

PRIMARY FINANCIAL STATEMENTS SUMMARY REPORT

FIELD-TEST WORKSHOP WITH FINANCIAL INSTITUTIONS

7 July 2020



Introduction

EFRAG, in close coordination with European National Standard Setters and the IASB[®], is conducting field-tests of the IASB proposals included in the Exposure Draft ED/2019/7 *General Presentation and Disclosures* (ED), which have been published in December 2019.

The purpose of the field-tests is to identify potential implementation and application concerns, determine whether there is a need for additional guidance and estimate the effort required to implement and apply the proposals.

The participants involved were asked to apply the IASB's proposals to their financial statements and answer a questionnaire from EFRAG and the IASB. The results were discussed in a workshop on 7 July 2020.

The following companies participated in this workshop:

- Allianz Group (Germany)
- Alpha Bank (Greece)
- CaixaBank (Spain)
- Erste Group (Austria)

This report has been prepared for the convenience of European constituents to summarise the workshop and will be further considered by the involved organisations in the respective due process on the IASB proposal.

Results of the field-test

Jens Berger, EFRAG FIWG Chairman, welcomed participants, introduced the speakers, and provided an overview of the agenda.

Sue Lloyd, IASB Board member, thanked participants for their participation and time devoted to the preparation of the workshop and **Aida Vatrenjak**, IASB Technical staff, explained the objective of the field-test.

Didier Andries, EFRAG Senior Technical Manager, presented the key themes identified in the feedback received for each topic (please see Appendix 1 – Slides for Discussion).

Aida Vatrenjak, IASB Technical Staff, introduced the points for discussions for each topic (Appendix 1 – Slides for discussion).

TOPIC 1: New subtotals and categories: Classification of income and expenses

The ED proposes that an entity presents three new subtotals and that applying these proposed new subtotals, an entity would present in the statement of profit or loss the categories operating, investing and financing ('integral associates and joint ventures' is discussed below).

Subtotal operating profit or loss

Participants noted that according to the IASB proposals, financial institutions would be formally required to present the subtotal 'operating profit or loss', which would include most of the income and expenses of a bank or a conglomerate (i.e. very little would be presented outside of operating profit). For example, one participant noted that the only items presented outside of operating profit were 'unwinding of discount on pension liabilities and provisions' and 'share of profit or loss of associates and joint ventures, which were not very significant (accounting for between 1 to 3% of the overall profit over the last 6 years).

One participant considered that the new subtotal 'operating profit or loss', as defined by the IASB, would not reflect management's perspective of operating performance. This participant suggested that the IASB considers an alternative approach such as relabelling the subtotal or not requiring this subtotal for financial institutions. This participant also explained that currently their key performance measure was labelled

'operating result', thus they would have to revisit their key performance measures in light of the IASB proposals.

Sue Lloyd asked which type of income and expenses were excluded from the 'operating result'. This participant replied that they excluded, for example, impairments of financial instruments (mainly due to their volatility), provisions under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, impairments on non-current assets under IAS 36 *Impairment of Assets*, gains on sale of non-current assets and contributions to resolution and recovery fund.

Financial conglomerates

One participant explained that the IASB proposals would have a significant impact on the presentation of the statement of profit or loss for financial conglomerates, particularly for those who have banking and insurance activities. This participant called for more guidance on the structure of the statement of profit or loss for financial conglomerates. This significant impact on presentation was because of the interaction of the IASB proposals with the new presentation requirements in IFRS 17 *Insurance Contracts*. For example, it would impact the classification of the interest margin, the new line items related to the insurance result and the absolute amount of expenses included in the statement of profit or loss.

This participant explained that currently the company was using the subtotal 'gross margin' which was required by regulators and provided useful information to users of financial statements. This participant stated that currently there are some lines presented after 'gross income', such as administrative expenses, amortisation and depreciation, that would have to be included in the subtotal *Operating Profit or Loss*. To continue to use the subtotal 'gross margin', this participant explained that they would need to split and reclassify a significant part of their expenses, among other complex adjustments, whose allocation is required by IFRS 17.

