Primary Financial Statements
Issues Paper

Objective

1 The objective of this agenda paper is to provide an update to EFRAG FR TEG members on the IASB's latest tentative decisions.

Background

2 In September the IASB discussed a number of important topics, including:

(a) unusual income and expenses;

(b) associates and joint ventures held by entities with specified main business activities;

(c) investments in subsidiaries, associates and joint ventures;

(d) incremental expenses;

(e) specified subtotals; and

(f) presentation of operating expenses.

3 The IASB will continue to redeliberate the project proposals over the next few months and discuss a number of project topics, including:

(a) remaining proposals relating to subtotals in the statement of profit or loss and entities with specified main business activities;

(b) further discussion relating to general principles of disaggregation; and

(c) remaining proposals relating to management performance measures.

Unusual income and expenses

IASB's proposals in the ED and feedback received

4 In their responses to the 2017 Discussion Paper *Disclosure Initiative—Principles of Disclosure*, many investors expressed support for the IASB to develop disclosure requirements for 'unusual' items as current lack of guidance is leading to inconsistent practices and misinformation. For example, companies often disclose unusual expenses but rarely disclose unusual income. It is also often unclear how or why items have been identified as unusual (e.g., recurring restructuring expenses).

5 In the ED, the IASB proposed to define 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'*. The IASB also proposed to require 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.

6 In their responses to the ED, stakeholders expressed strong support for the IASB to develop a definition of unusual income and expenses. Such definition would provide consistent input for analysis by users and would reduce opportunistic classification of items as unusual.

7 However, there was no agreement with the proposed definition because of:

(a) concerns over the scope of the items captured, which were also related to the concerns over the IASB's proposed objective for the requirements; or

(b) concerns over the subjectivity inherent in the proposed definition.

8 In addition, there was also no clear consensus on an alternative definition (respondents suggested different definitions).

EFRAG comment letter

9 EFRAG welcomed the IASB's efforts to define unusual items and require disclosures of such items in the notes, as they provide useful information to users of financial statements.

10 However, EFRAG highlighted that the proposed definition seemed to be rather narrow, as it only focused on whether expenses/income will occur in the future.

11 Instead, EFRAG suggested that the IASB considers not only items that 'will not arise for several future annual reporting periods' 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).

12 In addition, EFRAG called for the IASB to provide more implementation guidance for preparers.

IASB tentative decisions

13 In September 2022, the IASB tentatively decided to not proceed with any specific requirements for unusual income and expenses as part of this project.

14 Before making the decision, the IASB explored, at the beginning of 2022, how to proceed with a definition of unusual items, acknowledging that a 'perfect' answer may not be possible. At the time, the IASB requested feedback on 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.

15 The EFRAG Secretariat notes that IASB Board members agreed in its September meeting not to proceed with this topic as part of the project for the following reasons:

(a) to complete the PFS project on a timely basis;

(b) there was a lack of consensus on what the definition of unusual income and expenses should be, including exploring revised definitions which were not originally considered in the ED;

(c) the risks of not disclosing unusual income and expenses could be mitigated:

(i) by the general requirement to disaggregate amounts when information about the disaggregated amounts is material; and

(ii) partially by the disclosure requirements relating to MPMs.

EFRAG Secretariat analysis/recommendations

16 The EFRAG Secretariat considers that providing a definition and requiring disclosures on unusual items would be useful for users of financial statements as it would bring more transparency and discipline on its use. Similar feedback was received during the EFRAG TEG CFSS Meeting on 28 June 2022.

17 However, the EFRAG Secretariat acknowledges the difficulties of developing a definition of unusual items and is of the view that timely completion of the PFS project is a priority. Thus, agrees with the IASB's tentative decision on this topic.

18 Leaving disclosure of any such information subject only to the application of the general requirement to disaggregate amounts whenever information about the disaggregated amounts is material, or as a voluntary disclosure, and reconciliations related to MPMs could mitigate, to a certain extent, the lack of information being provided under the definition of unusual income and expenses.

19 In the context of disaggregation, the EFRAG Secretariat considers that the IASB could consider reinforcing paragraph B15 of the ED by mandating a separate/single disclosure of the items listed in paragraph B15 of the ED, including comparatives, and linking these disclosures to the reconciliations of MPMs (e.g. most common adjustments to MPMs items are restructuring and impairment costs).

