Primary Financial Statements
Application to financial institutions

Objective

1 The objective of this agenda paper is to obtain TEG-CFSS members' views on how the IASB's tentative decisions to date could apply to financial institutions.

Applying the IASB tentative decisions to financial institutions

2 Up to this stage, the IASB has scoped out financial institutions from its decisions on the *Primary Financial Statements* project. The IASB Staff has now started its preliminary research on financial institutions by focusing on banks to see how the IASB's tentative decisions could be applied to them.

3 The IASB's project scope and tentative decisions are included on pages 17 to 24 of agenda paper 11-05. In short, the IASB proposes to:

(a) Statement of financial performance:

(i) Introduce the subtotals 'profit before finance income/expenses and income tax' (i.e. EBIT) and 'profit before income /expense from investments, finance income/expenses and income tax' (i.e. proxy of operating profit);

(ii) define 'finance income/expenses' and related line items;

(iii) define 'income/expenses from investments';

(iv) require the separate presentation of the entity's share of profit or loss from 'integral' and 'non-integral' associates and joint ventures;

(v) Introduce new requirements on the presentation of management performance measures (MPMs); and

(vi) improve communication of other comprehensive income ('OCI') by renaming the existing categories.

(b) Statement of cash flows:

(i) eliminate the classification options for interest and dividends;

(ii) require to use the new sub-total 'profit before investing, financing and income tax' as the starting point for the indirect method;

(iii) require the separate presentation of cash flows that arise from 'integral' and 'non-integral' associates and joint ventures; and

(iv) clarify the current description of 'financing activities' in IAS 7 *Statement of Cash Flows* by indicating that it involves the receipt/use of a resource from a provider of finance, the expectation that the resource will be returned and that the provider of finance will be compensated through the payment of a finance charge, which is dependent on both the amount of the credit and its duration.

(c) Other improvements:

(i) explore the development of templates for a small number of industries; and

(ii) achieve a better disaggregation of line items.

4 The IASB staff made the following analysis on how the IASB's tentative decisions would apply to financial entities:

Statement of financial performance	Application to financial entities
Introduction of the subtotal '**profit before finance income/expenses and income tax'** (i.e. EBIT), definition of 'finance income/expenses' and introduction of five new line items: • 'interest income from cash and cash equivalents calculated using the effective interest method'; • 'other income from cash, cash equivalents and financing activities'; • 'expenses from financing activities'; • 'other finance income'; and • 'other finance expenses'**.**	Different views on the usefulness of this subtotal for financial entities. For banks, finance expenses are part of their core business, however providing separate information about financing decisions could be useful. Challenges may arise if the same guidance for 'finance income/expenses' and line items are applied to financial institutions. For example, classification of interest on cash and cash equivalents as financing may be less appropriate for financial entities.
Introduction of the subtotal '**profit before income/expense from investments, finance income/expenses and income tax**' (i.e. proxy operating profit) and definition of 'income/expense from investments' as income/expenses from assets that generate a return individually and largely independently of other resources held by the entity'.	Different views on the usefulness of this subtotal for financial entities. For banks, income from investments is part of their core business, however providing separate information about investing decisions could be useful. Challenges arise if the same definition for 'income/expense from investments' is applied to financial institutions. For example, financial assets held by financial entities could be seen as generating a return independently of each other, however assets could be managed together at a portfolio level.
Removal of the classification option for interest and dividends in the statement of cash flows.	Could apply to financial entities, although different classification than for corporates may be more appropriate for interest paid/received for banks and dividends received for investment entities.

Requirement of a consistent starting point for the indirect method.	Same principle could be applied to financial entities, but a different starting point may be needed, depending on which subtotals are required in the statement(s) of financial performance.
Providing templates	Templates could apply to financial entities, but separate templates will be required for banks, insurance companies and possibly also investment entities. Conglomerates might need to use a combination of templates.
Introduction of principles to disaggregate line items in profit or loss by nature and by function	Same principle could be applied to financial entities. However, there is diversity in how items are disaggregated in banks' statements of financial performance and additional specific guidance may be useful, for example on how by-nature/by-function presentation applies to fair value gains/losses.

5 Considering this analysis, the IASB Staff questions whether:

(a) the same principles could apply to all entities;

(b) the same principles could apply to all entities with different specific provisions for financial entities. For example, focusing only on target improvements to the statement of financial performance (i.e. removal of options and consistent starting point), providing templates and developing disaggregation principles for line items in profit or loss by nature and by function.

