# Primary Financial Statements
# Summary of EFRAG discussions

## Objective

1 The objective of this agenda paper is to provide EFRAG TEG a summary of the feedback received from EFRAG TEG and EFRAG TEG working groups.

2 This feedback has been considered by the EFRAG Secretariat when preparing the key messages to be included in EFRAG Draft Comment Letter.

## EFRAG Discussions on the project

3 The EFRAG Secretariat has provided updates to EFRAG groups on several occasions. More specifically, from 2016 to 2019 EFRAG discussed this topic in 26 different meetings:

(a) 9 public meetings with EFRAG TEG-CFSS

(b) 7 public meetings with EFRAG TEG

(c) 5 meetings with EFRAG User Panel

(d) 2 meetings with EFRAG IAWG

(e) 1 meeting with EFRAG FIWG

(f) 1 joint public meeting with EFRAG TEG-User Panel meeting

(g) 1 joint public meeting with EFRAG TEG-Board

4 A summary of the key feedback received can be found below. Nonetheless, it is worth noticing that the IASB proposals evolved significantly over time (e.g. initially the IASB considered providing guidance on “management operating performance measures” or MOPM but ended up defining “operating profit or loss” and providing guidance on “management performance measures” more generally).

5 Therefore, EFRAG Secretariat focused only on the feedback that is relevant when considering the IASB final proposals.

## Feedback received from EFRAG TEG-CFSS

6 When discussing the IASB’s project *Primary Financial Statements*, EFRAG CFSS members provided the following feedback:

*General comments*

(a) Generally welcomed the IASB’s project on *Primary Financial Statements* and agreed with the direction of the IASB’s project;

(b) expressed mixed views as to whether the IASB proposals should lead to the replacement of IAS 1 or an amendment to IAS 1. Nonetheless, many members were in favour of replacing IAS 1 with a new standard.

(c) members broadly agreed that any approach taken by the IASB should consider the timing of completing the project as a priority; and

(d) generally agreed that it would be useful to undertake field tests during the IASB's consultation period.

*Subtotals in the statement of financial performance*

(e) generally supported the IASB's decision to focus its project on the structure and content of primary financial statements to improve comparability, particularly the statement of financial performance;

(f) generally supported principles around the structure and content of the financial statements but members were not in favour of having a strict approach. An overly prescriptive approach on the presentation of line items and subtotals would not provide preparers with sufficient flexibility to explain their business model and could create difficulties to those that belong to a specific industry such as banking and insurance. In addition, an overly prescriptive approach may lead to an increase use of Alternative Performance Measures (APMs);

(g) considered that it would be difficult to agree on a principle-based approach for operating profit without defining principles such as performance, Other Comprehensive Income (OCI) and profit and loss;

(h) members provided cautious support for the concept of an investing category;

(i) some members called for the IASB to further discuss the notion of 'excess cash' (to take into account working capital needs) and the income tax component;

(j) highlighted that users of financial statements had called for the definition of EBITDA (earnings before interest, tax, depreciation and amortisation);

(k) some considered that provisions and discounting may be more like to operational costs than financing costs; and

(l) for financial institutions, some thought that the IASB should review what was currently dictated by regulators in terms of templates as in some countries they were already part of the law. There was a large demand from preparers to align, as much as possible, the regulatory report and the financial statements, including separate financial statements.

*Management Performance Measures*

(m) general principles on the use of management performance measures ('MPMs') could be useful, particularly when these measures were mentioned in the primary financial statements. This to bring more transparency and consistency to their use;

(n) the principles in the ESMA Guidelines on APMs could be extended to those presented within the financial statements to increase transparency on their use;

(o) a practice statement setting out general principles on the use of MPMs could be useful, particularly when these measures are mentioned in the primary financial statements;

(p) some expressed concerns about requiring the use of MPMs in the financial statements and elevating them into an IFRS-defined term;

(q) some MPMs, such as constant currency measures, would be difficult to reconcile to an IFRS defined subtotal;

(r) were unsure on whether an MPM would be disclosed in connection with the P&L;

(s) the IASB should clearly explain the objective of is proposals on MPMs;

(t) companies tend to use many different MPMs, which often change over time, and highlighted the risks of disclosure overload and increased costs to preparers if the scope of the IASB's proposals was too wide; and

(u) there could be restrictions on the presentation of non-IFRS items within financial statements, particularly for regulated entities.