Derivatives and hedging activities on net position

One participant questioned the use of the investing category as a default category for derivatives used to manage net risk positions, including those that are not in hedging relationships. Currently, such gains or losses were classified within operating profit. Using the investing category as a default category for such gains or losses would not provide useful information to users of financial statements as the participant's hedging activities were not related to investing activities. Instead, this participant suggested the IASB make operating profit the default category because hedging instruments were mainly related to the operating category, with only some hedging instruments related to the financing category. In addition, this participant noted that currently their IT systems would not allow an allocation of the gains or losses of derivatives to the different categories.

Sue Lloyd asked whether currently this participant had documentation available which could be used if the systems were changed. The participant replied that the information on hedging transactions could be made available but would require a significant change to the systems. The information was recorded at a legal entity level, but it was not centralised because this is not currently a requirement. The participant noted that the proposals on the classification of fair value gains and losses on derivatives and hedging instruments were among the ones of the ED that would require the most important changes to their IT-infrastructure.

Accounting policy choice in the ED for financing income and expenses

Some participants welcomed the accounting policy choice in paragraph 51 of the ED, which had been used for the purpose of the field-test. These participants explained that any split between financing related to customers and pure financing would be artificial, would require significant changes to the systems and would be costly to make.

Aida Vatrenjak asked whether it would be easy to justify an undue cost and effort exception. Participants replied that at this stage they only could say that it would be costly.

Sue Lloyd asked to those that had used the relief in paragraph 51(b) of the ED whether the amounts included in the operating profit were mainly related to 'Net Interest Income' (NII) or whether there was other interest income and expense recognised within operating profit.

One participant explained that NII was a key revenue item and they would prefer to have all interest income and expenses within the operating category. One other participant explained their NII included three main components:

- i) interest revenue following application of the effective interest method in accordance with IFRS 9 *Financial Instruments* (loans and receivables),
- ii) interest from insurance business (investments in bonds) and
- iii) all interest expense had also been included in the NII (interest finance expense for the banking business and insurance finance expense in accordance with IFRS 17).

Finally, another participant explained that they had included everything within operating profit, using the choice available in the paragraph 51 of the ED since the split was currently not available. This participant estimated that would be costly and would require a considerable effort to make the split.

Unwinding of discount

When discussing the line item unwinding of discount of liabilities, participants referred to different experiences:

- One participant said that 'unwinding of discount on pension liabilities and provisions' should also be transferred to the operating category for entities providing financing to customers as a main business activity.
- One other participant said that 'unwinding of discount on pension liabilities and provisions' had been presented in a separate line but within operating profit (see also the comments below with on unwinding of discount in a financial conglomerate).
- One participant noted that 'unwinding of discount on pension liabilities and provisions' had been included in the financing category according to the paragraph 49(c) and B37 of the ED, even though it was not a material item worthy of being presented separately as a line item in the financing category.

TOPIC 2: Integral and non-integral associates and joint ventures

In the ED, the IASB proposes to define and require entities to provide information about 'integral associates and joint ventures' and 'non-integral' separately.

Participants had different experiences by either:

- classifying all associates and JVs as integral,
- having both integral and non-integral, and
- having immaterial investments.

One participant explained that their business in investments in associates and joint ventures were not significant. Thus, this participant considered that they would not need to develop a complex internal guidance for the distinction. Such a policy could be developed within the proposed requirements.

Some participants considered that the IASB's proposals on the distinction between integral and non-integral associates and joint ventures needed to be expanded; i.e. the IASB should reconsider the included indicators and clarify how the indicators should be applied. One of these participants noted that:

- there could be different reasons why an associate does not share the same brand,
- there could be impediments, including legal ones, to use a common network to sell and distribute the products, and

- integrated lines may not be possible if the operations are executed in a different country.

