

# PRIMARY FINANCIAL STATEMENTS SUMMARY REPORT

## ROUNDTABLE WITH CORPORATES

4 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 corporate companies on 4 November 2022. This report has been prepared for the convenience of European constituents to summarise 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.

**Jens Berger**, EFRAG FR TEG Vice-Chair, welcomed participants and provided an overview of the agenda.

**Nick Anderson**, IASB member, presented the status of the project and the purpose of the targeted outreach. Furthermore, he 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. He clarified that the IASB's discussions on the results of the outreach activities would be held in the first half of 2023.

**Ioana Kiss**, EFRAG Technical manager, presented EFRAG's planned 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 webinar, with the objective of discussing whether the IASB has achieved the intended balance of costs and benefits; and
- discussions with the EFRAG Working Groups including the EFRAG User Panel and ad hoc meetings with representatives of users and preparers.

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

The following companies participated in this roundtable:

- Arla Foods Amba
- Bayer AG
- DSM N.V.
- Eni Group
- Roche

- Telenor Group
- Welding Alloys Polska Sp z o.o.

## Roundtable discussion

For each topic identified below:

- **Nick Anderson, Bertrand Perrin**, IASB member, **Nick Barlow** and **Juliane-Rebecca Upmeier**, IASB Technical staff, 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**, EFRAG Senior Technical Manager, and **Ioana Kiss**, EFRAG Senior Technical Manager, 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 \_4 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.*

*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?*

In general, participants welcomed the revised structure and content of the statement of profit or loss.

However, participants expressed concerns about the fact that the statement of financial performance and the statement of cash flows will have three categories with similar **labelling** (operating, investing, and financing) while their definitions are not aligned. Some participants detailed that having investing and financing categories defined differently in the statement of profit or loss and statement of cash flows could create confusion and increase judgmental choices. One participant requested guidance to explain the existence of differences in classification with similar labelling and whether this was a temporary situation which would be fixed in the future. Highlighting the problem of differences between the definitions may help avoid confusion for practitioners.

**On the operating category**, some participants expressed concerns about having an operating category defined as a residual category (default category) in the statement of profit or loss. As a result,

this category would not only include income and expenses that arise from the entity's main business activity but also those from residual and ancillary activities ('dumping ground'). One participant explained that some auditors currently use a checklist approach to review the cash flows statement in accordance with the requirements of IAS 7 *Statement of Cash Flows*. If an item is not on the checklist under either the investing or financing categories, it will be classified as operating, even if its character is clearly investing or financing. For an operating category to be defined as a residual category, it requires clear principle-based definitions of the investing and financing categories to ensure a meaningful classification. Participants suggested having guidance to avoid the establishment of a similar checklist approach for the statement of profit or loss. One participant acknowledged the need to have a default category, but this participant also highlighted the risk that such a decision could reduce the understandability of financial statements by allowing an entity to classify unusual transactions in the operating category without a proper explanation of the effects. Hence, there should be disclosure requirements. Another participant added that the use of a default category could lead to the increased use of MPMs (including new subtotals in the statement of profit or loss) related to operating profit.

Some participants expressed some concerns and called for additional guidance on the **financing category**. In particular:

- one participant noted that the definition of the financing category was unclear (e.g., it is unclear where interest income and expenses from extended payment terms to customers and from suppliers would be classified). This participant called for additional guidance to help with the implementation of the definition of the financing category. Furthermore, there is a risk that, during implementation, companies will rely on the definitions that might be used in their local GAAP.
- one participant disagreed with the proposal to include the unwinding of the discount on a decommissioning, restoration or similar liability within the financing category. This is because this discount is not related to the cost of debt, which is used by management and users for decision making.

Finally, one participant also called for additional guidance on how the operating category in the statement of profit or loss would reconcile and interact with that reported in the operating segment disclosures according to IFRS 8 *Operating Segments*.

**Bertrand Perrin, Nick Anderson and the IASB Staff** clarified that:

- *Operating profit as a residual category*: the IASB was focusing on providing thorough definitions of the investing and financing categories. A default category is necessary to ensure there is a place for all income and expenses, including those that are difficult to classify;
- *Labelling*: this project was mainly focused on the statement of profit or loss. However, the need to redefine the categories in the statement of cash flows could be further discussed within a project focused on this particular financial statement. The IASB did explore in the past the alignment between the balance sheet, the income statement and the cash flow statement but not all aspects of these proposals were well received;
- *Financing category*: highlighted that the financing category had been defined with the objective of including the impact from pure financing (for a non-financial entity) and the unwinding of the discount on certain liabilities. Consequently, the IASB could consider whether to provide additional application guidance on the content of the financing category; and
- *Classification of income and expenses*: the main assumption was that generally the income and expenses related to assets would be classified in either the operating or investing category, whereas those related to liabilities would be classified in the financing category.

## TOPIC 2: 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.*

Two participants appreciated the IASB's proposal to drop the distinction between integral and non-integral associates and joint ventures. They considered that such a categorisation would be difficult to apply at both the investment date and on an ongoing basis as the investment's purpose and nature could subsequently change.

