventures that entities consider part of their main business activities. In many capital-intensive industries, it is common to cooperate with other companies through joint arrangements and associates, and it may be of less importance who operates the joint operation or controls the associate. Many such co-operations will not fulfil the requirements in paragraph 20D of IFRS 12 and will be categorised as non-integral. Nevertheless, the arrangements and associates are in fact considered part of the main business activities of the entity.

176 These respondents suggested the IASB to provide the clarifications or make the following changes to the definition:

(a) to remove the wording "and hence do not generate a return individually and largely independently of the other assets of the entity", as it is not necessary and could potentially restrict the scope (e.g., arguably, a joint investment by a real estate company in a separate entity holding commercial property might not meet the definition);

(b) alternative definition of 'integral': An associate or joint venture should be classified as 'integral' if its business activity is closely related to the main business activities of the parent entity or one of its significant subsidiaries (i.e. both – the associate or joint venture and the parent entity (or one of its significant subsidiaries) – share one main business activity);

(c) to change a label of the subtotal from 'operating profit or loss and income and expenses from integral associates and joint ventures 'to 'operating profit or loss including income and expenses from integral associates and joint ventures';

(d) the IASB should ensure that the proposed new definitions of integral and non-integral are consistent with the terms used by other IFRS Standards, such as the classification of investees by type of influence (i.e. 'subsidiary', 'joint ventures', and 'associates' as defined by IFRS 10, IFRS 11 *Joint Arrangements* and IAS 28 *Investments in Associates and Joint Ventures*);

(e) the definition should focus on whether management sees associates and joint ventures as an integral part of the business model.

177 Some respondents called for more guidance:

(a) on the notion of "main business activity". The criteria of generating returns individually and largely independently appears to be a justification for including the item in, or excluding it from, "operating", "investing" or "financing" at the same time, with only the unclear (and undefined) concept "in the course of its main business activities" making the difference. The lack of a definition of "main business activity" is a major handicap in this area, as it is a notion which is relied upon heavily in the ED to justify specific rules for the treatment of individual items, as indicated in the example above;

(b) further guidance in addition to the indicators in paragraph 20D of IFRS 12, by expanding the guidance already given in the ED (further details please see below in paragraphs 189 - 191 of this document);

(c) illustrative examples which may showcase how to make that assessment;

(d) on the type of situations where it can be concluded that the relationship has changed (change the classification of an associate or joint venture as integral or non-integral), in order to improve the enforceability and prevent opportunistic changes in category driven by the profitability of different joint ventures and associates;

(e) for separate financial statements, especially with respect to classification of returns from investments in subsidiaries and equity accounted investments;

(f) the interaction of integral - non integral assessment and the requirements of IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations.* More specifically, if the classification as held for sale of an associate or joint venture affects the assessment and where to classify in profit or loss any measurement differences (from using the equity method to fair value measurement).

<u>*No support for definition and/or separate presentation of integral and non-integral*</u>

178 Many respondents did not support neither the IASB proposal to define integral and non-integral associates and joint ventures nor separate presentation of their results on the face of the profit or loss.

179 Some respondents although supporting the IASB proposal to define the integral and non-integral associates and joint ventures, did not support the separate presentation on the face of the profit or loss.

180 These respondents argued that:

(a) due to significant judgement involved, the proposal risks to be counterproductive to the overall purpose of improving comparability in the presentation by adding a layer of complexity and may result in producing information that is not relevant to the users of financial statements;

(b) the proposal gives too much emphasis and undue prominence on this sub-total and would make the structure of the statement of profit or loss unduly complicated, damaging comparability;

(c) the new differentiation gives no added value, especially with regard to the existing disclosure requirements of IFRS 12 making the differentiation totally hypothetical and arbitrary;

(d) it is not consistent to include associate's income and expenses as it combines income and expenses that cannot be compared. The equity-method figure is post-tax and includes the contribution of the financial structure of the associates (i.e. interest) which is not reported in the statement of financial position of the group;

(e) the proposal adds complexity, increases costs and creates the risk of misstatements. It is questionable if the expected benefits in terms of increased transparency or comparability outweigh the reporting burden it will put on entities;

(f) the IASB should clarify the interaction between an integral associates and joint ventures and the concept of control as defined in IFRS 10. Even if the assessment of control is based on different criteria, it may be difficult to argue that an associate that an entity lacks control over is an integrated part of that entities main business activities;

(g) the use of the condition of the generation of "a return individually and largely independently of other assets" in the definitions of integral and non-integral equity-accounted entities is confusing. This is because the same condition is used in a combination of paragraphs 47 and 48 of the ED to mandate the inclusion of investments in the operating category. In these paragraphs, it is the use of the investments in the course of the main business activity which is the determining factor. This confusion indicates that the principles for the presentation of the income statement require further consideration;

(h) focusing on the importance for the "reporting entity" may add complexity if the classification differs between the parent company and the subgroups;

(i) a separation of entities into the two categories should be made with reference to main business activities, and not level of integration. This would facilitate a more coherent categorisation throughout the standard, and it would facilitate more consistency by reducing the number of judgemental terms;

(j) It would have been more sensible to wait for the post-implementation review of IFRS 11 before proposing this definition of integral associates and joint ventures and requiring presentation of their results just after the operating profit or loss, outside the investing category, which is not solving the major issues raised by IFRS 11 (no proportional consolidation permitted) in terms of relevance of the financial information provided for users.

181 Several respondents not supporting the split, suggested alternative location of the information about integral and non-integral associates and joint ventures:

(a) the majority of them suggested to provide a split between "integral" and "non-integral" in the notes to the financial statements to allow the users to make their own decisions regarding the classification of an entity's interests in associates and joint ventures, and not on the face. The disclosures would achieve the objective of providing greater insight into the business model of reporting entities. The disclosures would also better align with the role and function of the primary financial statements and the notes as proposed in the ED. In addition, such information should only be provided for material interests;

(b) one respondent suggested an optional presentation of equity accounted entities. if an entity considers that an integral equity-accounted entity is an important part of its operations, it should be permitted to include it in a clearly labelled line-item within its operating profit or loss category. This optional presentation would help reduce the clutter on the face of the income statement and enable the entity to present a single operating result sub-total, while allowing analysts to identify and deal with such items as they see fit;

(c) income and expenses from associates and joint ventures accounted under the equity method can be presented either in a separate line item on the statement of profit or loss or a separate subtotal within operating profit or loss category. The latter is because integral associates and joint ventures are defined as being "integral to the main business activities of an entity".

182 Five respondents suggested that for the insurance industry these results should be reported in one or two-line items within operating and not investing category. They disagreed with the restriction in paragraph 48 of the ED, namely *"An entity shall not classify income and expenses from non-integral associates and joint ventures in the operating category"* as it would create a 'presentation mismatch' that would fail to reflect the way insurers manage their activity - this is because an insurance entity would present in the investing category income and expenses from associates and joint ventures while it would present the effects of the changes in insurance liabilities in the operating category. These respondents suggested that the categorisation should not depend on the inclusion method but on the link to the reporting entity's business model. Also, categorising only income and expenses from this particular type of investments in the investment category hinders entities in displaying (the portion of) their investment business forming part of their main business activities in one category, reducing the information value of both the operating category and the investing category for users.

183 Three respondents noted that separate presentation of the results of integral and non-integral associates and joint ventures in the **statement of cash flows** within the investing activities (paragraph 38A of IAS 7 in the ED) would not be consistent with the presentation of separate lines within the statement of profit or loss, when the share of profit/losses of integral associates and joint ventures are presented in a separate category (i.e. outside the investing category). In addition, all dividends from associates and joint ventures are included in the investing section of the statement of cash flows. These respondents recommended the IASB to align the presentation in the statement of cash flows with the new proposed categories of the statement of profit or loss and to undertake a more extensive project to meet user needs and to identify potential improvements.

<u>*Support for separate presentation of integral and non-integral*</u>

184 Four respondents who supported the definition of integral and non-integral, also welcomed the IASB's proposal to present a separate subtotal for "operating profit or loss and income and expenses from integral associates and joint ventures" (in line with EFRAG DCL).

185 Three respondents although supporting the split between integral and non-integral suggested alternative locations for the respective subtotal or line item:

(a) two respondents suggested to classify in operating profit or loss the results of associates and joint ventures (either integral or not) in which entities invest in the course of their main business activities. This would allow insurers, private equity entities, and holding companies to classify the share of profit or loss of non-integral associates and joint ventures as part of operating profit or loss, if it was generated in the course of their main business activities;

(b) one respondent supported the distinction but suggested to present the results of integral associates and joint ventures within the operating section, and the results of non-integral associates and joint ventures – outside the operating results.

186 One respondent agreed with a separate presentation of subtotals of *"operating profit or loss and income and expenses from integral and non-integral associates and joint ventures".* However, as this subtotal combines both operating and non-operating results (like financing or income tax), this respondent suggested to present a subtotal for integral investments with a new label *"profit or loss from operating category and integral associates and joint ventures".* This respondent also agreed with the proposed disclosure requirements but suggested to present them within a new Standard and not within IFRS 12, because those requirements are not consistent with the objectives set out in paragraph 1 of IFRS 12.

187 One respondent who did not support the IASB definition, however agreed that income and expenses from identified 'integral' associates and joint ventures should be separated from those arising from other associates and joint ventures as suggested in the exposure draft.

Question to constituents

188 Paragraph 93 of EFRAG DCL: Do you consider that the IASB needs to expand the new paragraph 20D 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? Please explain.

189 Several respondents considered that the IASB needs to expand the new paragraph 20D of IFRS 12 to reduce the level of judgement involved when making a distinction between integral and non-integral entities (in line with EFRAG DCL). For example, the IASB should:

(a) include **further guidance and more examples** for the distinction between integral and non-integral associates and joint ventures, including positive and negative;

(b) include **additional indicators** taking into consideration common constellations of associates and joint ventures (e.g. start-ups, co-operations in R&D, co-operations in foreign markets);

(c) the **concept of significant interdependency should be further explored** and defined, and that a broader range of examples of significant interdependency is provided to support practical application;

(d) formulate the proposed paragraph 20D of IFRS 12 in terms of **indicators for** whether an associate or joint venture does or does not '**generate a return**

individually and largely independently of the other assets of the entity'. This would lead to a stronger alignment between the proposed paragraph 20D of IFRS 12 (and its respective indicators) and the definitions for integral and non-integral associates and joint ventures as proposed in appendix A;

(e) **consider the interrelationships between the proposed indicators**. For example, the larger an associate or joint venture, the less likely it seems that the associate or joint venture and the entity have integrated lines of business (e.g. the more likely it is that the associate or joint venture owns separate production sites), however, the more likely the entity could incur difficulties in replacing a business relationship with this associate or joint venture that would be deemed as a 'significant business disruption';

(f) clarify whether associates and joint ventures of **holding companies** should be classified as integral or non-integral entities;

(g) review the definition so that it considers analogy in the activities being performed between the reporting entity and the associate and joint venture and to provide additional practical guidance;

(h) not only consider the reporting entity's perspective on a stand-alone basis, but rather the **business relationship as a whole**;

(i) clarify whether entities shall also apply the proposed definitions to associates or joint ventures when preparing their **separate financial statements** under IAS 27 given that the equity method is not applicable;

(j) clarify that when an associate is integral to a subsidiary, such an associate should also be reported as integral in the consolidated financial statements of the parent entity;

(k) to also include in paragraph 20D of IFRS 12 the integration of an associate and joint venture into **operating segments** (IFRS 8) as this provides a solid indication that an associate and joint venture is integral;

(l) develop an **alternative 'management perspective'** approach to require management to assess and identify whether it views an associate or joint venture as integral and to explain why it has reached this conclusion;

(m) to include the **rebuttable presumption** that joint ventures are typically integral and associates – non-integral to the main body of the Standard and not in the Basis for Conclusions.

