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## Primary Financial Statements Cover Note

### Objective

- 1 The objective of the session on *Primary Financial Statements* project is threefold:
  - (a) to seek EFRAG FR TEG – CFSS interest to conduct targeted outreach on some proposals on the project;
  - (b) to discuss disclosure of operating expenses by nature based on the IASB's recent deliberations on the topic; and
  - (c) to seek EFRAG FR TEG-CFSS's views on the IASB's recent discussions and proposed direction for income and expenses with limited recurrence (unusual income and expenses).
- 2 This agenda paper is structured as follows:
  - (a) Background on the IASB's project;
  - (b) Targeted outreach;
  - (c) Disclosure of operating expense by nature;
  - (d) Income and expenses of limited recurrence (unusual income and expenses).

### Background on the IASB's project

- 3 On 17 December 2019, the IASB published the Exposure Draft [General Presentation and Disclosures](#) ('ED') 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.

### Targeted outreach

- 5 In H2 2022, the IASB plans to conduct targeted outreach on some topics of the project to assess whether the IASB's tentative decisions to change some of its proposals in the ED will function as intended, including costs and benefits of proposals that were not in part of the initial ED. The IASB is interested to hear from all stakeholders through EFRAG FR TEG-CFSS network on the following targeted topics:
- (a) *Income and expenses of limited recurrence (unusual income and expenses)*
  - (b) *Disclosure of operating expenses by nature*
  - (c) Management performance measures – rebuttable presumption
  - (d) Change in approach for classifying income and expenses within the financing category
  - (e) Aspects of proposals for entities with specified main business activities (to be discussed at a future IASB meeting)

### EFRAG Secretariat analysis

- 6 The EFRAG Secretariat considers that it would be useful to test the key changes proposed by the IASB, including:
- (a) the IASB's new approach on the classification of items in the financing category;
  - (b) the classification of hybrid contracts with host liabilities and embedded derivatives;
  - (c) the new application guidance for unusual items;
  - (d) a solution for the analysis of expenses by nature in the disclosures when presenting by function;
  - (e) the inclusion in the scope of the requirements for MPMs the numerator or denominator of a ratio, if that numerator or denominator meets the definition of a MPM; and
  - (f) how the IASB's proposals on the statement of cash flows in the project *Primary Financial Statements* will interact with a potential project on IAS 7 *Statement of Cash Flows*.

#### Question for EFRAG FR TEG/CFSS

- 7 Would EFRAG FR TEG-CFSS like to conduct targeted outreach on the topics included in paragraph 5(a) and 5(b) above? Do you have any comments on the proposed topics and timing for targeted outreach?

### Disclosure of operating expense by nature

#### ED's proposals

- 8 The ED's initial proposal with respect to disclosure of operating expenses is to require an entity that presents an analysis of operating expenses using the function of expense method in the statement of profit or loss to also disclose in a single note an analysis of its **total operating expenses** using the nature of expense method. The proposal is illustrated with an example included in Appendix 1 to this paper.

*Feedback received*

- 9 Feedback from consultation on this topic was mixed. Some respondents agreed that the analysis of expenses would provide comprehensive information and help users make forecasts as well as enhance comparability because it was less judgmental than analysis by functions. However, other respondents disagreed with the proposals and commented that both methods were equally relevant, but the proposals seem to favour by-nature analysis and the costs of providing the analysis by nature would be higher than the benefits. Furthermore, feedback from fieldwork identified practical difficulties with the proposed requirements.

*IASB's redeliberations*

- 10 In April 2022, the IASB discussed the feedback received and considered a partial matrix approach of how to disclose operating expense by nature to provide a potential solution. The partial matrix approach is illustrated in paragraphs 2 and 3 of Appendix 1.
- 11 Based on the feedback received and its April discussion, the IASB suggested that requiring an entity to disclose, at a minimum, the amounts of depreciation, amortisation, and employee benefits included in each line item(s) in the statement of profit or loss could be an alternative to the proposal in the ED that better balances costs and benefits.
- 12 As next steps on this topic, the IASB plans to explore:
- (a) whether additional expense items could be added to a requirement to disclose amounts included in each line item in the statement of profit or loss; and
  - (b) whether, for the expense items selected, the requirement should be to disclose any related line items in the statement of profit or loss, or any related functions (whether presented or disclosed).

