Primary Financial Statements
Cover Note

Objective

1 The objective of the session is to approve an EFRAG Draft Comment letter to the EFRAG Board on the IASB's Exposure Draft ED/2019/7 *General Presentation and Disclosures* (the ED).

2 In addition to this cover note, agenda paper 06-02 – EFRAG Draft Comment Letter has been provided for the session.

Background

3 On 17 December 2019, the IASB published the ED, where it proposes the new requirements on general presentation and disclosures in financial statements. The ED is available on the IASB's web page here, and consists of the following files:

(a) Exposure Draft: General Presentation and Disclosures;

(b) Exposure Draft: General Presentation and Disclosures: Basis for Conclusions; and

(c) Exposure Draft: General Presentation and Disclosures: Illustrative Examples.

4 In January 2020, EFRAG TEG discussed the EFRAG Draft Comment Letter on *Primary Financial Statements* prepared by the EFRAG Secretariat based on the feedback received from EFRAG TEG and EFRAG Board in December 2019.

5 EFRAG TEG provided the following drafting suggestions:

Question 2 - Operating category

(a) noted that the IASB defines an operating profit as both positive and residual category;

Q3 - Operating category: income and expenses from investments made in the course of an entity's main business activities

(b) give more emphasis to the challenges of making a split of income and expenses from investments between operating and investing categories;

(c) To add questions to constituents about usefulness and practicability of separating the returns from investments made in the course of the main business activities from those that are not;

Question 4 - Operating category: an entity that provides financing to customers as a main business activity

(d) when welcoming the IASB proposal, state that the IASB's proposals will provide relevant information to users rather than improve comparability;

(e) avoid using the word 'conglomerate', to highlight that it is a broader issue and to include reference to IE11 in paragraph 38;

(f) improve EFRAG comments on accounting options, particularly for non-financial institutions;

(g) request the IASB to address the existing diversity in practice on how entities with different business segments related to different industries present their performance;

(h) For entities with different business activities, add a new question to constituents on whether the IASB should provide more guidance on the accounting policies to be applied when splitting income and expenses between the different business activities (reflecting internal transactions) within the statement of profit or loss;

Question 5 - Investing category

(i) highlight the challenges of splitting the income and expenses from cash and cash equivalents between financing and investing category;

(j) EFRAG TEG members had split views on the allocation of income and expenses from cash and cash equivalents between financing and investing activities. They suggested to present the arguments supporting the two views and to add a new question to constituents to gather additional input;

(k) redraft the EFRAG proposal to allocate income from the financial assets to the investing and expenses from the financial liabilities to the financing category;

(l) To highlight a need of a risk management definition;

Question 6 - Profit or loss before financing and income tax and the financing category

(m) EFRAG TEG members had split views on the classification of changes in time value of money on liabilities that do not arise from financing activities (i.e. classified either as financing or operating activities). They suggested to present the arguments supporting the two views;

(n) add a new question to constituents to ask for the views on if the income and expenses related to the time value of money on liabilities that do not arise from financing activities should be a part of financing or operating activities;

Question 7 - Integral and non-integral associates and joint ventures

(o) redraft/remove the paragraphs about the EFRAG concerns on the distinction between debt and equity;

(p) highlight that the IASB's proposals would also apply to the separate financial statements, which may raise complexity;

(q) highlight the importance of the robustness of the definition of integral and non-integral;

(r) add a new question to constituents to have their views on a proposal to expand the paragraph 20D of IFRS 12 to include additional indicators with an aim to reduce the level of judgement involved when making a distinction between integral and non-integral entities;

Question 9 - Analysis of operating expenses

(s) ask for clarification when mixed presentation is allowed or required and refer to paragraph IE6 of the Illustrative Examples;

(t) clarify whether an entity will be required to present the line item 'cost of sales' when presenting income and expenses by nature;

(u) add a new question to constituents to ask for their views on the usefulness and potential costs of presenting disclosures by nature in the notes when an entity presents its expenses by function on the face of the financial statements;