190 One respondent did not consider additional indicators necessary, as **no list of indicators will be exhaustive enough** and judgement will likely to be required anyway. In this respondent's view, the requirement to disclose information about significant judgements would be sufficient.

191 One respondent noted that associates and joint ventures were not material for his entity. Therefore, no complex guidance was needed.

Question to constituents

192 Paragraph 94 of EFRAG DCL: Considering that the IASB is proposing the subtotal 'profit before financing and income tax', which includes the result of associates and joint-ventures on a net basis, do you consider that it would be useful to separately present or disclose the income tax related to associates and joint-ventures accounted for under the equity method?

193 Four respondents replied that the income tax related to associates and joint ventures accounted for under the equity method **should not be separately presented**. The following reasons were mentioned:

(a) such taxes are not derived from taxable income or taxable losses of the entity/group. In addition, such presentation would cause additional complexities between IFRS and local tax accounting rules and would diverge from the principles in IAS 28;

(b) such presentation does not respond to a cost - benefit approach and does not offer a relevant information to the stakeholders.

194 Few respondents proposed **to disclose the income tax** related to associates and joint ventures accounted for under the equity method **in the notes**.

195 One respondent considered it useful to require separate presentation or disclosure of the income tax related to equity-accounted associates and joint ventures.

196 One respondent did not consider that this question should be addressed as part of this project.

No replies

197 Four respondents did not comment on the Question 7.

Question 8 Roles of the primary financial statements and the notes, aggregation and disaggregation

(a) Paragraphs 20-21 of the Exposure Draft set out the proposed description of the roles of the primary financial statements and the notes.

(b) Paragraphs 25-28 and B5-B15 of the Exposure Draft set out proposals for principles and general requirements on the aggregation and disaggregation of information.

Paragraphs BC19–BC27 of the Basis for Conclusions describe the Board's reasons for these proposals.

Do you agree with the proposals? Why or why not? If not, what alternative approach would you suggest and why?

EFRAG's tentative position

EFRAG welcomes the IASB's efforts to improve the general requirements on disaggregation as a complement to the created additional subtotals in the statement of profit or loss. EFRAG notes that having the principles and general requirements on aggregation and disaggregation of information in the financial statements within a single place in the new standard will improve clarity and consistent application across entities.

Summary of constituents' comments

198 Many respondents agreed with the IASB's proposal to describe the roles of primary financial statements and the notes, aggregation and disaggregation as such proposals would reduce the diversity in practice and provide relevant information to users.

199 Nonetheless, one respondent highlighted that assessing whether items should be grouped in a single line requires judgement and would welcome more guidance to exercise such judgement. For example:

(a) Currently there is no indication whether any restrictions, other than materiality considerations, apply to the maximum level of disaggregation allowed:

(i) whether the depreciation/amortisation charge can be split between the component relating to the carrying amount before the purchase price allocation (PPA) and the fair value adjustment resulting from the PPA);

(ii) whether assets can be grouped in a single line item if they share a common operational purpose (i.e. all assets are controlled for the purpose of a rental activity) but differ in the way they are financed (for example, if purchased with or without a buy-back agreement);

(iii) whether fair value adjustments can be separated from other income/expenses from the asset (for example, should cost of sales include fair value adjustments on biological assets harvested and sold?).

200 Some respondents related the principles of aggregation and disaggregation with specific line items:

(a) One respondent recommended that the IASB proposes examples relating to aggregation / disaggregation which may showcase the separate presentation of trade payables covered by reverse factoring if they present different characteristics from other types of trade payables. This would be very important for users of financial statements to address the current asymmetry of information faced by users of financial statements;

(b) Two respondents referred to the challenges related to the presentation of the line items in paragraph B15 of the ED, which seem to be inconsistent with other IASB's proposals (e.g. presentation by function and prohibition of the mixed approach).

201 One respondent supports the IASB's proposals for principles and general requirements on the aggregation and disaggregation of information. In particular, they agree with the IASB's decision not to introduce a quantitative threshold for the disaggregation of a group of items. Paragraph 28 specifies that if the aggregation steps described in paragraph 28 do not lead to descriptions that result in a faithful representation, an entity shall disclose in the notes information about the composition of the aggregated items. Illustrative Examples 6, 8, 9 and 10 illustrate the requirement in paragraph 28 by presenting statements of profit or loss with line items beginning with the label 'other'. In this case, the illustrative examples specify that paragraph 28 requires the composition of the line item to be analysed in the notes. However, the examples do not illustrate any such analysis. This respondent thinks an illustration of that analysis could have been helpful.

202 One respondent stressed the importance of maintaining the requirement that only material items should be shown on the face of the financial statements.

203 One respondent questioned the need for paragraph 20(c) (i.e. 'identify items or areas about which users of financial statements may wish to seek additional information in the notes' is too generic.

204 One respondent considered that the principles for aggregation and disaggregation were quite abstract, which limited their usefulness.

205 One respondent did not agree with paragraph 28 of the IASB's proposals which requires information in the notes about the composition of aggregate immaterial items presented as 'Other'. This conflicts with the concept of materiality and in practice may effectively lead to detailed disclosures of immaterial items. It should be clarified that this requirement is only applicable where the aggregated item itself results in a material "Other" balance.

206 One respondent suggested the IASB to clarify whether an entity applying the principles of (dis)aggregation:

(a) would (not) need to retain the amount of detail presented in prior year financial statements (if it has concluded that another level of aggregation or disaggregation was appropriate); or

(b) may change its presentation (including a restatement of the comparative information presented).

207 One respondent provided a number of suggestions:

(a) the definition of the role of primary financial statements is expanded to refer to the provision of useful information for assessing the prospects of future cash flows and for assessing management's stewardship of the entity's resources;

(b) the 'understandability' of the primary financial statements continues to be given prominence alongside 'comparability';

(c) would welcome clarity on the interaction between paragraph 24 and paragraphs 27 and 28 of the ED. The proposals in paragraphs 27 and 28 of the ED could lead to presentation and disclosure of immaterial items which could obscure the presentation of relevant information;

(d) recommend that paragraph 24 of the Exposure Draft is reworded to read 'an entity should exclude a specific presentation or disclosure required by an IFRS Standard if the information resulting from that presentation or disclosure is not material, and that this is the case even if the IFRS standard contains a list of specific requirements or describes them as minimum requirements;

(e) provide guidance on whether to prioritise understandability over consistency from year to year, or the comparability of the financial statements with those of other entities when determining an appropriate structure for the notes;

(f) propose of the disclosure requirements for the notes should be met by including a cross-reference in the notes to information provided elsewhere in the financial report. This would reduce the duplication of information in different components of the financial report.

208 Two respondents considered that paragraphs 27 and 28 are unworkable in practice, particularly in respect of analyses of items reported in consolidated accounts. In many cases, the items reported in an "other" line do not share similar characteristics and so paragraph 27(b) would apply. In a consolidated group of over 400 reporting entities, a very long list of the items that have been aggregated is likely to be required to comply with that paragraph. Given that this long list is specifically of immaterial items, this requirement will serve only to add clutter to the financial statements and increase the risk of important information being obscured. In addition, Paragraph 28 will either add unnecessary clutter (the same result could be achieved simply by an entity choosing to disclose the largest item in the "other" category as a separate item in the analysis table) or be easily circumvented by aggregating an item previously disclosed separately into the "other" category and then providing the narrative description of the item and its amount.

209 One respondent was concerned that little consideration was given how the proposals for the profit or loss account might be reflected in other comprehensive income and the cash flow statement.

210 One respondent found the proposals clear and asked clarifications on the interaction of the new categories and subtotals and the definition of materiality.

211 One respondent found the definition of the role of PFS and notes too descriptive. They recommend the definition be based on the objectives of general-purpose financial reporting as mentioned in the Conceptual Framework for Financial Reporting.

212 They consider that the proposed definition describes neither conceptually nor factually the purpose of primary financial statements and their notes. In their view, the definition should focus on (a) the determination of the boundaries of the primary financial statements and notes, (b) what they are expected to present and (c) the nature of the information to be disclosed. They think that the role of the primary financial statements should focus on the overall position, performance, cash flows and stewardship of an entity, rather than the elements (assets, liabilities, equity, income, expenses) included in those financial statements. They consider that the IASB should consider the overall relevance of primary financial statements and how

they meet users' needs rather than trying to specify a list of items that an entity should present in those primary financial statements. This would better help entities decide on (a) the information to provide in the primary financial statements or in the notes and (b) the required level of detail to provide useful information.

Minimum line items

213 Two respondents noted that paragraph 82 of the ED requires to present goodwill as a separate line item in the statement of financial position, whereas *Discussion Paper on Goodwill and Impairment* suggests presenting total equity before and after goodwill.

214 One of these respondents noted that the combined requirements of those two projects provide excessive prominence to the goodwill and recommended that the IASB determines which of the two requirements is the most relevant.

215 One respondent questioned the consistency between what is prescribed by paragraph 42, which would require entities to present additional line items in the statement of financial performance (including by disaggregating required minimum line items) when such presentation is relevant to the understanding of the entity's financial performance, and the proposals of paragraph B46 forbidding to do so.

216 This respondent considered that this inconsistency should be at least clarified in the final standard, and suggested amending B46 and paragraph 65 (b) (ii) to ensure that paragraph 42 could be applied with no restriction.

No replies

217 Two respondents did not reply to this question.

Question 9 Analysis of operating expenses

Paragraphs 68 and B45 of the Exposure Draft propose requirements and application guidance to help an entity to decide whether to present its operating expenses using the nature of expense method or the function of expense method of analysis. Paragraph 72 of the Exposure Draft proposes requiring an entity that provides an analysis of its operating expenses by function in the statement of profit or loss to provide an analysis using the nature of expense method in the notes.

Paragraphs BC109–BC114 of the Basis for Conclusions describe the Board's reasons for the proposals.

Do you agree with the proposals? Why or why not? If not, what alternative approach would you suggest and why?

EFRAG's tentative position

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 the IASB clarifies that paragraph B47 of the ED allows or even requires a mixed basis of presentation when an entity is required to present line items under paragraphs 65 and B15 of the ED. EFRAG suggests the IASB to include the reference to paragraph B15 directly in paragraph B47 of the ED for clarity purposes.

