Primary Financial Statements
Cover Note

Objective

1 The objective of the session is to discuss and recommend 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 Considering the outcome of TEG discussion in December, the EFRAG Secretariat does not expect significant debate in Question 1, Question 2, Question 8, and Question 13. Therefore, in the meeting, we would like to focus on other questions and simply ask for TEG members' agreement on the proposed response to these questions. In general, wording suggestions are welcomed

3 If you have any specific issues or the drafting suggestions on these sections, please let the EFRAG Secretariat know in advance so that we have time discuss critical issues at the EFRAG TEG meeting.

Background

4 In December 2019, EFRAG TEG discussed the direction and key messages for the EFRAG Draft Comment Letter on the IASB's project *Primary Financial Statements* (the DCL). At that meeting, the EFRAG Secretariat proposed a number of key messages to be included in the DCL based on the feedback received from EFRAG TEG and EFRAG TEG Working Groups. EFRAG TEG provided the following comments:

(a) generally supported the IASB's efforts to improve the structure and content of the primary financial statements, particularly the introduction of the subtotal operating profit or loss;

(b) welcomed the IASB's approach to issue the ED and propose a new standard that will replace IAS 1 *Presentation of Financial Statements*.

(c) 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. Nonetheless, it was mentioned that for non-financial entities it would be at least useful to separately disclose the investment dimension;

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

(e) some members noted that the statement of financial performance and the statement of cash flows was going to have three different categories with similar names (operating, investing and financing) although they were not aligned; the differences should be clearly identified and explained. By contrast, some mentioned that it could be useful to align the statement of cash flows and the statement of financial performance;

(f) welcomed the IASB's effort to provide more discipline on the use of Management Performance Measures (MPMs). However, EFRAG TEG did not support the IASB's proposals. In particular, members questioned the IASB's proposal to require entities to disclose information inside the financial statements about MPMs that are presented in public communication, outside the financial statements. Members rather supported disclosures on MPMs that are presented inside the financial statements. Some highlighted that European entities already complied with ESMA Guidelines on Alternative Performance Measures (APMs) and questioned the interaction of the IASB's proposals with the ESMA guidelines;

(g) some considered that if entities used MPMs other than those prepared under IFRS 8 *Operating Segments*, they should explain why;

(h) generally welcomed the proposed additional guidance on disaggregation and separate presentation of integral and non-integral associates and joint ventures. Nonetheless, one member mentioned that the IASB proposals did not solve the issue for joint ventures for which proportional consolidation would be the most appropriate approach;

(i) 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 when by function presentation was used;

(j) expressed several concerns on the IASB's proposal to define and require separate disclosure on unusual items. For example, members mentioned that it was unclear how 'unusual' would differ from 'extraordinary' and 'non-recurring'; referred to translation issues; and noted the importance of having information about restructuring expenses;

(k) considered that there was still room to improve primary financial statements and disclosures in the future, including a more comprehensive discussion on the Statement of Cash Flows; and

(l) 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.

5 In December 2019, the EFRAG Board also received an update on the latest discussions of the IASB and EFRAG TEG's on the project *Primary Financial Statements*. EFRAG Board provided the following comments:

(a) generally supported the IASB's efforts to improve the structure and content of primary financial statements, particularly the introduction of operating profit;

(b) the IASB should closely communicate with regulators on the interaction of the IASB proposals with existing regulatory frameworks on presentation of financial statements. In addition, there was a need to investigate the impact of the IASB's proposals for financial institutions and conglomerates.

(c) performance measures defined by management can provide useful information but should be used in a more transparent and disciplined way. Thus, EFRAG should support new guidance on this topic. However, EFRAG Board members raised many questions on the scope of the IASB proposals on MPMs, including questions on:

(i) the differences between MPMs and APMs;

(ii) how many MPMs were going to be included in the financial statements in the future;

(iii) how the IASB proposals on MPMs would interact with information already provided in accordance with IFRS 8 *Operating Segments*; and

(iv) whether companies would have to disclose measures required by regulators, particularly banks and insurance companies;

(d) discussed whether and to what extent information provided in public communication should be aligned with the information provided in the financial statements, particularly when considering that in public communication entities tend to provide a more positive view of performance;

(e) highlighted the importance of having information about performance measures such as EBITDA;

(f) considered that EFRAG should investigate whether the IASB's project was going to raise new issues for ESEF and XBRL;

(g) the definition of integral would be crucial as there are different approaches on how it could be interpreted.

