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## **Primary Financial Statements Cover Note**

### **Objective**

- 1 The objective of the session is to:
  - (a) Provide EFRAG CFSS members a brief update on the IASB's redeliberations on the proposals in the Exposure Draft *General Presentation and Disclosures* and seek general advice on way forward; and
  - (b) Obtain EFRAG TEG-CFSS members' views on the analysis of operating expenses by nature in the notes when an entity provides analysis of operating expenses by function in the statement of profit or loss

### **Agenda Papers**

- 2 In addition to this cover note, agenda papers for this session are:
  - (a) Agenda paper 11-02 – Slide Presentation
  - (b) Agenda paper 11-03 – IASB tentative Decisions and EFRAG FCL – (background only);
  - (c) Agenda Paper 11-04 - AP3 PFS\_ASAF March 2022 (background only)
  - (d) Agenda Paper 11-05 - AP3A PFS Appendix\_ASAF March 2022 (background only)

### **Background**

- 3 On 17 December 2019, the IASB published the ED [General Presentation and Disclosures](#) where the ultimate objective is to replace IAS 1 *Presentation of Financial Statements* with a new Standard that would comprise new requirements on presentation and disclosures in the financial statements and requirements brought forward from IAS 1 with only limited changes to the wording. In particular, the IASB proposed:
  - (a) requiring companies to present additional defined subtotals/categories in the statement of profit or loss;
  - (b) strengthening requirements for disaggregating information; and
  - (c) requiring companies to disclose information about management performance measures (MPMs) in the notes.
- 4 In November 2020, EFRAG issued its [Final Comment Letter](#) where it welcomed the ED and the IASB's efforts to improve the structure and content of the primary financial statements. It also supported the IASB's proposals to present an operating, investing and financing category in the statement of profit or loss to improve

comparability and reduce diversity in practice. However, EFRAG had reservations over some of the proposals in the ED. Also in November 2020, EFRAG published its [feedback statement](#), which summarised the main comments received by EFRAG and explained how those comments were considered by EFRAG.

- 5 In January 2021, the IASB discussed and agreed on a redeliberation plan, which was based on four main factors (the project objectives and its focus; the linkages between project topics; timeliness and efficiency). Since then, the IASB has been progressing on its re-deliberations and making a number of tentative decisions (for more details, please see the tables below and the Agenda Paper 11-05).
- 6 EFRAG TEG-CFSS members already discussed the IASB’s redeliberation plan ([EFRAG TEG-CFSS in March 2021](#)) and some of the IASB’s tentative decisions ([EFRAG TEG-CFSS in September 2021](#)). In those meeting, members:
  - (a) welcomed the IASB’s plan for re-deliberations and agreed to have a stage approach for some topics and to give priority to topics supported by stakeholders. Nonetheless, members noted that it may be more efficient to first focus on the statement of profit or loss, particularly when considering that disclosure is, to some extent, a contentious topic.
  - (b) highlighted the importance of clarifying the notion of main business activities;
  - (c) highlighted the importance of the interaction of the definitions of operating profit or loss, unusual items and MPMs;
  - (d) expressed preference for having MPMs not only being related to the statement of financial performance but also to the balance sheet and to the cash flow statement; Also questioned whether cross-referencing would be allowed for MPMs; and
  - (e) advised that a project on IAS 7 was important, particularly when considering the new developments in crypto assets.

### Project Status

- 7 The IASB’s redeliberations are moving forward (please see table below), however the IASB does not have yet an expected date for the end of its deliberations. It is also worth noting that at the timing of writing this agenda paper the IASB has not yet redeliberated its proposals for entities with particular main business activities, such as banks, insurance companies and financial conglomerates.

