EFRAG
European Financial Reporting Advisory Group

Primary Financial Statements
Project Update

Objective

1 The objective of this session is to provide an update to EFRAG Board members on the IASB Project *Primary Financial Statements*.

Agenda Papers

2 In addition to this agenda, the following agenda papers have been uploaded:

(a) 08-02 – *Overview of the IASB Proposal* (for background only);

(b) 08-03 – *Key messages for EFRAG DCL* (for background only – this agenda paper was discussed by EFRAG TEG in December 2019 and has not been updated to reflect TEG discussions reported below); and

(c) 08-04 – *EFRAG Research Activities on PFS* (or background only – this agenda paper was discussed by EFRAG TEG in November 2019 and has not been updated since then).

Why a project on Primary Financial Statements?

3 The *Primary Financial Statements project* is part of the IASB's plan to promote Better Communication in Financial Reporting. The project started in 2016, in response to the feedback received during the IASB's 2015 Agenda Consultation, when many stakeholders identified this project as a priority. The key milestones on this project are:

(a) in its September 2018 meeting, the IASB moved the *Primary Financial Statements* project from the research programme to the standard-setting programme;

(b) in its May 2019 meeting, the IASB decided to issue an Exposure Draft, rather than a Discussion Paper; and

(c) an Exposure Draft is expected to be published by the end of December 2019 with a comment period of 180 days (i.e. end of June 2020).

The scope of the project and the IASB's key decisions to date

4 This project aims to improve the structure and content of the primary financial statements, with a focus on the statement(s) of financial performance. More specifically, the IASB proposes:

Statement of financial performance
The introduction of three new subtotals, including operating profit or loss, and the introduction of three new categories (operating, investing and financing categories) to improve comparability between entities.
Separate presentation of 'integral' and 'non-integral' associates and joint ventures: in the statement of financial performance.
To continue to require the disaggregation of expenses either by nature or by function in the statement of financial performance (no mix allowed) and new requirements on the factors to consider when deciding which method of expense analysis to use.
Improvements to the communication of OCI (more descriptive labels).
Statement of Cash Flows
New starting point for the indirect method: operating profit.
Elimination of classification options (interest and dividends).
Separate presentation of Integral' and 'non-integral' associates and joint ventures: in the statement of cash flows.
Other improvements to the structure and content of financial statements, including disclosures
New disclosure requirements on Management Performance Measures to improve transparency and discipline on their use, including a proposal for their definition (i.e. subtotals of income and expenses that are used in public communications with users, outside financial statements, complements totals or subtotals included in IFRS Standards and communicate management's view of an aspect of an entity's financial performance).
Disclosures on unusual income and expenses, including their definition ('income or expenses with limited predictive value because it is reasonable to expect that similar income and expenses will not arise for several future annual reporting periods').
The introduction of revised principles and general requirements on aggregation and disaggregation of information in the financial statements.

5 For that purpose, the IASB is expected to propose a new IFRS Standard that includes both the new IASB proposals as well as improvements to the existing presentation and disclosure requirements of IAS 1 *Presentation of Financial Statements* (e.g. align the terminology used with the new Conceptual Framework and improve the consistency of the terms used). In addition, the IASB is expected to:

(a) move from IAS 1 to IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* the requirements dealing with the definition of material, fair presentation and compliance with IFRS Standards, going concern and the accrual basis of accounting;

(b) move from IAS 1 to IFRS 7 *Financial Instruments: Disclosures* paragraphs relating to disclosures about puttable financial instruments classified as equity to IFRS 7;

(c) draft the proposed changes to the statement of cash flows as amendments to IAS 7 *Statement of Cash Flows*;

(d) draft the proposals related to earnings per share as amendments to IAS 33 *Earnings per Share*; and

(e) propose a definition of integral and non-integral associates and joint ventures (including the guidance to help entities apply the definition) as an amendment to IFRS 12 *Disclosure of Interests in Other Entities*.

What has EFRAG been doing since the beginning of the project?