(c) different principles might be needed for financial entities.

EFRAG Secretariat analysis

6 The EFRAG Secretariat acknowledges that the IASB needs to investigate the issues that arise in specific industries (e.g. banking), however we consider there is a need to first discuss the IASB's tentative decisions more in general before discussing their application to financial institutions. In addition, we note that other non-financial industries, such as mining and private equities, might have specific needs and addressing specifically some industries only may raise questions on why the needs of other industries should not also be taken into account.

7 The EFRAG Secretariat undertook limited research activities focused on a number of European banks based on their 2016 financial statements. The findings are described in Appendix 1. Based on our limited research activities, the EFRAG Secretariat considers that it will be difficult to apply the IASB's tentative decisions to financial institutions, in particular to banks.

8 When analysing the statement(s) of financial performance, the EFRAG Secretariat observed that banks use many subtotals but not 'profit before finance income/expenses and income tax' or 'profit before income/expense from investments, finance income/expenses and income tax'. Therefore, the introduction of such subtotals would be a significant change in practice and could encompass a few line items only, particular when considering the subtotal 'profit before income /expense from investments, finance income/expenses and income tax'.

9 In addition, the EFRAG Secretariat assesses that the distinction between operating, financing and investing profit or loss is more complex when dealing with banks, particularly when considering different the business models within the banking industry (e.g. retail banks, investment banks, mutual banks, etc.).

10 For example, 'interest income', 'interest expenses' and 'net interest income' are key elements of the statement of financial performance and are typically classified as operating. Arguably, in accordance with the IASB tentative decisions, interest expenses on long term deposits could be classified as finance expenses and interest income on loans could be classified as investment income. However, this would represent a significant change to current practice and would be not aligned with the particular nature of the business activities of banks. Similar questions arise with interest income on long-term debt investments.

11 The EFRAG Secretariat acknowledges that banks use subtotals or line items such as 'net interest income on trading activities', 'net trading income', 'net income from financial instruments designated at fair value' and that these are typically within the operating activities. Arguably, such gains and losses could be classified, in accordance with the IASB tentative decisions, as investment income/expenses. However, once again, this would represent a significant change to current practice and be not aligned with the particular nature of the business activities of banks.

12 Therefore, the EFRAG Secretariat considers that the IASB should further explore the different business models of banks and their specific needs in terms of line items and use of subtotals. In the process, the IASB should consider current presentation practice in different jurisdictions as regulators may require a specific structure for the financial statements of banks.

13 In regard to the statement of cash flows, we understand the importance of having a common starting point for the indirect method. However, the EFRAG Secretariat questions the elimination of options in accordance with the IASB tentative decisions up to date. In particular, the option for having interest paid and received classified as operating activities. We note that paragraph 33 of IAS 7 *Statement of Cash Flows* states that interest paid and interest and dividends received are usually classified as operating cash flows for a financial institution.

14 More in general, the EFRAG Secretariat recalls that, in 2015, EFRAG published the Discussion Paper *The Statement of Cash Flows: Issues for Financial Institutions* and that respondents shared EFRAG's concerns about the relevance of the statement of cash flows for financial institutions. Therefore, the EFRAG Secretariat considers that the IASB should consider the issue of the statement of cash flows for banks more comprehensively.

Questions for EFRAG TEG-CFSS

15 For which, if any, areas in the project scope the IASB should consider different proposals for financial entities?

16 For each subtotal discussed in paragraphs 3(a)(i), do EFRAG TEG-CFFS members consider the subtotal would be useful for financial entities?

- (a) if considered useful, how should the IASB define it for financial entities?
- (b) if considered not useful, should the IASB:
  - (i) develop an alternative subtotal for financial entities
  - (ii) not require any specific subtotal for financial entities
  - (iii) do something else?

17 Please share information about evidence that would be useful to the IASB in making decisions on way forward for financial entities.

Appendix 1 - Key findings from EFRAG's research activities

EFRAG's limited research activities

18 In 2018, the EFRAG Secretariat decided to complement its initial findings about the presentation practices of *Primary Financial Statements* by analysing banks.

19 Therefore, the EFRAG Secretariat undertook limited research activities focused on a number of European banks based on their 2016 Financial Statements. More specifically, we analysed the statements of financial performance of 12 listed financial institutions[1] included in the S&P Europe 350 Index in order to broaden our view on current practice on presentation.