*EFRAG Secretariat analysis*

- 13 EFRAG Secretariat is of the view that requiring a single note of line items by nature already required to be disclosed in other IFRS Standards could be a potential solution. For example:
- (a) IAS 1 *Presentation of Financial Statements* - requires an entity classifying expenses by function to disclose additional information on the nature of expenses, including depreciation and amortisation expense and employee benefits expense (paragraph 104); circumstances that would give rise to the separate disclosure of items of income and expense include write-downs, restructurings, disposals, discontinued operations, litigation settlements (paragraph 96); gain/loss on disposal of property, plant and equipment (paragraph 97-98);
  - (b) IAS 2 *Inventories*: requires disclosure of cost of inventories recognised as expenses, write-downs of inventories and reversals of write-downs (paragraph 36);
  - (c) IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*: requires disclosure of government grants towards training costs, amortisation of government grants towards purchase of property, plant and equipment (paragraph 39);
  - (d) IAS 21 *The Effects of Changes in Foreign Exchange Rates*: requires net foreign exchange losses/(gains) (paragraph 52);
  - (e) IAS 36 *Impairment of Assets*: disclosure of impairment of property, plant and equipment (paragraph 126); impairment of goodwill (paragraph 126);
  - (f) IAS 38 *Intangible Assets*: requires disclosure of research and development costs (paragraph 126);

- (g) IFRS 7 *Financial Instruments: Disclosures*: requires disclosure of loss allowance on trade receivables, loss allowance on other financial assets measured at amortised cost, loss allowance on debt investments measured at FVTOCI, loss allowance on amounts due from contract assets (paragraph 20);
  - (h) IFRS 16 *Leases*: requires disclosure of depreciation of right-of-use-asset (paragraph 53).
- 14 Illustration of the proposed recommendation is included in paragraph 4 of Appendix 1.

**Question for EFRAG FR TEG/CFSS**

- 15 Does EFRAG FR TEG-CFSS have any comments on the basis for the way forward and next steps being explored for the analysis of operating expenses by nature in the notes when an entity reports operating expenses by function in the statement of profit or loss?

**Income and expenses of limited recurrence (unusual income and expenses)**

*ED's proposals*

- 16 The ED proposed introducing a definition of 'unusual income and expenses'; and proposed requiring all entities to disclose unusual income and expenses in a single note. The proposed definition determined unusual income and expenses as income and expenses with limited predictive value. Income and expenses have limited predictive value when it is reasonable to expect that income or expenses that are similar in type and amount will not arise for several future annual reporting periods. Income and expenses from the recurring remeasurement of items measured at a current value would not normally be classified as unusual.
- 17 With respect to disclosure related to unusual income and expenses, the ED requires companies to disclose, in a single note, for each unusual item:
- (a) the amount recognised in the period;
  - (b) a narrative description of how it arose and why it meets the definition of an unusual item;
  - (c) in which line item(s) in the statement of profit or loss it is included; and
  - (d) an analysis by nature, if the company presents operating expenses by function in the statement of profit or loss.

*Feedback received*

- 18 Many respondents agreed that the IASB should define unusual items. Respondents indicated that defining unusual items would be useful as it will provide consistent input for users' analysis for identifying recurring or normalised earnings without having to rely on voluntary disclosures by entities. A few respondents also commented that defining unusual items would reduce opportunistic classification of items as unusual.
- 19 Most of the respondents, however, did not agree with the IASB's definition of unusual items. They said important aspects of the definition were unclear and suggested various clarifications and changes which did not lead to a clear consensus on what an alternative definition should be. There were concerns over:
- (a) the scope of the items captured in the proposed definition (i.e., comparison with the past as well as the future, items that are expected to arise in more than one reporting period);
  - (b) the subjectivity inherent in the proposed definition – more guidance needed.

- 20 Regarding disclosures of unusual items, respondents were split with respect to the proposed disclosure in a single note:
- (a) some respondents preferred presentation in the statement of profit or loss because it would provide a clear ‘normalised’ profit amount, but others thought that would add clutter to the statement and provide an incentive for opportunistic labelling of items as unusual;
  - (b) some respondents agreed with disclosure in a single note because it would allow easy access to the information and help in tracking the items classified as unusual over time;
  - (c) others respondents were of the view that it would be more helpful to include the information in the notes for the specific items of income and expenses in question, for example the notes for IAS 37 Provisions or IAS 36 Impairments. These respondents also commented that the requirement for a single note disclosure could lead to duplication of information required by other IFRS Standards or regulations to be given elsewhere.