20 In addition, the IASB could consider an approach similar to ESMA's approach, where the focus is avoiding misuse of the terms unusual, non-recurrent, etc.

(a) *Issuers or persons responsible for the prospectus should not mislabel items as non-recurring, infrequent or unusual. For example, items that affected past periods and will affect future periods will rarely be considered as non-recurring, infrequent or unusual (such as restructuring costs or impairment losses).*

Question for EFRAG FR TEG

21 Does EFRAG FR TEG agree with the EFRAG Secretariat analysis in paragraphs 16 and 19?

22 Do EFRAG FR TEG members have any comments on the IASB tentative decisions?

Associates and joint ventures held by entities with specified main business activities

IASB's proposals in the ED and feedback received

23 Users of financial statements have highlighted that the structure of the income statement often varies. This diversity makes it difficult for investors to compare companies' financial performance. One of the examples mentioned was the presentation of 'share of profit or loss of associates and joint ventures', which is typically presented in different places in the statement of profit or loss. For example, sometimes it is included within operating profit while others at the bottom of the statement of profit or loss. Stakeholders also have different views on what the best location should be.

24 To address those concerns about diversity in practice, in the ED the IASB proposed:

(a) the exclusion from operating profit of all income and expenses from equity-accounted associates and joint ventures;

(b) the introduction of a distinction between integral and non-integral associates and joint ventures with consequences on presentation; and

(c) the introduction of a category integral associates and joint ventures

25 In terms of the feedback received by the IASB, those that expressed an overall view, more disagreed with the proposals than agreed. In particular, there were many concerns around the IASB's proposal to identify and separately present integral associates and joint ventures. Considering this, the IASB's tentatively decided in 2021 to not to proceed with its initial proposal on integral and non-integral associates and joint ventures. The share of results of all associates and joint ventures accounted for under the equity method would be instead required to be presented in the investing category.

26 Nonetheless, on the presentation of income and expenses from equity-accounted associates and joint ventures:

(a) most users agreed with the proposal for entities to classify income and expenses from associates and joint ventures accounted for using the equity method outside of operating profit;

(b) most respondents from the banking industry agreed with the proposal that income and expenses from associates and joint ventures accounted for using the equity method be classified outside of the operating category;

(c) a few respondents from the real estate industry disagreed, in particular, with classifying income and expenses from joint ventures accounted for using the equity method outside of the operating category;

(d) some respondents from the insurance industry disagreed with classifying income and expenses from associates and joint ventures accounted for using the equity method outside the operating category and expressed concerns about presentation mismatches arising when investments in associates and joint ventures accounted for using the equity method are held to cover insurance contract liabilities; and

(e) one respondent, an accountancy body, suggested that the IASB require all entities to present income and expenses from associates and joint ventures accounted for using the equity method in a separate single line item classified in the investing category or a category between the operating category and the investing category

EFRAG comment letter

27 EFRAG highlighted that the IASB's proposal to require a subtotal of operating profit or loss that excludes associates and joint ventures had the potential of enhancing comparability.

28 However, EFRAG was concerned that the proposed separation of integral and non-integral investments would involve a significant degree of judgement, which would hinder comparability and relevance.

29 EFRAG also suggested that the IASB should further consider how its proposals should be applied in specific circumstances. In particular, for entities that invest in the course of their main business activities, investments in associates and joint ventures that are part of an entity's investment strategy and where substantially all risks and rewards impact parties other than shareholders (e.g. investments that fund insurance liabilities included in the operating category) should be also presented in the operating category.

IASB tentative decisions

30 The IASB tentatively decided to require an entity with specified main business activities to classify in the investing category income and expenses from associates and joint ventures accounted for using the equity method.

31 Still, when discussing this topic, some IASB members expressed concern about requiring entities with specified main business activities to classify income and expenses from associates and joint ventures accounted for using the equity method in the investing category because there are businesses whose main business activity is to invest in associates and joint ventures (e.g. insurers). Thus, requiring these income and expenses in the investing category would not be reflective of the performance of the entity. Nonetheless, many IASB members did not support having exceptions to the general principle for specific industries.

