Primary Financial Statements
Cover Note

Objective

1 The objective of this session is to update FRB members on the Targeted Outreach result and agree on the content of *EFRAG Summary Report and Recommendations* (agenda paper 07-02) as proposed by EFRAG FR TEG which will be published on EFRAG Website and sent to the IASB.

Background

2 In December 2019, the IASB published the Exposure Draft *General Presentation and Disclosures* focused on improving how information is communicated in the financial statements, with a focus on information about performance in the statement of profit or loss. The IASB's comment period ended in September 2020. EFRAG send its comment letter on 2 November 2020 to the IASB.

3 Early in 2021, the IASB discussed the feedback received and has since made tentative decisions on key aspects of the proposals in response to the feedback received. Some of these tentative decisions result in changes from the proposals in the ED.

4 In September 2022 the IASB launched an outreach on a targeted selection of its tentative decisions through roundtable discussions. The topics selected for outreach are those where the IASB's tentative decisions change the proposals in the ED.

5 Also in September 2022, EFRAG FR TEG and EFRAG CFSS members discussed the targeted outreach activities planned by EFRAG and the IASB on a selection of tentative decisions that represent a change to the initial proposals included in the IASB's exposure draft on this project.

6 From October to November 2022 EFRAG organised, jointly with the IASB and in coordination with the national standard setters, a number of roundtables. The summary reports of the roundtables on 24 October, 2 November, 4 November and 15 November have been published on EFRAG Website.

7 Finally, the EFRAG Secretariat has prepared a summary report with recommendations (agenda paper 05-02) that reflects all the feedback received in the roundtables, working groups meetings and other ad hoc meetings.

(a) Meeting with pharmaceutical companies on 12 October 2022;

(b) Meeting with EFASS on 21 October 2022;

(c) Meeting with User Panel on 24 October 2022;

(d) Roundtable with corporates on 24 October 2022 (summary report);

(e) Meeting with FIWG on 25 October 2022;

(f) Meeting with ESMA on 31 October 2022;

(g) Roundtable with financial institutions on 2 November 2022 (summary report);

(h) Meeting with IAWG on 3 November 2022;

(i) Roundtable with corporates on 4 November 2022 (summary report);

(j) Meeting with RRA working group on 8 November 2022;

(k) Meeting organised by ANC on 10 November 2022;

(l) Roundtable organised by ASCG on 11 November 2022;

(m) Roundtable with preparers, users and auditors on 15 November 2022 (summary report); and

(n) ENG Conference – International Financial Reporting & Compliance on 22 November 2022 (Financial Institutions);

(o) Meeting with OIC on 24 November 2022;

(p) EFRAG Academic Panel on 29 November 2022; and

(q) EFRAG CFSS meeting on 30 November 2022.

Summary report and recommendations

8 In general, participants in the roundtable discussions welcomed the IASB's efforts to improve the structure and content of primary financial statements, particularly users of financial statements, as it would improve comparability. Participants also welcomed the roundtables organised by EFRAG and the IASB's efforts to address the comments received by the IASB on its ED, particularly on difficult topics such as disclosures by nature when presenting by function and unusual income and expenses.

9 However, some preparers noted that the IASB's proposals would still lead to considerable implementation costs for them in specific areas, such as disclosures by nature when presenting by function. Participants in the roundtables also raised a number of questions and expressed concerns on the IASB's tentative decisions.

10 Some of these questions and concerns had already been raised in the IASB's consultation period on the 2019 ED. Nonetheless, most of the concerns and questions were related to the implementation of the revised proposals. The key concerns expressed by participants were:

(a) **Operating category**: there were questions on the classification of specific items and concerns on having an operating category defined as a residual category, which would be wide and reflect ancillary activities and unusual items (similar feedback was received in the 2019 ED consultation). For conglomerates, determining the entity's main business activities at the reporting-entity level will be complex and costly;

(b) **Financing category**: the wording used by the IASB to define the financing category was not always well understood and there was a call for additional application guidance. Many financial institutions also expressed concerns on the IASB's revised proposal on the classification of income and expenses from lease liabilities, which could no longer be reclassified into operating category under paragraph 51 of the ED;

(c) **Cash and cash equivalents**: both users and preparers highlighted that it would be more appropriate for corporates to present income and expenses from cash and cash equivalents in the financing category, particularly for those that use a net-debt concept. Financial institutions and conglomerates were also concerned about not having the possibility of classifying income and expenses from cash and cash equivalents in operating profit under paragraph 51 of the ED;

(d) **Hybrid contracts**: the IASB's tentative decisions were considered unclear and there was a call for the IASB to provide the rationale and more application guidance on its tentative decisions;

(e) **Derivatives**: corporate companies expressed concerns that the default category for the classification of derivatives and hedging instruments was now the operating category;

(f) **Associates and joint ventures**: there were mixed views on the presentation of income and expenses from associates and joint ventures (similar feedback was received in the 2019 ED consultation) and many questions were raised on the use of additional subtotals related to associates and joint ventures (e.g. interaction of such subtotals with the IASB's proposals on specified subtotals and MPMs);

(g) **Associates and joint ventures for insurance companies**: insurance industry highlighted that the issue of associates and joint ventures is important and requested presenting investments in associates and joint ventures that are linked to insurance contracts within the operating profit. Else, there would be a mismatch as the operating category would only include expenses related to insurance contract liabilities and no associated investment results from the assets held to service those liabilities;