*IASB’s redeliberations*

- 21 So far, with respect to unusual items the IASB tentatively decided:
- (a) to explore how to proceed with a definition of unusual items acknowledging that a ‘perfect’ answer may not be possible;
  - (b) to remove the reference to ‘limited predictive value’ from the definition of ‘unusual income and expenses’ and to clarify that it is a necessary characteristic of unusual income and expenses, not the sole characteristic;
  - (c) to develop the application guidance accompanying the definition of ‘unusual income and expenses’:
    - (i) to clarify that the definition means that ‘unusual income and expenses’ can be dissimilar in type or amount from income and expenses expected in the future;
    - (ii) to provide guidance and help entities to assess whether similar income or expenses will arise in the future based on future transactions and other events in other IFRS;
  - (d) to label the items captured by the definition as ‘income and expenses with limited recurrence’. The IASB will consider whether to also restrict the use of the label ‘unusual income and expenses’ at a future meeting;
  - (e) to proceed with the following **working definition**
    - Income and expenses have limited recurrence when it is reasonable to expect that income or expenses that are similar in type and amount will cease, and once ceased will not arise again, before the end of the assessment period.*
  - (f) to explore how to define the **assessment period**, for example by linking it to the period of budgets and forecasts or specifying a minimum and/or maximum number of years.

*Working definition*

- 22 The working definition as proposed by the IASB is consistent with the proposal in the ED because:
- (a) similar income and expenses can have arisen in the past; and
  - (b) income and expenses will be captured by the definition if they are dissimilar in type or amount to expected ongoing income or expenses;

- 23 However, the working definition introduces a change from the ED because similar income and expenses can be expected to arise within the assessment periods, as long as they cease by the end of the assessment period.
- 24 The IASB initial discussion on the working definition of unusual items indicated some potential concerns about some items that would meet the definition, for instance, revenue lower than expected in the future because of an expected future acquisition. Therefore, there might be a need to consider *possible constraints* on the definition such as:
- (a) requiring a comparison with past income and expenses;
  - (b) limiting the definition to income and expenses that are dissimilar to future expected income or expenses *in type*, i.e. do not include income and expenses that are only dissimilar *in amount*;
  - (c) requiring the comparison to future income and expenses to be based on future events for which there is sufficient objective evidence, consistent with the requirements in IAS 37 on when future events should be reflected in a provision.

*Assessment period*

- 25 In the IASB's preliminary deliberations, the assessment period is considered to be the future period in which the entity needs to make an assessment of whether similar income or expenses are expected to arise. However, setting the assessment period:
- (a) too short might result in the definition of unusual items being:
    - (i) too restrictive by excluding items even though they are expected to arise over only a few annual periods (because they do not cease soon enough); or
    - (ii) too broad by capturing items that are expected to arise in the future but not immediately (because they do not arise again soon enough).
  - (b) too long might result in the definition of unusual items being:
    - (i) too broad by capturing items that are expected to arise for many periods;
    - (ii) too restrictive by excluding items that are not expected to arise again for many years.

- 26 Possible ways of setting the *assessment period*:

- (a) link to period of budgets and forecasts;
- (b) period or range specified by the IASB (i.e. 2-4 years);
- (c) period decided by the entity

*EFRAG Secretariat analysis*

- 27 The EFRAG Secretariat welcomes the IASB's efforts to improve the definition of unusual or non-recurrent items.
- 28 In EFRAG's Comment Letter, EFRAG stated that the definition of unusual items seemed to be rather narrow, as it only focused on whether expenses/income would occur in the future. Instead, EFRAG suggested that the IASB considered not only items that 'will not arise for several future annual reporting periods' (as expressed in the ED) but also items that presently occur 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).
- 29 It seems that the IASB's discussions are in line with EFRAG request in its Comment Letter to make the definition wider.

**Question for EFRAG FR TEG/CFSS**

- 30 Does EFRAG FR TEG-CFSS have any comments on the possible constraints to the working definition of income and expenses of limited recurrence? Do you have any comments on the assessment period?

**Agenda Papers**

- 31 In addition to this cover note, agenda paper 12-02 – *ASAF Agenda paper AP6 Primary Financial Statements* – has been provided for the session.