Topic	Proposals discussed by the IASB	Proposals yet to be redeliberated
<b>Subtotals</b>	<ul style="list-style-type: none"> <li>• Required subtotals</li> <li>• Classification in categories, general model</li> <li>• Associates and joint ventures</li> </ul>	<ul style="list-style-type: none"> <li>• Classification by entities with specified main business activities</li> <li>• Remaining issues related to investing and financing categories</li> </ul>
<b>MPMs</b>	<ul style="list-style-type: none"> <li>• Scope and definition</li> <li>• Disclosure of reconciliation</li> </ul>	<ul style="list-style-type: none"> <li>• Disclosure of tax and non-controlling interest</li> <li>• Single note, columns, cross-referencing, relationship with segments and other</li> </ul>
<b>Disaggregation</b>	<ul style="list-style-type: none"> <li>• Roles of primary financial statements and notes</li> </ul>	<ul style="list-style-type: none"> <li>• Definition of unusual income and expenses, related disclosures</li> <li>• Disclosure of operating expenses</li> </ul>

Primary Financial Statements – Cover Note

	<ul style="list-style-type: none"> <li>• General principles of aggregation and disaggregation</li> <li>• Direction for unusual income and expenses</li> <li>• Presentation of operating expenses</li> <li>• Direction for disclosure of operating expenses</li> </ul>	<ul style="list-style-type: none"> <li>• Proposals relating to items labelled 'other' and other remaining general disaggregation topics</li> <li>• Consequential amendments</li> </ul>
<b>Cash flow statement</b>	<ul style="list-style-type: none"> <li>• Most issues related to Statement of Cash Flows</li> </ul>	<ul style="list-style-type: none"> <li>• Remaining proposals for statement of cash flows</li> </ul>

**Key changes to the ED**

8 During its redeliberations, the IASB has tentatively decided to retain many of its proposals in the ED. Nonetheless, the IASB has also decided to change many of its proposals. The main changes are described below.

<b>Subtotals and categories</b>	<ul style="list-style-type: none"> <li>• Classification of income and expenses from cash and cash equivalents from financing to the investing category (<i>considered by EFRAG TEG-CFSS in September 2021</i>).</li> <li>• Approach to classification of items in the financing category (<i>considered by EFRAG TEG-CFSS in September 2021</i>).</li> <li>• Default category for gains and losses from derivatives and hedging instruments changed from investing to the operating category (<i>considered by EFRAG TEG-CFSS in September 2021</i>).</li> <li>• Undue cost or effort relief for FX classification (<i>considered by EFRAG TEG-CFSS in September 2021</i>).</li> <li>• Distinction between integral and non-integral associates and joint ventures removed as well as related subtotal.</li> <li>• Add application guidance for some income and expenses in investing category, include objective in the Basis for Conclusions, and remove definition of 'income and expenses from investments'.</li> <li>• Income and expenses from associates and joint ventures classified in investing category.</li> </ul>
<b>Disaggregation</b>	<ul style="list-style-type: none"> <li>• Include a reference to understandability in the description of the role of financial statements (<i>discussed by EFRAG TEG-CFSS in September 2021</i>).</li> <li>• Emphasise that single dissimilar characteristic can be enough to disaggregate if it is material (<i>discussed by EFRAG TEG-CFSS in September 2021</i>).</li> <li>• State the purpose of disaggregation more clearly and strengthen the application of disaggregation (<i>discussed by EFRAG TEG-CFSS in September 2021</i>).</li> <li>• Provide additional guidance to apply the principles, both in the primary financial statements and the notes.</li> <li>• Remove the proposed prohibition on a mixed presentation approach for operating expenses.</li> <li>• Remove 'limited predictive value' from definition of unusual items and add application guidance.</li> <li>• Revise the general principle for the presentation of line items and add application guidance.</li> </ul>

<b>MPMs</b>	<ul style="list-style-type: none"> <li>• Subtotal of income and expense used in the numerator or denominator of a ratio is MPM (<i>discussed by EFRAG TEG-CFSS in September 2021</i>).</li> <li>• In the definition, remove the reference to ‘complementing’.</li> <li>• Introduce a rebuttable presumption that a subtotal used in public communications represents management’s view of an aspect of the entity’s financial performance, and add application guidance on rebuttal.</li> <li>• Add application guidance, and refer to general requirement for faithful representation, removing specific requirement.</li> <li>• Application guidance for disclosure of why an MPM communicates management’s view of performance.</li> <li>• Disclose, for each reconciling item, amount(s) related to each line item in the statement(s) of financial performance.</li> </ul>
<b>Other</b>	<ul style="list-style-type: none"> <li>• Amend the specified subtotal ‘operating profit or loss before depreciation and amortisation’ to exclude impairments of assets within the scope of IAS 36</li> </ul>

