Primary Financial Statements
Cover Note

Objective

1 The objectives of the session are to:

(a) consider the feedback received in response to EFRAG's draft comment letter on the IASB Exposure Draft ED/2019/7 *General Presentation and Disclosures* issued by the IASB in December 2019 (the 'ED'); and

(b) approve EFRAG final comment letter on the ED.

Background

2 The IASB has undertaken this project in response to concerns from investors about the comparability and transparency of companies' performance reporting.

3 In December 2019, the IASB published the Exposure Draft *General Presentation and Disclosure* (the ED) where it includes proposals to improve how information is communicated in the financial statements, with a focus on the statement of profit or loss.

4 The ultimate objective is to replace IAS 1 *Presentation of Financial Statements* with a new Standard that would comprise new requirements on presentation and disclosures in the financial statements and requirements brought forward from IAS 1 with only limited changes to the wording. It also sets out proposed amendments to other IFRS Standards.

5 The IASB expects that the proposals in this ED will affect all entities that apply IFRS Standards, including financial institutions. However, the effect of these proposals will vary between entities depending on their current practice.

6 EFRAG's early and extensive involvement enabled us to publish our Draft Comment Letter (EFRAG DCL) in February 2020, only two months after the publication of the IASB's ED. The comment period deadline was 28 September 2020.

EFRAG's initial position

7 In its Draft Comment Letter, EFRAG welcomes the ED and the IASB's efforts to improve the structure and content of the primary financial statements.

8 EFRAG supported the IASB's proposals to present an operating, investing and financing category in the statement of profit or loss to improve comparability and reduce diversity in practice. However, EFRAG had reservations over some of the proposals in the ED:

(a) the newly created categories in the statement of profit or loss are not aligned with the presentation of cash flows in the statement of cash flows, however, they have similar labelling;

(b) clear guidance is needed on the notion of 'entity's main business activity' to distinguish between categories in the statement of profit or loss; and

(c) the ED proposals should consider the interaction with existing regulatory frameworks on presentation of financial statements;

9 EFRAG also asked for views from constituents on the IASB's approach to consider as part of the financing category the income and expenses that arise from:

(a) cash and cash equivalents;

(b) time value of money on liabilities that do not arise from financing activities.

10 EFRAG considered that separate presentation of integral and non-integral associates and joint ventures will result in relevant information for users of financial statements and enhance comparability. EFRAG highlighted that such presentation will involve significant judgement and needed to be tested in practice.

11 EFRAG welcomed the IASB's efforts to provide guidance on management performance measures (MPMs) which are often used in practice and additional guidance on non-IFRS measures could bring more transparency and consistency on their use. However, EFRAG highlighted a number of challenges in regard to the ED proposals and asked for views of its constituents on a possible alternative narrower scope. EFRAG also suggested that the IASB further articulates the link between MPMs and IFRS 8 *Operating Segments*.

12 EFRAG welcomed the IASB's efforts to define unusual income and expenses and to require entities to disclose such items in the notes, however the definition of unusual items seems to be rather narrow, as it focuses on whether expenses/income will occur in the future.

EFRAG Outreach activities

13 After the publication of its draft comment letter, EFRAG realised a programme of outreach events, field-testing and stakeholder meetings in partnership with other organisations, including with the IASB.

14 On 8 October, EFRAG Board has received an update on the feedback received in the outreach activities. A summary of the feedback received can be found in agenda paper 02-02.

15 More recently, EFRAG has issued its last summary report on the outreach event took place on 16 September 2020 (in close coordination with the DASB and the IASB). For more details, please click here.

Comment letters received

16 At the time of writing, EFRAG received 36 comment letters, which have been uploaded into EFRAG website. EFRAG comment letter analysis can be found in agenda paper 02-03. The links to the letters can be found below. You can also find comment letters received on EFRAG's website.

EFRAG TEG voting on final comment letter

17 On 15, 21 and 22 October 2020, EFRAG TEG reviewed the feedback received in response to EFRAG's draft comment letter and considered the final comment letter to be recommended to the EFRAG Board.

18 On 22 October 2020, EFRAG TEG voted and recommended a final comment letter, which is in agenda paper 02-05 EFRAG Comment Letter.

19 The following members voted in favour: Chiara Del Prete, Nicklas Grip, Jens Berger, Jenny Carter (UK FRC liaison member), Ana Cortez, Geert Ewalts, Emmanuelle

Guyomard, Erlend Kavaal (except for one topic described below), Vincent Louis, David Procházka, Christoph Schauerte, Olivier Scherer, Ambrogio Virgilio, Jed Wrigley.