20 However, we note that the sample is not statistically representative of all European banks and that insurance companies have been scoped out because they are in the scope of the new requirements of IFRS 17 *Insurance Contracts*.

21 In our research we focused on:

(a) the use of the presentation options for the analysis of expenses (i.e. by nature or by function);

(b) the use of subtotals;

(c) the use of the option to present a single statement of comprehensive income or two statements;

(d) the presentation of share of the profit or loss of associates and joint ventures accounted for using the equity method;

(e) any other form of earnings per share presented;

(f) the level of disaggregation in the statement of financial position, especially the level of disaggregation of equity;

(g) the classification of interest and dividends in the statement of cash flows; and

(h) the starting point for the indirect method.

22 We have not been able to confirm whether any of the line items, subtotals and totals have been calculated in accordance with IFRS requirements.

23 The companies analysed represented the following countries of incorporation:

Country of Incorporation	Number of companies
United Kingdom	4
France	3
Spain	2
Denmark	1
Italy	1
Netherlands	1
Total	**12**

Statement of financial performance: presentation by nature and by function

24 Our research revealed that part of the banks (50%) presented their analysis of expenses using the classification based on their nature while the remaining companies (50%) used a classification based on a combined approach by mixing the nature (e.g. depreciation and amortisation expense) and function presentation (e.g. administrative expenses).

[1] Selection based mainly on size (market capitalization).

25 We thus identified a different trend within the banking industry compared to our limited research in 2017 on non-financial companies. The majority of the non-financial companies presented their analysis of expenses using the classification based on their function. The remaining companies, either used a classification based on their nature or a combined approach.

Statement of financial performance: *Use of subtotals*

26 The EFRAG Secretariat noted that companies use many different subtotals on the face of the statement of financial performance. These include:

(a) *Operating profit*: this subtotal or equivalent subtotals (e.g. operating income) were used by many banks. Operating profit normally included interest income, fee and commission income, trading income, dividend income, gains or losses on financial assets and liabilities, personnel and other administrative or operating expenses. In many cases, this subtotal excluded line items such as impairment charges (e.g. loans), 'share of profit in associates and joint ventures', 'negative goodwill', 'changes in value of goodwill', 'gains and losses on non-financial assets and investments', 'gains or losses on derecognised of non-financial assets and subsidiaries' and 'profit or loss on non-current assets and disposal of groups classified as held for sale'.

(b) *Profit before tax*: 83% of the companies used this subtotal.

(c) *Profit or loss*: All companies used this subtotal as required by IAS 1 *Presentation of Financial Statements*. Some banks used different terms such as 'net income' or 'net result' to present their profit for the period.

(d) *Other subtotals*: the EFRAG Secretariat also noticed the use of other subtotals such as 'result before tax from continuing operations', 'trading surplus' and 'profit before loan impairment charges'.

27 None of the companies made explicit reference to 'profit before interest and tax' or 'EBIT'. In addition, none of the companies presented a separate subtotal named 'finance result' or 'investment result'.

Statement of financial performance: Number of subtotals

28 The EFRAG Secretariat noted that banks tend to use more subtotals than those required by IAS 1. In addition to 'profit or loss' or 'profit for the year', all of the companies presented at least 3 subtotals within their statement of financial performance.

29 For example, the main subtotals that several banks presented were:

(a) net interest income;

(b) net fee income;

(c) revenue;

(d) total income;

(e) operating income;

(f) operating profit;

(g) net result from continuing operations; and

(h) profit before tax.

30 The number of 'main subtotals' used generally varied from 4 to 7. The majority (67%) presented 6 different subtotals that captured every line item above.

31 We also noted that 58% presented additional subtotals within some of the main subtotals. The number of these additional subtotals within main subtotals varied from 1 to 5.

32 Therefore, altogether banks included up to 11 subtotals in their statement of financial performance. Those subtotals aggregating line items within main subtotals referred in most of the cases to net interest, net fee and commission income and operating expenses.

Statement of financial performance: Use of "non-recurring", "exceptional" and "non-core" items

33 The EFRAG Secretariat noted that banks did not include an explicit reference to the term non-recurring, exceptional, non-core items or extraordinary on the face of the statement of financial performance.