Summary of constituents' comments

Present analysis by function or by nature

218 Many respondents supported the IASB's proposal to present an analysis of expense using either by-function or by-nature method. (in line with EFRAG DCL)

219 Many respondents rejected or disagreed with the IASB proposal to make a choice between presentation by function or by nature because:

(a) suggested additions in the ED [compared to IAS 1] will not achieve the desired objective as the IASB does not make clear where and in which cases the method currently selected by entities has failed in practice to provide the most useful information to users and thus the objective itself is unclear;

(b) the definition of a function in paragraph 70 is missing an underlying principle;

(c) requires too much judgement; or

(d) increases costs.

220 Users are split; international users consider that both methods are useful and by nature is not superior, while European users consider by nature is superior and ask to have by nature on the face. A few respondents, including two analysts' associations and one national standard setter, specify that they do not consider one of the two methods superior to the other. A presentation by nature of expenses allows users to better forecast operating expenses for future operating expenses, while a presentation by function of expenses facilitates the calculation of some performance metrics and margins. One of them adds that keeping the possibility open of using either by nature or by function may jeopardise comparability. That risk is compensated by the fact that certain sectors almost unanimously go for one or the other. One respondent suggested the IASB to investigate further which information about operating expenses (by function and/or by nature) is needed by users of financial statements.

221 One respondent, international user organisation, noted that irrespective of whether a company selects the nature of expense method or the function of expense method to present its operating expenses on the statement of profit or loss, they believe it should be required to provide an analysis of its operating expenses using the other method in the notes. In their view companies would provide a full matrix, showing expenses both by function and nature. If this is too costly, then a partial matrix, covering the majority of expenses would be much more helpful. They provided examples relating to employee costs, depreciation and amortisation expenses and restructuring costs.

222 One of them, European user organisation, considers that the option to choose between two methods impair comparability and suggests that entities should present on the face expenses based on the by nature method as this brings more useful information. Another one proposed to complement the definition of cost of sales with a less simplistic example of restructuring expenses.

223 One respondent noted that the requirement to present an analysis of operating expenses by nature, whether in the statement of profit or loss or in the notes, has the unintended consequence of encouraging entities to analyse operating expenses by nature in the statement of profit or loss.

224 Some respondents are in favour of allowing the mixed presentation, including financial conglomerates and two national standard setters.

(a) One national standard setter recommends more analysis by the IASB, to investigate more which information about operating expense is needed by nature (similar to a preparers association and another national standard setter that ask or more field test);

225 the other national standard setter recommends that an entity present additional line items when such presentation is relevant to an understanding of its financial performance, regardless of the analysis of operating expenses retained. In this case, the statement of profit or loss would mix by-function and by-nature methods. In their view, the main users' information needs could be met by requiring an entity

to disclose only some expense amounts such as the employee benefits expenses, depreciation and amortisation expenses and impairment losses. A few respondents had comments about the guidance provided to make a choice between presentation by function or by nature (paragraph B45).

(a) further examples and guidance are to be provided;

(b) the proposed indicators 'information in B45 (a) and (b) are neither supporting the nature of expense nor the function of expense method in their circumstances, as internal reports and communication to investors focus on items of income and profit rather than on expense items. Therefore, in practice, the third proposed indicator 'industry practice' (paragraph B45(c)) will likely be the predominant factor. Furthermore, the proposals do not provide guidance for situations where one or more indicators support the nature of expense method, but other indicators support the function of expense method.

226 Generally, preparers and preparers organisations disagreed with the requirement to present by nature when presenting on the face by function, while users, some national standard setters and one regulator agreed with the requirement.

227 One respondent noted that insurers were not aware of users needing information on the nature of expenses, including depreciation, amortisation and employee benefits.

228 Some respondents asked for expansion of the requirement:

(a) To interim financial statements;

(b) A breakdown by business line and on a same business structure basis allowing analysts to arrive at valuations by business lines what is critical for a correct formation of prices in the market. In this regard an alignment with IFRS 8 would be helpful.

229 One respondent, national standard setter, noted any standard-setting should not prevent entities from presenting their statement of profit or loss using a mixture of both methods. This is because that presentation may provide the best information for some line items (such as impairment losses related to goodwill if maintained as part of the operating category or to an item of property, plant and equipment).

230 The respondent thinks that (a) no useful information is lost when entities adequately use a mixture of both methods and (b) the statement of profit or lost is more relevant when some items are presented separately irrespective of the method used to classify operating expenses. They have identified some circumstances in which the statement of profit or loss may not provide useful information if a mixture of both methods is not used. For example, an entity may have recognised an impairment loss related to its trade receivables and a material impairment loss on its goodwill. If the entity were to present its expenses using the function of expense method, the entity would be required to:

(a) allocate the impairment loss on goodwill to the functions;

(b) present a separate line item for the impairment loss on the trade receivables applying paragraph 65(b) (ii) of the ED.

231 In this case, the statement of profit or loss would not directly provide information about the impairment loss on goodwill i.e. an event that is significant to an understanding of the entity's performance. However, that statement of profit or loss would directly provide information about the impairment loss on the entity's trade receivable. In the respondents' view, this outcome would not be satisfactory.

232 They recommend that an entity present additional line items when such presentation is relevant to an understanding of its financial performance, regardless of the analysis of operating expenses retained. In this case, the statement of profit or loss would mix by-function and by-nature methods.

Cost-benefit analysis

233 Many respondents noted the requirement to present expenses by nature in the notes when a presentation by function was used in the profit or loss could/would result in additional costs for preparers. Some of them noted the costs would exceed the benefits. One respondent clarified this would not only require an expensive renewal of their group consolidation system but also require very expensive and time-consuming redesigns to the underlying accounting systems at several of their companies. Another respondent did not understand why some users are claiming that an analysis of expenses by nature will allow them to better forecast future operating expenses, when such information is currently not available internally and yet management is able to make budgets and mid-term plans based on the function method. It makes no sense to consider certain information key for users when such information is not internally available. One respondent called upon the IASB to consult in detail with preparers and users to identify what the essential requirements are and to ensure that an appropriate cost/benefit balance is achieved by this.

234 One respondent noted having been presented with mixed evidence by companies during their outreach, where some entities might be able to switch presentation formats by pushing the button and others might not be able to do so given legacy systems.

235 One respondent provided the following reasons why the costs would exceed the benefits:

(a) first, applying paragraph 68 of the ED, when presenting their expenses within operating profit or loss, entities use the method that provides the most useful information to users, for entities using the function of expense method, the nature of expense method will yield relatively less useful information;

(b) second, applying paragraph B48 of the ED, when providing additional disclosures by nature, an entity would not be required to disclose an analysis of each functional line item by nature. As such, users would not be able reconcile the information about expenses as analysed by nature and by function. The incremental information value of disclosures by nature would, thus be limited. In particular these disclosures would not shed light on each function's expenses by nature and thus, e.g. not contribute to users' ability to forecast each function's expenses;

(c) third, an entity presenting its expenses within operating profit or loss by function is already required to disclose additional information on the nature of expenses (specifically including depreciation and amortisation expense and employee benefits expense) in accordance with IAS 1.104.

236 One respondent noted more field testing is undertaken to assess the cost to preparers of implementing the proposals.

Detailed comments

237 Some respondents asked for a clarification of paragraph 65 of the ED:

(a) some respondents noted that paragraph 65(a)(vii) (in combination with paragraph B47) could be read as requiring a disclosure of cost of sales on the face of the statement of profit or loss, even when a by nature presentation is used. Some of them suggested:

(i) combining this requirement with paragraph 71 to make it clear that it is only when a by function is used that a cost of sales line item is required;

(ii) Clarify within paragraph 68 that the requirement to analyse operating expenses in the statement of profit and loss by nature or function is effectively over-ridden by the requirement to present the line items identified in paragraph 65;

(iii) One respondent does not support EFRAG's proposal to include a reference to paragraph B15 in paragraph B47 of the ED, as this would represent yet another exception to the principle.

(b) another respondent noted it is not clear what is the interaction between a prohibition of a mixed presentation and the minimum line items required by paragraph 65 of the ED, some of which are expenses by nature.

238 A few respondents asked to clarify paragraph B15 of the ED.

(a) the IASB should clarify whether an entity that presents an analysis of expenses applying the function of expense method is permitted to present separately the line items (that is characterised by their nature) in paragraph B15 of the ED (preference of the respondent). Alternatively, whether such entities are permitted only to present the items in paragraph B15 of the ED in the notes to the financial statements;

(b) provisions may include expenses of many natures. A change in a provision is not a 'nature' and this presentation is compatible with the by-nature approach only if all changes in provisions are shown on a separate line, similar to changes in inventories of finished goods and work in progress.

239 One respondent noted that the specific nature of goodwill requires that any impairments thereof should be presented separately on the face of the income statement. The Board has recognised the unique nature of goodwill in this ED by requiring separate presentation in the balance sheet (paragraph 82(d)), and we consider that the same approach is needed with regard to the statement of profit or loss.

240 One respondent doubted whether para. B45 (a) is a helpful indicator for choosing a presentation of operating cost by function or nature. Para. B45 requires entities to decide "which method of expense analysis provides the most useful information" and subparagraph (a) is essentially requiring the same. They suggested eliminating (a) because (b) to (d) provide sufficient guidance.

241 One respondent suggested the IASB to address retrospective application if an entity concludes that it needs to change its method of expense analysis. Therefore, changes in the presentation of the method of expense analysis are a change in accounting policies in accordance with IAS 8 *Accounting policies, changes in accounting estimates and errors*.

242 A few respondents suggested that the IASB defines 'cost of sales' as there is a certain degree of diversity in practice on what the line item encompasses. One of them preferred a broader, less complex definition of cost of sales that comprises all cost of production regardless of whether they are attributable to past, current or future sales. For example, excluding non-capitalised development costs, but including amortisation of development costs will result a distortion between companies capitalising and companies not capitalising. For them costs of litigations was a typical example of other operating expenses. This is because they are by nature highly variable, with no direct connection to the development of the business itself. Further, they can be connected to different functions like costs of sales (e.g. lawsuit with a supplier) or selling expenses (e.g. lawsuit with a retailer).

243 One respondent explained their view in more detail:

(a) adding an analysis of operating expenses by nature will risk the use of hindsight to materiality or to the definitions of the items by function through interaction;

(b) they reject the presentation of the line item reversal of inventory write-downs. A faithful calculation of such an item without undue costs and effort is impossible for a large fully integrated group due to intercompany elimination.

They would appreciate if the IASB revises the disclosure requirements of IAS 2 *Inventories*;

(c) they disagree with the detailed disaggregation into amortisation, depreciation and impairment as they provide a detailed split up in the table of assets and this would double the information provided;

(d) they ask to clarify the line item raw material, because of the lack of a line item for received services. In practice a differentiation between both items requires certain judgment as beside traditional raw materials like steel coils and acquired services there are a lot of mixed items like prefabricated components, warranty costs or development costs, which contain on a different level raw material and services received.

