

# COMMENTS ON IASB'S PRIMARY FINANCIAL STATEMENTS EXPOSURE DRAFT (ED)

## NEW IFRS TO REPLACE IAS1

*30 September 2020*

## I – Introduction and general comments

EFAMA<sup>1</sup> is grateful for the opportunity to comment on the International Accounting Standards Board (Board) [Exposure Draft ED/2019/7](#) (ED) General Presentation and Disclosures, including [Basis for Conclusions](#) (BC) and [Illustrative Examples](#) (IE).

The proposals in the ED aim to improve how information is communicated in the financial statements, with a focus on information in the statement of profit or loss. The proposals would result in a new IFRS Standard that sets out general presentation and disclosure requirements relevant for all companies, replacing IAS 1 Presentation of Financial Statements. IASB is also proposing to amend some other IFRS Standards. In the ED, the IASB Board proposes the following key changes:

- New layout for the P&L statement, including 3 new mandatory sub-totals. Currently IFRS does not have a set layout, resulting in entities using different formats and making it difficult for investors/analysts to compare performance.
- New requirement around disaggregating and analysing operating expenses in P&L statement and notes to the Financial Statements (FS).
- New disclosure in the audited notes to the FS, requiring a reconciliation of P&L related 'management performance measures' (MPMs) made outside the FS to the P&L statement sub-totals.

Before commenting on the several queries raised in the public consultation documents, EFAMA takes the opportunity to share the following general comments:

- In general, EFAMA is very supportive of IASB's efforts to improve consistency in the layout of the primary financial statements and to overall improve the relevance of the financial statements.
- Specifically, the proposals around new defined sub-totals and line items will improve consistency and will assist in the implementation of electronic reporting format initiatives such as the European electronic reporting format (ESEF)<sup>2</sup> and other technology advances.
- Currently most funds are presented in a similar way and comparable. However, based on the examples that are being considered, if the IASB decides to move forward with the proposals at stake there is a risk of losing the comparability.
- EFAMA calls the IASB to understand that Balance Sheet should be structured differently for an investment fund. Thus either we should add more examples (which will make the standard longer) or go back to a more non-rule based but more principle based way of drafting the standard.

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<sup>1</sup> The European Fund and Asset Management Association, EFAMA, the voice of the European investment management industry, represents 28 member associations, 60 corporate members and 23 associate members. At end Q2 2020, total net assets of European investment funds reached EUR 17.1 trillion. These assets were managed by almost 34,200 UCITS (Undertakings for Collective Investments in Transferable Securities) and more than 29,100 AIFs (Alternative Investment Funds). More information available at [www.efama.org](http://www.efama.org)

<sup>2</sup> Commission [Delegated Regulation \(EU\) 2018/815 of 17 December 2018](#) supplementing Directive 2004/109/EC of the European Parliament and of the Council with regard to regulatory technical standards on the specification of a single electronic reporting format. More information and guidance on ESEF is available on [ESMA's website](#).

## II – EFAMA comments on specific questions:

Besides the aforementioned general comments, EFAMA takes the opportunity to comment on the specific questions set out in the ED.

### Question 1—operating profit or loss

Paragraph 60(a) of the Exposure Draft proposes that all entities present in the statement of profit or loss a subtotal for operating profit or loss. Paragraph BC53 of the Basis for Conclusions describes the Board’s reasons for this proposal.

We agree with the proposal and the explicit mention that this category includes income and expenses (including realised and unrealised returns) from investments if made in the course of the entity’s main business activities. In practice, most investment funds already present a similar “operating profit/loss” sub-total. IASB’s proposal to define this sub-total will therefore improve consistency and comparability in practice.

### Question 2—the operating category

Paragraph 46 of the Exposure Draft proposes that entities classify in the operating category all income and expenses not classified in the other categories, such as the investing category or the financing category. Paragraphs BC54–BC57 of the Basis for Conclusions describe the Board’s reasons for this proposal.

We agree in principle with the proposal, however we seek some clarifications.

