

# PRIMARY FINANCIAL STATEMENTS SUMMARY REPORT

## ROUNDTABLE WITH FINANCIAL INSTITUTIONS

2 November 2022



## Introduction

In order to receive input from preparers and to stimulate the discussion on the key tentative changes to the IASB® proposals included in the Exposure Draft *General Presentation and Disclosures* ('the ED') (as a result of the IASB's redeliberation), EFRAG and the IASB arranged a joint outreach roundtable with financial institutions on 2 November 2022. This report has been prepared for the convenience of European constituents, summarises the event and will be further considered by the organisations involved in their respective due processes on the proposals.

The purpose of the targeted outreach activity is to assess whether the selected tentative decisions made by the IASB will function as intended and achieve the intended balance of costs and benefits.

The information obtained in the outreach will also:

- help the IASB in completing its due process and will be used to support the IASB's decisions on any of the proposals before issuing the final IFRS Accounting Standard; and
- support EFRAG's potential endorsement advice activities once the final IFRS Accounting Standard is published.

**Silvie Koppes**, EFRAG FR TEG member, welcomed participants and provided an overview of the agenda.

**Linda Mezon-Hutter**, IASB member, presented the status of the project and the purpose of the targeted outreach. Furthermore, she stated that the feedback collected during the outreach activities would be a key component of the IASB's thinking when finalising the proposals and deciding on the next step of this project. She clarified that the IASB's discussions on the results of the outreach activities would be held in 2023.

**Filipe Camilo Alves**, EFRAG Senior Technical Manager, presented EFRAG's outreach activities, which include:

- Two roundtables with corporate companies (e.g., Energy, Industrials, Healthcare, Technology, Telecoms, Utilities, etc), including those that conduct investing or financing activities as part of their main business activities (e.g., manufacturers providing financing to customers);
- One roundtable with financial institutions (e.g., banks and insurance companies), conglomerates and investment property companies;
- One roundtable with users and preparers, in the form of a public webinar, with the objective of discussing whether the IASB's tentative decisions achieve the intended balance of costs and benefits; and
- Discussions with the EFRAG Working Groups, including EFRAG FIWG, EFRAG IAWG and EFRAG User Panel, and *ad hoc* meetings with representatives of users and preparers.

The preparers involved were asked to provide their feedback on the IASB's selected tentative decisions as detailed below.

The following companies participated in this roundtable:

- ABN AMBRO Bank N.V.
- Allianz Group
- Alpha Bank Group
- CaixaBank S.A.

- DZ BANK AG
- Erste Group Bank AG
- Svenska Handelsbanken AB

## Roundtable discussion

For each topic identified below:

- **Nick Barlow** and **Roanne Hasegawa**, IASB Technical Staff, and **Laura Abeni**, EFRAG Technical Manager, introduced the main relevant parts of the IASB's tentative decisions to be discussed and responded to participants' questions (Appendix 1 – IASB Outreach information (September 2022)).
- **Filipe Camilo Alves** outlined the preliminary feedback arising from the EFRAG's outreach activities to date (Appendix 2 – Slides with key messages received in advance of the meeting\_2 November).

### TOPIC 1: Subtotals and categories in the statement of profit or loss

*The IASB staff presented a comparison of the structure of the statement of profit or loss as proposed in the ED with the new structure resulting from the IASB's redeliberations until September 2022, outlined the main new required subtotals, and described the content of the operating, investing and financing categories for entities with specified main business activities.*

*Questions for participants:*

- Is the revised proposal for classifying income and expenses within the financing category clearer and easier to apply than the proposal in the ED?*
- Are you aware of any issues that may arise from the expected change in outcome from the ED for lease liabilities and amounts payable for goods and services received?*
- Does the revised proposal for classifying income and expenses in the financing category result in a change from the proposals in the ED for the classification of any income and expenses from liabilities other than lease liabilities and amounts payable for goods and services received?*
- Are you aware of any entities that provide financing to customers as a main business activity that do not also invest in financial assets as a main business activity that would be impacted by the possible change to the ED?*

Some participants welcomed the IASB's redeliberations on subtotals and categories and they considered the current definitions to be clearer than those in the ED. One participant noted the new definitions offer the flexibility for banks and insurance companies to classify their income and expenses based on what they consider to be their main business activities (e.g., banking, insurance, sale of real estate, collateral, financial and non-financial products, and credit card payments). Another participant highlighted that the new definitions lead to clarity in some respects but create more confusion in other respects (described in the following paragraphs).