EFRAG Secretariat analysis/recommendations

32 The EFRAG Secretariat still considers that for entities that invest in the course of their main business activities, investments in associates and joint ventures that are part of an entity's investment strategy and where substantially all risks and rewards impact parties other than shareholders (e.g. investments that fund insurance liabilities included in the operating category) should be presented in the operating category. Nonetheless, the EFRAG Secretariat plans to discuss this issue with EFRAG IAWG, EFRAG FIWG and financial institutions during the targeted outreach activities.

33 The EFRAG Secretariat highlights that in many cases, the share of profit or loss from equity accounted investments would be one of the few lines presented outside of the operating profit category when an entity classifies all income and expenses from financing activities within operating profit. In addition, the EFRAG Secretariat notes that in such cases, an entity cannot present the subtotal 'profit or loss before financing and income tax'. Therefore, it might not be very clear, in terms of presentation, that the share of profit or loss from equity accounted investments are included in an investing category.

Statement of financial performance - - Redeliberations

Interest income	x
Interest expense	x
Net interest income	**x**
Fee and commission income	x
Fee and commission expense	x
Net fee and commission income	**x**
Net trading income	x
Net investment income	x
Credit impairment losses	x
Employee benefits expense	x
Depreciation and amortisation expenses	x
Operating profit	**X**
Share of profit or loss of associates and joint ventures	x
Specified income and expenses on other liabilities	x
. Net interest expense/income on a net defined benefit liability/asset	x
. Unwinding of the discount on a decommissioning, restoration or similar liability	x
. Interest expenses on lease liabilities	x
Profit before tax	**X**
Income tax expense	x
Profit for the year	**X**

Questions for EFRAG FR TEG

34 Does EFRAG FR TEG agree with the EFRAG Secretariat analysis?

35 Do EFRAG FR TEG members have any comments on the IASB tentative decisions?

Investments in subsidiaries, associates and joint ventures

IASB's proposals in the ED and feedback received

36 In its ED, the IASB did not specifically addressed the issue of how to present subsidiaries, associates and joint ventures in the separate financial statements.

37 Nonetheless, a few respondents and fieldwork participants asked the IASB to clarify how an entity should classify income and expenses from investments in subsidiaries, associates and joint ventures in its separate financial statements.

38 There were also questions on how an entity should classify income and expenses from investments in subsidiaries, associates and joint ventures in consolidated and separate financial statements when the measurement basis used in the consolidated and separate financial statements differs.

39 One respondent suggested including venture capital organisations, mutual funds, unit trusts and similar entities including investment-linked insurance funds that can apply the election to measure investments in associates and joint ventures at fair value through profit or loss (in paragraph 18 of IAS 28) to the examples of entities that invest in the course of main business activities in paragraph B27 of the ED.

40 One fieldwork participant suggested that a holding company that invests in subsidiaries, associates and joint ventures as its main business activity should classify all income and expenses from such investments, including investments accounted for using the equity method, in the operating category.

EFRAG comment letter

41 In its comment letter, EFRAG recommended clarifying how the IASB's proposals would apply to subsidiaries, associates and joint ventures in the separate financial statements.

42 For example, EFRAG considered that it was not clear whether the parent company in its separate financial statements should classify:

(a) dividends from subsidiaries, associates and joint ventures, regardless of the measurement basis, in the operating or in the investing category if the parent is a holding company; and

(b) the share of profit or loss from subsidiaries measured applying the equity method, as allowed by IAS 27 *Separate Financial Statements*, in the operating or in the investing category.

43 Finally, if the main activity of the parent company is to finance subsidiaries, joint ventures and associates, it is not clear where to classify the related financial income and expenses in the separate financial statements.

IASB tentative decisions

44 The IASB tentatively decided to:

(a) clarify that income and expenses from associates and joint ventures not accounted for using the equity method includes income and expenses from associates and joint ventures accounted for:

(i) at cost (paragraph 10(a) of IAS 27 *Separate Financial Statements*);

(ii) in accordance with IFRS 9 *Financial Instruments* (paragraph 10(b) of IAS 27); and

(iii) at fair value through profit or loss in accordance with IFRS 9 (paragraph 18 of IAS 28 *Investments in Associates and Joint Ventures*).