One participant had some concerns about the proposal to link the classification of income and expenses from associates and joint ventures accounted for using the equity method. In particular, some concerns arise for the presentation of the separate financial statements of entities that invest as a main business activity. In other words, the proposal to drive the classification on the basis of whether equity method accounting is applied could lead to some unintended consequences. This participant acknowledged that the IASB's proposal aims at avoiding having an operating category that includes post-tax and post-non-controlling interest ('NCI') amounts derived by the use of the equity method. Nevertheless, in the separate financial statements, it is not so clear why dividends (that are a proxy of a post-tax and post-NCI income), from a subsidiary measured at cost could be classified, subject to certain conditions, in the operating category while the results from an associate accounted for using the equity method have to be classified in the investing category. Furthermore, this participant stated that the same concerns could arise in the consolidated financial statements of venture capital organisations that elect to account for their associates and joint ventures using the equity method instead of measurement at fair value. For these entities, the income and expenses of associates and joint ventures accounted for using the equity method would be classified in the investing category while measurement at fair value would lead to a classification of the fair value gains and losses in the operating category.

Nonetheless, some participants highlighted that the IASB's proposal could have a significant impact on entities that currently invest in associates and joint ventures that are viewed as integral to their main activities. One participant noted that it is more difficult to budget the results of associates and joint ventures which might result in deviations from the expected result. Therefore, this participant could understand that some entities did not like the volatility in the operating category. Nevertheless, investments of 20% or more represent in most cases strategic investments as part of the entity's main business activities. In addition, it was noted that the proposed classification seemed to be mainly driven by the measurement method and not by the substance of the investment. That is, investments of a similar nature but measured differently would be classified differently in the statement of profit or loss even if such investments are quite similar in substance. Therefore, the entity's operating profit may not provide a proper reflection of its performance. However, one of these participants preferred to keep the original distinction between integral and non-integral associates and joint ventures.

These participants suggested the following alternative approaches:

- have a classification, especially for the separate financial statements, of income and expenses from investees driven by the core activities of the investor rather than by the accounting method used;
- a classification that is applied consistently with how the entities currently define the reporting segments in accordance with IFRS 8 *Operating Segment*; and
- define a default category but allow an accounting policy choice to designate an investment as integral or non-integral to the entity's main business activities to better reflect the substance of the investment in the financial statement. Therefore, to allow preparers to present additional subtotals which include operating profit and the results of associates and joint ventures that are closely related to the entity's main business activities.

One participant expressed concerns about the classification of FX effects related to associates and joint ventures. From this participant's view, the income and expense of such investments have to be classified now within investing while the FX effects are classified in operating and this would be an unintended consequence.

**Nick Anderson** clarified that the proposal to classify income and expenses from associates and joint ventures accounted for using the equity method outside the operating profit, which was already included in the ED, was one of the most appreciated proposals by users. He also highlighted that it is not prohibited to provide a differentiation between integral or non-integral or strategic investments within the notes or by presenting additional subtotals in the statement of profit or loss when these provide more useful information. It was noted that the IASB had not prescribed an order to the line items included in the investing category and had tentatively decided to add a specified subtotal defined as "operating profit or loss and income and expenses from investments accounted for using the equity method" which would not be an MPM. He also pointed out that income and expenses from associates and joint ventures accounted for using the equity method are different to other items, as they are not only post-tax but they also do not contribute to revenue.

**Bertrand Perrin** added that users have said they want a 'pure' operating profit without associates and joint ventures and that one of the objectives of the project is to provide comparability in the statement of profit or loss. Providing an accounting policy choice would not be suitable for meeting that objective.

**Nick Anderson** also highlighted that in the IASB's research different presentations of associates and joint ventures were one of the factors contributing to the diversity of what is included in operating profit. Some users screen many companies at once and therefore want a consistent operating profit across entities.

**Filipe Alves** suggested that the IASB could include in the Basis for Conclusion additional guidance to better explain the interaction between disclosure requirements related to specified subtotals and MPMs. In particular, it should explain how these concerns about the classification of the investments accounted for using the equity method and the notion of integral and non-integral could be mitigated by the use of additional subtotals, specified subtotals or through the use of MPMs.

### TOPIC 3: 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 of presentation of operating expenses will result in useful information for users? Are they clear and easy to apply?*
- (b) do you identify any potential implementation and application difficulties or concerns?*

Participants generally agreed with the IASB's proposal to continue to allow entities to present an analysis of operating expenses using either the by-nature or by-function method.

However, one participant highlighted that the IASB's tentative decision to withdraw the proposed prohibition of a mixed presentation of operating expenses could lead to a decrease in the understandability, clarity and comparability of the financial statements within the same industry.

The **IASB Staff** highlighted that this tentative decision was mainly driven by the feedback received from the users that a mixed presentation can provide useful information, the existence of some specific items that cannot be allocated in a non-arbitrary way (e.g., goodwill impairment), and the requirement to present in the statement profit or loss the specified line items as prescribed by paragraph 65 of the ED.