Question 10 - Unusual income and expenses

(v) express the support to the IASB proposals more clearly but to suggest that the scope of unusual items needs to be refined;

(w) ask for clarification if the column presentation would also apply to unusual items;

(x) move the 'extraordinary items' section to the notes to constituents to clarify that this notion would disappear;

(y) ask for clarification if entities could present unusual items on the face of financial statements as 'unusual line items' or 'unusual subtotals';

Question 11 - Management performance measures

(z) emphasise that the scope of the IASB proposals is limited in terms of types of measures (i.e. only subtotals related to financial performance) and thus would not solve all the existing issues on APMs;

(aa) redraft some paragraphs in a more neutral way and to remove the word 'mandate';

(bb) emphasise that the scope in terms of public communication is very wide and could raise issues in identifying relevant communications;

(cc) EFRAG TEG members had split views on the scope of the MPM proposals. They suggested to gather input from constituents before forming a final view and agreed to consult on two possible alternatives to the IASB proposed approach in terms of scope:

  (i) limit the scope to the subtotals presented in the financial statements and management commentary practice statement; or

  (ii) enlarge the scope above by the communications released jointly with the annual report including earnings releases. This second alternative would be narrower than the IASB proposed scope

(dd) Reflecting the above, to add three new questions to constituents; and

Question 13 - Statement of cash flows

(ee) suggest the IASB to undertake a separate project on IAS 7 *Statement of Cash Flows* to consider its better alignment with the statement of financial performance;

Draft comment letter

6 The EFRAG Secretariat has uploaded the agenda paper 06-02 EFRAG Draft Comment Letter for your approval, which already reflects the recommendations received from EFRAG TEG in January 2020 summarised above. The key messages and questions to constituents are:

Question	EFRAG's initial position
Question 1 - operating profit or loss	EFRAG supports the IASB's proposal to require all entities to present the subtotal 'operating profit or loss' to reduce diversity in practice and improve comparability of financial statements.
Question 2 - the operating category	EFRAG supports the IASB's proposal to define the 'operating category' as described in paragraph 46 of the ED. EFRAG notes that in paragraphs 46 and B25-B31 of the ED the IASB starts by defining the

	operating category positively and then introduces a residual element in its definition. This residual element is further explained in paragraphs BC54 and BC55 of the Basis for Conclusions. However, EFRAG highlights the importance of having clear guidance on the notion of the "entity's main business activity" or "in the course of the entity's main business activity".
Question 3 - the operating category: income and expenses from investments made in the course of an entity's main business activities	EFRAG agrees with the proposal as it will enhance the comparability between entities and provide relevant information to users of financial statements. Nonetheless, EFRAG calls upon the IASB to closely communicate with regulators on the interaction of the IASB proposals with existing regulatory frameworks, particularly those that in Europe. *The DCL includes two questions to constituents on the expected impact/costs of the IASB's proposals, particularly for those in a regulated industry.*
Question 4 - the operating category: an entity that provides financing to customers as a main business activity	EFRAG agrees with the IASB's proposals for entities that provide financing to customers as a main business activity as it provides relevant information to users of financial statements. However, EFRAG questions the proposal to provide a the 'free' accounting policy choice in paragraph 51(b) to non-financial institutions. *The DCL includes two questions to constituents on the expected impact/costs of the IASB's proposals, particularly for those in a regulated industry.*
Question 5 - the investing category	EFRAG supports the IASB's proposal to require the presentation of an investing category subject to materiality considerations. Nonetheless, EFRAG considers that the IASB should better explain the interaction of the new subtotals and categories with the notion of materiality. EFRAG notes that the IASB's approach to consider income and expenses that arise from cash and cash equivalents being related the entity's financing allows management to reflect its intention in managing debt and equity financing. However, there might be value relevance in another possible approach where the financing category is linked to the management of liabilities that arise from financing activities (as described in IAS 7) and the investing category is linked to the management of investments in assets. Finally, EFRAG is concerned about presenting gains and losses on derivatives in the investing category under certain conditions, particularly when referring to financial institutions. EFRAG is also seeking views on the costs of the proposal for presentation of exchange differences. *The DCL includes two questions to constituents on whether they view the presentation of income and expenses from cash and cash equivalents as part of financing or investing activities and the expected impact/costs of the IASB's proposals and the expected impact/costs of the IASB's proposals*
Question 6 - profit or loss before financing and income tax and the financing Category	EFRAG supports the IASB's proposal to require and define "Profit or loss before financing and income tax" and the "financing category". However, as mentioned above EFRAG highlights the challenges of the IASB's proposals to make the distinction between the investing and financing category. On time value of money on liabilities that do not arise from financing activities, EFRAG notes these income and expenses can be seen either as a component of the operating category or of the financing category.