(b) require income and expenses from investments in <u>subsidiaries not accounted for using the equity method to be classified</u>:

(i) in the investing category if investing in subsidiaries is not a main business activity; and

(ii) in the operating category if investing in subsidiaries is a main business activity.

(c) clarify that income and expenses from subsidiaries not accounted for using the equity method includes income and expenses from all subsidiaries that are accounted for:

(i) at cost (paragraph 10(a) of IAS 27) in accordance with IFRS 9 (paragraph 10(b) of IAS 27); and

(ii) at fair value through profit or loss in accordance with IFRS 9 (paragraph 31 of IFRS 10 Consolidated Financial Statements).

(d) require that an entity classifies income and expenses from subsidiaries accounted for using the equity method in the investing category.

(e) clarify that how an entity categorises subsidiaries, associates and joint ventures to assess whether investing in subsidiaries, associates and joint ventures is a main business activity should be consistent with how the entity categorises investments to determine the measurement basis (paragraph 10 of IAS 27)

EFRAG Secretariat analysis/recommendations

45 The EFRAG Secretariat highlights that in accordance with the IASB tentative decisions:

(a) the share of profit or loss of **all equity accounted investments would be classified in the investing category**, even in the separate financial statements.

(b) the income and expenses of **equity investments not accounted for using the equity method** (i.e. cost or in accordance with IFRS 9) **would be presented in the investing category unless investing is a main business activity of the entity**.

46 Such an approach is consistent with the IASB's approach developed for consolidated financial statements.

47 Nonetheless, EFRAG highlights that the key principle for separate financial statements is that the focus is upon the performance of the assets as investments and that most of income and expenses in the separate financial statements are likely to be related to these investments.

48 Therefore, it may be useful to clarify how the notion of main business activity should be applied when preparing separate financial statements (not only to financial institutions and conglomerates). Else, it is possible that most of the income and expenses will be reflected in the investing category while operating profit will be residual.

49 The EFRAG Secretariat also questions the appropriateness of making a distinction in terms of presentation based on whether the equity method is used or not as in the separate financial statements the use of the equity method is an option. Considering this, the EFRAG Secretariat considers that the IASB's tentative decisions may influence the entity's decision when opting one of the three methods available to account for investments in the separate financial statements. For example, entities might opt to account for their investments at cost or in accordance with IFRS 9 to be able to reflect their investments in operating profit when investing is a main business activity of the entity. Else, it is possible that most of the income and expenses will be reflected in the investing category while operating profit will be residual.

Questions for EFRAG FR TEG

50 Does EFRAG FR TEG agree with the EFRAG Secretariat analysis?

51 Do EFRAG FR TEG members have any comments on the IASB tentative decisions?

Incremental expenses

IASB's proposals in the ED and feedback received

52 In the ED, the IASB proposed that the investing category includes returns from investments, that is, income and expenses from assets that generate a return individually and largely independently of other resources held by the entity. It also proposed that the investing category includes related incremental expenses.

53 The IASB defined incremental expenses as those that the entity would not have incurred had the investments giving rise to the income and expenses from investments not been made.

54 Most respondents agreed with the IASB's proposal to include "income and expenses form investments", defined as "income and expenses from assets that generate a return individually and largely independently of other resources held by the entity", but many of them did not specifically comment on incremental expenses

55 Some respondents explicitly expressed their support for classifying in the investment category only incremental expenses because it would be difficult for the entities to allocate all directly related expenses to the investing category.

56 Some respondents were concerned that IASB's proposal would be inconsistently applied in practice because there is diversity in practice in how entities identify incremental expenses and similar concepts applying existing Accounting Standards.

57 In addition, few of them asked the IASB to clarify:

(a) whether incremental financing expenses for investments would be classified in the investing category,

(b) at which level expenses need to be qualified as incremental (e.g. at individual investment level or at the portfolio level); and

(c) whether legal and advisory fees incurred in purchasing an investment are incremental.

58 A few respondents suggested the IASB should clarify whether incremental expenses related to financing activities should be classified in the financing category by symmetry.

59 A few fieldwork participants said that it was unclear which expenses were considered incremental expenses and suggested further guidance would be helpful. One participant asked how it should allocate to the investing category interest expenses arising from the financing of investments such as its investment properties.