Nonetheless, one participant highlighted that 'operating result' was currently a key performance measure for their bank and questioned the merit of the IASB's proposal on the operating profit subtotal for banks, particularly when considering that income and expenses from associates and joint ventures accounted for under the equity method and 'specified income and expenses on other liabilities' are

presented outside of the operating category although these line items were related to operations and/or were immaterial. The participant could understand the technical reasons behind the IASB's decision as it would improve comparability but considered that this decision will decrease the relevance of the presentation of these amounts. The participant confirmed the amounts of these two items were not material for their financial institution.

Participants also provided comments on the following two topics.

*New definition of financing category - specified income and expenses from other liabilities*

Some participants disagreed with the outcome of the revised definition of the financing category for which '*interest expenses on lease liabilities and amounts payable for goods and services received*' would now be captured by '*specified income and expenses from other liabilities*' and could not be reclassified into operating profit even for financial institutions.

Presenting '*specified income and expenses from other liabilities*' outside of the operating category would not reflect the way a bank is financing its operating activities (e.g., by providing finance to customers).

These participants noted that most of their leases are for buildings, branch offices, employees' company cars, and other office facilities. The interest expenses of these contracts are naturally connected to the operating activities (the related rights of use assets are operational assets) and presenting them outside operating profit would represent a change to current practice.

In addition, some participants believed that interest expenses on employees' benefits and the unwinding of the provisions for loan commitments and financial guarantees under IFRS 9 *Financial Instruments*, which were also considered part of '*specified income and expenses from other liabilities*', should be presented within the operating category. Although the presentation of these amounts within the financial category would improve comparability, it would decrease the relevance of the presentation of these amounts for financial institutions and alter the composition of operating profit.

Many participants also highlighted that, for financial institutions, the interest expenses on other liabilities would not be significant, or even immaterial, when compared to the operating profit. Presenting these as single line items on the face of the financial statements could incur significant costs for preparers, while the benefits for users would be limited. For this reason, these participants believed that, based on the materiality of the amounts, the IASB should allow financial institutions to present the interest expenses on other liabilities both in a specific line item on the face of the financial statements (preferably with no breakdown) and/or within the operating category.

Finally, one participant believed that the argument from the IASB that comparability would be enhanced by requiring all entities to present income and expenses on other liabilities outside of the operating category, regardless of their business models, would only increase compliance, since financial institutions manage their business by focusing on net cash flows holistically with no distinction between finance liabilities and 'other' liabilities.

The **IASB Staff** explained that the IASB decided not to make a distinction between financial institutions and other companies for the presentation of interest expenses on lease liabilities or on employees' benefits as it was not possible to distinguish why these liabilities would be different for general manufacturers relative to financial institutions. The **IASB Staff** noted that the presentation of the unwind of provisions for long-term commitments and financial guarantees under IFRS 9 had not been specifically discussed by the IASB at the time and this issue could be addressed in future meetings. In addition, the **IASB Staff** noted that currently financial institutions are not presenting these amounts homogeneously in the statements of profit or loss and the IASB's intention is to improve comparability.

Finally, the **IASB Staff** explained that by applying the materiality concepts, some financial institutions may conclude that nothing should be presented separately in the financing category.

#### *Income and expenses from cash and cash equivalents*

Some participants believed that the IASB should maintain the accounting policy choice in paragraph 51 of the ED, including for the classification of income and expenses from cash and cash equivalents and for entities that provide financing to customers as a main business activity. The IASB should allow the latter entities to present income and expenses from financing to customers and cash and cash equivalents in the operating category.

These participants also noted that for a financial institution, investing in financial assets is closely related to providing financing to customers, and it would be very difficult and costly to separate and segregate these activities into different categories. Furthermore, it would not be possible to separate which part of the funding raised by a bank (in whatever form) is used to finance customers and which to invest in financial assets.

One participant pointed out that cash and cash equivalents are an integral part of banks' operating activities and that they are used in liquidity risk management to meet legal requirements (e.g., liquidity ratios). If the IASB did not allow banks to classify income and expenses from cash and cash equivalents within operating profit, banks would be incentivised to identify investing in financial assets as a main business activity even if the focus of some banks is only on their lending activity.

One participant believed that the IASB should assume that investing in financial assets is a main business activity for financial institutions. However, the same participant also noted that the significant cost for preparers to separate income and expenses from cash and cash equivalents between the operating category and the investing category would not be balanced with the benefit of providing relevant information for users of financial statements.