244 One respondent noted the main functions used in their industry are (i) cost of sales, (ii) Research and development costs and (iii) Selling and General Administrative expenses ("SG&A"). None of these functions are defined by IFRS. Consequently some expenses such as impairment losses on trade receivables, and warranty costs, are already presented either in Cost of sales or in SG&A, dramatically jeopardising comparability between entities in the same industry, and the ED offers no improvement to this situation. Furthermore, some natures of expenses / costs such as goodwill impairment cannot be clearly allocated to any of the above-mentioned functions, and as the ED seems to prohibit using a mixed presentation (i.e. by function and by nature) for the statement of profit or loss, entities will have different ways to allocate it, rendering comparability between competitors impossible.

245 One respondent asked for further clarification of paragraph 69:

(a) it is unclear to the respondent how expenses related to raw-materials, employees, equipment and intangibles are all examples of 'materials'? A more generic term would be 'resources';

(b) one of the examples in paragraph 69 is "expenses related to employees (employee benefits)". Does this example imply that the broader term 'personnel expenses' is not a nature since it may include hired personnel? If so, what is the nature of hired personnel, is it the hiring that decide the nature so it should be grouped with hired cars etc, or is it the similarity to employees that decide the nature?

No replies

246 A few respondents did not reply to this question.

Question to constituents

247 Paragraph 121 of EFRAG DCL: Do you consider that it is useful to have disclosures by nature in single note when an entity presents its expenses within operating profit or loss by function (i.e. when an entity assesses that presentation by function provides the most useful information)? Do you anticipate that such information will be costly to provide? Please explain.

Disclosing by nature when presenting by function (paragraph 72 of the ED)

248 Many respondents disagreed with the requirement.

249 Some respondents agreed that when the statement of profit or loss is presented as per the function method, disclosing in a single note the total operating expenses using the nature of expense method provides more comprehensive information as well as helps users in making forecasts and calculating EBITDA. (in line with EFRAG DCL) One respondent noted this should be expanded to every time the company discloses its cost structure per function, e.g. in a midyear press release.

250 Generally, preparers and preparers organisations disagreed while users, some national standard setters and one regulator agreed with the requirement.

251 One respondent noted the predictive value of some expense items under the nature of expense method might be low. They encourage the IASB to investigate further which information about operating expenses by nature is needed by users of financial statements.

252 One respondent was concerned whether entities using the nature of expense method should present the 'cost of sales' line item.

253 One respondent provided, amongst others, the following reasons for their disagreement:

(a) adding an analysis of operating expenses by nature will risk the use of hindsight to materiality to the definitions of the items by function;

(b) a faithful calculation of the line item reversal of inventory write-downs without undue costs and effort is impossible for a large fully integrated group due to intercompany elimination. It would also affect the disclosure requirements of IAS 2 *Inventories*;

(c) they ask to clarify the line item raw material, because of the lack of a separate line item for received services. In practice a lot of items are of a mixed nature.

254 One respondent did not support the IASB's proposal to require entities to provide disclosures by nature when presenting their expenses within operating profit or loss by function and proposed an exemption for entities whose main business activities relate to the insurance business. Also, this respondent noted insurers should be exempted from the requirement to present cost of sales separately.

255 One respondent was strongly against the possibility to use a mixed approach in the statement of profit or loss.

256 One respondent, while pointing at the negative cost-benefit analysis for preparers, agrees that an analysis by nature may provide useful information and help users forecast an entity's future performance. In their view, the main users' information needs could be met by requiring an entity to disclose only some expense amounts such as the employee benefits expenses, depreciation and amortisation expenses and impairment losses.

257 A few respondents replied that it is useful to have disclosures by nature in single note when an entity presents its expenses within operating profit or loss by function. They thought companies usually have systems that would allow them to provide this information.

258 One respondent noted the answer will mainly depend on the IT Systems, to which extent they are integrated and transversal. If there is a significant amount of accounting processes, interfaces, etc, making any change will lead to a great cost for the company.

259 One respondent did not reach consensus on whether the use of a single method should be required, or a mixture of both methods allowed, and it is unclear to them why the IASB created an exception to its general principle.

Question to constituents

260 Paragraph 122 of EFRAG DCL: Do you consider that it is useful to have in the statement of profit or loss:

(a) *a strict presentation either by nature or by function (no mix);*

(b) *a general presentation by nature or by function together with limited additional requirements as suggested in the ED by the IASB; or*

(c) *a mix presentation basis (no restrictions). Please specify why.*

<u>*Mixed presentation: general*</u>

261 Some respondents were in favour of a mixed format. A few respondents believed that presentation of expenses in the statement or profit or loss should be either by nature of by function method only. A mix of the two methods impairs comparability and transparency in the market. One of them asked for more guidance to explain how individual costs might be separated out under the function of expense method. For example, to explain how impairment of goodwill might be split and presented between different functions.

262 One respondent believed firms should be required to provide a general presentation by nature or by function together with limited additional requirements. When presenting expenses by function one should also disclose in a specific note all the income and expenses by nature. One respondent thought such disclosures are useful. They did not expect such information to be over costly to provide either.

263 One respondent had several concerns with prohibiting a mixed approach:

(a) the IASB is weakening its principle itself when stating, on the one hand, that entities shall not use a mixture of the nature of expense method and the function of expense method and, on the other hand, articulating an exception to this principle in paragraph B47. Furthermore, no (principle based) rationale for the exemption has been provided;

(b) the link between paragraph B15 and paragraph B47 is unclear. It is questioned whether the IASB aims to exclude the circumstances listed in paragraph B15 from the prohibition of a mixture of both methods, or whether the reference in paragraph B47 applies to the line items listed in paragraph 65 only;

(c) according to paragraph BC110, users have raised concerns that useful information can be lost because entities choose which method to use. In this regard the respondent suggests the IASB investigate and clarify:

(i) precisely what kind of useful information is lost – according to the concerns raised by users – because in practice many entities in our jurisdiction use a mixture of both methods and have not been confronted with such concerns;

(ii) which line items would (not) fit into the structure of the nature of expense method (or the function of expense method respectively) to address the concerns raised by users more specifically; and

(iii) whether and to what extent a ‘pure’ presentation shall be required, i.e. whether any kind of ‘mixed presentation’ shall in fact be prohibited.

<u>*Financial conglomerates*</u>

264 A few respondents noted that presentation either by nature or by function was not appropriate for financial conglomerates. This because:

(a) a prohibition makes it difficult for conglomerates to combine the banking and insurance business in a single income statement. A bank typically presents operating expenses by nature [although certain aspects of by function are used also] whereas an insurance company presents operating expenses by function as required by IFRS17;

(b) if all the operating expenses were reported under 'other expenses' this would not be a faithful presentation of the performance of an insurance company;

(c) the interaction of the IFRS 17 requirements and the disaggregation principles of the ED was not clear. It is feared that is no longer possible to present the 'insurance revenue service' on a gross basis, i.e. without deducting those costs that are conglomerate level are directly attributable to insurance contracts/ groups. While this fits for a pure insurer, this is not how financial conglomerates manage insurance business and present drivers of profitability to users (i.e. cost vs gross income ratio).They clarify that currently the profit and loss account presents most of the expenses by nature. The stand-alone presentation of the insurance business which is based on a by destiny [sic] presentation, is reversed at consolidated level and the margin of the insurance business is integrated on a gross basis. This means that in the consolidated profit and loss there is no attribution of a part of the total expenses to this business. However, as required by IFRS 17, at consolidated level there will be a portion of these total expenses that will reduce the 'insurance service result'. The remaining operating expenses incurred at consolidated level will be related mainly to the banking and complementary businesses, which may not be very useful for users as they could assume that these costs are necessary to provide both financial and insurance contracts;

(d) prohibition for mixed presentation would force banks to reconsider the structure of their profit or loss in areas where it is not necessary.

265 In addition, these respondents suggested that:

(a) a mixed presentation should be only prohibited for cases where the concerns actually arise (non-financial entities using the 'cost of sales' line item because a large part of major expenses such as depreciation, amortisation, personnel expenses are aggregated);

(b) if the mixed presentation is prohibited then additional guidance for distinguishing between the presentation methods would be helpful;

(c) the IASB should clarify whether certain items which are typical of the 'by function' approach (administrative expenses) may also fit the 'by nature' logic.

266 Two respondents asked for additional guidance:

(a) the use of 'Other administrative expenses' line item in the statement of income comprising items such as costs for office space, trainings, travel, personnel leasing, cars, cash transportation, IT, advertising, marketing, legal, consulting or audit (personnel expenses and depreciation/amortisation are excluded). These are expenses which are not related to a specific IFRS standard and are accounted for applying the general accrual principle. As a result, they seem to be similar in their accounting nature. Thus, it would be helpful to clarify that certain items which are typical of the 'by function' approach may also fit the 'by nature' logic;

(b) if restructuring provisions relate to expected personnel and other administrative expenses, they are presented in the respective income statement line items (unlike expenses from other IAS 37). It could be clarified whether in such cases the 'by function' or 'by nature' presentation is applied.

267 One respondent noted the following:

(a) no illustrative example exists for financial conglomerates, creating comparability concerns;

(b) the operating expenses of all businesses are not presented in one line on the face of the income statement as IFRS 17 requires determining the 'directly attributable expenses to insurance contracts' and to present these as part of 'insurance service result';

(c) in accordance with the ED, the operating expenses of the different business activities are recognised in a different manner and presented mixed either by function (sales) or by nature (staff or IT expenses);

(d) profitability of each business is difficult to determine because of intercompany eliminations; and

(e) operational burden occurs when calculating the Contractual Service Margin representing all income and expenses of the financial conglomerate related to a group of insurance contracts. Implies calculating a second CSM for group reporting purposes.

Question 10 Unusual income and expenses

(a) Paragraph 100 of the Exposure Draft introduces a definition of 'unusual income and expenses'.

(b) Paragraph 101 of the Exposure Draft proposes to require all entities to disclose unusual income and expenses in a single note.

(c) Paragraphs B67–B75 of the Exposure Draft propose application guidance to help an entity to identify its unusual income and expenses.

(d) Paragraphs 101(a)–101(d) of the Exposure Draft propose what information should be disclosed relating to unusual income and expenses.

Paragraphs BC122–BC144 of the Basis for Conclusions describe the Board's reasons for the proposals and discuss approaches that were considered but rejected by the Board.

Do you agree with the proposals? Why or why not? If not, what alternative approach would you suggest and why?

EFRAG's tentative position

EFRAG welcomes the IASB's efforts to define unusual income and expenses and to require entities to disclose such items. In EFRAG's opinion, the proposals would result in useful information provided to users and will reduce the diversity in practice of providing financial information about unusual income and expenses.

However, EFRAG highlights that the definition of unusual items seems to be rather narrow, as it only focuses on whether expenses/income will occur in the future. Instead, EFRAG suggests the IASB to consider not only items that will not arise for several future annual reporting periods (as expressed in the ED) but also items that occur presently in the business, but only for a limited period of time (e.g. those identified in paragraph B15 of the ED such as restructuring costs). Thus, EFRAG would suggest that entities are required to provide disclosures on the items identified in paragraph B15 of the new Standard.

EFRAG notes that the translation of term 'unusual' may raise issues in some jurisdictions.