EFRAG comment letter

60 In its comment letter, EFRAG noted that in accordance with paragraph 47 of the ED, entities would classify in the investing category incremental expenses incurred to generate income and expenses from investments. However, the ED is silent on incremental expenses related to the financing category. EFRAG considered that it would be useful to clarify whether incremental expenses related to financing activities should also be in the financing category (by symmetry).

61 EFRAG also called for further clarifications on the notion of incremental expenses, (e.g. whether, for example, legal and advisory fees for activities including due diligence, negotiating terms, preparing legal documents, etc. are incremental) as per other IFRS Standards (e.g. IFRS 16 *Leases*, IFRS 15 *Revenue from Contracts with Customers*, IFRS 9, IAS 32 *Financial Instruments: Presentation*) have resulted in inconsistent or inadequate reporting disclosures.

IASB tentative decisions

62 In September 2022 the IASB tentatively decided to withdraw the proposed requirement in the ED for an entity to classify incremental expenses in the investing category.

63 Furthermore, the IASB Board asked the IASB staff as a drafting consideration to explain the types of income and expenses classified in the investing category.

64 The EFRAG Secretariat highlights that the IASB Board members unanimously agreed with IASB Staff recommendations above for the following reasons:

(a) to reduce application issues and diversity in practice;

(b) to increase subtotal comparability between entities, including operating profit;

(c) to avoid application issues and potential inconsistencies with other standards clarifying the scope of incremental expenses by application guidance, which could reduce the amount of judgment and complexity involved, and/or by listing eligible expenses, which on the other hand could have unintended consequences for other standards and may be challenging to develop a comprehensive list of such expenses.

EFRAG Secretariat analysis/recommendations

65 The EFRAG Secretariat acknowledges that the use of the concept of incremental expenses as per other IFRS Standards (e.g. IFRS 16 *Leases*, IFRS 15 *Revenue from Contracts with Customers*, IFRS 9, IAS 32 *Financial Instruments: Presentation*) has resulted in inconsistent or inadequate reporting disclosures. Therefore, we understand the IASB's tentative decision.

66 However, to ensure completeness the EFRAG Secretariat considers that it could be useful to include in the investing category, at least, the transaction costs that are directly attributable to the issue of investments as in paragraph 5.1.1 of IFRS 9. This would also improve comparability between investments that are measured differently (i.e., are measured differently at the initial recognition in terms of transaction costs).

Questions for EFRAG FR TEG

67 Does EFRAG FR TEG agree with the EFRAG Secretariat analysis in paragraphs 65**Error! Reference source not found.** and 66?

68 Do EFRAG FR TEG members have any comments on the IASB tentative decisions?

Specified subtotals

IASB's proposals in the ED and feedback received

69 In the ED, the IASB proposed that management performance measures are subtotals of income and expenses that are used in public communications outside financial statements, complement totals or 'subtotals specified by IFRS Standards' and communicate management's view of an aspect of a company's financial performance.

70 In the ED, the IASB proposed that 'subtotals specified by IFRS Standards' include:

(a) the three new subtotals proposed by the IASB;

(b) 'operating profit or loss before depreciation and amortisation';

(c) 'gross profit or loss' and similar subtotals, such as 'net interest income';

(d) 'profit or loss before tax'; and

(e) 'profit or loss from continuing operations'.

71 These subtotals are not MPMs, even when used in public communications outside financial statements, and would be a starting point for reconciliation of MPMs.

72 A few respondents stated that the IASB was following a rules-based approach with respect to specified subtotals. These considered that the IASB should develop a principle that would be applied to all entities because there may be other subtotals commonly used within individual industries and not included in the IASB's list of specified subtotals. Further, few respondents suggested replacing the proposed list with a principle that subtotals presented in the statement of profit or loss in accordance with paragraphs 42 and 43 of the ED are not MPMs.

73 A few respondents suggested IASB extend the disclosure requirements for MPMs to specified subtotals, without a reconciliation, providing especially to users useful descriptions of why this subtotals communicate management's view of an aspect of a company's financial performance.

74 One respondent commented that the IASB needs to clarify whether MPMs can be reconciled to a specified subtotal only if it is presented in the statement of profit or loss.