## Appendix 1: Disclosure of operating expense by nature – illustrative example

- 1 To demonstrate the IASB’s proposal to disclose operating expenses by nature, the slides below contain an illustrative example of the IASB’s proposals:

Statement of profit or loss	20X2	20X1
Revenue	3000	...
Cost of goods sold	(600)	...
<b>Gross profit</b>	<b>2400</b>	...
Selling expenses	(500)	...
General and administrative expenses	(100)	...
Research and development expenses	(300)	...
Other income	300	...
<b>Operating profit or loss</b>	<b>1800</b>	...

  

Disclosure	20X2	20X1
Depreciation, Amortisation (bundled for simplification)	(300)	...
Employee benefits	(300)	...

Only a few natural items are specifically required in IAS 1

  

Disclosure in a single note	20X2	20X1
Changes in inventories of finished goods and work in progress	300	...
Materials	(700)	...
Depreciation, Amortisation (bundled for simplification)	(300)	...
Employee benefits	(300)	...
Impairment	(200)	...
Other	(300)	...
<b>Operating expenses total</b>	<b>(1500)</b>	...

Preparers considered that it was too costly to provide the total amount of operating expenses by nature in the disclosures

- 2 Potential solution – *Partial matrix 1*: some expenses by nature would be disaggregated by function line items

Statement of profit or loss	20X2	20X1
Revenue	3000	...
Cost of goods sold	(600)	...
<b>Gross profit</b>	<b>2400</b>	...
Selling expenses	(500)	...
General and administrative expenses	(100)	...
Research and development expenses	(300)	...
Other income	300	...
<b>Operating profit or loss</b>	<b>1800</b>	...

  

Disclosure in a single note	20X2	20X1
<b>Depreciation, Amortisation (bundled for simplification)</b>	<b>400</b>	...
Cost of goods sold	250	...
Selling expenses	50	...
General and administrative expenses	50	...
Research and development expenses	25	...
Delta	25	...
<b>Employee benefits</b>	<b>400</b>	...
Cost of goods sold	150	...
Selling expenses	100	...
General and administrative expenses	50	...
Research and development expenses	50	...
Delta	50	...

Could help replacing the information presented by function and help investors developing cash-flow models on a by nature basis

Could help identifying where non-cash flows items are located (e.g. amortisation)

Would the benefits for users outweigh the cost for preparers?

**Matrix 1 - Some expenses by nature would be disaggregated by function line items**

- 3 Potential solution – *Partial matrix 2*: some expenses by function would be disaggregated by nature line items

Statement of profit or loss	20X2	20X1
Revenue	3000	...
Cost of goods sold	(600)	...
<b>Gross profit</b>	<b>2400</b>	...
Selling expenses	(500)	...
General and administrative expenses	(100)	...
<b>Research and development expenses</b>	<b>(300)</b>	...
Other income	300	...
<b>Operating profit or loss</b>	<b>1800</b>	...

  

Disclosure in a single note	20X2	20X1
<b>Cost of goods sold</b>	<b>600</b>	...
Depreciation, Amortisation (bundled for simplification)	250	...
Employee benefits	150	...
<b>Materials</b>	<b>150</b>	...
Impairment	25	...
Other	25	...
<b>Selling expenses</b>	<b>500</b>	...
Depreciation, Amortisation (bundled for simplification)	100	...
Employee benefits	150	...
<b>Materials</b>	<b>200</b>	...
Other	50	...

Disaggregation could help investors that currently prepare cash-flow models on a by function basis

Could help identifying what drives each expense presented by function (e.g. cost of sales)

May lead to a very long list of items by nature

Would the benefits for users outweigh the cost for preparers?

**Matrix 2 - Some expenses by function would be disaggregated by nature line items**



*Primary Financial Statements – Cover Note*

4 EFRAG Secretariat – Potential solution based on disclosure of material items already required in other IFRS Standards

Statement of profit or loss	20X2	20X1
Revenue	3000	...
Cost of goods sold	(600)	...
<b>Gross profit</b>	<b>2400</b>	...
Selling expenses	(500)	...
General and administrative expenses	(100)	...
Research and development expenses	(300)	...
Other income	300	...
<b>Operating profit or loss</b>	<b>1800</b>	...

Disclosure in a single note	20X2	20X1
Materials	(700)	...
Depreciation, Amortisation (bundled for simplification)	(300)	...
Employee benefits	(300)	...
Impairment	(200)	...

**Require a single note line items by nature already required to be disclosed in other IFRS Standards**