Primary Financial Statements
Cover Note

Objective

1 The objective of the session is to:

(a) to provide an update to EFRAG TEG-CFSS members on the IASB's redeliberations on the proposals included in the Exposure Draft *General Presentation and Disclosures*; and

(b) to seek input from EFRAG TEG-CFSS members on any implications of the IASB's redeliberations so far.

Agenda papers

2 In addition to this cover note, agenda papers 08-02 – *IASB Agenda Paper AP3* and 08.03 – *IASB Agenda Paper AP3A* have been provided for the session.

Background

3 In its *Primary Financial Statements* project, the IASB is examining possible changes to the structure and content of the primary financial statements. The IASB's project is focused on:

(a) requiring companies to present additional defined subtotals in the statement of profit or loss ('*Subtotals and categories*')

(b) strengthening requirements for disaggregating information ('*Disaggregation*'); and

(c) requiring companies to disclose information about management performance measures in the notes ('*Management Performance Measures or MPMs*').

4 On 17 December 2019, the IASB published the ED *General Presentation and Disclosures* where 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.

5 In November 2020, EFRAG issued is Final Comment Letter where it welcomed the ED and the IASB's efforts to improve the structure and content of the primary financial statements. It also 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. Also in November 2020, EFRAG published its feedback statement, which summarised the main comments received by EFRAG and explained how those comments were considered by EFRAG.

6 Since then, the EFRAG Secretariat has been monitoring the IASB's discussions and providing updates. The last update to EFRAG TEG-CFSS was in March 2021, where members discussed the IASB's approach for redeliberations.

Summary of the IASB's Discussions

Subtotals and categories

7 The ED proposed that an entity presented three new subtotals in the statement of profit or loss. In applying those new subtotals, an entity would present four categories: (i) operating, (ii) integral associates and joint ventures, (iii) investing and (iv) financing.

IASB Tentative Decisions	**EFRAG Comment Letter**
The IASB tentatively confirmed that entities would be required to present an **operating profit** subtotal.	EFRAG supported the IASB's proposals to present an operating profit subtotal.
The IASB tentatively decided not to develop a direct definition of **operating profi**t and that the following income and expenses are excluded from operating category: investing, financing, income tax, and discontinued operations. It also tentatively decided that the **operating category** comprises all income and expenses arising from an entity's operations, including, but not limited to, income and expenses from an entity's main business activities. It also includes volatile and unusual items.	EFRAG supported the IASB's proposals to present an operating category. However, it noted that the IASB needed <u>to further consider the presentation of operating profit or loss when one or more-line items between categories are immaterial (particularly for financial institutions)</u>. EFRAG agreed with the IASB's approach of having combination of a positive definition and a residual element in the definition of operating category. However, it <u>called for more guidance on the notion of 'an entity's main business activities and considered that the IASB should consider improvements to the interaction between the proposal in the ED and IFRS 8, by, for example, including minor or auxiliary business activities (i.e., not main business activities) as a different segment</u>.
The IASB confirmed its proposal to define and present the subtotal '**profit before financing and income tax'** (**financing category**).	EFRAG supported the IASB's proposal to require and define 'profit or loss before financing and income tax' and the 'financing category
On the **financing category**, the IASB tentatively decided not to proceed with a change to the definition of 'financing activities' in IAS 7 *Statement of Cash Flows.* Instead, it tentatively decided to change its approach on the classification of items in the financing category. That is, classify in the financing category all income and expenses from liabilities that arise from transactions that involve only raising finance (that involves the receipt of cash, own equity instruments or reduction in a financial liability and the return of cash or own equity instruments) and specified income and expenses from other liabilities.	EFRAG highlighted the challenges of the IASB's proposals to make the distinction between the investing and financing category and give more emphasis to the need of having additional guidance to help implementation. EFRAG also considered that there are arguments to support a different classification of income and expenses from cash and cash equivalents and of time value of money that liabilities that do not arise from financing activities. However, EFRAG concurred with the IASB that the proposed classification in the financing category would provide a reasonable compromise.