*Analysis of expenses*

(v) highlighted that entities sometimes mix a by-nature and by-function presentation and considered that the IASB should continue to allow a mixed approach as it made sense in some industries;

(w) did not oppose having additional guidance, such as indicators, that would help entities determine whether they should use a by-function or by-nature presentation;

(x) generally agreed that most of the criteria proposed by the IASB were common sense; and

(y) considered that the absence of disclosures on the nature of expenses was mainly a compliance issue.

*Integral and non-integral associates and joint ventures*

(z) agreed that the IASB should explore the presentation of investments in associates and joint ventures as its presentation could depend on whether an investee is 'embedded' within the operations of the investor or is similar to an investment; and

(aa) generally considered that associates and joint ventures were close to the entity's main business.

*Unusual items*

(bb) highlighted the challenges of defining items such as recurring and no-recurring as this would involve defining an absolute versus a relative performance measure;

(cc) suggested that if entities do adjustments or identified unusual items, these adjustments should be identifiable in the following years; and

(dd) suggested having disclosures on unusual items in the current year and subsequent years.

*Improvements to the presentation of other comprehensive income*

(ee) were not supportive of changing the labels of OCI items and called for a comprehensive discussion on the use of OCI. Members considered that it would be difficult to significantly improve the understandability of OCI without addressing the distinction between profit and OCI and the role of recycling.

(ff) Considered that further changes to OCI without considering fundamental aspects on the use of OCI would undermine its credibility;

*Disaggregation principles and general requirements*

(gg) generally supported the IASB's efforts to develop general principles that would assist management to disaggregate information in the statement of financial performance; and

(hh) disagreed with having quantitative thresholds to promote more disaggregation and considered that the IASB should not be too prescriptive

*Statement of cash flows*

(ii) the statement of cash flows could be further improved, and members highlighted a number of specific issues that needed to be addressed, including some of the definitions and options that exist in IAS 7 *Statement of Cash Flows* and the linkage between the different primary financial statements;

(jj) some members considered that the reconciliation of the cash flow statement with the profit and loss statement was difficult due to their conceptual difference;

(kk) welcomed the findings of, and related feedback on, the UK Financial Reporting Council Discussion Paper *Improving the Statement of Cash Flows*. They also considered that the IASB should take the opportunity to consider improvements to the statement of cash flows more comprehensively. Some members added that further research work could be done on having a statement of cash flows statement that is structured differently for financial institutions to ensure that it provides relevant information to users and mentioned EFRAG's Discussion Paper issued in 2015;

(ll) disappointed that the IASB had tried to link the work on the cash flow statement to the primary financial statements project in the short term instead of trying to develop a future research project; and

(mm) cash flow statements were useful at least in the industrial and commercial sector, but not so useful in other sectors.

*Other*

(nn) some members called for improvements to the statement of changes in equity (e.g. more standardisation to improve comparability);

(oo) broadly supported of not having strictly defined templates but called for the IASB to focus on identifying key line items and gaining more consistency on how they were used;

(pp) considered that the IASB should do more work to define net debt.

**Feedback received from EFRAG TEG**

7 When discussing the IASB's project *Primary Financial Statements*, EFRAG TEG members provided the following feedback:

*General comments*

(a) generally agreed with the IASB's proposal to update existing requirements on presentation of financial statements by issuing a new IFRS Standard rather than amending IAS 1;

(b) raised questions on the interaction between the IASB tentative decisions, the IFRS taxonomy, European Single Electronic Format and the effective dates of a future standard;

*Subtotals in the statement of financial performance*

(c) welcomed the IASB's efforts to improve the structure and content of primary financial statements and, particularly, the statement of financial performance. However, there was a request for the IASB to further improve the structure of other parts of the financial statements including the presentation of disclosures;