Finally, 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.

Summary of constituents' comments

Identifying and disclosing unusual items

268 The majority of the respondents agreed or supported the IASB's proposals to require disclosure of unusual items. In particular, these respondents welcomed the IASB's effort to define unusual income and expenses.

269 By contrast, many respondents, expressed significant concerns or even disagreed with the proposals on identifying and disclosing unusual items. These respondents argued that:

(a) the new concept of MPMs in combination with the rather rigid definition of unusual items is most likely to add confusion around performance measurement and may be a cause of impaired confidence in financial reports;

(b) it duplicates information from the management report and is no real improvement as users still have to read the notes to understand the impact of an unusual event on the line items effected;

(c) disclosures on unusual items will not have the desired effect of preventing adjustments outside the financial statements;

(d) the proposals are ambiguous and leave room for interpretations;

(e) the proposals are highly judgemental;

(f) questions about usefulness of the resulting financial information or whether identifying all unusual items is feasible at all;

(g) if the intention of the proposal is to provide the users of financial statements with clarity on which income and expenses would not be expected to recur in the future, this principle should be clearly stated in the ED without introducing the definition for unusual income and expenses;

(h) IFRS already includes other requirements that require entities to disclose unusual items that are material. For instance, paragraph 24 in the ED states that "An entity shall also consider whether to provide additional disclosures when compliance with the specific requirements in IFRS Standards is insufficient to enable users of financial statements to understand the impact of transactions and other events and conditions on the entity's financial position and financial performance;

(i) the introduction of MPMs might address unusual items;

(j) rather than defining unusual items, the IASB should base its requirements on the principle of the highlighting of items "with limited predictive value" and provide guidance on how to identify and present such items;

(k) it is difficult to have a definition of unusual income and expenses can be developed that can be applied across entities and industries; and

(l) the IASB should create an "unusual items category" to present unusual items on the statement of profit or loss, rather than disclosing them in the notes.

270 In the view of one respondent it was of equal importance to highlight that a faithful assessment of unusual income and expenses can only be achieved if the management and steering of operating activities are taken into account. Thus, the IASB should clarify that the assessment of unusual income and expenses comprises the level of operating segments.

Definition of unusual items

271 When referring to the scope of the IASB's proposed definition of unusual items, respondents provided mixed views:

(a) Many considered that the IASB definition is too narrow as it is only focused on whether expenses/income would occur in the future. The definition would restrict the number of unusual items identified and, consequently, disclosures would have limited added value (e.g. an entity undertaking one-off six-month restructuring during the current reporting period would report restructuring costs as an unusual item in the current reporting period, whereas an entity conducting one-off six-month restructuring straddling two reporting periods would not report those restructuring expenses as an unusual item in the current year). In particular:

(i) a few respondents agreed with EFRAG proposal in terms of scope (to 'consider not only items that 'will not arise for several future annual reporting periods' but also items that presently occur in the business but only for a limited period of time (e.g. those identified in paragraph B15 of the ED such as restructuring costs); and

(ii) two respondents considered that unusual items should be defined by management's view.

(b) Some respondents agreed with the IASB's proposed scope, subject to materiality;

(c) Two respondents considered that the scope should be narrower;

(d) One respondent considered that there should be a list of line items for which entities have to provide disclosures (e.g. restructurings, impairments, litigations, etc);

(e) One respondent considered the definition of unusual expenses and income gives too much importance to the future. This definition should also consider past events to determine whether an item is unusual or not.

Single note

272 Some respondents (slide majority of those responding) supported disclosing unusual items in a single note. Some disagreed with it.

Disclosures

273 Many respondents supported disclosing unusual item. Some respondents disagreed with it. One respondent thought that unusual items should be presented as a single separate line item within the relevant category on the face of the statement of profit or loss, supported by appropriate disclosures. This would support the role of the statement of profit or loss in providing information which is relevant as well as comparable

274 One respondent thought that general requirements for the fair presentation and disclosure of 'unusual income and expenses' should be developed, including:

(a) requiring entities to disclose their accounting policy as to how the entity's management defines an item to be 'unusual' (including an explanation regarding the period over which an entity assesses it is reasonable to expect that similar income or expenses will not arise);

(b) emphasising that a neutral and unbiased approach should be applied in identifying unusual or infrequent items (i.e. an entity shall not unilaterally identify expenses/losses to be 'unusual' and exclude unusual income/gains from its definition of 'unusual');

(c) requiring entities to classify and present unusual income and expenses consistently over time;

(d) requiring entities to disclose information about 'unusual income and expenses' (as proposed by the IASB in paragraph 101), including an explanation why an item was classified as 'unusual' in the reporting period; and

(e) a guidance how an entity should present ‘unusual’ items that were determined to be ‘unusual’ in previous reporting periods, but – due to new facts and circumstances – are not considered to be ‘unusual’ in the current period.

275 In addition, respondents expressed the following concerns:

(a) the notions of ‘several reporting periods’ and ‘similar in type and amount’ are highly judgemental when determining whether an item is unusual or not;

(b) The wording unusual may raise translation issues; and

(c) the requirement to disclose items that meet the definition of unusual income or expenses may create confusion with the proposals on management performance measures (MPMs).

Improve existing guidance

276 Many respondents called for the IASB to improve existing guidance by changing the scope or giving more guidance to help implementation.

277 When providing suggestions on how to improve the definition, respondents provided the following suggestions:

(a) Those that considered that the scope was too narrow, stated that:

(i) users also want entities to identify some material expenses not representative of the business (non-core) and / or showing very material changes from one period to the other, such as restructuring expenses, to help them estimate what the operating performance would have been without these impacts and form an idea of future operating performance;

(ii) entities should be able to exercise judgement, considering entity’s specific facts and circumstances when deciding on whether an item should be classified as ‘unusual’ (management’s view);

(iii) urge the IASB to revise the definition of ‘unusual income and expenses’ to focus on whether the items are unusual for the entities’ main business activity rather whether they have limited predictive value;

(iv) unusual items should be defined as, ‘income and expenses which have limited predictive value because they are triggered by events or conditions which are not expected to recur within the next reporting period or on a frequent or regular basis in the future; and

(v) as mentioned above some agreed with EFRAG proposal.

(b) Those that considered that the scope was too wide, stated that

(i) income and expenses which have arisen in past annual reporting periods or that are expected to arise in future reporting periods (such as restructuring costs or impairment losses) should generally not be considered as “unusual; and

(ii) the definition of unusual items should only apply to rare circumstances (earthquake in a non-earthquake region).

(c) In addition, respondents provided more general suggestions:

(i) the IASB should test the new ED proposals in the context of COVID-19. For example, one respondent referred to whether changes in the fair value of financial assets measured at FVPL and changes in ECL of amortised costs loans and advances due to the COVID-19 should be considered (or part of them) as unusual items;

(ii) asked the IASB to reconsider its guidance on what should be considered ‘several reporting periods’ and ‘similar in type and amount’ in determining whether an item is unusual or not;

(iii) advised rephrasing paragraph 101 of the ED so that the information provided on the note on unusual incomes and expenses adheres to the materiality principle;

(iv) further clarity is necessary on the extent to which the proposals allow the presentation of unusual items on the face of the statement of profit or loss;

(v) considered that unusual items should presented as a single separate line item/category within the relevant category on the face of the statement of profit or loss, supported by appropriate disclosures;

(vi) entities should not be allowed to present unusual items on the face of the financial statements by specifically referring to 'unusual line items' and 'unusual subtotals' within the subtotals required by the ED;

(vii) it would be helpful if the proposals in paragraph 110 of the ED specified that entities shall not use additional columns to present unusual line items;

(viii) clarify whether income and expenses would only qualify as unusual if they are not expected to recur in the future by type and amount (or either by type or amount);

(ix) the definition should depend on its recurring nature, regardless of whether it spans several reporting periods or not;

(x) allow entities to disaggregate these unusual items in their statement of profit or loss as prescribed by paragraph 42 of the ED;

(xi) the "Extraordinary results" line item on the statement of profit or loss could be allowed to be disclosed;

(xii) entities with multiple business activities should be allowed to analyse and identify unusual income and expenses on a segment level (IFRS 8), considering that each segment is steered according to a business model specific to its objective, customer groups, innovation and investment focus. Thus, the IASB should clarify that the assessment of unusual income and expenses comprises the level of operating segments;

(xiii) the definition should focus on the items that are related to an unusual event.

Question 11 Management performance measures

(a) Paragraph 103 of the Exposure Draft proposes a definition of 'management performance measures'.

(b) Paragraph 106 of the Exposure Draft proposes requiring an entity to disclose in a single note information about its management performance measures.

(c) Paragraphs 106(a)–106(d) of the Exposure Draft propose what information an entity would be required to disclose about its management performance measures.

(d) Paragraphs BC145–BC180 of the Basis for Conclusions describe the Board's reasons for the proposals and discuss approaches that were considered but rejected by the Board.

Do you agree that information about management performance measures as defined by the Board should be included in the financial statements? Why or why not?

Do you agree with the proposed disclosure requirements for management performance measures? Why or why not? If not, what alternative disclosures would you suggest and why?

EFRAG's tentative position

EFRAG agrees that non-IFRS measures are often used in practice and additional guidance could bring more transparency and consistency in their use. EFRAG therefore welcomes the IASB's efforts to provide guidance on MPMs. However, EFRAG notes that the scope is limited to subtotals of income and expenses (thus it will not solve all the existing issues related non-IFRS measures) and highlights a number of challenges in regard to the IASB's proposed scope. EFRAG is also seeking views from constituents on possible alternative approaches to define a narrower scope. Finally, EFRAG considers that the IASB has not sufficiently articulated the link between MPMs and IFRS 8 and suggests the IASB to require an explanation of how MPMs interact with performance measures already presented under IFRS 8.

Summary of constituents' comments

Information about management performance measures

278 Many respondents disagreed with the proposals (or to their application in all cases). They explained that:

(a) the proposals may not bring the expected discipline in reporting outside of financial statements;

(b) there is already existing regulation concerning performance measures from ESMA;

(c) the issues should rather be addressed by the regulators;

(d) MPMs should not be within the scope of IFRS or be limited to those that are covered by an IASB standard;

(e) the cost of implementation is not justified by the benefits;

(f) Further reporting requirements in line with external communication should be rather placed in the management reports. And not in the notes;

(g) one respondent strongly believed that accounting standards should not restrict disclosure of MPMs, they proposed to delete paragraph 104 of the ED.

279 Many respondents expressed support for the proposed guidance because:

(a) the proposals promote a more disciplined and transparent approach to reporting management-defined performance measures;

(b) it will improve transparency, clarity and consistency or provide a true and fair view; and

(c) it will improve comparability.

280 One respondent believed the IASB should reconsider a number of aspects to avoid misunderstandings and to add more clarity.

281 One respondent noted that if a company considers those performance measures as KPI the company should disclose how those performance measures are linked to executives' remuneration scheme.