20 One EFRAG TEG member was absent: Tommaso Fabi.

Dissenting views on the presentation of income and expenses that reflect the effect of the time value of money on liabilities that do not arise from financing activities.

21 One EFRAG TEG member, Erlend Kvaal, recommends the letter to the EFRAG Board but disagrees with the conclusion on paragraphs 59 to 61 of the letter. Erlend Kvaal thinks that the unwinding of discount should be classified according to the general principles of the ED and not according to some artificial special rule. In his view, the interest on a pension liability could be considered as financing, since this liability potentially can be discharged in a market. For other recognized obligations (like decommission or litigation obligations) there is no market, and they cannot be reasonably seen as substitutes for the financing of the entity. Unwinding of discount on those liabilities should therefore be classified as operating. In his view, the only argument from the IASB for a rule-based solution to the unwinding of discount is that users would like to have them assembled. That need could be resolved through disclosures.

EFRAG's final position

New subtotals and categories in the statement of profit or loss

22 In general, EFRAG welcomes the IASB's efforts to improve the structure and content of primary financial statements, as currently there is diversity in practice on the presentation of subtotals. In particular, EFRAG supports the IASB's proposals to present an operating, investing and financing category, subject to materiality considerations, as they have the potential benefit of reducing diversity in practice and improving comparability of financial statements. However, EFRAG considers that:

(a) it is key to have clear guidance on the notion of the 'entity's main business activity' or in the course of the entity's main business activity' (please see EFRAG's reply to Question 3 in Appendix 1);

(b) the IASB should consider, as part of the effects of these proposals, the interaction of the IASB proposals with existing regulatory frameworks on the presentation of financial statements;

(c) both the statement of financial performance and the statement of cash flows will have three different categories with similar labelling (operating, investing, and financing) even if they are not aligned. As long as the two statements are not aligned, EFRAG considers that it would be useful to use a different labelling in the two statements to avoid confusion. As further described below, EFRAG would encourage a separate project on IAS 7 Statement of Cash Flows to improve consistency with the new content and structure of the statement of profit or loss.

(d) the 'free' accounting policy choice in paragraph 51(b) of the ED (for entities that provide financing to customers) may result in the loss of relevant information for users, in particular when used by non-financial institutions (e.g. manufacturer providing financing to customers);

(e) it would be useful to consider whether 'incremental expenses' related to financing activities should also be in the financing category, by symmetry, with expenses relating to investing activities;

(f) it would be useful to further consider the presentation of operating profit or loss when one or more line items between categories are immaterial;

(g) the IASB should further consider how its proposals should be applied in specific circumstances, including the interaction of the IASB's proposals with IFRS 17 I*nsurance Contracts* and IFRS 9 *Financial Instruments*; and

(h) the IASB should provide more guidance and examples on the classification of foreign exchange differences and of fair value gains and losses on derivatives and hedging instruments to ease implementation.

Integral and non-integral associates and joint ventures

23 EFRAG's research , similar to the findings of other recent studies, has shown that there is diversity in practice on the presentation of the share of profit or loss of associates and joint ventures, which was presented either before or after the subtotal 'operating profit or loss' by the majority of the entities analysed by EFRAG in its early stage analysis. Thus, the IASB's proposal to require a subtotal of operating profit or loss that excludes this component has the potential of enhancing comparability.

24 EFRAG also welcomes the IASB's efforts to make a distinction between integral and non-integral associates and joint ventures as it would provide relevant information to users of financial statements and help them to easily distinguish between associates and joint ventures that are closely related to the entity's main business activities and those that are not.

25 However, EFRAG is concerned that the proposed separation of integral and non-integral investments would involve a significant degree of judgement, which would hinder comparability and relevance. With this in mind, EFRAG proposes the IASB to clarify or revisit the concept of integral, including its adjacent definitions of 'main business activity', 'generate a return individually and largely independently of the other assets of the entity' and 'significant interdependency'. EFRAG suggests, should the IASB go forward with the proposed definition, to expand the new proposed paragraph 20D of IFRS 12 Disclosure of Interests in Other Entities to widen the scope, to include additional indicators and more examples with the objective of reducing the level of judgement involved.

26 EFRAG considers that providing separate information about the share of profit or loss of integral and non-integral associates and joint ventures is useful, however does not support the IASB's proposal to require an entity to present on the face of the statement of profit or loss a subtotal for 'operating profit or loss and income and expenses from integral associates and joint ventures'. Instead, should the IASB go forward with the proposal of separating the two categories, EFRAG suggests that the IASB requires the presentation of the results of all associates and joint ventures below and close to the subtotal ‘operating profit or loss’ as a separate line item and a subtotal ‘operating profit or loss and income and expenses from associates and joint ventures’ on the face of the statement of profit or loss and to require to disclose an illustration of the split between ‘integral’ and ‘non-integral’ in the notes to the financial statements.

