PRIMARY FINANCIAL STATEMENTS

PREPARERS ROUNDTABLE

1 September 2020

EFRAG
European Financial Reporting Advisory Group

IFRS

BUSINESSEUROPE

AGENDA

09:30 Opening and welcome by **Claes Norberg, EFRAG Board Member and Chair of BusinessEurope Sounding Board**

09:35 **Nick Anderson, IASB Member** and **Aida Vatrenjak, IASB Technical staff** to explain the objective of the joint field-test

Kathrin Schoene, EFRAG Project Director to explain EFRAG's outreach activities and the workshops established with companies.

09:40 Discussion on the application of the IASB proposals and experiences of the field-test. For each topic identified below:

- **Nick Anderson and Aida Vatrenjak** to outline the main relevant parts of the IASB's proposals included in the Exposure Draft
- **Filipe Camilo Alves, EFRAG Senior Technical Manager,** to outline the key themes identified in field-tests
- **Representatives of companies, including those that participated in the field-tests**, to provide their experience in applying the Exposure Draft's proposals on the selected topics
- **Claes Norberg** to seek input from other preparers and facilitate discussion
- **Christoph Schauerte, EFRAG TEG Member and Head of Accounting and Group Accounting Officer Vonovia SE** moderate the polling questions and questions from the audience.

Topic 1: Classification of income and expenses

Topic 2: Integral or non-integral associates and joint ventures

Topic 3: Analysis of expenses by function and by nature

Topic 4: Management performance measures disclosures and unusual items

12:15 Closing remarks and main takeaways by Chiara del Prete, EFRAG TEG Chairwoman.

12:30 End of the webinar.

Introduction

PRESENTERS AND MODERATORS

Chiara Del Prete
EFRAG TEG Chairwoman

Nick Anderson
IASB Board Member

Claes Norberg
EFRAG Board Member and Chair of BusinessEurope Sounding Board

Aida Vatrenjak
IASB Technical Staff

Christoph Schauerte
EFRAG TEG Member and Head of Accounting and Group Accounting Officer Vonovia SE

Kathrin Schoene
EFRAG Project Director

Filipe Alves
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SPEAKERS

Ewa Wanda Maruszewska
Welding Alloys Polska

Eva Kalk
Manager Financial Instruments & Liabilities Accounting Policies

Susanne Bek
Finance Expert Corporate Financial Reporting, SAP

Andre Besson
Head of Financial Reporting Guidelines, Nestlé

Ezio Santroni
ENI Accounting Principles and Regulations Competence Center

What has the Board heard?

Companies should provide **more granular** information….

Subtotals in the statement of profit or loss need to be **comparable**

….and **information grouped** in a way that provides better inputs for investor analysis

Management-defined performance measures provide useful information, but more **transparency** is required

How do the Board's proposals respond?

Require additional defined subtotals in the statement of profit or loss	Three new required subtotals in the statement of profit or loss	Items of income and expense included in "operating" when part of main business activities
Strengthen requirements for disaggregating information	Principles for aggregation & disaggregation	Improvements to analysis of operating expenses Disclosure of unusual income and expenses
Require disclosures about management performance measures	Management performance measures and related disclosures located in a single note	Reconciliation required to the most directly comparable subtotal/total specified by IFRS Standards

Purpose of fieldwork

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

Resulting feedback will be a valuable resource, helping the Board gain a better understanding of how the project proposals are likely to affect those who use and apply IFRS Standards.

Project status

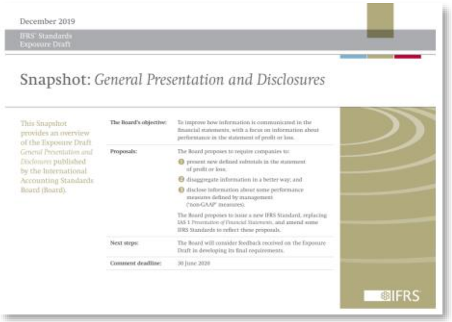
Consultation

Q4 2019	Q1–Q3 2020	Q4 2020
Exposure Draft published for public comment	Comment period (ends 30 September)*	Board considers feedback

The proposals, if finalised, would result in a new Standard and replace IAS 1 *Presentation of Financial Statements*.