Scope of disclosed MPMs

282 Regarding the completeness of the disclosed MPMs:

(a) One respondent noted that some are concerned that the benefits of the MPMs may be muted if they are disclosed in the notes, as some users rely on data aggregators rather than using the source documents. Instead, they propose to require companies to disclose MPMs just below the bottom line of the statement of profit or loss;

(b) one respondent was concerned about the scope of MPMs that seems very large and about the resources needed to prepare and audit these MPMs;

(c) one respondent emphasised that there is an audit risk, that is difficult to operationalise in regards of ensuring completeness of the MPMs;

(d) another respondent believed there may be information published throughout the year which fits the definition what could create a challenge for entities to ensure completeness of this disclosure e.g. quarterly results announcements, analyst reports, results presentations, and would also make auditing of the MPM note difficult;

(e) another respondent noted it would be very challenging in practice to identify all public communications and all potential measures; and

(f) One respondent thought the list of subtotals that are not MPMs in paragraph 104 of the ED was to be extended. In their view the IASB's proposals should aim to narrow the use of MPMs in practice by increasing the number of subtotals specified by IFRS Standards.

283 Another respondent, however, did not share EFRAG's concerns (see paragraph 178 of the DCL) about the list of measures not considered to be MPMs being rule-based (paragraph 104 of the ED), because no underlying principle needs to be included.

Interactions with IFRS 8

284 Some respondents recommended the IASB to explain the interactions between MPMs and IFRS 8 disclosures. In particular, one respondent believed that the new guidance may create confusion to the users by developing MPMs that could potentially contradict the vision of management as described in the IFRS 8 disclosures.

Other comments

285 The respondents provided further comments:

(a) one respondent believed that IASB should provide at least 24 months for implementing after the new standard is issued;

(b) one respondent encouraged the IASB to reconsider the use of columns to present management performance measures in the statement(s) of financial performance, which is currently prohibited by paragraph 110; this presentation could be useful to the users of the accounts;

(c) one respondent requested more guidance on who the management is, what "complement totals or subtotals" means, and what "communicate to users of financial statements" mean.

Questions to constituents

Paragraph 185 of EFRAG DCL: What is your assessment of the overall costs and benefits of the IASB's proposal on the calculation of the income tax effect and the effect on non-controlling interests for each item disclosed in the reconciliation as required by paragraph 106(b)?

Paragraph 186 of EFRAG DCL: What is your assessment on number of MPMs that will need to be disclosed by entities under the IASB's proposals? Please indicate which MPMs you have identified.

Paragraph 187 of EFRAG DCL: What is your assessment on the relevance of the MPMs identified (is it too much? too little? which additional ones?)

Paragraph 188 of EFRAG DCL: Do you agree with the scope of the IASB's proposals? If not, which alternative (Alternative 1 or Alternative 2 above) would you prefer so that financial statements remain relevant?

Paragraph 189 of EFRAG DCL: Do you agree with EFRAG's suggestion 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)?

Paragraph 190 of EFRAG DCL: The ED is introducing more structure in the presentation requirements, including a requirement to present on the face of the income statement a new subtotal named "operating profit or loss", which will become an IFRS defined measure. Entities that currently use a performing measure labelled "operating profit or loss" on the face or in the notes will be forced to either (i) change the label for their performing measure and continue to use both the old measure and the new IFRS defined "operating profit", or to (ii) discontinue the pre-existing performance measure, replacing its use with the new IFRS defined "operating profit or loss".

In the context described above, do you believe that the IASB's proposals on the structure and content of the statement of profit or loss will lead to an increased number of MPMs?

The scope of the proposals and alternatives proposed by EFRAG (in regard to where MPMs are presented) (EFRAG's Draft Comment Letter paragraph 188)

Public communication

286 Many respondents considered that the definition of the MPMs in respect to their use in public communication may be too broad. However, they provided mixed comments regarding what the scope should actually be. Their detailed comments are provided below.

287 Many respondents considered that it is not clear how the term public communication should be understood.

Scope – what is to reconcile?

288 Two respondents disagreed that the subtotals listed in paragraph 104 (b) to (e) do not need to be considered as MPMs because only subtotals which are calculated from IFRS figures and are defined in IFRSs should be exempted from MPM requirements.

289 One respondent noted that unless a requirement is introduced for issuers to disclose separately "depreciation" and "amortisation", either in the face of the financial statement or in the Notes, "operating profit or loss before depreciation and amortisation" should be considered an MPM.

290 In contrast, one respondent considered that a subtotal that is presented in the statement of profit or loss should not be considered as a MPM, irrespective of whether it is presented outside the financial statements because the information an entity discloses in the notes about a MPM presented in the statement of profit or loss would duplicate the information provided in the statement of profit or loss itself.

Which scope alternative?

291 **EFRAG Alternative 1**: scope restricted to MPMs that are voluntarily presented within the financial statements and the proposed MPM disclosure guidance should be introduced in the IFRS Practice Statement 1 Management Commentary: preferred by few.

292 **EFRAG Alternative 2**: scope restricted to communication released jointly with the annual or interim report. Preferred by few. However, in addition some preferred a scope in the same line, i.e. MPMs which are publicly disclosed in (or along with) interim or annual reports.

Other possible alternative approaches to the scope:

293 One respondent believed that the public communication could be limited to be limited to regulatory information or to the examples provided in paragraph B79 of the ED.

294 One respondent proposed that if an entity presents MPMs within its financial statements or notes, it should be required also to include the relevant explanations and reconciliations in the notes as proposed. However, if MPMs are included in the document that contains audited accounts but not in the accounts or notes themselves, then the explanations and reconciliations should be included in the wider document, but not necessarily within the audited accounts.

295 Another respondent, however, did not share EFRAG's concerns about the list of measures not considered to be MPMs being rule-based, because no underlying principle needs to be included.

Where the information should be disclosed

296 Two respondents would prefer to locate these disclosures on MPMS as a part of management commentary, since management performance measures provide insight into how management views the company's financial performance. They thought that it should be allowed to provide the required disclosures on MPMs by cross-reference to the management report.

The scope of the proposals (in regard to type of measure - formula and information used to calculate MPMs) (EFRAG's Draft Comment Letter paragraph 189)

297 Many respondents considered that the scope of the IASB proposals in regard to the type of measure was too narrow and could be extended to include other types of measures as ratios and the measures based on the information coming not only from the statement of financial performance but also from the statements of financial position and cash flows. In particular:

(a) agreed with EFRAG's suggestion to apply the MPM requirements also to the non-GAAP/non-IFRS performance measures, presented within financial statements, that may not satisfy the proposed criteria of MPMs (e.g. adjusted revenues and ratios);

(b) noted also the following measures should be included: net debt, return on equity, free cash flow, cost to income ratio or adjusted EPS. This respondent believed these are essential for an understanding of how management views the entity's financial position and cash flows, how the business is managed and the sustainability of its business model;

(c) mentioned other financial performance measures such as i) Alternative Performance Measures, as defined in ESMA Guidelines on Alternative Performance Measures (ESMA/2015/1415) (ESMA APM Guidelines) included in its annual management report; ii) Prudential measures including measures defined in the Capital Requirements Regulation and Directive – CRR/CRD IV included in its primary financial statements and other reports; iii) Other indicators with great interest for stakeholders included in its public communications, such as management reports, corporate presentations, quarter results presentations webcasts, and other reports;

(d) one respondent believes that the proposed definition of management performance measures should be expanded to include not only subtotals of income and expenses, but any sub-total or ratio presented in an annual or interim reporting package which includes any items of income, expenses, assets, liabilities or equity derived from IFRS figures.

298 Two respondents wondered why numbers like free cash flow (statement of cash flows) or gross or net debt and working capital (statement of financial position) were

not included. One respondent also referred to adjusted revenue in the non-financial sector and cost to income ratios in the insurance industry. One further noted that depending on how an entity is managed and the prevailing industry practice, these measures are commonly reported in practice, and disclosing such measures does provide useful information to users. Excluding these measures would result in an incomplete picture of how management views the entity's financial performance and how the business is managed. They did not suggest extended the definition of MPMs but encouraged the IASB to investigate how the proposed guidelines and disclosures requirements interrelate with similar disclosure requirements about performance measures that have been published by regulators.

299 By contrast, two respondents did not agree with EFRAG's suggestion 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. Ratios such as ROA, ROE, cost/income ratio are by nature not directly reconcilable to the IFRS subtotals.

300 One respondent noted the ED does not consider the Transparency Directive, Market Abuse Regulation or the Prospectus Directive which result in duplicating the information to meet the requirements in those regulations.

Overall costs and benefits (EFRAG's Draft Comment Letter paragraph 185)

Disclosing tax and NCI effect in reconciliation

301 Many respondents considered that IASB's proposal on the calculation of the income tax effect and the effect on non-controlling interests for each item disclosed in the reconciliation may be overly burdensome, or not cost-beneficial in every case. Overall, the respondents considered that the information in the requested detail is not stored in the financial system, because of specificity of the companies' tax activities (different local tax regimes, tax optimalisation).

302 The detailed comments are as follows:

(a) currently, the IT systems do not track such effects for the reconciling items therefore providing such an information would require significant system costs;

(b) income tax expenses are calculated in a tax ledger and this calculation is driven by local tax legislation and in many cases in accordance with local GAAP and thus is disconnected from IFRS;

(c) calculation of the NCI effects is not disconnected from IFRS as it is performed in the consolidation system but would still require new system setups;

(d) the level of detail here is very deep given we have not come across request of such depth of disclosure in this area, therefore, k the benefits of providing the disclosure be outweigh by the cost of providing it;

(e) providing effects of reconciling items on income taxes and minority interests will not be reasonable for groups that own many subsidiaries; the benefit will be limited (or be less than the costs, especially because IAS 12 already requires the presentation of a tax proof at the consolidated level in the notes to financial statements;

(f) disclosing reconciliations for each MPM is not relevant as such effects are not disclosed for the MPM itself and the most directly comparable subtotal when this subtotal excludes the effects of income tax and non-controlling interests.

303 One respondent supported the proposed requirement for an entity to disclose the 'income tax effect and the effect on non-controlling interests' for each item included in the reconciliation between a Management Performance Measure (MPM) and the most directly comparable IFRS subtotal or total.

Simplified approach

304 Two respondents considered that the requirement in paragraph 107 of the ED prescribing to use a simplified approach to calculate the income tax effect, mitigates the costs but is not clear how this can provide useful information to users of financial statements.

305 One respondent noted with regard to interim financial statements that MPM reconciliations (including the income tax effect and effect on NCI for reconciling items) should be required and believe that the benefits outweigh the costs.

Other comments

306 The respondents provided further comments on the topic:

(a) one respondent questioned the need for providing disclosures on the calculation of the income tax effect and the effect on non-controlling interests and questioned the reasoning provided in BC177 when an entity does not provide adjusted EPS ratios in with IAS 33 *Earnings Per Share*; that approach was also supported by another respondent;

(b) one respondent believed that the tax effects on individual unusual items may not make sense on a stand-alone basis. In effect, they may result from tax effects on usual items within the same tax group or may be confidential information;

(c) one respondent considered the tax and NCI impact for all MPMs might not provide useful information.

