# Primary Financial Statements
# Update on the latest IASB's decisions

## Objective

1 The objective of the session is to provide EFRAG FR TEG members with an update on the:

(a) Tentative decisions taken at the IASB meeting in May included in this paper, which was already uploaded to the EFRAG FR TEG July meeting, but not yet discussed by EFRAG FR TEG; and

(b) Tentative decisions taken at the IASB meetings in June and July, which are included in the agenda paper 06-03.

## Structure of the document

2 In the following sections, for each of the topics listed below, it is provided a summary of the IASB proposal in the Exposure Draft *General Presentation and Disclosures* ("the ED"), EFRAG's position in its final comment letter, the latest IASB's discussions and decisions and the EFRAG Secretariat analysis.

3 The topics to be discussed are:

(a) Associates and joint ventures accounted for using the equity method (IASB AP21A, May 2023), including:

(i) Classification in the statement of profit or loss of income and expenses from investments in associates and joint ventures accounted for using the equity method; and

(ii) Cash flows from investments in associates and joint ventures.

(b) Management Performance Measures - Issues related to Management Performance Measures (MPM) and IFRS 8 *Operating Segments* (IASB AP21B, May 2023).

## Associates and joint ventures accounted for using the equity method

*Classification in the statement of profit or loss of income and expenses from investments in associates and joint ventures accounted for using the equity method*

*IASB proposal in the ED*

4 In the ED (see paragraphs 47, 48, 53 and 60 of the ED), the IASB proposed that income and expenses from associates and joint ventures accounted for using the equity method would be classified outside of the operating category by all entities as follows:

(a) income and expenses from associates and joint ventures accounted for using the equity method that are integral to the entity's operations would be classified in a separate category directly below operating profit followed by a subtotal of 'operating profit or loss and income and expenses from integral associates and joint ventures'; and

(b) income and expenses from non-integral associates and joint ventures would be classified in the investing category.

*EFRAG Final Comment Letter*

5 In its comment letter to the IASB's 2019 ED, EFRAG recommended that the IASB should require the presentation of the results of all associates and joint ventures below the subtotal 'operating profit or loss'. In addition, EFRAG suggested that the IASB require the split between "integral" and "non-integral" in the notes to the financial statements (but not as a presentation requirement on the face of the statement of profit or loss). EFRAG noted that in accordance with paragraph 66 of the ED, entities can always make the split on the face of the financial statements if such split is considered useful.

6 Furthermore, EFRAG suggested that for entities that invest as part off 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.

*IASB discussions and tentative decisions*

7 In the redeliberations on the proposals in the ED, the IASB has tentatively decided to require all entities to classify income and expenses from associates and joint ventures accounted for using the equity method in the investing category in the statement of profit or loss, withdrawing the distinction between "integral" and "non-integral" investments and the related subtotal in the statements of profit or loss (see Agenda Paper 21A of the October 2021IASB meeting, Agenda Paper 21B of the December 2021 IASB meeting and Agenda Paper 21B of the September 2022 IASB meeting).

8 Regardless the absence of a specific question on this topic from the IASB (only included as EFRAG additional questions), during the targeted outreach the IASB received mixed views from users, national standard-setters and other stakeholders. In particular, those stakeholders operating in the insurance industry expressed some concerns about the IASB's tentative decision asking for an accounting exception to present the results from equity-accounted investments within the operating profit because of the nature of these investments (e.g., directly or indirectly linked to insurance contract liabilities) and their relevance across the industry.

9 The IASB Staff acknowledged the concerns raised by stakeholders during targeted outreach and that the IASB's tentative decisions may result in a change in practice for some stakeholders and a classification outcome which some stakeholders do not view as ideal. However, the IASB Staff also noted that users of financial statements generally continue to support the IASB's tentative decision and that the classification of such investments in a consistent location will ensure that users have a consistent starting point for their analysis across all entities.

10 Furthermore, to address aforementioned stakeholders' concerns the IASB considered providing transition requirements to permit entities to apply the election in IAS 28 *Investments in Associates and Joint Ventures* to measure investments in associates and joint ventures at fair value through profit or loss in accordance with IFRS 9 *Financial Instruments* on transition to IFRS X (see Agenda Paper 21D of the May 2022 and Agenda Paper 21B of the September 2022 IASB meetings). Indeed, income and expenses from associates and investments measured at FVTPL are classified in the operating category if the entity makes that investment as a main business activity (see paragraph 48 and B32 of the ED).