Another participant noted that the IASB's definition of investing activity ('*assets that generate returns individually and largely independently of other resources held by an entity*') is not appropriate for financial institutions that manage their business on a net basis, regardless of the distinction between investing and financing activities.

## **TOPIC 2: Subtotals – Hybrid contracts with host liabilities and embedded derivatives**

*The IASB tentatively decided to require an entity to classify income and expenses related to:*

- *separated host liabilities to be classified in the same way as income and expenses on other liabilities;*
- *separated embedded derivatives to be classified in the same way as income and expenses on stand-alone derivatives; and*
- *contracts that are not separated to be classified in the same way as income and expenses on other liabilities.*

*The IASB also tentatively decided to explore an approach that would classify all income and expenses in the financing category of the statement of profit or loss for liabilities that arise from transactions that do not involve only the raising of finance and that are hybrid contracts in the scope of IFRS 9 measured at amortised cost and include an embedded derivative the economic characteristics and risks of which are closely related to the economic characteristics and risks of the host contract.*

Some participants asked for more clarity on the meaning of “in the same way as income and expenses on other liabilities” in the context of the IASB redeliberations for hybrid contracts. In particular, it was unclear whether the “other liabilities” mentioned in the text of the IASB tentative decisions were related to other operating liabilities or other liabilities that should be presented outside of operating profit. Generally, financial institutions use hybrid contracts as a source of funding. From the point of view of these participants, the income and expenses arising from hybrid contracts (with the host liability and the embedded derivative) should be presented within the operating category, consistently with the income and expenses deriving from deposits received and plain vanilla bonds issued. In particular, they were concerned that remeasurements of hybrid contract at fair value were now being captured by 'specified income and expenses from other liabilities' and could not be reclassified into operating profit.

Regarding the prevalence of hybrid contracts, one participant noted an extensive use of these instruments (accounted for mainly under the fair value option and partly by separating the embedded derivative). Whereas another participant noted that the low level of interest rates in recent years has not favoured the issuance of these hybrid contracts but, thanks to the current increase in interest rates, these could become more prevalent again.

The **IASB Staff** clarified that the IASB tentative decisions on hybrid contracts should be read in conjunction with the general guidance for the financing category. Income and expense from liabilities that are hybrid contracts would be classified based on the same requirements that apply to liabilities in general and 'other liabilities' did not refer to liabilities that do not meet the proposed 'only the raising of financing' criteria. The presentation of income and expenses of hybrid contracts is determined by applying this guidance to the contract in its entirety. For financial institutions, the related income and expenses will usually be presented in the operating category. The presentation is not affected by the presence or separation of the embedded derivative as, for financial institutions, most items in the financing category would be reclassified into the operating category.

### TOPIC 3: Subtotals – Classification of derivatives

*The IASB tentatively decided to classify in the operating category, rather than in the investing category, income and expenses on derivatives under certain conditions such as grossing up gains and losses or undue cost or effort.*

*In addition, The IASB tentatively decided to require an entity to classify fair value gains or losses on derivatives not used for risk management in the operating category, unless a derivative relates to financing activities and is not used in the course of the entity's main business activities. In such cases, an entity classifies all fair value gains or losses on the derivative in the financing category.*

While not raising practical concerns, one participant noted that the guiding principle identified by IASB for the presentation of income and expenses of derivatives (e.g., used for risk management) is not the most appropriate for financial institutions since banks manage risks as their business.

One participant asked for clarification on the meaning of the term “gross up gains and losses” used in the IASB's tentative decision.

The **IASB Staff** clarified that the requirement does not represent a change to current practice. IFRS 9 requires that the net results of hedging derivatives be allocated to a separate line item without the different components being grossed up and allocated to different line items. The IASB proposal is in line with this current requirement and would allow financial institutions to classify the income and expenses of risk management derivatives in the operating category.

#### TOPIC 4: Subtotals – Accounting for associates and joint ventures accounted for using the equity method

*The IASB tentatively decided to require entities to present income and expenses from all associates and joint ventures accounted for using the equity method in the investing category of the statement of profit or loss.*

*The IASB also tentatively decided that income and expenses from associates and joint ventures not accounted for using the equity method should be presented in the investing category unless investing in financial assets is a main business activity of the entity. In such cases, income and expenses from associates and joint ventures not accounted for using the equity method should be presented in the operating category.*

Most of the participants disagreed with the IASB's tentative decision that income and expenses from all associates and joint ventures (JVs) accounted for using the equity method should be presented in the investing category of the statement of profit or loss.