27 EFRAG also recommends clarifying how the IASB's proposals would apply to associates and joint ventures in the separate financial statements.

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

28 EFRAG welcomes the IASB's proposal to describe the respective roles of primary financial statements, the notes and the proposal for principles, and the general requirements on the aggregation and disaggregation, as a complement to the 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 consistency. Notwithstanding the above, EFRAG is of the view some further clarifications on the principle of aggregation are necessary.

Analysis of operating expenses

29 EFRAG supports 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.

30 EFRAG believes that it would be useful if the IASB clarified its primary objective for the presentation of expenses by nature or by function, including the role and scope of a mixed basis of presentation (i.e. clearly state what a mixed presentation basis is and when such mixed presentation is allowed). EFRAG is also of the view further guidance would be useful in a number of areas including to better describe the two methods and to provide a definition of presentation by-function.

31 In the light of preparer's concerns regarding the disclosure on a by-nature basis in the notes when presenting by-function on the face, EFRAG recommends the IASB to further investigate the cost/benefit profile of its proposals and, if appropriate, consider focusing on which information is most needed by users.

Unusual income and expenses

32 EFRAG welcomes the IASB's efforts to define unusual income and expenses and to require entities to disclose such items in the notes, as such disclosure provides useful information to users of financial statements. 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 considers not only items that 'will not arise for several future annual reporting periods' (as expressed in the ED) 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).

33 EFRAG also calls for the IASB to provide more implementation guidance for preparers. In particular, more guidance on the use of the terms 'several future annual reporting periods' and 'predictive value', which may involve significant judgement, and more guidance how to report unusual amounts. Interactions with IFRS 8 Operating Segments and with the proposals on management performance measures should be further considered as well.

Management performance measures ('MPMs')

34 EFRAG agrees that non-IFRS measures are often used in practice and additional guidance could bring more transparency and consistency on their use. EFRAG therefore welcomes the IASB's efforts to provide guidance on MPMs.

35 However, EFRAG considers that the definition of an MPM should be extended to include also measures related to the statement of financial position, ratios and not be limited to the subtotals presented on the face of the statement of profit or loss. In addition, EFRAG invites the IASB to consider:

(a) making the definition of public communication narrower, limiting the scope to the MPMs presented in public communications released jointly with the annual or interim reports;

(b) excluding from the scope the performance measures required by regulators, and

(c) extending the scope to cover possible MPMs presented in the financial statements but not in other public communications.

36 EFRAG also suggests the IASB to consider whether a change of the formula of an MPM constitutes a change of an accounting policy in accordance with the guidance of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

37 EFRAG also 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.

38 In regard to the proposed amendments to IAS 34 *Interim Financial Reporting*, EFRAG has some concerns about requiring a reconciliation of the MPMs to the most directly comparable subtotal or total specified in IFRS Standards as such reconciliations, including the tax effect and NCI effect, can be costly, particularly when preparing interim financial statements at consolidated level (e.g. tax includes income tax of different subsidiaries and not transactions).

EBITDA

39 EFRAG considers that it would have been useful to define EBIT and EBITDA as they are among the most used performance measures. However, as such measures have not been defined by the IASB, they should be included in the scope of the IASB's proposals regarding MPM disclosures. In addition, EFRAG suggests that the IASB clarifies the principle behind the list of measures not considered to be MPMs provided in paragraph 104 of the ED.

Statement of cash flows

40 EFRAG supports the IASB's proposal to require entities to use 'operating profit or loss' as the starting point for the indirect reconciliation of cash flows from operating activities in the statement of cash flows. This is because it specifies a consistent starting point for the indirect method of reporting cash flows from operating activities and reconciles the operating category in the statement of profit or loss with the operating activities in the statement of cash flows. EFRAG also supports the removal of options for the classification of interest and dividends in the statement of cash flows for non-financial entities, as it will improve consistency in presentation of similar line items and will better reflect the nature of the respective cash flows.

41 However, EFRAG suggests that the IASB should 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.

Other comments: presentation of revenue and costs in different business lines

42 EFRAG highlights that, currently, there is diversity in practice in how entities that operate business activities in different industries present their performance (e.g. a manufacturer providing financing to customers or entities operating both banking and insurance services). Some entities present information about their different business activities in the statement of profit or loss, as part of operating profit, by adding separate rows and allocating revenues and expenses reflecting the different business activities (as in paragraph IE11 of the Illustrative Examples). On the contrary, other entities present all income and expenses related to different business activities without any business activity distinction, accompanied by more detailed information in the segment reporting section in accordance with IFRS 8.