The effect on number of presented MPMs (EFRAG's Draft Comment Letter paragraphs 186)

Number of MPMs

307 The respondents presented mixed views as follows:

(a) two respondents did not consider that the IASB's proposals on the structure and content of the statement of profit or loss will lead to an increased number of MPMs;

(b) one respondent believed that the fact that only 'subtotals of income and expenses' would qualify as MPMs, may significantly limit the number of MPMs, however, the proposals will lead to an increased use or at least no decrease in the use of MPMs by entities, especially with regard to an 'adjusting' performance measure for 'operating profit';

(c) two respondents noted it was too early to say what the effect would be, and had no expectations;

(d) one respondent thought that the list of subtotals that should not be considered as MPMs could be extended to include subtotals presented in the primary financial statements or outside that are based on concepts or notions specified by IFRS Standards and, generally, the aim of the IASB should be to narrow the use of MPMs in practice by increasing the number of subtotals specified by IFRS Standards.

Relevance of MPMs (EFRAG's Draft Comment Letter paragraphs 190)

308 Regarding the relevance, one respondent considered that the existing performance measures 'Operating result' and 'Operating income' would provide the most relevant information. From this perspective if new MPMs have to be introduced and they replace the currently used measures in order to reduce the noise brought by the mandatory 'Operating profit or loss' subtotal this should be considered as a suboptimal situation.

309 Another respondent thought that the proposals will lead to new MPMs that were not considered previously making IFRS financial statements less and less relevant to users. The reason for this being that defining the operating category as a residual category will mean that no entity's operating profit or loss can be consistent with the operating performance measure they are currently using or the segment results as prescribed by IFRS 8.

310 One respondent noted that the scope of the proposals would capture only a few out of many of its KPIs and this will not provide useful information.

311 Another respondent thought that tax information on MPMs may not provide relevant information to the users of the consolidated financial statements.

Question 12 EBITDA

> Paragraphs BC172–BC173 of the Basis for Conclusions explain why the Board has not proposed requirements relating to EBITDA.
>
> Do you agree? Why or why not? If not, what alternative approach would you suggest and why?

EFRAG's tentative position

> In EFRAG's opinion, defining EBIT and EBITDA would be useful for users of financial statements and would reduce diversity in practice. As they have not been defined by the IASB, they should be included in the scope of the IASB's proposals regarding MPM disclosures.
>
> Furthermore, EFRAG suggests the IASB to clarify the principle behind the list of measures not considered to be MPMs provided in paragraph 104 of the ED.

Summary of constituents' comments

Overall assessment

312 Many respondents agreed with EFRAG's request the IASB to define EBITDA, as one of the measures most commonly used by users. In particular one respondent questioned the reasoning of the IASB to define operating profit while not defining EBITDA. One respondent suggested that the IASB should provide a standard definition of EBITDA before exceptional issues. Another respondent proposed that EBITDA should be defined based on profit or loss subtotals and the entities using a different calculation, would not be allowed to name this measure as EBITDA.

313 Many respondents disagreed with EFRAG's request to require the IASB provide a definition of EBITDA. One respondent argued that EBITDA doesn't serve clear purposes in the context of IFRS. Another respondent argued that the IASB should not venture into the area of regulating performance indicators but instead leave this to the regulator in each jurisdiction.

314 A few respondents do not publish EBITDA at all and therefore did not respond to the question.

Additional comments on EBITDA

315 Some additional comments were provided, as follows:

(a) a few respondents requested the IASB to explicitly include EBITDA in the MPM disclosure requirements;

(b) a few respondents recommended the IASB to include EBITDA in the list of exempted performance measures in paragraph 104;

(c) one respondent requested the IASB to clarify whether operating profit or loss before depreciation and amortisation includes or excludes impairments (and reversals thereof).

Question 13 Statement of cash flows

(a) The proposed amendment to paragraph 18(b) of IAS 7 would require operating profit or loss to be the starting point for the indirect method of reporting operating cash flows from operating activities. (b) The proposed new paragraphs 33A and 34A–34D of IAS 7 would specify the classification of interest and dividend cash flows. Paragraphs BC185–BC208 of the Basis for Conclusions describe the Board's reasons for the proposals and discusses approaches considered but rejected by the Board. Do you agree with the proposals? Why or why not? If not, what alternative approach would you suggest and why?

EFRAG's tentative position

EFRAG supports the IASB's proposal to require entities to use the 'operating profit or loss' as the starting point for the indirect reconciliation of cash flows from operating activities in the statement of cash flows, as it specifies a consistent starting point for the indirect method of reporting cash flows from operating activities. It also reconciles the operating category in the statement of profit or loss with the operating activities in the statement of cash flows. EFRAG supports the removal of options for the classification of interest and dividends in the statement of cash flows for non-financial entities. This will improve consistency in presentation of similar line items and will better reflect the nature of the respective cash flows. EFRAG observes that some of those line items will be classified into different categories in the statement of cash flows and the statement of profit or loss. However, EFRAG suggests the IASB to have a separate project on IAS 7 with the objective of having a comprehensive review of the challenges that arise in practice (e.g. financial institutions) and improve consistency with the new content and structure of the statement of profit or loss. Finally, EFRAG would welcome guidance on the presentation of arrangements where an intermediate is used to pay trade receivables (i.e. supply-chain financing arrangements or reverse factoring).

Summary of constituents' comments

<u>*Starting with operating profit or loss*</u>

316 Majority of respondents welcomed the IASB proposal to require the 'operating profit or loss' as a starting point for the indirect reconciliation of cash flows from operating activities in the statement of cash flows. Some of respondents agreed with EFRAG's tentative position that this will improve comparability and standardise to an extent the adjustments made to the operating profit or loss in the operating cash flow category. This will result in better alignment between the statement of cash flows and the statement of profit or loss and enable users to understand how the operating profit or loss is converted to operating cash flows. However, some respondents questioned whether the requirement would result in actual increase in comparability as operating profit or loss is defined as a residual category and not directly.

317 A few respondents commented that there was no compelling reason for prescribing a starting point for the indirect reconciliation of cash flows as their members used either operating profit, net profit or loss or net income and in their view users were provided with more useful and transparent information.

318 Two respondents disagreed with the proposal to require all entities to use the same starting point for the indirect reconciliation of cash flows from operating activities as it will not improve the quality of the information provided to the users of financial statements. One respondent further commented that the use of operating profit or

loss would reduce the number of reconciling items and thus, may deprive users of information about all accruals, not only operating accruals. The respondent suggested profit or loss to be the starting point for the indirect method of reporting cash flows from operating activities.

Elimination of options

319 Many of the respondents agreed with EFRAG's position for removing the classification options for interest and dividend cash flows. This would improve comparability and provide better alignment with the entity's activities. One respondent commented that for financial entity the proposed approach to classify interest and dividend cash flows was rather technical and complex to read. Another respondent noted that current policy choice worked well and should remain unchanged.

320 Two respondents asked for improving the guidance related to the presentation of interest and dividend cash flows for entities that have more than one business activity. In particular, in case of a manufacturer providing also financing to customers, whether paragraph 34B-34D of IAS 7 apply only to interest received and paid in the course of its financing business activity or both interest received and paid from the manufacturing as well as the financing business activity. Additionally, the question was raised whether entities with more than one business activity should allocate interest and dividend cash flows to their main activities which may result in a presentation of interest and dividend cash flow in more than one category in the statement of cash flows. Suggestion was made that an entity be permitted to present the cash flows in a manner that is consistent with the presentation retained for the related income and expenses which would help achieve comparability. One respondent also disagreed with the proposal that cash flows from the acquisition and disposal of, as well as dividends received from 'integral' associates and joint ventures be classified as cash flows from investing activities in the statement of cash flows.

321 Some respondents strongly disagreed with the proposal to present cash interest payments in cash flows from financing activities and cash interest income in cash flows from investing activities as it will severely jeopardise the comparability between IFRS Standards and U.S. GAAP financial statements. One respondent recommended to only allow interest paid and received to be presented in operating cash flows in the statement of cash flows. On the same grounds, the respondent disagreed with the proposal to present all dividends received in the investing category. Furthermore, presentation of dividends received from integral associates and joint ventures in investing cash flows is unjustified as the share in the profit or loss of integral associates or joint ventures is more of an operating nature than an investing nature. Another respondent disagreed with the classification of interest paid/ received and dividends paid/ received on the grounds that the term investing should keep its current meaning of deployment of resources in general as in IAS 7.

322 One respondent observed that the proposed changes to IAS 7 are difficult to follow and subject to interpretation. The respondent called for the IASB to redraft this guidance to facilitate understanding.

Financial institutions

323 Some respondents noted that the statement of cash flows for the financial industry might not convey useful and relevant information to the users and more fundamental change is needed. One respondent suggested that banking institutions should at least be exempt from the new reporting requirements on the statement of cash flows considering preparers' costs of resetting their systems and processes to reflect changes that would have a limited value in terms of improving financial reporting by banks specifically. Another respondent commented that distinction between operating, investing and financing activities is of limited relevance for most investment funds' entities. The respondent suggested that certain investment fund

entities should be exempt from the requirement to present a statement of cash flows. Respondents generally questioned the usefulness of the statement of cash flows for financial institutions.

Labelling

324 Many respondents noted that the usage of the terms ‘operating’, ‘investing’ and ‘financing’ was inconsistent across the statement of profit or loss and the statement of cash flows which could create confusion and reduce understandability. One respondent observed that this inconsistency was further extended to the categorisation of ‘non-integral associates and joint ventures’ and ‘integral associates and joint ventures’ between these two statements. Another respondent observed that the classification of cash and cash equivalents may depend on its use (e.g. cash and cash equivalents allocated to working capital vs excess cash balances presented within financing category). Some respondents questioned whether the current misalignment of the definitions of the three proposed categories was fully justified. One respondent disagreed with the requirement to split the cash flows from integrated and non-integrated associates and joint ventures in the statement of cash flows.

325 Consequently, many respondents supported the EFRAG suggestion that the IASB should consider undertaking a separate project on IAS 7 Statement of Cash Flows to comprehensively review the challenges that arise in practice (e.g. for financial entities) and to improve consistency with the newly proposed content and structure of the statement of profit or loss.

Reverse factoring

326 Furthermore, a few respondents welcomed further guidance on the presentation and disclosure of supply chain financing arrangements even though the matter has been currently addressed by the IFRS Interpretations Committee.

327 One respondent called for the IASB to provide more guidance on the disclosures required for reverse factoring programs - the lack of information about such transactions is a widespread issue that involves significant amounts. This respondent suggested that IASB provides:

(a) more guidance on aggregation/ disaggregation (please see Question 8); and

(b) a definition of trade payables and provide further guidance on the distinction between trade payables and other financial liabilities.

Question 14 Other

Do you have any other comments on the proposals in the Exposure Draft, including the analysis of the effects (paragraphs BC232–BC312 of the Basis for Conclusions, including Appendix) and Illustrative Examples accompanying the Exposure Draft?