(h) **Analysis of expenses**: users and preparers often expressed different views on the proposed disclosures. Users and a few preparers were more supportive of the IASB's approach in the ED, while other preparers preferred the IASB's revised disclosures. However, targeted outreach participants (including users) acknowledged that the IASB's tentative decision was a compromise, even if costly for preparers;

(i) **Management performance measures**: there were questions on to what extent additional subtotals would be considered as MPMs. Highly regulated entities, such as banks, raised questions on the effective applicability of the rebuttable presumption for all the significant measures communicated for regulatory purposes. Finally, there were mixed views on the simplified approach to calculating the tax effect; and

(j) **Unusual items**: although many preparers welcomed the IASB tentative decision to withdraw its proposals on unusual income and expenses, the majority of users and regulators were disappointed with the IASB's decision. These considered that any high-level application guidance would be useful to mitigate diversity in practice.

11 Finally, several participants highlighted the importance of completing the project as soon as possible as it was considered very useful. In this respect, these participants were willing to reach a compromise in order to support a timely publication of a future standard.

12 Considering the feedback received and EFRAG's position in its letter to the IASB on the 2019 ED, EFRAG considers that it would be useful to:

(a) **Operating category**: retain the existing approach but consider the comments provided by EFRAG in its comment letter on the IASB's 2019 ED (please see below for more details) and support it with an explanation of the reasoning of the chosen approach and its resulting impact on the use of MPMs in the Basis for Conclusions;

(b) **Financing category**: improve the definition of the financing category by providing application guidance to better explain the wording used by the IASB in its definition and illustrate how its definition would apply to some transactions;

(c) **Cash and cash equivalents**: classify income and expenses from cash and cash equivalents in the financing category as it would provide relevant information to users, particularly when corporates use a net-debt concept. In addition, for financial institutions and conglomerates it would be useful to retain the possibility of classifying income and expenses from cash and cash equivalents in the operating category under paragraph 51 of the ED;

(d) **Hybrid contracts**: have additional clarifications and application guidance (e.g., illustrative examples and/or flowchart to help implementation) to help preparers understand the mechanics of the IASB's tentative decisions, including when hybrid instruments should be classified in the operating category;

(e) **Derivatives**: clarify the IASB's proposals related to situations that would involve grossing up gains and losses and consider alternatives (including revisiting the default presentation in the operating category) to mitigate the issue of corporates related to bringing the impact of derivatives into the operating category, which could bring significant volatility to this category;

(f) **Associates and joint ventures**: have clarifications on the interaction of having additional line items and subtotals (in accordance with paragraph 66 of the ED) with the IASB's proposals on specified subtotals and MPMs, including when the reconciliation disclosure requirements would apply;

(g) **Associates and joint ventures for insurance companies**: present results from investments in associates and joint ventures that are linked to insurance contracts (e.g., that are backing up insurance liabilities) in the operating category;

(h) **Analysis of expenses**: retain the IASB's revised approach on requiring companies to disclose an analysis of their operating expenses by nature when presenting by function but would suggest adding impairments and write down of inventories to the list of minimum items to be disclosed and exploring a practical expedient to provide the total costs of the year (as a proxy) rather than the expenses recognised in the statement of profit or loss, when it involves undue cost and effort (please see details below). In addition, EFRAG is not in favour of an approach for entity to disclose, for all operating expenses disclosed in the notes, the amounts included in each line item in the statement of profit or loss;

(i) **Management performance measures**: have additional application guidance on to what extent additional subtotals (e.g., subtotals of subtotals and subtotals merely reflecting reclassification of line items) would be permitted and whether they would be considered as MPMs or specified subtotals. EFRAG also expresses some concerns on establishing a rebuttable presumption on MPMs for highly regulated entities as this could increase complexity and may unintendedly enlarge the scope of MPMs. EFRAG is concerned that the IASB's tentative decision to require an entity to disclose, for each reconciling item, the amount(s) related to each line item(s) in the statement(s) of financial performance may increase significantly the costs for some preparers;

(j) **Unusual items**: have information on how an entity defines its unusual items (if the entity identifies such items in the financial statements) and provide clarity on the possibility of showing separately in the statement of profit or loss items that an entity views as non-recurring or unusual items.

13 Finally, EFRAG highlights that this project responds to a strong demand from users of financial statements to have improvements on how information is communicated in the financial statements.

Questions for EFRAG Board

14 Do EFRAG FR TEG members have any general questions on the process and roundtables?

15 Based on the feedback received EFRAG FR TEG discussed and recommended as part of the summary report recommendations for the IASB redeliberations. Do EFRAG FRB members agree with the summary report as recommended by EFRAG FR TEG:

a) Does EFRAG FRB agree with the summary report and recommendations on the subtotals and categories?

b) Does EFRAG FR TEG agree with the summary report and recommendations on **management performance measures**?

c) Does EFRAG FR TEG agree with the summary report and recommendations on **unusual income and expenses**?

d) Does EFRAG FR TEG agree with the summary report and recommendations on **other comments**?

Agenda Papers

16 In addition to this cover note, agenda papers for this session are:

(a) Agenda paper 07-02 – Summary Report and Recommendations

(b) Agenda paper 07-03 – Letter to the IASB