(d) called for the IASB to clarify where the effects of discontinuing hedge accounting would be presented;

(e) called for the IASB to clarity on how the IASB's proposals would apply to entities that present expenses by function;

(f) raised a number of concerns around the IASB tentative decisions on gains and losses on derivatives in the statement(s) of financial performance, particularly on requiring entities to present such gains in the investing category under certain conditions as gains and losses related to hedging activities are typically related to operating or financing category. Some EFRAG TEG members were also concerned about implementing the IASB proposals to more complex hedging transactions with embedded derivatives;

*Management Performance Measures*

(g) emphasised the importance of non-IFRS measures for investors and the need for guidance on their use within the financial statements;

(h) provided mixed views on the presentation of MPMs as subtotals in the statement of financial performance;

(i) it is important to clarify how defined subtotals and management operating performance measures would interact with each other within the statement of profit and loss and OCI;

(j) highlighted the risk of management presenting MPMs, that are not aligned with the entity's accounting policies and giving them more prominence;

(k) emphasised the practical challenges of providing disclosures about the effect of tax and non-controlling interest (NCI) for the purpose of reconciling MPMs and analysing adjusted earnings per share ratios; however, one EFRAG TEG member supported such disclosures from for those disclosures.

*Integral and non-integral associates and joint ventures*

(l) expressed general support for the proposals on presentation of share of profit and loss of integral associates and joint ventures in the statement of financial performance and the targeted improvements to the statement of cash flows.

*Analysis of expenses*

(m) noted that many investors preferred the presentation of analysis of expenses by nature within the operating profit or loss; when an entity provides an analysis of its expenses by function, it should be required to disclose the expenses by nature, including in the interim financial statements;

(n) the new standard should include at least one example of by-nature presentation;

*Unusual items*

(o) questioned whether entities would continue to be able to present additional subtotals or line items related to non-recurring items on the face of the financial statements as it was current practice;

*Statement of cash flows*

(p) some suggested that the guidance on statement of cash flows generally needed to be improved and that the starting point of cash flow statement should be *profit after tax* or *net profit* in order to allow reconciliation of the net profit to the changes in the cash position; however, other members explained that they would rather have a line by line reconciliation of operating profit to operating cash flows;

(q) suggested that disclosures that would help assessing net debt reconciliation would be useful.

**Feedback received from EFRAG User Panel**

8 When discussing the IASB's project *Primary Financial Statements*, EFRAG User Panel members provided the following feedback:

*General comments*

(a) there was a strong support and general agreement with the direction of the project;

(b) highlighted the need for the IASB to clarify the linkage between the different primary financial statements. This would improve comparability and transparency of the information;

*Subtotals in the statement of financial performance*

(c) comparability of financial statements is very important for users and consistency needs to be achieved through, for example, additional guidelines on the content and structure of financial statements and elimination of presentation options;

(d) favoured having strong principles for the definition of subtotals, such as EBIT, with limited choices for preparers in terms of allocation of line items so that users obtain a comparable starting point for their analysis; and

(e) generally expressed a positive view on having an EBIT subtotal (or similar) defined by the IASB as it would improve comparability.

*Management Performance Measures*

(f) agreed that there is often lack of transparency on the use and calculation of APMs;

(g) expressed some support for having additional guidance on the use of APMs when used in the financial statements;

(h) the IASB could consider, as a starting point, the existing guidelines on APMs provided by regulators;

(i) it would be interesting to understand whether investors would still rely on APMs if the statement of financial performance was improved and provided a higher level of disaggregation;

(j) gross debt, net debt, EBITDA and EBIT were important APMs;

(k) noted that companies tend to choose measures that show a more "favourable" picture of performance than IFRS measures (i.e. measures that are more rosy than realistic);

(l) considered that it would be interesting to reach out to users of financial statements to better understand how and why APMs are used in practice;

(m) welcomed the additional guidance on MPMs and unusual items as it would bring more discipline and transparency to their use;

(n) concerns on whether entities would be able to provide reliable information about the income tax effect for each difference identified in the reconciliation of the MPMs with the most directly comparable subtotal or total specified by IFRS Standards;

(o) there is the risk that companies may continue to provide different MPMs over time, which would not improve consistency;

*Analysis of expenses*

(p) it was fundamental to have full analysis of expenses by nature in the notes when expenses were presented by function in the statement of financial performance;

(q) by-nature cost disclosure should also be provided in the interim financial statements; and

(r) the new standard should include at least one example of by-nature presentation.