EFRAG comment letter

75 In its comment letter, EFRAG acknowledged that the IASB recognised some subtotals, currently not specified by IFRS Standards, as commonly used in the financial statements, and well understood by users of financial statements. Such subtotals include gross profit or loss (i.e., revenue less cost of sales) and similar subtotals, operating profit or loss before depreciation and amortisation, profit or loss from continuing operations, and profit or loss before income tax.

76 EFRAG agreed with the IASB proposal, however it noted that the drafting of paragraph 104 of the ED, which specified those subtotals, was not clear. The description of the measures, included in the list, may be misleading and the reasons to include or exclude measures from the list were unclear, indicating that the list was rules-based.

77 Moreover, EFRAG also suggested the IASB to consider introducing the same disclosure requirements for other non-GAAP performance measures presented within financial statements, that may not satisfy the proposed criteria of MPMs (e.g. adjusted revenues and ratios).

IASB tentative decisions

78 In September 2022 the IASB tentatively decided to:

(a) confirm that specified subtotals listed in paragraph 104 of the ED70 are not MPMs;

(b) add 'operating profit or loss and income and expenses from investments accounted for using the equity method' to the list of specified subtotals in paragraph 104 of the ED;

(c) confirm the examples of subtotal similar to gross profit listed in paragraph B78 of the ED;

(d) specify in the application guidance that if a MPMs is reconciled to a specified subtotal that is not presented in the statement of profit or loss, an entity is required to reconcile that specified subtotal to a subtotal presented in the statement(s) of financial performance. An entity would not be required to disclose any other information relating to the specified subtotal.

79 The IASB Board also asked the IASB staff to explore a general reconciliation requirement for subtotals disclosed in the notes and not presented in the statement(s) of financial performance.

80 IASB Board members unanimously agreed with IASB Staff recommendations above because they:

(a) provided relief to preparers from the disclosure requirements for MPMs, both in terms of information to be disclosed and reconciling items; and

(b) should ensure greater transparency on entities' financial information in line with the scope of the project.

EFRAG Secretariat analysis/recommendations

81 The EFRAG Secretariat agrees with the IASB's tentative decisions on this topic.

82 The EFRAG Secretariat also suggests that the IASB introduces the same disclosure requirements for other subtotals not specified by IFRS Standards and that do not satisfy the proposed criteria of MPMs (e.g. not used in public presentations outside financial statements) when they are presented in the notes but not in the face.

Questions for EFRAG FR TEG

83 Does EFRAG FR TEG agree with the EFRAG Secretariat analysis in paragraphs 81 and 82?

84 Do EFRAG FR TEG members have any comments on the IASB tentative decisions?

Presentation of operating expenses [Ioana]

IASB's proposals in the ED and feedback received

85 Investors have raised concerns that currently companies can freely choose to present their operating expenses either by nature or by function. This is because companies may not choose the method that provides the most useful information and use a mixture of both.

86 In addition, some investors have told the IASB that they need information about the nature of operating expenses for all companies because expenses by nature are easier to forecast than expenses by function.

87 To address these concerns the IASB proposed to:

(a) require companies to present an analysis of operating expenses using the method—by nature or by function— that provides the most useful information to investors (together with a set of indicators to help companies assess which method provides the most useful information);

(b) prohibit the mix of the two methods;

(c) require companies to disclose in a single note an analysis of their *total* operating expenses by nature.

88 The IASB received mixed views on the proposal to use the method that provides the most useful information when presenting an analysis of operating expenses. Many respondents agreed with the proposal, however, some respondents disagreed because:

(a) the proposal provided entities with free choice as the criteria for selecting a method were not sufficiently robust and resulted in loss of comparability;

(b) the application of the proposal would result in additional costs for entities to implement the requirement; and

(c) the proposal would conflict with local corporate law, which requires minimum line items by function to be presented in the statement of profit or loss.

89 The IASB also received mixed views on the proposed prohibition on a mixed method of presentation. Many respondents agreed with the proposed requirement because it would enhance comparability, both from period to period for a reporting entity and in a single period across entities. However, many respondents disagreed with this requirement because:

(a) the mixed method could provide useful information to users and should be allowed;

(b) the mixed method is common for entities operating in some industrial sectors;

(c) the proposed requirements would not enhance comparability (e.g. especially with companies applying US GAAP); and

(d) the requirement would result in high costs because it would require a change in reporting systems.