These participants thought there were situations in which the associates should be classified as an integral since the operating activities share many features, and therefore such associates should have an impact on the operating category of the parent entity rather than on the investing category.

These participants called for additional indicators in paragraph 20D of IFRS 12 *Disclosure of Interests in Other Entities* and illustrative examples.

One participant detailed that the indicators proposed in paragraph 20D of IFRS 12 were insufficient to ensure consistent application within and across entities and considered that the proposed distinction would require a high level of judgment, thereby reducing comparability across entities. The participant suggested reconsidering the following elements:

- The role of the link between an associate and joint venture's main business activities and the entity's main business activities, the underlying purpose of the investment and the high level of judgment related to the assessment of a 'significant business disruption'. As to the latter, for instance, it might be appropriate in some cases to not consider the reporting entity's perspective on a stand-alone basis, but rather the business relationship as a whole.
- The link between the different indicators. For instance, the larger an associate / joint venture, the less likely it seems that the associate / joint venture and the entity do in fact have integrated lines of business, however, the more likely it seems that the entity would incur difficulties in replacing a business relationship with this associate / joint venture that would be deemed as a 'significant business disruption'.
- Additional indicators to take into consideration common constellations of associates / joint ventures (e.g. start-ups, cooperations in R&D, cooperations in foreign markets).

Some of these participants also suggested that the focus should be on whether the associate's or joint-venture's business activities are strongly aligned with the entity's main business activities. This could be the case even if the proposed indicators in paragraph 20D of IFRS 12 were not met.

Sue Lloyd asked whether it was an issue related to the lack of clarity of the proposed requirements, disagreement with the rationale of the proposed requirements or both.

Some participants replied it was mainly a question of having more indicators and illustrative examples.

One of these participants clarified that all their investments were made in the course of their main business activities and, thus all related income and expenses should be classified in the operating category, including items related to non-integral associates and joint ventures (even if in separate line items). This is because most of their investments (except for associates and joint ventures accounted for using the equity method that represent a cooperation in the insurance business which are an extension and part of the business, and that would be, conceptually, qualified as integral) were made with the aim to generate investment returns to cover the expenses incurred in the context of the insurance business, namely to cover policyholders' claims. In the view of this participant the link with business activities was not sufficiently clear in the ED.

Sue Lloyd asked, in case the guidance of the ED would be changed, whether this participant would still have both categories of associates and joint ventures (integral and non-integral).

In case the IASB would be willing to change the guidance of the ED by considering the comments made, the participant would still have non-integral associates and joint ventures (for those used to generate investment returns) and integral associates and joint ventures (for those that are related to the insurance business). Also, in certain markets only minority positions are allowed (joint ventures with a minority stake), not permitting a company to exercise control. In such cases, the brand name of the joint venture partner who has the majority of the shares are adopted and for regulatory purposes a company needs to be set up so that it has its own

finances. In these cases, they would still view these joint-ventures as integral, but the current indicators would not allow such classification.

One other participant replied that associates should be classified as integral when the operating activities are broadly the same and their results should be presented within operating profit. This participant also noted that the application of the proposed definition in the context of subgroups may lead to inconsistencies. For example, there was the question of whether an integral associate of a fully owned subsidiary, which uses its own and separate brand, should not be regarded as integral in the ultimate consolidated financial statements, i.e. a follow-through approach would be preferred.

Finally, a third participant considered it was also a question of clarifying the IASB proposals. For example, clarifying the rationale behind the concepts 'integrated line of business' and 'integral to the main business activities of the entity'.

Sue Lloyd and **Aida Vatrenjak** considered that the fact patterns mentioned were relevant and welcomed the input provided.

TOPIC 3: Analysis of expenses

In the ED, the IASB proposes that entities shall present in the operating category of the statement of profit or loss an analysis of expenses using a classification based on either their nature - the nature of expense method - or their function within the entity - the function of expense method, constructed on the method that provides the most useful information to users of their financial statements.