*Integral and non-integral associates and joint ventures*

(s) mixed views on the notion of integral and non-integral associates and joint ventures accounted for under the equity method. Some considered that any distinction between integral and non-integral would be subjective and difficult to make; others considered that it was feasible and would provide relevant information to users; finally there was the view that entities could provide additional information about their associates and joint ventures through disclosures and users would then decide how to use that information.

*Improvements to the presentation of other comprehensive income*

(t) highlighted the importance of discussing the definition of performance, use of OCI and the need for recycling; and

(u) highlighted that relevant information about OCI was also provided in the statement of financial position (e.g. separate components of equity) and that this information was particularly relevant for financial institutions.

*Unusual items*

(v) expressed mixed views with regards to how the IASB should define and address non-recurring items. Some were concerned about having APMs that only excluded expenses (and not income) while others considered the information useful and called for a clear definition on non-recurring items.

*EBITDA*

(w) the definition of EBITDA should also exclude impairments of assets that are subject to depreciation or amortisation;

*Disaggregation principles and general requirements*

(x) dividends paid to shareholders of the parent and NCI should be split and presented separately; and

(y) better disaggregation should be particularly focused on the operating section rather than on other sections of the statement of performance.

*Statement of cash flows*

(z) there is room to improve IAS 7. A number of specific issues were highlighted that needed to be addressed, including improvements to the current definitions (operating, investing and financing), removal of options that exist in IAS 7 (e.g. removing presentation options for dividends and interest in the statement of cash flows) and better linkage to other primary financial statements;

(aa) it is worth exploring whether notional cash flows should be reflected in the financial statements;

(bb) noted that the statement of cash flows provided useful information to investors when assessing stewardship;

(cc) if the IASB changed the content and structure of the statement of financial performance to include, for example, EBIT, then the IASB would have to consider the potential impact of those changes on the statement of cash flows, particularly when using the indirect method of presentation;

(dd) mixed views on the use of direct and indirect method of presentation. Some argued that the direct method provided a higher level of detail and disaggregation, while others argued that the indirect method provided the same information with the benefit of being linked to other primary financial statements and this was key for investors' analysis;

(ee) the starting point of cash flow statement should be profit after tax in order to allow reconciliation of the net profit to the change in cash position; however, other members explained that we would rather have a better (e.g. line by line) reconciliation of operating profit to operating cash flows

*Others*

(ff) there were some concerns about having a new Adjusted Earnings Per Share figure as it would not beneficial for users and would create room for misuse by preparers;

(gg) the IASB project could also have addressed the statement of financial position, including the definition of financial debt and distinguishing between operating and financial liabilities;

**Key feedback received from FIWG**

9 When discussing the IASB's project Primary Financial Statements, EFRAG FIWG members provided the following feedback:

*Management Performance Measures*

(a) questioned the scope of MPMs and called for clarity on which type of performance measures would be considered as MPMs;

(b) questioned the IASB's mandate to require the disclosure on performance measures which are presented outside of the financial statements (e.g. press releases) and possible impact of such requirements in the endorsement of a IFRS Standard in Europe;

(c) questioned whether EBITDA, a measure which is often used in practice, would be considered as an MPM and whether entities would have to present a full reconciliation with an IFRS number (including NCI and Income Tax effect).