In practice, most investment funds already present most income and expenses within an operating category, except for certain financing expenses. IASB’s proposals as detailed in Paragraph 52, B30 and BC57, indicates that financing expenses such as interest expense on bank overdrafts or other financing arrangements, incurred as part of an investment fund’s main business activity investing in financial instruments, may need to be presented within the operating category. For example, if bank overdrafts or other short-term credit facilities are managed by the investment fund as part of its cash management strategy then the interest expense on such cash balances and bank overdrafts would form part of the operating activity in the cash flow statement. On the other hand, to the extent loans and borrowings are undertaken to finance the assets under management of the investment fund, then cash flows on interest on such financing activities would probably form part of the financing activity in the cash flow statement. This could therefore give rise to unnecessary subjectivity and different interpretation in practice and would therefore recommend that the IASB provides some clarification on this point or alternatively recommend that this exception related to cash & cash equivalents is eliminated for consistency.

We would also recommend that B30 is expanded to include or make reference to investment Entities (as defined in IFRS 10). This will further improve consistency in presentation between Investment Entities regardless of whether investing in financial instruments and or non-financial instruments such as property.

### Question 3—the operating category: income and expenses from investments made in the course of an entity’s main business activities

Paragraph 48 of the Exposure Draft proposes that an entity classifies in the operating category income and expenses from investments made in the course of the entity’s main business activities. Paragraphs BC58–BC61 of the Basis for Conclusions describe the Board’s reasons for this proposal.

We agree with the proposal. Please also refer to our response to Question 2 in relation to the presentation of financing expenses for investment funds.

**Question 4—the operating category: an entity that provides financing to customers as a main business activity**

No response.

**Question 5—the investing category**

Paragraphs 47–48 of the Exposure Draft propose that an entity classifies in the investing category income and expenses (including related incremental expenses) from assets that generate a return individually and largely independently of other resources held by the entity, unless they are investments made in the course of the entity’s main business activities. Paragraphs BC48–BC52 of the Basis for Conclusions describe the Board’s reasons for the proposal.

We agree with the proposal and specifically paragraphs 48 and BC48. In practice, most investment funds already present investment related income and expenses arising from their main business activity within the operating category. However, we would suggest that the IASB also explicitly clarifies that, for such investment funds, fair value measurement gains/losses from financial instruments shall also be presented within the operating category.

Please also refer to our response to Question 2 in relation to presentation of financing expenses.

**Question 6—profit or loss before financing and income tax and the financing category**

(a) Paragraphs 60(c) and 64 of the Exposure Draft propose that all entities, except for some specified entities (see paragraph 64 of the Exposure Draft), present a profit or loss before financing and income tax subtotal in the statement of profit or loss.

(b) Paragraph 49 of the Exposure Draft proposes which income and expenses an entity classifies in the financing category.

Paragraphs BC33–BC45 of the Basis for Conclusions describe the Board’s reasons for the proposals.

We agree in principle with the proposal. However we would recommend that the exception detailed in Paragraph 48 is extended to the application of both Paragraphs 51 and 52. Otherwise entities which apply Paragraph 52, and present all their income and expenses in the operating category, will need to report two sub-totals “Operating Profit or Loss” and “Profit or loss before financing and income tax” with the same figure.

Please also refer to our response to Question 2 in relation to the presentation of financing expenses for investment funds.

**Question 7—integral and non-integral associates and joint ventures**

No response.

**Question 8—roles of the primary financial statements and the notes, aggregation and disaggregation**

(a) Paragraphs 20–21 of the Exposure Draft set out the proposed description of the roles of the primary financial statements and the notes.

(b) Paragraphs 25–28 and B5–B15 of the Exposure Draft set out proposals for principles and general requirements on the aggregation and disaggregation of information.

Paragraphs BC19–BC27 of the Basis for Conclusions describe the Board’s reasons for these proposals.

We agree in principle with the proposal. However we do not agree with Paragraph 28 of the IASB’s proposals which requires information in the notes about the composition of aggregate immaterial items presented as ‘Other’. This conflicts with the concept of materiality and in practice may effectively lead to detailed disclosures of immaterial items<sup>3</sup>. It should be clarified that this requirement is only applicable where the aggregated item itself results in a material “Other” balance.