Published materials

Exposure Draft & Illustrative Examples



Snapshot

Video and webinars

*Extended from 30 June due to covid-19 pandemic.

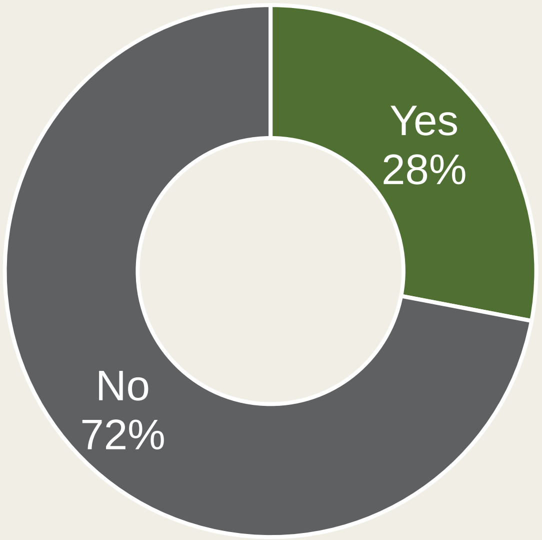
EFRAG CONSULTATION AND JOINT FIELD-TEST

- EFRAG published its Draft Comment Letter on 24 February 2020, including the results of the **Early Stage Analysis.** Comment letters are welcomed by **28 September 2020**
- Outreach with different types of European stakeholders, including users, preparers and NSS, and different jurisdictions have been converted into **public webinars and online events**, with technical support of EFRAG Secretariat
- **Field test with preparers** in coordination with European National Standard Setters and the IASB, **by 31 August 2020**
  - Field-Test Workshop on 7 July with preparers of financial statements – 5 corporates
  - Field-test workshop on 7 July with preparers of financial statements – 4 Financial Institutions
  - Field-test workshop on 24 August with preparers of financial statements – 2 Financial Institutions and 4 Corporates

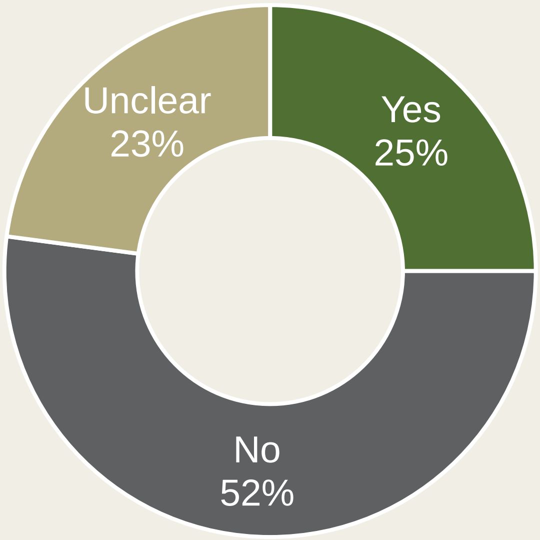
Profit or loss statement subtotals

Current practice: Same headings, different meanings

Share of profit or loss of associates and joint ventures included in operating profit?



Interest cost on defined benefit pension liabilities included in operating profit?



In a sample of 100 companies, we found that 63 companies reported operating profit in the financial statements, **using at least nine different definitions.**

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Subtotals: general corporate example

Revenue	347,000
Other income	3,800
Changes in inventories of finished goods and work in progress	3,000
Raw materials used	(146,000)
Employee benefits	(107,000)
Depreciation	(37,000)
Amortisation	(12,500)
Professional fees and other expenses	(10,030)
Operating profit	**41,270**
Share of profit or loss of integral associates and joint ventures	(600)
Operating profit and income and expenses from integral associates and joint ventures	**40,670**
Share of profit or loss of non-integral associates and joint ventures	3,380
Dividend income	3,550
Profit before financing and income tax	**47,600**
Expenses from financing activities	(3,800)
Unwinding of discount on pension liabilities and provisions	(3,000)
Profit before tax	**40,800**
Income tax	(7,200)
Profit for the year	**33,600**