EFRAG comment letter

90 In its comment letter, EFRAG supported the IASB's proposal to continue requiring entities to present an analysis of expenses using either a by-function or by-nature method, based on whichever method provides the most useful information to the users of financial statements.

91 However, EFRAG believed that it would be useful if the IASB clarified 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 such a mixed presentation is allowed). EFRAG was also of the view that further guidance would be useful in a number of areas including to better describe the two methods and to provide a definition of presentation by-function.

92 In addition, EFRAG recommended the IASB to further investigate the cost/benefit profile of its requirement to disclose on a by-nature basis in the notes when presenting by-function on the face of the financial statements, and, if appropriate, consider focusing on which information is most needed by users. In this regard, EFRAG acknowledges the benefits for users of having information by nature but also notes the costs for preparers. EFRAG's outreach has shown that both users and preparers would likely accept a more balanced outcome (e.g. providing a partial presentation by nature of some operational expenses).

IASB tentative decisions

93 The IASB tentatively decided:

(a) to expand the explanation in the description of the function of expense method to clarify how the function of expense method involves allocating and aggregating operating expenses according to the activity to which the consumed economic resource relates;

(b) to provide application guidance to clarify the role of primary financial statements and the aggregation and disaggregation principles in applying the function of expense method;

(c) to require an entity to include in cost of sales the carrying amount of inventories recognised as an expense during the period when presenting cost of sales; and

(d) to require an entity that presents functional line items to disclose a narrative description of what types of expenses (based on their nature) are included in each functional line item.

94 Furthermore, the IASB also tentatively decided:

(a) to confirm the proposals to:

(i) require operating expenses to be presented in the statement of profit or loss using a classification based either on their nature or function; and

(ii) include application guidance on deciding which method of presenting operating expenses provides the most useful information, including the factors set out in paragraph B45 of the ED;

(b) to withdraw the proposed prohibition on a mixed presentation of operating expenses, and:

(i) require an entity, when considering which method to use, to consider the role of primary financial statements; and

(ii) provide examples of when a mixed presentation might provide the most useful information;

(c) to provide application guidance to clarify:

(i) the requirement for consistent presentation of operating expenses from one reporting period to the next; and

(ii) how to label nature line items when a mixed presentation is used.

EFRAG Secretariat analysis/recommendations

95 EFRAG Secretariat supports the IASB's tentative decision to withdraw the proposed prohibition on a mixed presentation of operating expenses as in some cases mixed presentation provides useful information to the users of financial statements.

96 EFRAG Secretariat supports the IASB's tentative decision to clarify and explain how the function of expense method involves allocating and aggregating operating expenses into functional line items. EFRAG Secretariat also agrees with the IASB's tentative decision to provide application guidance to clarify the role of primary financial statements and the aggregation and disaggregation principles in applying the function of expense method. EFRAG Secretariat notes that this is in line with the request made in the EFRAG comment letter on the ED.

97 EFRAG Secretariat also supports the IASB's tentative decision to reinforce the requirement in IAS 2 *Inventories* to include in cost of sales the carrying amount of inventories recognised as an expense during the period.

98 Furthermore, EFRAG Secretariat is of the view that the IASB reinforce the presentation requirements by referring (e.g. in the basis for conclusions) to the situations where mix presentation is useful or required. For example, mixed presentation of operating expenses could be required when an entity presents operating expenses by function but IFRS Accounting Standards require the presentation of line items by nature (e.g. impairments or restructuring). Mixed presentation could also be useful when there is a conglomerate with different business activities. However, it should be clarified that mixed presentation may not be useful when there is the use of nature line items such as depreciation and amortisation in addition to functional line items.

99 EFRAG Secretariat considers that the IASB's tentative decision to require an entity that presents functional line items to disclose a narrative description of the types of nature expenses included in each functional line item is the appropriate balance between achieving benefits for users of having information by nature and the costs for preparers when providing such information. Nonetheless, this will be discussed in the targeted outreach activities.

Question for EFRAG FR TEG

100 Does EFRAG FR TEG agree with the EFRAG Secretariat analysis in paragraphs 95 to 99?

101 Do EFRAG FR TEG members have any comments on the IASB tentative decisions?