**Question 9—analysis of operating expenses**

Paragraphs 68 and B45 of the Exposure Draft propose requirements and application guidance to help an entity to decide whether to present its operating expenses using the nature of expense method or the function of expense method of analysis. Paragraph 72 of

the Exposure Draft proposes requiring an entity that provides an analysis of its operating expenses by function in the statement of profit or loss to provide an analysis using the nature of expense method in the notes.

Paragraphs BC109–BC114 of the Basis for Conclusions describe the Board’s reasons for the proposals.

We agree with the proposal. In practice, most investment funds already present operating expenses using the nature of expense method. IASB’s proposal is not expected to have a significant impact for investment funds.

**Question 10—unusual income and expenses**

(a) Paragraph 100 of the Exposure Draft introduces a definition of ‘unusual income and expenses’.

(b) Paragraph 101 of the Exposure Draft proposes to require all entities to disclose unusual income and expenses in a single note.

(c) Paragraphs B67–B75 of the Exposure Draft propose application guidance to help an entity to identify its unusual income and expenses.

(d) Paragraphs 101(a)–101(d) of the Exposure Draft propose what information should be disclosed relating to unusual income and expenses.

Paragraphs BC122–BC144 of the Basis for Conclusions describe the Board’s reasons for the proposals and discuss approaches that were considered but rejected by the Board.

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<sup>3</sup> The disaggregation rules and the disclosure of unusual income may lead to more, rather than less, disclosures. This seems to imply that "other" cannot be used anymore for immaterial items, except if they are again described in the notes (that will include a disaggregation of something that is immaterial). This might not be aligned with the concept of materiality that is being proposed.

We welcome IASB's efforts to define unusual income and expenses and to require entities to disclose such items. However, we do not agree with the IASB proposal to define such items based on whether they have limited predictive value. For instance, Investment funds in their ordinary course of business may receive special dividends or other income from investee companies which inadvertently may meet the definition of unusual income under the current IASB proposal. Meeting the disclosure obligations of Paragraph 101 for each of such income item will be impractical and of limited value to users of the financial statements.

We would therefore urge the IASB to revise the definition of 'unusual income and expenses' to focus on whether the items are unusual for the entities' main business activity rather whether they have limited predictive value, aligning closer to the US GAAP definition of unusual items as follows:

*"The underlying event or transaction should possess a high degree of abnormality and be of a type clearly unrelated to, or only incidentally related to, the ordinary and typical activities of the entity, taking into account the environment in which the entity operates."*

#### **Question 11—management performance measures**

**(a) Paragraph 103 of the Exposure Draft proposes a definition of 'management performance measures'.**

**(b) Paragraph 106 of the Exposure Draft proposes requiring an entity to disclose in a single note information about its management performance measures.**

**(c) Paragraphs 106(a)–106(d) of the Exposure Draft propose what information an entity would be required to disclose about its management performance measures.**

**Paragraphs BC145–BC180 of the Basis for Conclusions describe the Board's reasons for the proposals and discuss approaches that were considered but rejected by the Board.**

**Do you agree that information about management performance measures as defined by the Board should be included in the financial statements? Why or why not?**

**Do you agree with the proposed disclosure requirements for management performance measures? Why or why not? If not, what alternative disclosures would you suggest and why?**

We agree in principle with IASB's efforts to improve the relevance of the financial statements and introduce some discipline around disclosure of Management Performance Measures (MPMs), outside the traditional financial statements

However, we would propose that disclosures are limited to MPMs disclosed in Annual and interim reporting packages (as defined in paragraphs 19B of ED Improvements to IFRS 8 Operating Segments), rather than any communication outside the financial statements over an undefined time period which is too broad.

Further the ED proposes to limit MPM's to subtotals of income and expenses and not to include other financial measures that are based on assets and liabilities and cash flows and are therefore not subject to the proposed disclosure requirements. We suggest the IASB to consider expanding the definition of MPM's to cover also financial measures that are not subtotals of income and expenses. We also would recommend closer alignment to ESMA APM Guideline disclosures and any other similar regulatory disclosures. The current proposed divergence in scope and definitions will make it challenging for preparers to comply with multiple similar disclosure requirements and is of no benefit to users of the financial statements.