On the **financing category**, the IASB tentatively decided to provide guidance on '*Hybrid contracts with host liabilities and embedded derivatives'* and *'Liabilities arising from transactions that do not involve only the raising of finance'* (i.e., interest expense and the effect of changes in interest rates from other liabilities) (see page 5 of agenda paper 08.03)	*In regard to hybrid contracts with host liabilities and embedded derivatives',* this topic was not considered by IASB and EFRAG before. In regard to *'Liabilities arising from transactions that do not involve only the raising of finance'* (e.g. income and expenses that reflect the effect of the time value of money on liabilities that do not arise from financing activities), EFRAG recommended that the IASB requires a disaggregation in the notes to the financial statements on the main components of the line and to better explain the reasoning behind the IASB decision to present in the financing category the effect of the time value of money on liabilities that do not arise from financing activities.
The IASB tentatively decided that the default category for **gains and losses from derivatives and hedging instruments** is the operating category (rather than the investing), including derivatives not used for risk management (*two Board members disagreed with operating being the default category for gains or losses on derivatives not used for risk management*). It also tentatively decided that when the derivative is not used for risk management, relates to financing activities and is not used in the course of the entity's main business activities, an entity classifies all fair value gains or losses in the financing category.	EFRAG expressed concerns about presenting gains and losses on derivatives in the investing category under certain conditions (i.e. exceptions related to grossing up of gains and losses or the undue cost or effort), particularly when referring to financial institutions. Regarding the classification of fair value gains and losses on derivatives, EFRAG considered that it would be useful to have a definition of 'risk management'.
The IASB tentatively decided to add an undue cost or effort as a relief from allocating **foreign exchange differences** to the different categories. In cases that involve undue cost or effort, an entity classifies the foreign exchange differences in the operating category.	EFRAG highlighted that tracking foreign exchange differences related to the operating, investing, and financing categories can be burdensome and costly and may outweigh the benefits of classifying the items in the sections of the statement(s) of financial performance.
The IASB tentatively confirmed to retain the proposal to introduce separate investing and financing categories in the statement of profit or loss.	EFRAG called for the IASB to further <u>consider the presentation of required subtotals when one or more-line items between categories are immaterial</u> (e.g. whether immaterial items from financing and investing activities can be presented within the operating category when immaterial; to avoid a nil amount between categories)
The IASB will discuss at a future meeting the precise definition of the **investing category**. Nonetheless, it already tentatively decided to require an entity to classify income and expenses from **cash and cash equivalents** in	On the presentation of income and expenses that arise from **cash and cash equivalents**, EFRAG decided, after considering the different views on the topic, to accept the approach proposed in the ED as requiring entities to split cash and cash equivalents between amounts in

the investing category (rather than the financing category).	the different categories could result in operational costs which would outweigh the benefits.

The EFRAG Secretariat analysis

8 In general, the IASB's tentative decisions are aligned with EFRAG requests for changes or additional guidance. Nonetheless, as highlighted above, at this stage the IASB has neither provided additional guidance on the notion of 'main business activities' nor improvements to the interaction between the proposal in the ED and IFRS 8, by, for example, including minor or auxiliary business activities (i.e. not main business activities) as a different segment.

9 In addition, the IASB has not yet considered the presentation of required subtotals when one or more-line items between categories are immaterial.

10 On hybrid contracts with host liabilities and embedded derivatives, EFRAG recalls that the IASB is currently considering the classification of complex financial instruments within its project *Financial Instruments with Characteristics of Equity* (e.g. bail-in instruments). Thus, both projects should monitor each other's activities and dully test in practice their approach.

11 Finally, the EFRAG Secretariat notes that classifying income and expenses from cash and cash equivalents in the investing category would be aligned with the classification in the statement of cash flows. Nonetheless, the EFRAG Secretariat acknowledges the different views on the topic.

Disaggregation

12 In the ED, the IASB proposed a description of the roles of the primary financial statements and the notes. In addition, the IASB set out proposals for principles and general requirements on the aggregation and disaggregation of information.

The IASB tentatively decided to state the purpose of disaggregation more clearly - items shall be disaggregated if the resulting disaggregated information is material.	EFRAG expressed concerns that the application of the proposals in paragraphs 27 and 28 of the ED could lead to the presentation and disclosure of immaterial items.
The IASB tentatively decided to emphasise that a single dissimilar characteristic between items would be sufficient to require an entity to disaggregate information, if material.	EFRAG called for other clarifications as it was, for example, unclear how the principles of (dis)aggregation relate to the use of comparatives (i.e. an entity 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).
The IASB confirmed the non-reinstatement of paragraph 29 of IAS 1 in the new IFRS Standard[1].	
The IASB tentatively decided to include a reference to understandability in the description of the role of the primary financial statements.	EFRAG expressed concerns that the description noted in paragraph 20(a) of the ED could be too narrow. Instead, it

[1] *An entity shall present separately each material class of similar items. An entity shall present separately items of a dissimilar nature or function unless they are immaterial*

	considered that the defined role of the primary financial statements should focus on the overall position, performance, cash flows and stewardship of the entity, rather than the individual line items.
The IASB will continue to discuss this topic in the future, including the definition of unusual items and expenses by nature or by function.	