11 This election can be applied when an investment in an associate or a joint venture is held by, or is held indirectly through, an entity that is a venture capital organisation, or a mutual fund, unit trust and similar entities including investment-linked insurance funds, which were not originally defined by IAS 28. However, an example of an investment-linked insurance fund was added to IAS 28 when IFRS 17 *Insurance contracts* was issued. These amendments to IAS 28 can be applied on initial recognition or when an entity adopts IFRS 17 (see paragraphs 18 and 45F of IAS 28).

12 Based on the feedback received, the IASB staff noted that:

(a) the objective of providing the mentioned election is because for these type of investments (e.g., investments held by venture capital organisations), fair value measurement provides more useful information to users;

(b) the concurrent amendments made to paragraph 18 of IAS 28 when IFRS 17 was issued ensure that measurement mismatches do not arise between associates and joint ventures and insurance contract liabilities.

(c) volatility is expected to arise in some instances for entities that do or do not apply the other comprehensive income (OCI) option in IFRS 17; and

(d) practice development in applying paragraph 18 of IAS 28 (i.e., scope interpretation) is expected to evolve after the first application of IFRS 17.

13 Therefore, in its May 2023 meeting the IASB:

(a) reconfirmed its tentative decision to require all entities to classify, in the investing category in the statement of profit or loss, income and expenses from associates and joint ventures accounted for using the equity method; and

(b) tentatively decided to provide transition requirements that will permit an entity to elect to measure investments in associates or joint ventures at fair value through profit or loss in accordance with IFRS 9 when the investment is held by, or is held through, an entity that is a venture capital organisation, a mutual fund, unit trust and similar entities including investment-linked insurance funds (see paragraph 18 of IAS 28).

14 Furthermore, the IASB Staff noted that:

(a) An entity could present the specified subtotal "operating profit or loss and income and expenses from investments accounted for using the equity method" when it is necessary for understanding performance of the entity and label it in a way that faithfully represents what is included in it;

(b) If an entity uses this subtotal to communicate its financial performance in its public communications, it would not meet the definition of a MPM. However, if an entity used a subtotal that included only the income and expenses from selected associates and joint ventures (e.g., those related to insurance contracts only), that subtotal would be a MPM.

*EFRAG Secretariat analysis*

15 The EFRAG Secretariat heard mixed views about this topic, which are summarised in EFRAG Summary Report and Recommendations on the targeted outreach.

16 Nonetheless, the most impacted industries, such as insurance and banking, expressed some concerns and asked for the IASB to consider their business model. In particular, representatives of the insurance industry highlighted:

(a) The inconsistency between IAS 1 and IFRS 17 as IAS 1 would ignore a fundamental principle of IFRS 17 which is the existence of a natural link between the investment assets and insurance liabilities;

(b) The existence of different interpretations of paragraph 18 of IAS 28. Any interpretation from the IASB on this paragraph could have a significant impact on the insurance industry;

(c) This tentative decision will require to the insurance companies to make significant changes to their statements of financial performance in addition to those just made to be in line with the requirements in IFRS 17 and IFRS 9; and

(d) that insurance companies in the future would have to rely on non-gaap indicators (adjusted operating profit) to be able to explain the performance of an insurance company.

17 Users generally welcomed the IASB's proposal to present the results for equity-accounted associates and JVs outside the operating profit. However, those operating within the insurance industry, sympathised with insurance companies' concerns detailed above.

18 The IASB's tentative decisions are likely to not entirely address the insurance industry's concerns, mainly because:

(a) measuring associates and JVs using fair value could increase earnings volatility, depending on the model in IFRS 17 that is applied and the measurement method of the assets; and

(b) The use of the specified subtotal "operating profit or loss and income and expenses from investments accounted for using the equity method" would not address some preparers' concerns (especially conglomerates and insurance companies) in terms of MPM disclosure requirements when they include in public communication another subtotal including only some of those investments (e.g., investments linked to insurance contracts).

19 The EFRAG Secretariat considers the IASB is not likely to change its position in the future as this topic was comprehensively discussed by the IASB and the IASB believes that its tentative decisions will provide users for more useful and comparable information across industry and, at the same time, provide preparers with transition reliefs.

20 However, even if the IASB acknowledged the issues, the EFRAG Secretariat continues to emphasise the concerns expressed mainly by insurance industry about:

(a) the requirement to provide specific MPM disclosures when subtotals other than specified subtotals are used in public communication to better reflect the entity's performance (e.g., subtotals of subtotals); and

(b) The different interpretations of paragraph 18 of IAS 28 (see paragraph 10 and 11 above), based on which an entity would not apply the aforementioned election.