43 EFRAG considers that it could be useful if the IASB could further explain how entities with different business activities should prepare their financial statements, especially when considering the example provided by the IASB in paragraph IE11 of the Illustrative Examples. The IASB should consider providing further illustration

on how the split between the operating/financing and investing categories should be done in this case. In addition, the need for consistency with the requirements in IFRS 8 should be considered together with the disclosure of judgement applied to allocate revenues and costs across business activities (e.g. in case of group internal transactions between businesses), when they are presented separately on the face of the statement of profit or loss.

Other comments: proposals on other comprehensive income

44 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 that 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.

Others: effective date and transition

45 EFRAG recommends 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.

46 EFRAG considers that the proposed time of 18 to 24 month for a retrospective first-time application may not be sufficient, particularly if the IASB decides to proceed with all its proposals (e.g. disclosures by nature when presenting by function).

47 EFRAG has also provided additional suggestions to improve presentation in the primary financial statements in other comments section.

Questions for EFRAG Board

48 Does EFRAG Board approve the EFRAG comment letter to the IASB?

Agenda Papers

49 In addition to this cover note, agenda papers for this session are:

(a) Agenda paper 02-02 – Overview of the feedback received from outreach events and field-tests; (this document was presented to EFRAG Board on 8 October 2020);

(b) Agenda paper 02-03 – Overview of the feedback received from comment letters;

(c) Agenda paper 02-04 – EFRAG Comment Letter with track changes; and

(d) Agenda paper 02-05 – EFRAG Comment Letter clean version;

(e) Agenda paper 02-06 – EFRAG DCL on PFS - summary of feedback and comment letters - presentation

Links to the comment letters received (comment letters are available on EFRAG's website)

CL 01 Soren Ploschke - EFRAG DCL PFS 2019.pdf

CL 02 - CNC - EFRAG DCL PFS 2019.pdf

CL 03 - AE - EFRAG DCL PFS 2019.pdf

CL 04 - Erste Group - EFRAG DCL PFS 2019.pdf

CL 05 - ESMA - EFRAG DCL PFS 2019.pdf

CL 06 - KBC - EFRAG DCL PFS 2019.pdf

CL 07 - DASC - EFRAG DCL PFS 2019.pdf

CL 08 - ESBG - EFRAG DCL PFS 2019.pdf

CL 09 - SUEZ - EFRAG DCL PFS 2019.pdf

CL 10 - Allianz Group - EFRAG DCL PFS 2019.pdf

CL 11 - DASB - EFRAG DCL PFS 2019.pdf

CL 12 - Aviva - EFRAG DCL PFS 2019.pdf

CL 13 - EFFAS - EFRAG DCL PFS 2019.pdf

CL 14 - ICAEW - EFRAG DCL PFS 2019.pdf

CL 15 - SEAG - EFRAG DCL PFS 2019.pdf

CL 16 - Volkswagen - EFRAG DCL PFS 2019.pdf

CL 17 - Groupe Renault - EFRAG DCL PFS 2019.pdf

CL 18 - ICAC - EFRAG DCL PFS 2019.pdf

CL 19 - IEAF - EFRAG DCL PFS 2019.pdf

CL 20 - AFME - EFRAG DCL PFS 2019.pdf

CL 21 - Insurance Europe - EFRAG DCL PFS 2019.pdf

CL 22 - NASB - EFRAG DCL PFS 2019.pdf

CL 23 - SFRB - EFRAG DCL PFS 2019.pdf

CL 24 - UK FRC - EFRAG DCL PFS 2019.pdf

CL 25 - BusinessEurope - EFRAG DCL PFS 2019.pdf

CL 26 - EFAMA - EFRAG DCL PFS 2019.pdf

CL 27 - CRUF - EFRAG DCL PFS 2019.pdf

CL 28 - GSK - EFRAG DCL PFS 2019.pdf

CL 29 - ASCG - EFRAG DCL PFS 2019.pdf

CL 30 - BASF - EFRAG DCL PFS 2019.pdf

CL 31 ABAF-BVFA - EFRAG DCL PFS 2019.pdf

CL 32 - AFRAC - EFRAG DCL PFS 2019.pdf

CL 33 - ABI - EFRAG DCL PFS 2019.pdf

CL 34 - OIC - EFRAG DCL PFS 2019.pdf

CL 35 - Südzucker - EFRAG DCL PFS 2019.pdf

CL 36 - ANC - EFRAG DCL PFS 2010.pdf