#### **TOPIC 4: 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?*

In general, participants welcomed the IASB's efforts to address the concerns expressed by some stakeholders that the costs (for entities presenting operating expenses using the function of expense method) of providing total operating expenses using the nature of expense method (as in the ED) would be higher than the benefits and find a solution that would better balance costs and benefits. In particular, three participants explained that the IASB's new approach would be costly to implement but acknowledged that it would better balance the costs for preparers and benefits for users.

However, participants in general expressed some practical and technical issues that can be summarised as follows:

- the requirement to disclose the specified operating expenses by nature allocated to individual line items in the statement of profit or loss would be costly for the entities even if limited to amortisation, depreciation and employee benefits . This is especially the case for those entities that do not already have this information in their IT system;
- the required precision level and the transition period would be critical aspects to assess the entity's ability to meet the new requirements on time, particularly when considering other future difficult implementations such as sustainability disclosures;
- providing such type of disclosure would require a lot of manual adjustments and it could also reduce the reliability and auditability of such information; and

- providing expense amounts rather than cost amounts would be challenging for entities using standard costing systems. For costs of a specific nature incurred in the period, it may be difficult to distinguish between costs that have been expensed in the period and costs that have been included in the carrying amount of an asset and will only be expensed in a future period.

If the IASB were to proceed with its tentative decision, one participant considered that it would make sense to also require disclosures of impairments and write-downs of inventory. One other participant noted that requiring disclosures for all other operating expenses disclosed in the notes would be too costly.

Finally, one participant expressed a preference for the IASB's initial proposal included in the ED. This participant explained that currently they already provided disclosures of all operating expenses by nature and changing the IT systems to provide the information in accordance with the IASB's tentative decision would be costly (even if limited to amortisation, depreciation and employee benefits). In addition, this participant noted that local GAAP required entities that present by function to disclose all their operating expenses by nature. Therefore, this participant would be required to prepare two sets of information on operating expenses by nature (IFRS and local GAAP).

The **IASB Staff** noted that the IASB had neither discussed the transition date/period nor the level of detail that would be required if the IASB pursued the approach of requiring an entity to disclose, for all expenses by nature disclosed in the notes, the amounts included in each line item in the statement of profit or loss. In addition, they highlighted that, based on the feedback received from some preparers, information related to amortisation, depreciation and employee benefits would be easier to provide as it related to items already disclosed in the notes, and this reduces the effort to change settings of their current IT system.

**Jens Berger** highlighted that, especially from an auditor's perspective, such disclosures should have the same quality as the primary financial statements as a whole.

## TOPIC 5: 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? If not, which alternative approach would you suggest?*
- (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 of the management performance measures requirements*

One participant expressed some concerns about the criterion used by the IASB to define an MPM. In particular, this participant asked how the criterion "are used in public communications outside financial statements" should be applied to non-listed entities. There was also the question of whether non-listed entities would have to consider measures used in public communications by the parent of the group.

One other participant suggested that the scope of MPMs should be restricted to entities whose securities are publicly traded or that are in the process of issuing securities to the public, as in paragraph 2 of IAS 33 *Earnings per Share*.



### *Rebuttable presumption*

One participant generally welcomed the IASB's proposal.

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

One participant welcomed the IASB's simplified method of calculating the tax effect for reconciling items, which would be less costly to calculate and would give users relevant information. This participant also suggested an entity should not be forced to disclose tax and NCI effects on a pre-tax MPM unless it already does so.

One participant expressed concerns about the IASB's proposal to "allocate any other tax effects related to the underlying transaction(s) based on a reasonable pro rata allocation of the current and deferred tax of the entity in the jurisdictions concerned, or any other method that achieves a more appropriate allocation". There are some tax exemptions, for example on the sale of some types of goods, that currently exist in different countries and that can lead to additional difficulties in applying the simplified method.

The **IASB Staff** explained the revised approach for the calculation of the tax effect is trying to make such calculations more mechanical and less judgemental. This should balance costs for preparers and benefits for users.

### **TOPIC 6: 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 whether this topic will be discussed at a later stage of this or other projects.

The **IASB Staff** stated that the IASB tentatively decided to withdraw the proposal in the ED because of the absence of general consensus around the definition of unusual income and expenses and in the interest of time. However, the IASB Staff also highlighted that the current MPMs disclosure and general disaggregation requirements could help entities to provide useful information increasing the transparency of their financial statements as well.

### **TOPIC 7: Additional EFRAG question**

*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*

One participant expressed concerns about recognising fair value gains or losses on derivatives in the operating category as it would introduce significant volatility into the operating category. This participant added that including volatile and unusual items in the operating category did not seem to be in line with users' needs to identify normalized earnings.

The **IASB Staff** explained that the transparency of financial statements is the key driver for helping users to understand where these types of transactions have been classified by the entity.

### Close of the meeting

**Jens Berger** 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. He 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.