Even if the decision of the IASB to withdraw the distinction between integral and non-integral associates and JVs is understandable, one participant believed that the IASB should focus more on the entity's business model. The participant noted that nowadays two types of associates and JVs are prevalent: the first relates to the banking system's infrastructure (e.g., payment processing) and the second relates to cooperation with other businesses and related products (e.g., insurance). In both cases, according to the current IASB's proposals, direct income and expenses related to these services would be presented in the operating category, while the net results from associated and JVs would be excluded from the operating category.

Another participant believed that the IASB should improve the original definition of integral and non-integral associates and JVs with additional application guidance that allows entities to appropriately distinguish between the different types of associates and JVs. Entities should be allowed to present within the operating category, the results from associates and JVs for which the activities are considered an extension or complementary to the business activities of the parent company. For example, the presentation within the investing category of income and expenses of associates and JVs that have the same business activities as the parent company (sharing the same products, branches and directors) would create misleading information for users of the financial statements. It would be more of a reflection of form (accounting method) than economic substance. In such a case, the related direct expenses would be presented in the operating category, while the net results from associates and JVs would be excluded from the operating category.

Furthermore, in some jurisdictions, insurance companies invest in associates and JVs that are investment vehicles to cover insurance liabilities. It would be difficult for stakeholders to understand why the results of such associates and JVs would be presented in the investing category while the results from other investments accounted for under IFRS 9 which also back up insurance liabilities would be presented in operating profit.

One participant noted that presenting income and expenses from associates and JVs accounted for using the equity method as investing would be a change to current practice.

On the use of a specified subtotal of operating profit and income and expenses from investments accounted for using the equity method, one participant noted that having a mandatory specified subtotal would not improve the structure of the statement of profit or loss since in some cases the results for associates and JVs accounted for using the equity method are not significant. Another participant would be in favour of a specified subtotal only if it were presented within the operating category.

### *Insurance companies*

One participant noted that for an insurance company, the majority of associates and JVs accounted for using the equity method are investments in real estate or private equity companies and are held for the purpose of generating investment returns to cover insurance liabilities. The participant also noted that for insurance companies, the presentation of the results of associates and JVs accounted for using the equity method outside operating profit would create a mismatch as the operating category would only include expenses related to insurance contract liabilities and no associated investment revenue from the assets held to service those liabilities. The current IASB's tentative decision would imply that a minimum change in the shares held would lead to a change in the accounting method for the investment and therefore would result in a change of presentation category without changing the economic substance of the investment.

Finally, the participant pointed out that the use of the election in IAS 28 *Investments in Associates and Joint Ventures* would not resolve entirely the presentation issue highlighted. In particular, the use of this election would only apply to associates that are underlying items for insurance contracts accounted for under the *variable fee approach*. However, many associates are held in connection with insurance contracts that are accounted for under the *general measurement model* or *premium allocation approach*. Furthermore, the election in IAS 28 could be applied in a way that only the portion of an associate that is an underlying item for insurance contracts accounted for under the variable fee approach is measured at FVTPL whereas the remaining part is accounted for using the equity method. Consequently, according to the current IASB proposal, income and expenses from the same associate would be presented partially in the operating category and partially in the investing category.

For these reasons, the participant believed that the inclusion of the results of associates and JVs in the operating profit should be guided by the connection with the main business activities and not by the accounting method. The participant also requested an exemption to allow insurance companies to present the income and expenses of associates and JVs accounted for using the equity method in a separate line item within the operating category.

The **IASB Staff** acknowledged the concerns raised by entities in the insurance industry and that the IASB's decision was a balanced decision not to provide an industry-specific exemption. The IASB staff also clarified that the information collected from different stakeholders and analysis of financial statements of insurance entities showed that the use of equity accounted associates and JVs that directly or indirectly back insurance liabilities was not pervasive across the insurance industry. Some users also preferred that income and expenses from associates and JVs accounted for using the equity method are classified in a single location outside of operating profit by all entities and did not think that the IASB should create an exception for insurance entities.

**Nick Anderson** added that the IASB has recently tentatively decided to allow for a specified subtotal represented by the operating profit and the results for associates and JVs that are accounted for using the equity method. This specified subtotal would not be mandatory but if used in public communications the disclosures for MPMs would not be required.