#### Question 12—EBITDA

As highlighted by the IASB in BC172 *“EBITDA is one of the most commonly used measures in communications with users of financial statements”*. Bearing in mind this and the fact that fund managers are a significant group of users of accounts, notwithstanding the challenges of this exercise, from an investors perspective (i.e. the perspective of investors in companies, fund managers investing in companies and/or interested in the accounts of companies as part of their research), EFAMA considers that it would be useful for users to have EBITDA defined.

#### Question 13—statement of cash flows

(a) The proposed amendment to paragraph 18(b) of IAS 7 would require operating profit or loss to be the starting point for the indirect method of reporting cash flows from operating activities.

(b) The proposed new paragraphs 33A and 34A–34D of IAS 7 would specify the classification of interest and dividend cash flows.

Paragraphs BC185–BC208 of the Basis for Conclusions describe the Board’s reasons for the proposals and discusses approaches that were considered but rejected by the Board.

Do you agree with the proposals? Why or why not? If not, what alternative approach would you suggest and why?

We agree with the proposal. Specifically, IASB’s proposals should simplify the presentation of operating cash flows and will bring more consistency to the presentation of such line items.

#### Question 14—other comments

Do you have any other comments on the proposals in the Exposure Draft, including the analysis of the effects (paragraphs BC232–BC312 of the Basis for Conclusions, including Appendix) and Illustrative Examples accompanying the Exposure Draft?

We have the following additional comments:

- Illustrative Examples - We welcome IASB’s Illustrative Example for a property investment entity. However, we would also recommend the inclusion of a more generic example for an investment entity trading in financial instruments, which will enable a more consistent interpretation of the proposed IASB requirements for such entities.<sup>4</sup>
- Presentation of Revenue - Paragraph 65 (a) (i) requires the presentation of revenue, however the standard does not further define what’s considered “revenue”. Specifically, we recommend that the standard further defines whether for an investment entity (as defined in IFRS) measurement

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<sup>4</sup> After reviewing the BC and the IE, we understand the proposed changes may make it easier to compare companies, but there is a risk the IASB is missing, as companies may not be that comparable and with the proposals at stake, they may end up pushed into a form that does not fit at the end. As an example: we may have Real Estate funds using the format for these entities (“Example II-1”), but others that use share deals do not fit into the form may end up using forms that are not appropriate to picture their reality. We could not find any examples for a fund investing in securities. Under the new standard none of the examples presented by IASB would fit to our industry’s needs, meaning that funds would be presenting in the general way (via normal balance sheet), which is completely irrelevant in the context of the aforementioned purposes of the IASB – as this does not fit to a security based fund.

gains or losses from financial instruments measured at fair value through profit or loss need to be presented within “revenue” along with interest and dividend income.<sup>5</sup>

- Statement of Cash Flows – The distinction between operating, investing and financing activities is of limited relevance for most investment funds’ entities that primarily trade in liquid financial instruments and have limited external debt or financing arrangements. Furthermore, other key international GAAP such as US GAAP and UK GAAP already allow for an exemption from the requirement to present a statement of cash flows for certain investment fund entities. Therefore, we would recommend that the IASB considers a similar exemption from the requirement to present a statement of cash flows for investment funds entities that meet all the following conditions during the period:
  - a) Substantially all of the entity’s investments were highly liquid;
  - b) Substantially all of the entity’s investments were carried at fair value;
  - c) The entity did not issued any debt (other than redeemable participating shares) or entered in any significant financing arrangements; and
  - d) The entity presents a statement of changes in net assets.
- Carried Interest - We would also welcome further guidance from the IASB on the presentation of Carried Interest within the primary statements. Carried interest is a type of compensation paid to designated investors in investment entities investing in private assets which is not necessary in direct proportion to any capital contributions made by such designated investors. Currently there is a divergence in practice where certain issuers disclose carried interest as an allocation of profits/reserves between such designated investors and other investors in the Statement of Changes in Equity (Ownership model) while other issuer disclose such as an expense item in the Statement of Comprehensive Income (Service model).

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<sup>5</sup> Under IFRS 15 definitions, revenue / income is defined as follows: i) “Revenue: Income arising in the course of an entity’s ordinary activities”; ii) “Income: Increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in an increase in equity, other than those relating to contributions from equity participants”. These definitions do not seem to cover the decrease in fair value in assets/long investments or similarly increase in fair value in liabilities/short investments.