6 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.

EFRAG Draft Comment Letter

7 The EFRAG Secretariat has uploaded the agenda paper 06-02 *EFRAG Draft Comment Letter* for discussion. This agenda paper was based on the key messages discussed by EFRAG TEG in December 2019 and updated to reflect the feedback received from EFRAG TEG and EFRAG Board in December 2019. The changes to the document are:

(a) 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;

(b) suggested that the financing category should be related to "funding of the entity's main activities" and the investing category related to entity's investments in assets, including the allocation of excess cash to investments;

(c) welcomed the IASB's effort to provide more discipline on the use of Management Performance Measures (MPMs) but not supported the scope of the IASB proposals. EFRAG would rather support disclosures on MPMs that are presented inside the financial statements. EFRAG acknowledges that not all jurisdictions have guidance on the use of APMs outside the financial statements and to address this issue, EFRAG suggests the IASB to consider introducing the proposals on MPM in the IFRS Practice Statement 1 Management Commentary. Also suggested that if entities used MPMs other than those prepared under IFRS 8 *Operating Segments*, they should explain why.

(d) suggested 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;

(e) highlighted that the scope of the proposals on unusual items is too narrow and suggested the IASB to further consider the scope of its proposals by, for example, requiring similar disclosures on items identified in paragraph B15 of the ED (write-downs, restructurings, disposals of items of property, plant and equipment; disposals of investments; litigation settlements; and reversals of provisions).'

Questions for EFRAG TEG

8 Does EFRAG TEG recommend the Draft Comment Letter to the EFRAG Board?

European Single Electronic Formal and IFRS Taxonomy Update

9 EFRAG Board and EFRAG TEG have mentioned about the interaction of the IASB's project Primary Financial Statements and the European Single Electronic Formal and IFRS Taxonomy Update. However, the EFRAG Secretariat has not included any reference to this interaction in the Draft Comment Letter.

10 This is because the EFRAG Secretariat assesses that, at this stage, no issues have been identified when considering how the IASB proposals will interact with the ESEF regulation. In particular, the EFRAG Secretariat highlights that:

(a) the new IASB proposals will impact the IFRS Taxonomy, as normally it is the case for any IASB Amendment or new Standard, and there will be changes to the Taxonomy resulting from this ED. As ESEF builds on the IFRS taxonomy, once the changes to the IFRS Taxonomy will occur, the ESEF regulation will capture them;

(b) the IASB proposals on new subtotals and line items are likely to improve the quality of financial reporting, thus more generally also the quality of electronic financial reporting. This is because the new proposed defined subtotals and line items would improve comparability. For example, with the IASB proposals operating profit or loss would be an IFRS defined subtotal. Thus, such subtotals would be comparable when tagged. Currently, when entities tag 'operating profit or loss', such measure is not comparable as companies use different definitions and labelling for operating profit or loss;

(c) during implementation/transition, if an APM or MPM is used by a preparer without being fully compliant with the definition provided by the IASB on the presentation of the financial statements, then it should not be linked to a so-called "full IFRS" tag i.e. a tag that is already defined in the IFRS taxonomy (and carried forward in the ESEF taxonomy). Such measures would be linked to a tag that is created by the preparer and identifiable as such;

(d) the IASB proposals on MPMs would not significantly impact ESEF as notes will be marked up by applying mark-ups for whole sections of the notes (block tagging). Therefore, when the disclosures on MPMs are tagged, users will see the whole section of the notes that would include reconciliations of MPMs with IFRS defined measures.