**Disclosure of operating expenses by nature in the notes for entities that report by function**

*IASB Proposals in the ED*

- 9 In the ED, the IASB proposed that entities continue to present an analysis of operating expenses using either the nature of expense method or the function of expense method. However, the method presented should be the one that provides the most useful information to users (factors would have to be considered when deciding which method should be used).
- 10 In addition, an entity that presents an analysis of operating expenses using the function of expense method in the statement of profit or loss would also be required to disclose in a single note an analysis of its total operating expenses using the nature of expense method.
- 11 Finally, the ED proposed prohibition on mixing the methods.

*EFRAG Comment Letter*

- 12 In its comment letter EFRAG supported the IASB’s proposal on the analysis of expenses using either by-function or by-nature method, based on whichever method provides the most useful information to the users. However, EFRAG:
  - (a) mentioned that a better description of the by-function and by-nature methods was needed (e.g. lack of guidance on the presentation of cost of goods sold and administrative expenses), particularly if the IASB decided to not allow a mixed presentation basis;
  - (b) referred to some of the concerns received about the application of paragraph B45 of the ED;
  - (c) called for the IASB to clarify its primary objective for the presentation of expenses by nature or by function, including the role and scope of a mixed basis of presentation (i.e. clearly state what a mixed presentation basis is and when it is allowed), particularly for insurers and financial conglomerates;
  - (d) acknowledged the benefits for users of having information by nature and the related costs for preparers. EFRAG also highlighted that both users and preparers were likely to accept a more balanced outcome (e.g. providing a partial presentation by nature of some fundamental operational expenses);

- (e) recommended that the IASB further investigates the cost/benefit of its proposals to disclose on a by-nature basis in the notes when presenting by-function;
- (f) requested the IASB to further clarify whether and how the proposed requirement in paragraph 72 of the ED is to be applied when entities are required to present on a mixed basis.

*Current status and partial matrix approach*

- 13 In terms of presentation in the statement of profit or loss, the IASB has tentatively decided to explore providing limited application guidance on the ‘function of expense’ method set out in paragraph 70 of the ED (e.g. require a narrative disclosure of the composition of functions and the presentation method used must be consistent from one reporting period to the next - see IASB tentative decision in [October 2021 Agenda Paper 21B](#)).
- 14 In terms of disclosures in the notes, some respondents to the IASB’s ED indicated that limited disaggregation of (some) functions into expenses by nature ( a partial matrix ) would be less costly for preparers and more useful for users than disclosing only totals of expenses by nature (e.g. depreciation, amortisation and employee benefits).
- 15 The IASB has asked its staff to develop a better understanding of whether a ‘ partial matrix’ could achieve a better cost benefit balance than the proposal in the ED (October 2021 Agenda Paper 21C). Possible way forwards include:
  - (a) **Partial matrix 1** – The IASB specifies which expenses by nature to be disaggregated by function – slide 22;
  - (b) **Partial matrix 2** – The IASB specifies the functions to be disaggregated by nature – slide 23
- 16 The IASB staff noted that outreach with preparers is necessary to determine whether a partial matrix would be a feasible solution to the cost concerns expressed with regards to the proposal in the ED. Nonetheless, initial discussions with preparers suggested that a partial matrix could be equally or more costly than the proposal (eg that disaggregation of cost of sales would be very challenging for entities using standard costing systems).