6 The EFRAG Secretariat provided updates to EFRAG groups on several occasions. More specifically, from 2016 to 2019 EFRAG discussed this topic in 26 different meetings. In December, EFRAG TEG discussed the direction and key messages to be included in EFRAG Draft Comment Letter (DCL) and provided the following comments[1]:

(a) EFRAG TEG members generally supported the IASB approach to issue an Exposure Draft and propose a new standard that would replace IAS 1;

(b) EFRAG TEG members welcomed the IASB's Exposure Draft on *Primary Financial Statements* and generally supported the IASB's efforts to improve the structure and content of primary financial statements, particularly the introduction of operating profit which would provide useful information about the entity's main business activities;

(c) EFRAG TEG members had mixed views on whether it was appropriate to define "investing" and "financing" category. Those that supported to have such definitions mentioned that for non-financial entities it would be useful information to separately disclose the investment dimension. Those that did not support this division mentioned that an attempt to segregate investing from financing components would be arbitrary. These EFRAG TEG members also highlighted the challenges and potential costs of making the distinction between investing and financing category, particularly when dealing with income and expenses from cash and cash equivalents (e.g. overdraft and investments in money market instruments). One member noted the partial information deriving from the three categories in absence of a requirement to separately disclose or present the tax impact on each of the categories;

(d) if to make distinction, some members considered that the financing category should be related to "funding of the entity's main activities" and investing more related to the allocation of excess cash to investments;

(e) some members also noted the challenge of separately identifying the financing components embedded in the core business activity (i.e. separating the financing from the operating cycle). For example, members noted some contracts with customers include a financing component and this financing component should be separately presented in accordance with IFRS 15 Revenue. If such interest was not presented in the financing category, there

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[1] Please note, that the approval procedure of the summary of decisions of December EFRAG TEG meeting is still in progress. Accordingly, EFRAG TEG members' views reported below are subject to change following eventual remarks from EFRAG TEG members.

could be a mismatch with other interest expenses presented in the financing category;

(f) some members mentioned that both the statement of financial performance and the statement of cash flows will have three different categories with similar name (operating, investing and financing) although they were not aligned, and this should be clear. Others mentioned that it could be useful to align the statement of cash flows and the statement of financial performance;

(g) EFRAG TEG members welcomed the IASB's effort to provide more discipline on the use of MPMs. However, they did not support the scope of the proposal. In particularly, they questioned the IASB's proposal to require entities to disclose information about MPMs that are presented in public communication outside the financial statements. EFRAG TEG would rather support a reconciliation of the MPMs presented in the financial statements. Some EFRAG TEG members noted that users were interested in MPMs and that the primary source of this information was the result announcements and management commentary; they observed that the reconciliation proposed by the IASB would arrive later, when compared to ESMA Guidelines. Some TEG member questioned the interaction with the ESMA guidelines and the possible need for the latter to further evolve;

(h) one TEG member proposed to revise the IASB decision and suggest a voluntary disclosure of the reconciliations, instead of mandatory;

(i) some TEG member considered the linkage with the information already provided by IFRS 8 *Operating Segments* and considered that if entities used MPMs other than those prepared under IFRS 8, they should explain why;

(j) EFRAG TEG members generally welcomed the proposed additional guidance on disaggregation and separate presentation of integral and non-integral associates and joint ventures. One EFRAG TEG member mentioned that the IASB proposal was not solving the issue for joint ventures for which proportional consolidation would be the most appropriate approach;

(k) some members expressed concerns about the IASB's proposal to not allow a mix presentation of expenses (by nature and by function) as this would not allow the use of some non-recurring items on the face;

(l) EFRAG TEG members had several concerns on the proposal to define and require separate disclosure on unusual items. This definition was perceived to be somehow redundant with the MPM proposal and rather anti-abuse in nature. It was as well observed that it was unclear how "unusual" would differ from "extraordinary" and "non-recurring". The proposed definition of "unusual" was particularly not clear: all the items should be in the scope of the activities that are allowed under the entity's statutes and in this sense, there are no "unusual items". Another example considered was the separate presentation of restructuring expenses, where a restructuring is an extraordinary process that lasts a few years. If this was the target, the IASB should better clarify the scope, where the discontinuity is not related to the future (i.e. items that would not occur in the future periods) but rather on the past (i.e. items that had not occurred in the past);

