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 paper 06-02 (which was already uploaded to the EFRAG FR TEG July meeting, but not discussed by EFRAG FR TEG); and

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

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) Outstanding issues related to categories and subtotals (IASB AP21A, June 2023), including:

(i) income and expenses arising on the derecognition of assets or liabilities;

(ii) income and expenses arising from transactions or other events that result in a change in the category in which an entity classifies income and expenses from assets or liabilities, without affecting the recognition of the assets or liabilities; and

(iii) Other outstanding issues for which no further action is required.

(b) IAS 29 *Financial Reporting in Hyperinflationary Economies* and IAS 12 *Income Taxes* (IASB AP21B, June 2023).

(c) Effective date and transition requirements (IASB AP21B, July 2023)

(d) Due process requirements and re-exposure criteria (IASB AP21C and AP21A, July 2023)

Outstanding issues related to categories and subtotals in the statement of profit or loss

IASB proposal in the ED

4 In the ED, the IASB does not specify the classification of income and expenses arising on the derecognition of assets or liabilities or change in classification of the income and expenses from an asset or liability, since the intention was to treat it as any other income or expense arising from the asset or liability.

EFRAG Final Comment Letter

5 In its comment letter to the IASB's 2019 ED, EFRAG did not request the clarification of income and expenses arising on the derecognition of (group of) assets or liabilities or change in classification of the income and expenses from an asset or liability.

IASB discussions and tentative decisions

6 During the feedback period, some stakeholders noted that judgement is involved when classifying income and expenses from transactions or other events that result in a change in category in which the income and expenses from the single asset or liability or a group of assets are classified.

7 The IASB staff identified some instances of transactions or other events that may result in a change in classification of income and expenses before and after the transaction. Some examples include, but are not limited to, step-up acquisitions, supply chain financing arrangements, sale and leaseback and others. These transactions or events would usually result in either:

(a) The derecognition of an asset or liability from the statement of financial position, which may result in the recognition of a gain or loss, followed by the subsequent recognition of another asset or liability; or

(b) The transfer of an asset from one type to another, without the asset being derecognised.

8 Thus far, it is not specified in the ED how the principles apply for classifying income and expenses from such transactions or events. The allocation of these gains or losses can be arbitrary and inconsistent to the category for which any other income or expense arising from the asset or liability was classified. Hence, the IASB staff highlighted the need for clarifying the principles for classifying income and expenses arising from the asset or liability.

9 The IASB staff recommended to allocate the generated income and expenses in a single category, ''operating'' by default, even though a part could qualify for another category. Some IASB members were concerned that this approach would not achieve the objective of faithful representation and were in favour of allocating the generated income and expenses as they qualify under the relevant categories. However, other members noted that their allocation in multiple categories could be arbitrary and highlighted the importance of reducing the level of complexity.

10 The IASB has tentatively decided <u>to clarify that in the statement of profit or loss (subject to drafting suggestions concerning (c)):</u>

(a) <u>income and expenses arising from the derecognition of an asset or liability are classified in the same category as the income and expenses generated by that asset or liability immediately before derecognition;</u>

(b) <u>income and expenses arising from a transaction or other event that changes the classification of income and expenses from an asset or liability (without affecting the recognition of the asset or liability) are classified in the category in which income and expenses were classified immediately before the transaction or other event;</u>

(c) <u>if income and expenses described in (a) and (b) arise from a single transaction or other event that involves a group of assets and liabilities for which income and expenses were classified in different categories immediately before the transaction or other event:</u>

(i) <u>the gain or loss on the transaction or other event is classified in the operating category if any of the assets in the group generated income and expenses that were classified in the operating category; and</u>

(ii) the gain or loss on the transaction or other event is classified in the investing category if all the assets in the group generated income and expenses that were classified in the investing category.

11 Moreover, the IASB reconfirmed that specific entities would not present the subtotal "profit or loss before financing and income tax". This prohibition would apply when an entity that provides financing to customers as a main business activity classifies in the operating category all income and expenses from liabilities that arise from transactions that involve only the raising of finance.