Operating

Integral associates and joint ventures

Investing

Financing

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Subtotals: investment and retail bank example

Interest revenue calculated using the effective interest method	356,000
Interest expense	(281,000)
Net interest income	75,000
Fee and commission income	76,800
Fee and commission expenses	(45,300)
Net fee and commission income	31,500
Net trading income	9,100
Net investment income	11,600
Credit impairment losses	(17,300)
Employee benefits	(55,100)
[other line items not shown in this illustration]	(11,800)
Operating profit	43,000
Share of profit or loss of integral associates and joint ventures	(2,400)
Operating profit and income and expenses from integral associates and joint ventures	40,600
Net interest on net defined benefit liability	(1,000)
Profit before tax	39,600
Income tax expense	(11,200)
Profit for the year	28,400

all expenses from financing activities classified in the operating category rather than the financing category

income (expenses) from investments made in the course of main business activities are classified in the operating category, rather than the investing category

no ‘profit before financing and income tax’ subtotal

Classification of income and expenses

CLASSIFICATION OF INCOME AND EXPENSES

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

CLASSIFICATION OF INCOME AND EXPENSES

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

Presentation of associates and joint ventures

Presentation of associates and joint ventures

Different stakeholder views

My associates and JVs are a part of my main business, so I want to include my share of their results in operating profit.

The share of associates' and JVs' profit is after financing and after tax so I want to analyse them separately from operating profit.

Proposal—balanced approach

- **exclude** income and expenses from **all** equity-accounted associates and joint ventures from operating profit.
- identify which of equity-accounted associates and joint ventures are closely related ('**integral**') to their main business activities, ie do not **generate returns independently**.
- income and expenses from integral associates and joint ventures would be presented **immediately below operating profit**. Income and expenses from **non-integral** associates and JVs, ie those meeting definition of income and expenses from investments, would be presented in the **investing** category.

INTEGRAL OR NON-INTEGRAL ASSOCIATES AND JOINT VENTURES

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

INTEGRAL OR NON-INTEGRAL ASSOCIATES AND JOINT VENTURES

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

Analysis of expenses

Analysis of operating expenses

Statement of profit or loss	Notes
Use method for analysis of operating expenses (by nature or by function) that provides the **most useful information**	Disclose analysis by **nature** in the notes if analysis by function is presented in the statement of profit or loss

Statement of profit or loss

- **Not a free choice**—the Board proposes to provide a set of indicators to help companies select a method.
- Companies should **not mix** the two methods.
- Would **remove option** to present analysis of expenses in the **notes only.**

Notes

- Analysis of **total** operating expenses—no requirement to analyse each functional line item by nature.