**EFRAG Secretariat analysis**

*Project status and redeliberations to date by topics*

- 17 The EFRAG Secretariat agrees with the IASB’s approach for redeliberation’s until now, however highlights the importance of ensuring that both its decision on presentation and disclosures are relevant for entities with specified main business activities (e.g. financial institutions). Therefore, the IASB should proceed with its discussions on the different topics (for all corporate entities) and ensure at the end of the discussions that the proposals are adequate for entities with specified main business activities (e.g. financial institutions).
- 18 In addition to the concerns already raised in September 2021 ([agenda paper 08-01](#)), the EFRAG Secretariat highlights:
  - (a) **Investing category:** The IASB has tentatively decided to add further application guidance to ensure consistent application. For example, application guidance on the classification of income and expenses that arise from business combinations and negative returns (such as negative interest rates). However, at this stage the IASB has not provided additional guidance on incremental expenses.

- (b) **Financing category, including classification of hybrid contracts with host liabilities and embedded derivatives:** the IASB tentatively decided not to proceed with a change to the definition of 'financing activities' in IAS 7 *Statement of Cash Flows*. Instead, it tentatively decided to change its approach on the classification of items in the financing category and to add new detailed guidance (e.g., hybrid contracts). This may be considered a significant change to the ED, which respondents have not had yet the opportunity to comment. Considering this, the EFRAG Secretariat recommends the use of consultative groups and targeted consultation to support the IASB's decision to finalise its proposals.
- (c) **Equity-accounted associates and joint ventures:** The IASB's tentative decision to not require identification and separate presentation of integral and non-integral associates and joint-ventures is not aligned with EFRAG's comment letter (EFRAG agreed with the distinction but called for more application guidance). The IASB's decision to require an entity to include income and expenses from equity-accounted associates and joint ventures in the investing category is also not aligned with EFRAG comment letter (EFRAG highlighted that equity accounted investments may need to be reported in the operating category in particular circumstances). Finally, the IASB has not yet provided clarifications on how the IASB's proposals would apply to subsidiaries, associates and joint ventures in the separate financial statements.
- (d) **Presentation of operating expenses by nature or by function:** The IASB's tentative decisions are fairly aligned with EFRAG comment letter. In particular, the IASB's decision to provide more application guidance on the function of expense. The EFRAG Secretariat notes that the IASB's decision to withdraw the proposed prohibition on a mixed presentation reduces the pressure on the distinction between presentation by-function and by-nature. However, the EFRAG Secretariat considers that the IASB should clarify when and to which extent entities may use mixed presentation, particularly when considering minimum line items, financial conglomerates and use of 'unusual items' on the face (e.g. restructurings).
- (e) **Minimum line items:** the IASB has not yet considered requiring, through minimum line items or subtotals, disaggregation of equity on the face of the statement of financial position.
- (f) **Unusual items:** Although the IASB has not concluded its discussions on unusual items and has decided to develop application guidance accompanying the definition of unusual income and expenses, the EFRAG Secretariat assesses that the IASB has not clarified or addressed, at this stage, most of EFRAG's requests (e.g. whether the whole amount should be recognised as unusual or only the incremental part of it when the amount varies significantly from previous periods). The EFRAG secretariat also highlights that the definition of unusual items continues to seem to be narrow, as it focuses on whether expenses/income will occur in the future.
- (g) **MPMs – Definition** - The IASB has addressed some of the concerns related to narrowing the definition of public communication. However, the EFRAG secretariat expresses concerns about the IASB tentative decision to establish a rebuttable presumption that a subtotal of income and expenses included in public communications outside financial statements represents management's view of an aspect of the entity's financial performance and to provide high-level application guidance on how to assess whether the entity has reasonable and supportable information to support the rebuttal.

This would increase the complexity and amount of disclosures related to this topic. Instead, the EFRAG Secretariat would prefer an improved definition of MPMs, which clearly states which measures are in the scope (i.e. those developed by management and not defined or specified by IFRS) and which measures are typically out of the scope (e.g. performance measures developed and required by regulators).