The EFRAG Secretariat analysis

13 The IASB has addressed some but not all the issues raised by EFRAG in its comment letter, particularly those underlined above.

Management Performance Measures

14 In the ED, the IASB proposes to define and require entities to provide disclosures in a single note on MPMs

The IASB tentatively confirmed the proposal to require an entity to include information about MPMs in the financial statements.	EFRAG supported the IASB's efforts to provide guidance on MPMs as non-IFRS measures are often used in practice and additional guidance could bring more transparency and consistency in their use
The IASB tentatively decided to include in the scope of its requirements for MPMs the numerator or denominator of a ratio, if that numerator or denominator meets the definition of a MPM. The IASB also tentatively decided not to further explore expanding the scope of MPMs to include measures based online items presented in the statements of financial performance; the cash flow statement, the statement of financial position; and ratios.	After considering the feedback received from its constituents, EFRAG invited the IASB to <u>not restrict the definition of MPMs to subtotals on the face of the statement of profit or loss and include also other measures, such as indicators of financial position or ratios; and possible MPMs presented in the financial statements but not in other public communications</u>.
The Board will discuss other aspects of proposals at a future IASB meeting, including the specific disclosures that will be required.	

The EFRAG Secretariat analysis

15 The IASB's discussions have been mainly focused on the scope of its proposals on MPMs. At this stage, the IASB has tentatively decided to not significantly widen the scope of the MPMs (to avoid scope creep and be aligned with focus of the project that is on the statement of financial performance; considering the MPMs relating to measures based on cash flows without considering the improvements to the statement of cash flows could be according to the IASB premature and prove to be problematic), even though many respondents called for the IASB to revisit the definition to include other measures such as those based on items presented in the statement of financial position or the statement of cash flows.

Other topics

16 In the ED, the IASB proposes to amendment IAS 7 *Statement of Cash Flows* to require the operating profit or loss to be the starting point for the indirect method of reporting cash flows from operating activities. In addition, the IASB proposes the removal of classification options of interest and dividend cash flows in IAS 7.

The IASB tentatively decided to maintain the scope of its work relating to the statement of cash flows in this project.	EFRAG supported the IASB's targeted improvements to IAS 7 in the ED but suggested that the IASB has 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.
The IASB tentatively confirmed the proposal to require an entity to use the operating profit or loss subtotal as the starting point for the indirect method of reporting cash flows from operating activities	EFRAG supported 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.
The IASB also tentatively confirmed proposals relating to the classification of interest paid and dividend cash flows for entities other than those for which investing and financing are main business activities. Accordingly, interest and dividends paid would be classified as financing activities, and dividends received would be classified as investing activities.	EFRAG supported the removal of options in IAS 7 for the classification of interest and dividends.

The EFRAG Secretariat analysis

17 The IASB has basically confirmed its initial proposals and considered that no additions should be made to the scope of the project on the statements of cash flows.

18 Nonetheless, the IASB has not discussed at this stage 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. There is the possibility that the IASB may consider revising IAS 7 as result of its agenda consultation.

19 Finally, the EFRAG Secretariat suggests that the IASB also considers the classification and presentation of supplier finance arrangements. In particular, on the presentation of the liabilities arising from such transactions (trade payables versus financial debt/borrowing) in the statement of financial position, the presentation in the cash flow statement as an operational cash flow or a financing cash flow in the statement of cash flows and presentation of related income and expenses as operating or financing in the statement of financial performance.

Questions for EFRAG TEG-CFSS

20 Given the IASB's tentative decisions on the proposals to date, what advice do EFRAG TEG-CFSS members have for the IASB?

21 In particular: do EFRAG TEG-CFSS members have any suggestions in approaching the remaining topics to be redeliberated given the tentative decisions so far?