12 The IASB also discussed and decided that there is no further action required, as the issue can be resolved by clarifying the wording in drafting IFRS X or is beyond the scope of this project, for the following issues:

(a) the presentation of subtotals that are equal to each other – the IASB tentatively decided that there is no need for the IASB to reconsider presentation requirements for subtotals that are equal. However, the IASB will explain in the Basis for Conclusions the IASB's reasons for illustrating subtotals that are equal in Illustrative Example II-2;

(b) the requirements for disclosures in interim financial statements relating to an entity's ability to continue as a going concern – The ED proposed to move paragraphs 25-26 of IAS 1 to paragraph 6K of IAS 8. It should be clarified in drafting that these paragraphs, when in IAS 8, would apply to condensed interim financial statements; and

(c) the requirements for disclosure of significant judgements made in applying presentation and disclosure requirements – A few respondents suggested the IASB to clarify that the requirement in paragraph 122 of IAS 1[1] includes significant judgements made in applying presentation, as well as disclosure requirements. As this paragraph will be moved to IAS 8, amending this paragraph may have unintended consequences. Therefore, the IASB tentatively decided to not provide any further clarification on this requirement as part of this project.

EFRAG Secretariat analysis

13 In the context of the targeted outreach events, the EFRAG Secretariat heard some concerns related to the lack of clarity on the classification of specific transactions under the operating category, such as gains or losses arising from disposals of businesses and consolidated subsidiaries, which are summarised in EFRAG Summary Report and Recommendations on the targeted outreach.

14 However, constituents did not specifically express concerns about the classification of income and expenses from transactions or other events that result in a change in category for classifying income and expenses.

15 The EFRAG Secretariat agrees with the IASB staff's recommendation and welcomes the IASB's tentative decision in providing clarity on the classification of these transactions or events. This will result in consistent application and would increase comparability in the classification of gains or losses arising from these specific transactions or events, since it would reduce the judgment involved.

Questions for EFRAG FR TEG

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

[1] Paragraph 122 of IAS 1 requires entities to disclose judgements that management has made in the process of applying the entity's accounting policies and that have the most significant effect on the amounts recognised in the financial statements.

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

IAS 29 *Financial Reporting in Hyperinflationary Economies* and IAS 12 *Income Taxes*

Issues related to IAS 29 Financial Reporting in Hyperinflationary Economies

IASB proposal in the ED

18 In the ED, there is no specific guidance on the classification in the statement of profit or loss of the gain or loss on the net monetary position recognised applying IAS 29.

Background information on IAS 29

19 IAS 29 is applied to all financial statements of any entity whose functional currency is the currency of a hyperinflationary.

20 Paragraph 9 of IAS 29 requires an entity to include the gain or loss on the net monetary position in profit or loss and disclose it separately. There are cases where it may be helpful if other income and expense items and foreign exchange differences related to invested and borrowed fund, are presented together with the gain or loss on the net monetary position (paragraph 28 of IAS 29).

EFRAG Final Comment Letter

21 EFRAG did not hear any concerns from its constituents on this specific topic, and hence it was not discussed in the comment letter.

IASB discussions and tentative decisions

22 Based on the feedback received on the classification of foreign exchange differences as proposed in the ED, the IASB further discussed this topic and its redeliberations to date can be summarised as follows:

(a) In July 2021 the IASB tentatively decided to require an entity to classify foreign exchange differences in the same category of the statement of profit or loss as the income and expenses from the items that gave rise to the foreign exchange differences, except when doing so would involve undue cost or effort in which case an entity classifies the foreign exchange differences on the item in the operating category; and

(b) In March 2023 the IASB tentatively decided to require an entity to use its judgement to determine in which category in the statement of profit or loss to classify foreign exchange differences on a liability that arises from a transaction that involves operating activities in addition to the raising of finance.

23 Therefore, applying the IASB's tentative decisions to date, items which relate to the gain or loss on the net monetary position arising from the application of IAS 29, such as interest income, interest expense and foreign exchange differences, are classified in different categories in the statement of profit or loss.