- (h) **MPMs - Disclosures:** the IASB 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, is a significant change to the ED which has not been tested and respondents have not had the opportunity to comment. The ED itself was less prescriptive and the illustrative example provided by the IASB in its ED (which was in line with the IASB tentative decision as it was combined with information on unusual items) was just a way of providing the information (not a specific format that was required in the main standard).
  - (i) **EBITDA:** the IASB has considered that issue of excluding impairments from assets that are amortised or depreciated. However, the IASB has not yet clarified whether EBITDA and other similar measures should be included in the scope of the IASB's proposals regarding MPM disclosures if they do not represent operating profit or loss before depreciation, amortisation, and specified impairments'.
- 19 For more details, please see agenda paper 11-03 – IASB tentative decision and EFRAG FCL.

*Disclosure of operating expenses by nature in the notes*

- 20 The EFRAG Secretariat highlights that paragraph 104 of IAS 1 already requires entities that classify expenses by function to disclose additional information on the nature of expenses. In particular, it requires disclosures on depreciation and amortisation expense and employee benefits expense.
- 21 However, from EFRAG's outreach activities and comment letters, the EFRAG Secretariat acknowledges
- (a) that many entities currently using a 'function of expense' method fail to disclose additional information on the nature of expenses and if such information is presented, it may be scattered across several notes.
  - (b) many users consider that information on the nature of expenses is useful in predicting future cash flows and that only a few natural items are specifically required in paragraph 104 of IAS 1 (ie depreciation, amortisation and employee benefits expense).
  - (c) many preparers disagree with the requirement to disclose additional information on the nature of expenses when classifying expenses by function because they are unable to provide this information with their current accounting systems.
  - (d) both users and preparers were likely to accept a more balanced outcome (e.g. providing a partial presentation by nature of some fundamental operational expenses).
- 22 Considering this, the EFRAG Secretariat considers that the IASB could take some steps to improve current requirements, including:
- (a) give more prominence to the existing requirements in paragraph 104 of IAS 1;
  - (b) make clear that disclosures required in paragraph 104 of IAS 1 should be presented in a single note;

- (c) relate these disclosures to the operating profit or loss category (as proposed in the ED);
  - (d) extend the list of natural items that are specifically currently required in paragraph 104 of IAS 1 (which would be included in a single note). For example, refer to the natural items already required by IAS 1 (e.g., ‘costs of restructuring’ as required in paragraph 98 of IAS 1) and other IFRS Standards (e.g., ‘impairment losses’ as required by paragraph 136 (a) of IAS 36), subject to materiality. In addition, confirm with users which natural items are fundamental for them, in addition to those already mentioned in the previous paragraph.
  - (e) mention in the application guidance that a disclosure in a ‘partial matrix’ form could be a useful way of presenting the information and include such format as an illustrative example (as a way of presenting the information but not as a requirement, similar to the approach taken in IFRS 15 for the disaggregation of revenue).
- 23 The EFRAG Secretariat considers that requiring disclosures based on a ‘partial matrix’ (which could be based on an expanded list of natural items required in paragraph 104 of IAS 1) could be useful for users but costly for some preparers. Therefore, the EFRAG Secretariat considers that after identifying the “expanded list of natural items”, the IASB Staff could consider whether a requirement, rather than example, would meet the cost-benefit threshold.

**Questions for EFRAG TEG-CFSS**

- 24 Given the IASB’s tentative decisions on the proposals to date (slides 9-13 of agenda paper 11-04), do you have any suggestions in approaching the remaining topics to be redeliberated?
- 25 Some of the IASB tentative decisions could be seem as a fundamental change to the ED and current practice which respondents have not had the opportunity to comment (e.g. changes to the proposed categories and MPMs). Do you think it would be useful to make target consultation to support a decision to finalise a proposal without the need for re-exposure? If so, which topics?
- 26 In your jurisdiction:
- a) compared to the proposal in the ED are there particular benefits or costs associated with a partial matrix approach that the IASB should consider; and
  - b) is a particular approach preferable and why?
- 27 Do you have any additional suggestions with regards to potential standard setting the IASB could provide to alleviate costs of a partial matrix (slide 27 of agenda paper 11-04)?