ESMA Guidelines on Alternative Performance Measures

11 The EFRAG Board and EFRAG TEG have questioned about the interaction of the IASB proposals with the ESMA Guidelines on APMS. At this stage, the EFRAG Secretariat assesses that:

(a) **Scope considering the type of measure:** the scope of MPMs is narrower than APMs when considering the type of measures. **MPMs are only subtotals** of income and expenses that are used in public communications outside financial statements and complement totals or subtotals specified by IFRS Standards and communicate to users of financial statements management's view of an aspect of an entity's financial performance; while

APMs is a wider concept, that includes ratios, financial measure of historical or future financial performance, financial position, or cash flows, other than a financial measure defined or specified in the applicable financial reporting framework. It is not clear at this stage whether and to what extent ESMA's guidelines will need to be reconsidered in the future, to adjust the meaning of 'financial measure defined or specified in the applicable financial reporting framework.'

(b) **Scope considering where it is published**: the scope of MPMs seems to be generic as it is related to "public communication" while APMs are related to regulated information and prospectuses (and supplements).

(c) **Reconciliations**. Both the IASB and ESMA require reconciliations. However, the scope is different:

(i) In accordance with paragraph 106 of the ED, **entities would be always required to present a reconciliation** between the MPM and the most directly comparable IFRS subtotal or total included in the statement of financial performance, including the income tax effect and the effect on non-controlling interest for each item disclosed in the reconciliation.

(ii) In accordance with paragraph 29 of ESMA Guidelines on APMs, **where an APM is 'directly identifiable from the financial statements' no reconciliation is required.** This applies for example when an APM is a total or subtotal presented in financial statements. ESMA has further clarified that where APMs directly identifiable from financial statements are also disclosed outside financial statements, the issuer or the persons responsible for the prospectus do not need to provide a reconciliation between the APM used and the most directly reconcilable line item, total or subtotal presented in financial statements.

The EFRAG Secretariat has explained this interaction in the notes to constituents in the Draft Comment Letter.

Questions for EFRAG TEG

ESMA APM guidelines and the IASB ED (related to questions 2 and 11 of the ED)

12 The ED is introducing a requirement to present on the face of the income statement a new subtotal named "operating profit or loss", which will become an IFRS defined measure. Entities that currently use a performing measure labelled "operating profit or loss" on the face or in the notes will be forced to either (i) change the label for their performing measure and continue to use both the old measure and the new IFRS defined "operating profit", or to (ii) discontinue the pre-existing performance measure, replacing its use with the new IFRS defined "operating profit or loss". EFRAG secretariat assesses that in both cases appropriate explanations and education of users will be needed in the first years of the new regulation. In the first case, the number of APM used will be the same, as the old APM will be renamed and will continue to be used. In the second case the number of APM will be reduced. In both cases there will be a positive impact in terms of comparability of the measures presented on the face.

Do TEG members agree with this assessment? Do EFRAG TEG members consider that there is a need to change the proposed draft comment letter following the considerations above? (Question to constituents: "Would constituents that are preparers go for approach (i) or (ii)?")

13 From one hand, the ESMA APM guidelines require entities to provide explanations and reconciliations with the most close IFRS equivalent measure, when they use performance measures that are not IFRS measures. From the

other hand, the IASB ED attracts in the scope of application of the IASB proposals on MPM those performance measures that are subtotals, when they are used in public communication (i.e. inside or outside the financial statements). The ED may be interpreted as attributing IFRS relevance to such subtotals, which would be indirectly defined by accounting policies illustrated by the entities through the reconciliations with subtotals that are on the face. If the ED is attributing to an MPM a status of IFRS defined measure', then one can argue that the number of APMs and reconciliations under ESMA guidelines may decrease. If not, then one can argue that the information of APMs and MPMs on performance would be relatively similar.

Do TEG members agree with this assessment?

Early Stage Analysis

14 The EFRAG Secretariat has prepared an Early Stage Analysis paper (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.

15 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 management performance measures, to provide a complete picture of the possible impact of the ED.

16 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.

Questions for EFRAG TEG

17 Does EFRAG TEG agree that the ESA is attached to the DCL as a tool to enhance constituent's understanding of the proposals?

18 Does EFRAG TEG suggest the EFRAG Secretariat to extend the scope of its research for ESA during the comment period? In which direction?

Agenda Papers

19 In addition to this cover note, the EFRAG Secretariat provided Agenda Paper 06-02 – EFRAG Draft Comment Letter.