	Finally, EFRAG considers that it would be useful to consider whether incremental expenses related to financing activities should also be in the financing activities by symmetry with expenses relating to investing activities. *The DCL includes one question to constituents on whether they view income and expenses that reflect the time value of money on liabilities that do not arise from financing activities as part of the entity's financing or operating activities*
Question 7 - integral and non-integral associates and joint ventures	EFRAG considers that providing a distinction between integral and non-integral associates and joint ventures will provide useful information to users of financial statements. However, EFRAG highlights that such changes to presentation requirements would involve significant judgement and need to be tested in practice. EFRAG also notes that the IASB's proposals would also apply to associates and joint ventures in the separate financial statements, which may in some cases raise questions about the applicability of the proposed definitions. *The DCL includes one question to constituents on whether they consider that there is a need to expand the new paragraph 20D of IFRS 12, for example to include additional indicators, to reduce the level of judgement involved when making a distinction between integral and non-integral entities.*
Question 8 - roles of the primary financial statements and the notes, aggregation and disaggregation	EFRAG welcomes the IASB's efforts to improve the general requirements on disaggregation as a complement to the created additional subtotals in the statement of profit or loss. EFRAG notes that having the principles and general requirements on aggregation and disaggregation of information in the financial statements within a single place in the new standard will improve clarity and consistent application across entities.
Question 9 - analysis of operating expenses	EFRAG supports the IASB's proposal to continue requiring entities to present an analysis of expenses using either by-function or by-nature method, based on whichever method provides the most useful information to the users of financial statements. However, EFRAG suggests the IASB to make clear that paragraph B47 of the ED allows or even requires a mixed basis of presentation when an entity is required to present line items under paragraphs 65 and B15 of the ED. EFRAG also suggests the IASB to include the reference to paragraph B15 directly in paragraph B47 of the ED for clarity purposes. *The DCL includes one question to constituents on whether they consider that it is useful to have disclosures by nature when an entity presents its expenses within operating profit or loss by function and related costs.*
Question 10 - unusual income and expenses	EFRAG welcomes the IASB's efforts to define unusual income and expenses and to require entities to disclose such items. However, EFRAG highlights that the scope of unusual items seems to be narrow, as it focuses on whether expenses/income will occur in the future. Instead, EFRAG suggest the IASB to consider not only items that will not arise for several future annual reporting periods (as in the ED) but also items that occur presently in the business, but only for a limited period of time (e.g. those identified in paragraph B15 of the ED such as restructuring costs). EFRAG notes that the translation of term 'unusual' may raise issues in some jurisdictions: a term 'non-recurring' would serve in a better way. Finally, EFRAG considers that it would be useful to clarify whether entities can present unusual items on the face of the financial