21 As a consequence, additional cost might arise for those choosing to communicate the performance of their main business activities with an additional subtotal that includes only part of the result from associates and joint ventures. Such impact needs to be considered during the endorsement process and balanced against the benefits. Regarding the different interpretation of paragraph 18 of IAS 28, the IASB concluded that the issue is outside the scope of the PFS project. EFRAG Secretariat will continue to monitor the issue.

**Questions for EFRAG FR TEG**

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

23 Do EFRAG FR TEG members agree with the EFRAG Secretariat analysis?

*Cash flows from investments in associates and joint ventures*

*IASB proposal in the ED*

24 Paragraph 38A of IAS 7 *Statement of Cash Flows* in the ED proposed that: "*An entity shall classify cash flows from the acquisition and disposal of investments in associates and joint ventures applying paragraphs 16(c)–16(d). An entity shall classify as cash flows from investing activities dividends received from associates and joint ventures accounted for using the equity method. An entity shall present cash flows in respect of its investments in integral associates and joint ventures separately from cash flows in respect of its investments in non-integral associates and joint ventures*."

25 Furthermore, the ED proposed amendments to paragraph 16(c)-16(d) of IAS 7 specifying that cash payments to acquire interests in associates and joint ventures and cash receipts from sales of interests in associates and joint ventures are cash flows arising from investing activities.

*EFRAG Final Comment Letter*

26 In its Comment Letter, EFRAG noted that income and expenses from integral associates and joint ventures would be presented within a separate category in the statement of profit or loss (category 'integral associates and joint ventures) while the cash flows from investments in integral associates and joint ventures would be presented within investment activities in the statement of cash flows. As long as the two statements are not aligned, EFRAG suggested using a different labelling from IAS 7 and to review the classification of integral associates and joint ventures to avoid confusion.

*IASB discussions and tentative decisions*

27 The IASB tentatively decided to withdraw the new paragraph 38A of IAS 7 proposed in the ED providing more understandable presentation for users. As a result, an entity would be required to classify in a single category dividends received from associates and joint ventures accounted for using the equity method, applying the requirements applicable to the entity for other dividends received (as tentatively decided in previous IASB meetings in March 2021 and in January 2023 and presented in previous EFRAG FR TEG meeting in May 2023).

28 In addition, the IASB Staff noted that the measurement method adopted should not influence the classification of cash flows related to dividend received by associates and JVs and, furthermore, that this tentative decision should have limited to no changes to the current practice (i.e., paragraph 33 of IAS 7 stated that dividends received are usually classified as operating cash flows for financial institutions).

*EFRAG Secretariat analysis*

29 The EFRAG Secretariat agrees with the IASB's tentative decision as such a single category approach would reduce misalignment between the statement of profit or loss and the cash flows statement. Indeed:

(a) Entities that invest in financial assets as a main business activity will classify income and expenses from equity-accounted associates and JVs in the investing category. Dividends received, including those from equity-accounted investments, will be classified in the statement of cash flows using the single category approach (accounting policy choice: operating or investing category);

(b) All the other entities (e.g., general corporates, entities that only provide financing to customers or invest in non-financial assets as a main business activity) will classify all dividend received in the investing category in both statements.

| **Questions for EFRAG FR TEG** |
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| 30 Do EFRAG FR TEG members have any comments on the IASB's tentative decisions? |
| 31 Do EFRAG FR TEG members agree with the EFRAG Secretariat analysis? |

## Management Performance Measures

*Issues related to Management Performance Measures (MPMs) and IFRS 8 Operating Segments*

*IASB proposal in the ED*

*32* Paragraph B83 of the ED states that "*in some cases, one or more of an entity's management performance measures may be the same as part of the operating segment information disclosed by the entity in applying IFRS 8. In such cases, the entity may disclose the required information about those management performance measures in the same note that it uses to disclose information about its operating segments provided the entity either:*

(a) *includes in that note all of the information required by paragraph 106 for management performance measures; or*

(b) *provides a separate note that includes all of the information required for management performance measures*."

33 Paragraph B82 of the ED states that "*all information required to be disclosed about management performance measures shall be included in a single note*."

*EFRAG Final Comment Letter*

34 In its Comment Letter EFRAG considered that the IASB had not sufficiently articulated the link between MPMs and IFRS 8 and suggested that the IASB required an explanation of how MPMs interact with performance measures already presented under IFRS 8.