24 The IASB Staff, based on the feedback received from stakeholders and on the analysis of a sample of 24 entities' financial statements across different jurisdictions, noted that entities present the gain or loss on the net monetary position in two different ways in their statement of profit or loss:

(a) In a single line item in the statement of profit or loss. However, diversity in practice was noted in relation to its classification, which could be above or below the operating profit.

(b) Together with other income and expenses arising from monetary assets and liabilities (i.e., in different line items and categories).

25 Being the accounting practice in paragraph 24(b) consistent with the IASB's redeliberations to date (as detailed in paragraph 22 above) and considering the entities often adopt approach in 24(a), the IASB staff considered only the classification of the gain or loss on the net monetary position when an entity presents it in a single line item in order to address the existing diversity in practice.

26 In particular, the IASB tentatively decided to clarify that the gain or loss on the net monetary position would be classified in the operating category in the statement of profit or loss when an entity applying IAS 29 presents it in a single line item, mainly because:

(a) The operating category is the default category;

(b) the gain or loss on the net monetary position in totally does not meet the requirements to be classified in the investing and financing category; and

(c) it would ensure consistent classification and less complexity for preparers, although there could be cases where classifying it in a category other than the operating one would provide useful information (e.g., when an entity has mainly monetary liabilities with income and expenses classified in the financing category).

EFRAG Secretariat analysis

27 The EFRAG Secretariat agrees with the IASB tentative decision as it would improve comparability across entities and would reduce complexity for preparers (e.g., no need to determine which are the predominant assets and liabilities that give rise to this gain or loss in order to determine in which category it has to be classified).

Issues related to IAS 12 Income taxes

IASB proposal in the ED

28 Paragraph 54 of the ED proposed that an entity shall classify in the income tax category income tax expense or income included in profit or loss applying IAS 12.

29 Furthermore, paragraph 78 of IAS 12 states that foreign exchange differences on deferred tax assets or liabilities may be classified as deferred tax expense (income) if that presentation is considered to be the most useful to financial statement users.

EFRAG Final Comment Letter

30 Thus far, EFRAG did not receive any feedback related to the classification of foreign exchange differences related to assets and liabilities on income taxes. This specific topic was not considered in EFRAG's comment letter.

IASB discussions and tentative decisions

31 The IASB staff noted that paragraph 54 in the ED as drafted could lead to different interpretations:

(a) foreign exchange differences arising from assets or liabilities on current tax do not meet the definition of the income tax category because they are not income taxes in the scope of IAS 12 and, therefore, should not be classified in the income tax category;

(b) applying the general principle for the classification of foreign exchange differences an entity would classify the foreign exchange differences arising from assets or liabilities on current tax in the income tax category;

(c) requirements in paragraph 78 of IAS 12 could imply that an entity can make an accounting policy choice for the classification of foreign exchange differences arising from deferred tax assets or liabilities.

32 To avoid diversity in interpretation of the requirements, the IASB tentatively decided:

(a) to clarify that the foreign exchange differences arising from assets and liabilities within the scope of IAS 12 that are recognised in profit or loss in accordance with IAS 21 would be classified in the income tax category in the statement of profit or loss, unless doing so would involve undue cost or effort;

(b) make a consequential amendment to the requirement in paragraph 78 of IAS 12 for classifying foreign exchange differences on deferred tax assets and liabilities to align with the tentative decision in (a) (e.g., replacing "deferred foreign tax liabilities or assets" with "foreign currency denominated assets and liabilities arising from income taxes" and including reference to the requirements in IFRS X).

EFRAG Secretariat analysis

33 The EFRAG Secretariat agrees with the IASB's tentative decision as it would reduce potential diversity in practice ensuring more comparability across entities. Indeed, the EFRAG Secretariat is of the view that this approach should not involve undue cost or effort for preparers.

34 The EFRAG Secretariat also agrees with the decision to make a consequential amendment to paragraph 78 of IAS 12, to ensure consistency when applying the requirements of both IAS 12 and IFRS X.

Questions for EFRAG FR TEG

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

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

Effective date and transition requirements

IASB proposal in the ED

37 In the ED, the IASB proposed a transition period of 18-24 months from the effective date of IFRS X, allowing for voluntary early application. The IASB had considered that the transition period would allow sufficient time for entities to prepare for the implementation of IFRS X.