Statement of financial performance: Single statement or two statements

34 All the companies in the sample used two statements to present their performance, thereby contributing to comparability.

Statement of financial performance: Results of associates and joint ventures

35 The presentation of results of associates and joint ventures varied. However, in most cases, the presentation of results of associates and joint ventures was shown after operating profit but within profit before tax.

Statement of financial performance: Earnings per share

36 The banks analysed by the EFRAG Secretariat did not present an unusual "earnings per share" figure at the bottom of the statement of financial performance.

37 In general, companies showed the basic and diluted earnings per share figure. 25% of the entities also presented the split between continued and discontinued operations. Entities also did not present any other APMs at the bottom of the statement of financial performance.

Statement of financial performance: OCI

38 The EFRAG Secretariat analysed the statement of other comprehensive income of the same 12 listed financial institutions in order to get a brief understanding of the current practice on presentation. The following was noted:

(a) All entities started the statement with profit after tax for the year;

(b) 42% of the entities presented reclassification adjustments to profit and loss within OCI;

(c) Most of the entities, except for two banks, presented a separate line item related to "other comprehensive income for the year, net of tax"; and

(d) Most of the banks (75%) showed the tax effects in OCI, whereas 25% showed every OCI line item net of tax.

Statement of financial position

39 The EFRAG Secretariat analysed the 2016 statements of financial position of the same 12 European banks. The following could be noted:

(a) none of the entities classified their assets and liabilities by current and non–current. Instead, they made use of the exception described in paragraph 60 of IAS 1 stating that an entity shall present all assets and liabilities in order of liquidity when a presentation based on liquidity provides information that is reliable and more relevant than separately presenting current and non-current assets, and current and non-current liabilities;

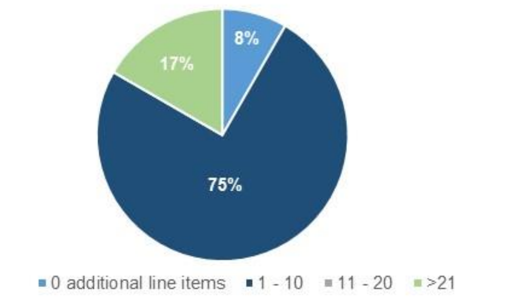
(b) most of the entities (83%) did not present subtotals and totals other than those required by IAS 1 (e.g. total assets, liabilities and equity);

(c) the EFRAG Secretariat observed that companies provide different levels of disaggregation of its equity within the statement of financial position. For example, two banks provided very detailed information about the composition of their equity. They showed more than 20 different line items on the face of their balance sheet while one bank did not provide any additional detail of the different equity components;

(d) IAS 1 *Presentation of Financial Statements* requires entities to present at least two line items in their statement of financial position within equity (i.e. 'issued capital and reserves attributable to owners of the parent' and 'non-controlling interest'). All entities, except for one bank, made the required disaggregation of equity attributable to owners of the parent and non-controlling interest; and

(e) In general, most of the banks presented additional equity components other than those required by IAS 1. However, the level of disaggregation of different equity components on the face of the statement of financial position generally varied. The majority of the banks (75%) showed between 1 and 10 line items that are not explicitly required under IFRS.

Additional line items not required by IFRS



(f) The following items were included by more than one entity on the face of the statement of financial position:

(i) Issued capital (92%);

(ii) Share premium (67%);

(iii) Retained earnings (67%);

(iv) Other reserves (58%);

(v) Other equity instruments (50%); and

(vi) Translation differences (25%).

Statement of Cash Flows: classification of interest and dividends

40 The EFRAG Secretariat analysed the statement of cash flows of the same 12 banks with the objective of understanding which option for classification of interest and dividends is the most common choice by financial institutions.

41 Concerning the classification of interest, most of the banks presented interest paid and received within 'operating activities'.

42 Dividends paid were typically classified as financing activities. When presented, dividends received from equity instruments were classified as operating activities. However, dividends received from associates and joint ventures were either classified within operating activities (two banks) or investing activities (one bank).

Statement of Cash Flows: starting point for the indirect method

43 All of the 12 banks used the indirect method in their statement of cash flows. However, they chose three different starting points for their presentation of cash flows. The majority of the banks (58%) used the 'profit before tax' as a starting point. A number of financial institutions (33%) presented their 'net profit after tax' on top of its cash flow statement. One bank used 'operating profit'.