	statements by specifically referring to 'unusual line items' and 'unusual subtotals' within the categories defined by the IASB or with the use of columns.
Question 11 - management performance measures	EFRAG agrees that non-IFRS measures are often used in practice and additional guidance could bring more transparency and consistency on their use. EFRAG therefore welcomes the IASB's efforts to provide guidance on MPMs. However, EFRAG notes that the scope is limited to subtotals of income and expenses (thus it will not solve all the existing issues related non-IFRS measures) and highlights a number of challenges in regard to the IASB's proposed scope. EFRAG is also seeking views from constituents on possible alternative approaches to define a narrower scope. Finally, EFRAG considers that the IASB has not sufficiently articulated the link between MPMs and IFRS 8 and suggests the IASB to require an explanation of how MPMs interact with performance measures already presented under IFRS 8. *The DCL includes six questions to constituents on the scope of MPMs and the expected impact of the IASB's proposals.*
Question 12 - EBITDA	In EFRAG's opinion, defining EBIT and EBITDA would be useful for users of financial statements and would reduce diversity in practice. However, as they have not been defined by the IASB, they should be included in the scope of the IASB's proposals regarding MPM disclosures. Furthermore, EFRAG urges the IASB to clarify the principle behind the list of measures not considered to be MPMs provided in paragraph 104 of the ED.
Question 13 - statement of cash flows	EFRAG supports the IASB's proposal to require entities to use the 'operating profit or loss' as the starting point for the indirect reconciliation of cash flows from operating activities in the statement of cash flows, as it specifies a consistent starting point for the indirect method of reporting cash flows from operating activities. It also reconciles the operating category in the statement of profit or loss with the operating activities in the statement of cash flows. EFRAG supports the removal of options for the classification of interest and dividends in the statement of cash flows for non-financial entities. This will improve consistency in presentation of similar line items and will better reflect the nature of the respective cash flows. EFRAG observes that some of those line items will be classified into different categories in the statement of cash flows and the statement of profit or loss. However, EFRAG suggests the IASB to have a separate project on IAS 7 with the objective of having a comprehensive review of the challenges that arise in practice (e.g. financial institutions) and improve consistency with the new content and structure of the statement of profit or loss. Finally, EFRAG would welcome guidance on the presentation of arrangements where an intermediate is used to pay trade receivables (i.e. supply-chain financing arrangements or reverse factoring).
Question 14 - other comments	EFRAG does not consider the IASB's proposals significantly improving the current requirements as they simply modify the labelling of OCI line items. EFRAG considers that it will be difficult to significantly improve the communication and understandability of OCI without addressing the distinction between profit or loss and OCI and the role of recycling

	In regard to the proposed amendments to IAS 34, EFRAG has some concerns about requiring a reconciliation of MPMs, including the effect of tax and non-controlling interests separately for each of the differences between the MPM and the IFRS measure, at interim financial statements. This is because, MPM reconciliations, including tax effect and NCI effect can be costly, particularly when preparing interim financial statements at consolidated level. EFRAG also considers that it could be useful if the IASB could further explain how entities that operate business activities in different industries (e.g. manufacturer providing financing to customers) should prepare their financial statements, especially when considering paragraph IE11 of the Illustrative Examples. EFRAG has also provided additional suggestions to improve presentation in the primary financial statements in *other comments* section. *The DCL includes one question to constituents on entities that operate business activities in different industries (e.g. manufacturer providing financing to customers).*

Early Stage Analysis

7 The EFRAG Secretariat has prepared an Early Stage Analysis (the ESA) of the expected impact of the IASB's proposals presented in the ED. The ESA is based on the EFRAG Staff research originally presented to the EFRAG TEG in January 2017 and March 2018. In November 2019, the EFRAG Secretariat presented a revised research which included a more detailed analysis of the most recent financial statements and a preliminary impact assessment based on the IASB's tentative decisions.

8 The findings of the research are generally consistent with the findings of the IASB Staff, summarised in the Basis for Conclusion of the ED, and other relevant reports, including a recently published ESMA report on the use of Alternative Performance Measures and on the compliance with ESMA's APM Guidelines (ESMA32-334-150). In the ESA, we also included the findings of the ESMA report regarding APMs, to provide a complete picture of the possible impact of the ED.

9 The ESA is included in Appendix 2 of the DCL with the main findings and elements of analysis provided in the notes to constituents of each part.

Comment Period

10 The EFRAG Secretariat proposes that the comment period for EFRAG DCL ends on 19 June 2020. This means that EFRAG would discuss EFRAG Final Comment Letter on 2 July 2020 and the EFRAG Board would approve it on 16 July 2020.

Questions for EFRAG Board

11 Do EFRAG Board members approve the EFRAG Draft Comment Letter recommended by EFRAG TEG?