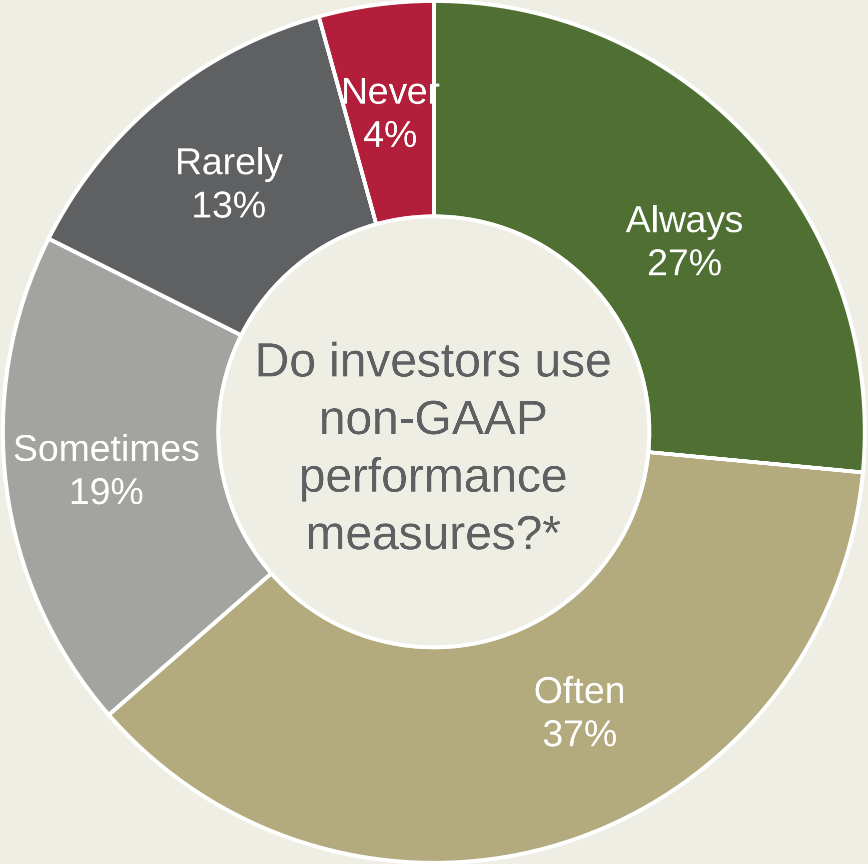
ANALYSIS OF EXPENSES BY FUNCTION AND BY NATURE

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

Management performance measures and unusual items

Non-GAAP performance measures

Investors find these measures useful… but seek greater transparency



*CFA Institute, 2016

> When analysing compliance with the Guidelines, overall ESMA observed a good level of compliance in relation to the principles on comparatives, consistency and unbiased nature of the APMs reported. On the other hand, shortcomings were identified in relation to compliance with the principles regarding explanations, reconciliations and definitions.

Report on the use of Alternative Performance Measures and on the compliance with ESMA's APM Guidelines, 2019

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Management performance measures (MPMs)

Disclosure in the single note of subtotals of income and expenses that:

Are used in public communications **outside financial statements**	**Complement** totals or subtotals specified by IFRS Standards	Communicate **management's view** of an aspect of an entity's financial performance

The proposed disclosure requirements are similar to existing regulatory guidance.

The disclosure of tax & NCI effects is likely to be new for most but not all entities.

MPMs would be subject to the same requirements regardless of the entity's jurisdiction.

Including MPMs in financial statements is expected to bring such measures into the scope of audit.

Not all performance measures are MPMs

Performance measures

Non-financial performance measures

For example:
- Number of subscribers
- Customer satisfaction score
- Store surface

Financial performance measures

(Sub)totals of income and expenses

IFRS-specified

For example:
- Profit or loss
- Operating profit
- Operating profit before depreciation and amortisation

MPMs

For example:
- Adjusted profit or loss
- Adjusted operating profit
- Adjusted EBITDA

Other measures that are not subtotals of income/expenses

For example:
- Free cash flow
- Return on equity
- Net debt
- Same-store sales

Example of MPM reconciliation in the notes

Adjusted operating profit (MPM)	52,870	Tax	NCI
Restructuring in Country X	(5,400)	900	(1,020)
Revenue adjustment	(6,200)	1,550	-
Operating profit (IFRS-specified)	41,270		

- The proposed disclosure requirements are similar to existing regulatory guidance.
- The disclosure of tax & NCI effects is likely to be new for most but not all entities.
- Management performance measures would be subject to the same requirements regardless of the entity's jurisdiction.
- Including MPMs in financial statements is expected to bring such measures into the scope of audit.

Unusual income and expenses

Definition

Income and expenses with **limited predictive value**.
Income and expenses have limited predictive value when it is reasonable to expect that income or expenses that are similar in type and amount will not arise for several future annual reporting periods.

Income and expenses from the recurring remeasurement of items measured at a current value would not normally be classified as unusual.

Disclosures

Amount & narrative description	Amount disaggregated by: • line items presented in statement of profit or loss; and • line items disclosed in analysis of operating expenses by nature, if the entity analyses expenses by function in the statement of profit or loss

MANAGEMENT PERFORMANCE MEASURES

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

UNUSUAL ITEMS

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

EFRAG receives financial support of the European Union - DG Financial Stability, Financial Services and Capital Markets Union. The content of this presentation is the sole responsibility of EFRAG and can under no circumstances be regarded as reflecting the position of the European Union.

Thank you

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