38 Paragraph 119 of the ED requires the retrospective application of IFRS X in accordance with IAS 8, since the standard is expected to result in significant changes to the statement(s) of financial performance.

39 Moreover, paragraph 118 of the ED states that in the first year of application of IFRS X, the entity shall present each of the headings and subtotals required by IFRS X in condensed financial statements provided in interim financial reports, despite the requirements of IAS 34 *Interim Financial Reporting.* This requirement ensures that for the first year of application the entities present the same subtotals in the interim financial statements as that of the annual financial statements, and as a result provide useful information to users.

40 In the ED, the IASB did not consider any transition requirements for condensed financial statements on the disaggregation requirements nor any amendments to IFRS 1 for first-time adopters. In addition, the IASB did not propose any transition requirements for the disclosure requirements in IAS 8 for the:

(a) Issued but not yet effective IFRS Accounting Standards that the entity has not applied;

(b) Initial application of IFRS Accounting Standard that impacts the reporting period when IFRS X is first applied, and any prior periods presented.

EFRAG Final Comment Letter

41 In its comment letter to the IASB's 2019 ED, EFRAG did not expect the proposed transition period of 18 to 24 months to be sufficient. In fact, EFRAG requested the IASB to take into account the implementation of other disclosure requirements when determining the effective date.

IASB discussions and tentative decisions

42 During the feedback period, stakeholders expressed their concerns that the 18-24 months transition period would not be sufficient for the following reasons:

(a) Some entities would need to change their systems and data collection processes in order to apply some of the requirements;

(b) The need to provide comparative information of at least one year prior to the effective date for delivering useful information to users, and in some cases two or more years of comparative information as required by local laws and regulations in some jurisdictions;

(c) Entities would have to prepare for other disclosure requirements (e.g., sustainability reporting) over the next few years;

(d) Some entities would require time to discuss the new requirements with internal and external stakeholders, since IFRS X would result in changes to remuneration policies and debt covenants;

(e) Entities would need to apply the requirement of the retrospective application of IFRS X in accordance with IAS 8 and in interim financial statements;

(f) Regulators would need time to incorporate the new requirements into their legal systems;

(g) Auditors would require a period to discuss with preparers some of the proposed disclosures.

43 However, some stakeholders noted that some entities would not need much time to implement IFRS X, while users would like to see the application of IFRS X as soon as possible. In fact, some members of the IASB with a user background did not consider necessary to allow for an extended transition period, since there were no significant changes to the ED and expected entities to be prepared for an implementation date of 1 January 2026.

44 The IASB considered the feedback received from users and acknowledged that this is a high priority project for users. However, the IASB highlighted that an effective date of 1 January 2026 would not be sufficient time for some entities, regulators and auditors to prepare and would involve a higher risk of jurisdictions delaying the effective date of IFRS X or requesting the IASB to extend it. The IASB stressed that IFRS X should be applied by all jurisdictions at the same time.

45 Concerning the disclosure requirements in IAS 8, the IASB recognised that it should be clarified how IAS 8 is applied on initial application of IFRS X. In addition, the IASB identified that some subtotals could be different to those defined under IFRS X, but could be labelled the same.

46 For first-time adopters, the IASB acknowledged that under IFRS 1 transition requirements of individual IFRS Accounting Standards are not applied. Therefore, the IASB considered to extend also to first-time adopters the transition requirements in paragraph 118 of the ED ensuring the presentation of each of the headings and subtotals required by IFRS X in their interim condensed financial statements too.