(d) questioned whether the IASB would have to define public communications and how far it would go. For example, whether it would be related to the financial statements (or Annual Report) which have just been published or related to all the communication made within a year. Or even if it could be related to a tweet;

(e) concerns about requiring APMs to be presented in the financial statements as this would give them more prominence and such measures would have to be audited, which would be a challenge (as it would raise many compliance issues);

(f) financial institutions are highly regulated and being required to provide disclosures about MPMs in the financial statements may bring in many questions and interest from regulators;

(g) financial institutions are often required by the regulators to present specific metrics. This would raise questions on whether such metrics would be considered MPMs;

(h) concerns about the scope of MPMs as some measures would be difficult to reconcile with IFRS numbers and as in case MPMs were changing during the year, which would be considered as a change in an accounting policy;

*Subtotals in the statement of financial performance*

(i) questioned whether with this new structure, an entity would still be able to provide additional subtotals and in which cases;

(j) in many jurisdictions, regulators have specific presentation requirements in addition to those required by the IFRS Standards (e.g. templates). Members suggested the IASB to closely communicate with the IASB on this topic to ensure that there is some flexibility to accommodate regulators needs (e.g. use of additional subtotals). This is because they were concerned about having to prepare different financial statements to comply with IFRS and requirements from regulators; and

(k) questioned the usefulness of presenting separately the unwinding of discounts on specific liabilities;

*Statement of cash flows*

(l) considered that currently the statement of cash flows was useless for financial institutions and questioned whether the IASB was going remove the requirement to present them;

**Key feedback received from IAWG**

10 When discussing the IASB's project *Primary Financial Statements*, EFRAG FIWG Panel members provided the following feedback:

*Subtotals in the statement of financial performance*

(a) this project is very important for insurance companies;

(b) entities might need replace 'operating profit or loss' by a new APM in their communication with users as currently operating profit does not include mismatch elements;

(c) the structure of the financial statements is currently established by regulators and called for the IASB to liaise with regulators;

*Management Performance Measures*

(d) highlighted that insurance companies already provide reconciliations under the ESMA's guidelines on Alternative Performance Measures and questioned their need.

*Integral and non-integral associates and joint-ventures*

(e) raise questions on the meaning on integral associates and joint ventures;

*Statement of cash flows*

(f) considered that the statement of cash flows was useless for life insurance and the IASB should give more priority the statement of cash flows to make it meaninful;

**Key feedback received from EFRAG TEG-User Panel**

11 When discussing the IASB's project Primary Financial Statements, EFRAG TEG-User Panel members provided the following feedback:

*General comments*

(a) welcomed the IASB's project and considered that the IASB was going in the right direction. However, members raised a number of specific concerns and provided additional inputs to the IASB's tentative decisions.

*Subtotals in the statement of financial performance*

(b) highlighted the importance of having a clear conceptual basis for the new structure for the statement of financial performance and clarifying the interaction with the statement of cash flows.

*Management Performance Measures*

(c) the IASB was going in the right direction particularly welcoming the proposed reconciliation;

(d) were concerned about requiring entities to identify their MPMs in the financial statements, particularly when considering that the definition of their measures as unclear. Alternatively, the IASB could take an approach similar to ESMA (guidelines are only applied when APMs are used, without a requirement to identify MPMs);

(e) were concerned about auditability and giving credibility to MPMs that are not measured or recognised in accordance with IFRS and highlighted the challenges of reconciling such MPMs with IFRS numbers;

(f) proposed that the IASB adds a disclosure of how the MPMs are used (e.g. incentives for top management or other managerial purposes);

(g) potential tension between the ESMA Guidelines on APMs and the IASB proposals on MPMs;

(h) many investors assumed that EBITDA excluded impairments.

*Integral and non-integral associates and joint ventures*

(i) Mixed views on the presentation of share of profit of associates and joint ventures. Some questioned whether the share of profit of integral associates and joint ventures should be segregated and presented in accordance with the proposed structure (net presentation). Others questioned the need for an additional subtotal focused on integral associates and joint ventures (pro rata presentation of items composing the net share)

*Analysis of expenses and disaggregation*

(j) In many cases entities used a mixed presentation (by nature and by function) and questioned how the IASB proposals would apply to the statement of financial performance presented by function; and

(k) amortisation and depreciation should be a separate line item.