*IASB discussions and tentative decisions*

35 The IASB tentatively decided:

(a) <u>to clarify that MPMs are measures that reflect management's view of the performance of the entity as a whole (i.e., sum of all the operating segments instead of at each individual segment level);</u>

(b) <u>to confirm the proposal in paragraph B83 of the ED, which states that, if one or more of an entity's MPMs are the same as part of the operating segment information disclosed by the entity in applying IFRS 8, the entity may disclose information about those MPMs in the same note as the operating segment information, provided the entity either:</u>

(i) <u>includes in that note all the information required to be disclosed for management performance measures; or</u>

(ii) <u>includes in a separate note all the information required for management performance measures.</u>

36 The IASB asked the staff to consider the relationship between paragraph B83 and the general requirement for presentation of notes in a systematic manner in paragraph 97[1] of the ED when drafting the proposed Standard.

[1] Paragraph 97 of the ED states: *"[IAS 1.113] An entity shall, as far as practicable, present notes in a systematic manner. In determining a systematic manner, the entity shall consider the effect on the understandability and comparability of its financial statements. An entity shall cross-reference each item in the primary financial statements to any related information in the notes (see paragraph B66)."*

37 The IASB discussed other outstanding issues related to management performance measures for which the staff had concluded no further action was required, including:

(a) subtotals included in the statement of profit or loss – the IASB would intend to clarify in drafting of IFRS X that applying the IASB's current proposals, subtotals that are made up of the sum of line items presented in the statement of profit or loss would fall within the scope of MPMs if they meet such a definition, including that the entity judges that the rebuttable presumption does not apply (see Agenda Paper 21B of the March 2023 IASB meeting) and they do not fall within the scope of a specified subtotal in paragraph 104 of the ED, which includes also subtotal similar to gross profit as defined in paragraph B78 of the ED[2] (e.g., net interest income) (see Agenda Paper 21E of the September 2022 IASB meeting).;

(b) subtotals (other than specified subtotals) disclosed in the notes and not presented in the statement of profit or loss – In September 2021 the IASB tentatively decided to require an entity to explain how a disclosed class of items is included in the line items in the primary financial statements (under the principles of disaggregation). The IASB staff think that this tentative decision would require an entity to make clear how a subtotal (other than a specified subtotal) disclosed in the notes relates to the line items presented in the primary financial statements; and

(c) public communications related to interim financial statements – a performance measure that relates to interim financial statements but not the annual financial statements would only be included in the interim and not the annual financial statements, and vice versa (i.e., if a performance measure is included in public communication related to the annual reporting only, it does not meet the definition of MPM in the interim reporting, and vice versa).

*EFRAG Secretariat analysis*

38 EFRAG Secretariat generally agrees with the IASB's tentative decisions to clarify that MPMs should reflect management's view of the performance of the entity as a whole and that, consequently, individual segment reporting measures do not fall in scope of MPM requirements (e.g., individual segment reporting measure when the entity has more than one reportable segment).

39 In addition, this clarification would provide preparers with relief in terms of reconciliation requirements and would not reduce the usefulness of the information provided for users (e.g., the reconciliation, including tax and NCI effect, will be provided at the entity level instead of at the operating segment one).

40 Furthermore, the EFRAG Secretariat agreed with the IASB's decision to confirm the proposal in paragraph B82 of the ED, allowing an entity to disclose information about all management performance measures in the note about its operating segments, when one or more MPMs are the same part of operating segment information.

41 However, the EFRAG Secretariat noted that a few IASB members expressed some concerns relating the disclosure requirements in paragraph B83 of the ED when a MPM is also part of the operating segment information. They thought this approach could be confusing reducing the clarity in terms of distinction between what is a MPM and what is a segment measure. To address this concern, to ensure more understandable and comparable information and to facilitate the digital report tagging of the notes, we suggest the IASB to

[2] Specified subtotals include subtotals similar to gross profit. A subtotal similar to gross profit represents the difference between a type of revenue and directly related expenses incurred in generating that revenue. Examples include net interest income, net fee and commission income, insurance service result, net financial result and net rental income.

require an entity who decides to use such an option, to clearly identify all the disclosed information about MPMs in a specific sub-paragraph within the operating segment section (e.g., by using understandable subtitles).

**Questions for EFRAG FR TEG**

42 Do EFRAG FR TEG members have any comments on the IASB's tentative decisions?

43 Do EFRAG FR TEG members agree with the EFRAG Secretariat analysis?