47 Therefore, the IASB tentatively decided:

(a) <u>to require an entity to apply the Standard for annual periods beginning on or after 1 January 2027;</u>

(b) <u>to confirm the proposal in the Exposure Draft to require an entity to apply the Standard retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*;</u>

(c) <u>to confirm the proposal in the Exposure Draft to require an entity to present each of the required headings and subtotals in the Standard in its condensed interim financial statements in the first year of applying the Standard. This requirement would also apply to a first-time adopter of IFRS Accounting Standards;</u>

(d) <u>to require an entity in the first year of applying the Standard to disclose a reconciliation between each line item in the statement of profit or loss presented by applying IAS 1 and each line item presented by applying the Standard. This disclosure would replace the disclosure required in paragraph 28(f) of IAS 8 and would be:</u>

  (i) <u>required for the comparative period immediately preceding the period in which the Standard is first applied;</u>

  (ii) <u>permitted but not required for the reporting period in which the Standard is first applied; and</u>

  (iii) <u>permitted but not required for comparative periods presented other than the comparative period specified in subparagraph (i).</u>

(e) <u>subject to drafting, to require an entity to disclose the reconciliation described in (d)(i) for line items in the statement of profit or loss presented in interim financial statements for interim periods in the first year of applying the Standard.</u>

48 The IASB also decided <u>to consider whether to provide transitional relief from restating amounts presented for additional comparative periods.</u>

EFRAG Secretariat analysis

49 At the July meeting, EFRAG FR TEG members generally expressed sympathy with the concerns of preparers about the proposal in the ED of 18-24 months transition period asking for at least an additional year (i.e., from 1 January 2027). In contrast, one member considered the transition period proposed in the ED as a fair proposal and suggested the IASB to consider adopting a "phasing approach" postponing to a later stage the applicability of some requirements (e.g., disclosure of operating expenses by nature).

50 The EFRAG Secretariat also acknowledges that the application of IFRS X will provide useful information to users, who would want to see financial statements applying IFRS X as soon as possible.

51 The EFRAG Secretariat agrees with the IASB's decision on the effective date and transition requirements, as it is a good compromise between preparers concerns and users' needs, mainly for the following reasons:

(a) An effective date of 1 January 2027 will allow preparers for enough time to adequately prepare for a standard that would bring significant changes to the presentation and disclosures of financial statements, especially considering the timing of the expected endorsement process, the relevant required changes to data collection process and IT systems and the impact of IFRS X starting from the interim financial statements;

(b) Transition requirements, including the reconciliation between the statement of profit or loss prepared in accordance with IAS 1 and IFRS X, will ensure more comparable and reliable information to users of financial statements;

(c) Extending some requirements to the interim financial statements to be presented in 2027 will not involve additional or undue costs for preparers and will provide users with more useful information.

52 Moreover, the EFRAG Secretariat considers appropriate the IASB's decision for permitting an early application of IFRS X, given that there is evidence that some entities (albeit limited) would be able to apply the new requirements at an earlier date, and would consider appropriate providing transitional relief from restating amounts presented for additional comparative periods, as otherwise it would shorten the effective transition period for the impacted entities.

Questions for EFRAG FR TEG

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

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

Due process requirements and re-exposure criteria

IASB discussions and tentative decisions

55 The IASB staff analysed the re-exposure criteria in the Due Process Handbook, summarised the due process steps undertaken during the entire project (including mandatory and optional activities) and concluded that re-exposure would not bring significant new information, since there were no fundamental changes to the main proposals on which the stakeholders have not had the opportunity to comment, and the benefits from re-exposing would not exceed the associated costs. The IASB considered the re-exposure criteria in the Due Process Handbook and decided to issue the Standard without re-exposing the proposals.

56 Regarding the due process requirements, the IASB confirmed that it has complied with the applicable due process requirements and has undertaken sufficient consultation and analysis to begin the process for balloting the Standard.

EFRAG Secretariat analysis

57 The EFRAG Secretariat agrees that benefits stemming from re-exposure do not outweigh costs. The IASB has given the opportunity to stakeholders, including EFRAG, to provide their input for various topics and has considered diverse viewpoints in the proposals. In addition, re-exposure would significantly delay the publication of the Standard. However, the EFRAG Secretariat will continue to monitor the IASB activities to verify whether some remaining issues highlighted in EFRAG Summary Report and Recommendations (e.g., call for additional clarifications on the definition of financing category, including the classification of hybrid instruments) will be addressed during the drafting process.

58 The EFRAG Secretariat considers that the IASB complied with the due process requirements and welcomes the IASB's decision to commence the balloting process of the Standard.

Questions for EFRAG FR TEG

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

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