(m) EFRAG TEG members considered there was still room to improve primary financial statements and disclosures in the future, particularly by a more comprehensive discussion on the statement of cash flows. Members highlighted the EFRAG FIWG proposal to eliminate the statement of cash flows and discussed the challenges of properly scoping out the entities that would be exempted from this statement; and

(n) although there was general acknowledgement that reverse factoring was an important issue, there were mixed views. Some members supported including this issue in the DCL while others questioned whether this issue should be highlighted in the DCL.

EFRAG secretariat analysis of the expected impacts

Background

7 During the consultation period of *Financial Instruments with Characteristics of Equity* (FICE) project, the EFRAG Secretariat decided to publish its Working Paper: *Early-Stage Analysis*. The Working Paper was intended to inform constituents about the effect of the IASB's project and be one of the inputs to a future comprehensive impact analysis if the IASB were to proceed with the.

8 Following the publication of the Working Paper, the EFRAG Secretariat requested public comments to be provided through either comment letter submission or by responding to an online survey that had questions on the usefulness, findings and areas for enhancement of the early-stage analysis. The EFRAG Secretariat also received feedback from respondents who were unable to submit formal written responses but were willing to give informal feedback through other channels, including email and verbal feedback.

9 EFRAG also sought public comments on the Working Paper to identify what analytical aspects are useful and where improvements could be made should a similar exercise be undertaken in the future. Overall, respondents found the early-stage analysis exercise performed by EFRAG Secretariat to be a comprehensive and useful supplement to EFRAG's current due process for influencing the development of IFRS Standards, which includes outreaches and the issuance of draft and final comment letters. It was also proposed that the early-stage analysis should be a standard part of EFRAG's process for key future standard setting projects.

Current project

10 Considering the feedback received, the EFRAG Secretariat plans to publish, together with EFRAG's DCL, an Early Stage Analysis (ESA) on possible impacts of the proposed guidance.

11 In November 2019, the EFRAG Secretariat already presented to the EFRAG TEG an analysis of current practice with a preliminary assessment on how the IASB's tentative decisions would affect current practice. This report is provided for background purposes as Agenda Paper 08.04. We note that the EFRAG TEG members shared the views and agreed to incorporate the findings in an appendix of the DCL in order to enhance the constituents' understanding.

12 We plan to align ESA with the structure of the DCL and provide the references to the particular parts of ESA in the notes to constituents of each section of the DCL. The analysis itself will form an additional appendix to the DCL.

13 Consequently, the EFRAG Secretariat proposes to

(a) attach this appendix with the disclaimer that it is a secretariat document; and

(b) the notes to constituents of the DCL would refer to this appendix when commenting the specific requirements.

EFRAG's project plan

14 During its consultation period, EFRAG will reach out to national standard setters, users of financial statements, preparers, regulators, business associations and other accounting experts to, among others:

(a) raise awareness about the IASB's discussions on PFS and EFRAG's DCL;

(b) test whether the IASB proposals can be applied in practice and related costs and benefits;

15 EFRAG Secretariat expects to use a number of different tools for its outreach activities.

16 Finally, during its consultation period, EFRAG will also reach out to its constituents to obtain data for its Early Stage Analysis (ESA) of the proposals.

Project planning overview						
Dec -19	**Jan 20**	**Feb 20**	**March 20**	**April 20**	**May 20**	**June 20**
Discuss key messages and direction of DCL	Recommend DCL and ESA at EFRAG TEG	Approve DCL and ESA at EFRAG Board	Outreach Activities and Field Tests	Outreach Activities and Field Tests	Updates on outreach activities and direction of FCL	Approve DCL and ESA at TEG and Board

Questions for the EFRAG Board

17 Do EFRAG Board members have any comments on the latest developments on IASB's project *Primary Financial Statements*?

18 Do EFRAG Board members have any comments on the EFRAG Secretariat's approach to the preparation of the DCL, ESA and of the outreach outlined above?