### **TOPIC 5: Subtotals – Presentation of operating expenses**

*The IASB tentatively decided to require operating expenses to be presented in the statement of profit or loss either by nature or by function (and to allow mixed presentation) and to include application guidance which supports entities deciding which method provides more useful information.*

*Questions for participants:*



- (a) do you think these tentative decisions for the presentation of operating expenses will result in useful information? Are they clear and easy to apply?*
- (b) do you identify any potential implementation and application difficulties or concerns?*

Some participants welcomed that companies could still present an analysis of operating expenses using the method by nature or by function, depending on which provides the most appropriate information, depending on the industry. These participants believed that the IASB's tentative decisions represent a positive development for the project and a good balance between the needs of different stakeholders.

#### **TOPIC 6: Disclosures of operating expenses by nature**

*The IASB tentatively decided to require an entity which presents operating expenses by function to disclose the amounts of depreciation, amortization and employee benefits included in each line item in the statement of profit or loss.*

*Questions for participants:*

- (a) Does the IASB's tentative decision provide a better balance of costs and benefits than the proposal in the ED?*
- (b) Do you think the list of line items in the proposal should also include impairments and write-downs of inventories?*
- (c) Do you think requiring an entity to disclose, for all other operating expenses disclosed in the notes, the amounts included in each line item in the statement of profit or loss would provide a similar balance between costs and benefits as the revised proposal?*

Participants did not provide many comments on this topic.

One participant asked for clarification on where 'general expenses' would be presented based on the IASB's tentative decisions.

The **IASB Staff** clarified that there are some general guidelines that entities could apply with judgment to provide the best understandable overview of the statement of profit or loss and decide which line items to present on the face of the financial statements. However, in the case of entities that present operating expenses by function, the IASB is seeking feedback on the requirement for the disclosure of the line items on the face of the statement of profit or loss that include the amount of depreciation, amortisation and employee benefits. No significant changes are expected from current practice, as banks typically present operating expenses by nature and no additional disclosures are required for such entities.

#### **TOPIC 7: Disclosures – Management Performance Measures**

*The IASB tentatively decided to add a rebuttable presumption that a subtotal of income or expenses included in public communications outside the financial statements represents management's view of an entity's financial performance and to simplify the method of calculating the tax effect for reconciling items.*

*Questions for participants:*

- (a) Do you think that establishing such a rebuttable presumption will achieve the intended objectives?
- (b) Does the revised method to calculate the tax effect of individual reconciling items provide a better balance of costs and benefits than the proposal in the ED?

### Scope

Participants did not provide many comments on this topic.

#### *Rebuttable presumption*

One participant suggested that the IASB might consider adding an explicit rebuttable presumption that all information that regulated entities publicly disclose outside the financial statements due to regulatory guidance are not MPMs.

#### *Reconciliations and simplified method of calculating the tax effect for reconciling items*

One participant welcomed the simplified calculation proposed by the IASB but, at the same time, expressed some concerns about the reliability of the information disclosed using this simplified method. The participant did not consider the disclosure of the tax effect for each reconciling item to be relevant as no questions were ever raised by users but acknowledged that the IASB received different feedback on this aspect. Therefore, a simplified calculation method was preferred.

**Bertrand Perrin** highlighted that users of the financial statements indicated that they did not necessarily need a precise calculation but to know which reconciling items would lead to tax effects and which would not.

### TOPIC 8: Unusual items

*The IASB tentatively decided that it will not proceed with any specific requirements for unusual income and expenses as part of this project.*

One participant asked for clarification on where the unusual items should be presented. In addition, the participant highlighted the importance of allowing entities to present unusual income and expenses outside the operating category in order to better align the structure of the statement of profit or loss with management's perspective.

The **IASB Staff** clarified that unusual income and expenses should be presented in the operating category, unless they referred to financing or investing categories.

**Bertrand Perrin** highlighted that entities could use MPMs to disclose unusual items.

### Close of the meeting

**Silvie Koppes** thanked participants for their participation in the roundtable discussion of the IASB's tentative decision to change the Exposure Draft ED/2019/7 *General Presentation and Disclosures* (ED) and for the time devoted to the preparation of the meeting. She also informed participants that the EFRAG Secretariat would prepare a summary report, which will include the main feedback received from each outreach session, and an aggregated summary report, which will summarise the feedback received from all the outreach activities. This would be done by the end of December 2022.