EFRAG’s tentative position

EFRAG does not consider that the IASB’s proposals on other comprehensive income (‘OCI’) are a significant improvement as they simply modify the labelling of OCI line items. EFRAG considers it will be difficult to significantly improve the communication and understandability of OCI without addressing the distinction between profit or loss and OCI and the role of recycling.

Summary of constituents’ comments

Other comprehensive income (OCI)

328 Some respondents considered that the proposed changes to the statement of other comprehensive income in paragraph 74 were minor changes in wording and are

unlikely to significantly improve understandability. Thus, recommended that the proposed wording and its extent are reviewed more fully as part of a separate project (in line with EFRAG DCL).

329 One respondent called for the IASB to provide clarity on the scope and common features of items to be presented within OCI. In particular, "remeasurements" is not a term which is defined in IFRS and the definition of OCI in Appendix A of IAS 1 only refers to "income and expenses". This respondent recommends that the IASB:

(a) addresses this inconsistency and undertakes further work on the OCI category to clarify its scope and features;

(b) should undertake further work on the concept of "capital", which is used in paragraphs 111-113 of this ED but not defined in IFRS.

Effective date and transition

330 Some respondents recommended that consideration is given to the practicalities and timescales of implementation of IFRS 17 together with any new standards or amendments arising from the ED. In particular:

(a) one respondent noted that insurance companies need to understand what to do with IFRS 17 that will enter into force before the PFS project so that there are no duplications;

(b) some respondents from the financial industry encouraged the IASB to align the effective date of the standard with IFRS 17 to avoid having to restructure systems to report the categories proposed in the ED using the existing IFRS 14 *Regulatory Deferral Accounts* presentation and then amending this presentation once IFRS 17 becomes effective.

331 Two respondents noted that the proposed time of 18 to 24 month for a retrospective first-time application was not sufficient. One of these respondents noted that retrospective application normally starts one year before the first fiscal year of adoption. Therefore, this respondent would have only one year or less left for concept, alignment, roll-out and worldwide implementation. This would not be possible even if there were only minor technical changes.

Interim financial statements

332 One respondent considered that companies should present for interim periods the same structure of primary financial statements as for year-end periods as this would significantly improve comparability and allow better monitoring of the performance by investors between different periods. This respondent strongly recommends that the requirement to present expenses by nature either on the face or in the notes of the financial statements should be expanded to interim financial statements given its purported value to users.

333 Another respondent considered that entities should not be required to always provide all disclosures about MPMs in their interim financial statements. If MPMs were already described in an entity's most recent annual financial statements and are not changed, then there would be no need to repeat such disclosures (i.e., those in paragraph 106(a) of the ED) in the interim financial statements. However, the disclosures in paragraph 106(b)-106(d) should be required for transparency purposes and to provide users with the information needed to make their own adjustments. We believe that the benefits of providing MPM reconciliations (including the income tax effect and effect on NCI for reconciling items) in interim financial statements outweigh the costs.

334 Finally, one respondent recommended that the requirement to undertake a going concern review, when preparing interim financial statements (as in paragraphs 4 and 25 of IAS 1) is maintained and that the paragraph referencing is amended to reflect this.

IFRS Taxonomy

335 One respondent considered that a stable structure for primary financial statements would be instrumental to the progressive digitalisation of financial reporting. A stable primary financial statement structure would facilitate the voluntary preparation of Inline XBRL (iXBRL) reports using the IFRS Taxonomy also for interim periods. The stability of companies' taxonomies between the year-end and the interim periods would be beneficial to users of machine-readable information.

Columnar format

336 One respondent considered that there is merit in retaining the flexibility for entities to use columns to explain their financial results. There may be instances where the columnar format aids the disaggregation of relevant information and hence improves the understandability of the financial statements.

Illustrative examples

337 Two respondents called for additional examples:

(a) one respondent recommended the inclusion of a more generic example for an investment entity trading in financial instruments, which will enable a more consistent interpretation of the proposed IASB requirements for such entities;

(b) one respondent would welcome more comprehensive illustrative examples to demonstrate the application of the proposals to insurance and banking entities and demonstrate the interaction of the proposals with IFRS 17 for an insurance entity with different lines of business.

338 Nonetheless, two respondents expressed some concerns:

(a) one respondent noted that currently most funds are presented in a similar way and comparable and expressed concerns that based on the examples that are being considered, if the IASB decides to move forward with the proposals at stake there is a risk of losing the comparability;

(b) one respondent disagreed with the concept of non-mandatory illustrative examples, as it had not worked out well in practice and puts companies in permanent danger of misstatements as their role as interpretative guidance within the judicial enforcement is nebulous. In particular, this respondent rejected IE II-4 Illustrative Example of a company with two main business activities, as it only adds complexity, duplicates information already to be found elsewhere, is not feasible and far too simple.

Minimum line items

339 One respondent noted that paragraph 65 (a) (i) requires the presentation of revenue, however the standard does not further define what's considered "revenue". Specifically, this respondent recommends that the standard further defines whether for an investment entity (as defined in IFRS) measurement gains or losses from financial instruments measured at fair value through profit or loss need to be presented within "revenue" along with interest and dividend income.

340 One respondent did not agree with the separate line item goodwill at the face of the balance sheet at least based on the arguments provided by the IASB. Setting the focus solely on goodwill but leaving the other assets with similar characteristics in their current valuation aside would be in their opinion misleading.

Future projects

341 One respondent recommended that projects are commenced to provide a more comprehensive review of the other primary financial statements and a holistic review of all primary financial statements and disclosures.

342 One other respondent strongly encouraged the Board to explore improvement in the presentation of the statement of financial position through a review of the line items to be presented as a new workstream as part of *the Primary Financial Statement* project.

<u>*Other comments*</u>

343 One respondent Paragraph 42 requires companies to present additional subtotals when they are relevant. The ED proposes the presentation of several subtotals including operating profit, and we are concerned that the requirement in paragraph 42 would just make the presentation of the statement of profit or loss overly complex, damaging the understandability of the statement. In addition, the objectives of paragraph 42 could overlap with those of the MPMs. Hence, we suggest deleting paragraph 42.

344 One respondent would like to propose systematic renumbering of existing IFRS standards now that major amendments have largely run their course as the numbering of the IFRS standards themselves has become too messy and unsystematic for stakeholders to use.

345 One respondent noted that the ED introduces some new terms, such as unusual and urged the IASB to check if translation issues in some languages may arise.

Question to constituents

Paragraph 250 of EFRAG DCL: Do you agree that the IASB should consider providing 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?

<u>*Entities with multiple business activities*</u>

346 Many respondents agreed that the IASB should consider providing 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 judgment applied in the allocation process.

347 These respondents noted that:

(a) there is diversity in how financial conglomerates across different jurisdictions in Europe prepare its profit and loss account, therefore we are not sure whether the new ED will help comparability. In order to guarantee the comparability of the financial statements between the financial conglomerates, specific guidance would be welcomed to avoid diversity in practice;

(b) no illustrative example exists for financial conglomerates, creating concerns on the comparability of financial statements amongst peers;

(c) most financial conglomerates opt for a semi-functional balance sheet and income statement (e.g. the interest income of the banking and insurance entity is integrated and presented in one line on the face of the income statement);

(d) financial conglomerates (bank/insurers) are confronted with specific issues when IFRS17 comes into force. The choice on how to present the balance and the income statement of a bank/insurer based on current ED becomes difficult when IFRS 17 comes into force as some issues arise;

(e) operational burden occurs when applying the ‘look through’ approach on a group level by calculating the Contractual Service Margin, representing all income and expenses of the financial conglomerate related to a group of insurance contracts. Implies calculating a second CSM for group reporting purposes;

(f) all non-insurance related operating expenses of the financial conglomerate (e.g. bank, asset management,…) are presented as ‘operating expenses’ and as such the total operating expenses of the bankinsurer group are split over different lines in the income statement Reconciliation between income statement and disclosure on analysis of operating expenses as required by the ED becomes more difficult;

(g) the operating expenses of all businesses are not presented in one line on the face of the income statement as IFRS 17 requires determining the ‘directly attributable expenses to insurance contracts’ and to present these as part of ‘insurance service result’;

(h) further guidance could lead to an increase in the degree to which entities with different business activities prepare their financial statements on a consistent and comparable basis;

(i) that the IASB should consider providing 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, in particular in the case of bancassurers;

(j) any standard should indicate whether the income and expenses from each activity and the related subtotals should be presented excluding or including inter-activities transactions: if one holds the view that they should be presented excluding inter-activities transactions—because consolidated financial statements always exclude all intercompany transactions—there is a risk that the subtotals presented might be irrelevant and/or misleading as well as potentially confusing with segment information. Therefore, the IASB should discuss explicitly this matter and develop adequate presentation requirements.

348 Profitability of each business is difficult to determine as the requirement of intercompany elimination according to IFRS 10 remains still in place. Under a functional scheme (bank and insurance business separately presented on the face of the income statement) it seems that elimination of intercompany transactions makes no sense because this would not give a fair view on the profitability of each business.

349 One respondent considered it not useful that there is more than one line item revenue. Beside operating profit, revenue is the most important line item of the statement of profit and loss. It is important not to confuse users by having not only a single number revenue but to scatter it through the statement of profit or loss in different categories.

350 One respondent considered that improvements of IFRS 8 were fundamental to users of financial statements.

Appendix 2 - List of respondents

CL01	Soren Ploschke	Germany	Individual Person
CL02	Comissão de Normalização Contabilistica (CNC)	Portugal	National Standard Setter
CL03	Accountancy Europe (AE)	Europe	Professional Organisation
CL04	Erste Group	Austria	Preparer
CL05	European Securities and Markets Authority (ESMA)	Europe	Regulator
CL06	KBC Group	Belgium	Preparer
CL07	DASC	Denmark	National Standard Setter
CL08	ESBG	Europe	Preparer organisation
CL09	Suez	France	Preparer
CL10	Allianz	Germany	Preparer
CL11	DASB	Netherlands	National Standard Setter
CL12	Aviva	UK	Preparer
CL13	EFFAS	Germany	User organisation
CL14	ICAEW	UK	Audit organisation
CL15	SEAG	Sweden	Preparer organisation
CL16	Volkswagen	Germany	Preparer
CL17	Renault	France	Preparer
CL18	ICAC	Spain	National Standard Setter
CL19	IEAF	Spain	User organisation
CL20	AFME	UK	Market organisation
CL21	Insurance Europe	Europe	Preparer organisation
CL22	NASB	Norway	National Standard Setter
CL23	SFRB	France	Preparer organisation
CL24	UKFRC	UK	National Standard Setter
CL25	BusinessEurope	Europe	Preparer organisation
CL26	EFAMA	Europe	Preparer organisation
CL27	CRUF	UK	User organisation
CL28	GSK	UK	Preparer
CL29	ASCG	Germany	National Standard Setter
CL30	BASF	Germany	Preparer
CL31	ABAF/BVFA	Belgium	User organisation
CL32	AFRAC	Austria	National Standard Setter
CL33	ABI	UK	Preparer Organisation
CL34	OIC	Italy	National Standard Setter
CL35	Suedzucker	Germany	Preparer
CL36	ANC	France	National Standard Setter