Insurance business

One participant noted that for an insurance company, the structure of the statement of profit or loss would be significantly predetermined due to the requirements in IFRS 9, IFRS 17 and paragraph 65 of the ED. Such predetermined structure would imply the use of a mixed approach. Considering this, it was not clear how entities that are required to use a mixed approach shall apply the requirements regarding the additional disclosures by nature, which would be costly to comply with. That is, whether entities that are required to use a mixed approach would also be required to provide additional information by nature. If so, the participant further questioned whether this would apply to all entities or whether this would only apply to entities that are required to use a mixed approach but analyse the 'discretionary' positions of operating expenses by function. In addition, the participant asked how entities that are required to use a mixed approach should apply paragraph B45 of the ED, which aims at supporting entities in choosing the method of expense analysis that provides the most useful information, if they could not generally elect to present their expenses within operating profit or loss by a single method in the first place.

This participant also questioned the additional information value of providing disclosures by nature when an entity has assessed that the function of expenses method provides the most useful information to users of their financial statements. Further, this participant noted that the requirement to provide disclosures by nature would lead to significant one-off implementation costs for setting up the IT systems which, in the participant's view, are likely not outweighed by benefits for users.

Finally, this participant noted that insurers should be exempted from the requirement to present cost of sales separately when the function of expense method or a mixed approach is applied. This is because:

- i) a separate disclosure of cost of sales does not seem appropriate;
- ii) would be of very limited use for users, and
- iii) it cannot be transferred to entities whose main business activities relate to the insurance business.

One other participant explained that to prepare the statement of profit or loss in accordance with the ED, they had subdivided employee benefits, administrative expenses and amortisations from their main insurance company between expenses directly attributable to insurance contracts and expenses that are not. The

participant had also reclassified the directly attributable ones to 'Insurance service expenses', the rest have remained where they were originally (employee benefits, amortizations or other expenses).

Banking business

One participant explained that as a bank they generally used the 'by nature' presentation. However, this participant noted that certain aspects of 'the function of expense method' could be found in their statement of profit or loss, such as 'administrative expenses'. The participant questioned whether the IASB should introduce restrictions on the mixed basis approach only when concerns actually arise (e.g. for entities that use the 'cost of sales' line item).

Sue Lloyd noted it would be useful to know what administrative expenses are composed of.

The same participant asked how restructuring provisions that relate both to future employee benefits and administrative expenses should be classified by function or by nature.

Financial Conglomerates

One participant noted it was difficult for conglomerates to identify the most useful method by nature or by function. Generally, the participant thought that for conglomerates it was useful to present their expenses from the banking activities by nature and the expenses from their insurance activities by function (i.e. a mixed approach). When applying IFRS 9 and IFRS 17 to their respective activities of the financial conglomerate, there would be two compulsory subtotals: 'Net Interest income' and 'Insurance service result'.

A first concern related to the identification of the acquisition cash flows for insurance contracts under IFRS 17, which is seen as a complex exercise and will require a highly sophisticated analysis.

A second concern related to the comparison of the core revenues from the insurance business and the core revenues from the banking business. This is because the net interest margin for the banking business considers only a narrow scope of costs while for the insurance business, the costs considered are much wider. When comparing these main revenues, users may have difficulties in understanding the outcome. When presenting the remaining expenses by nature, some users might conclude that they only relate to the banking business even though these will also partly relate to the insurance business. For example, in the case of the participant both main businesses share the same network and digital platform to sell contracts (human capital, amortisation and other expenses).

Finally, this participant noted that the example in the ED of a statement of profit or loss for an insurance company was not clear. The functional presentation of expenses contained only one line item and it was not clear how this relates to the general expenses.

TOPIC 4: Management performance measures

The ED proposes to introduce a definition of management performance measures (MPMs) and require an entity to disclose them in a single note. Management performance measures are subtotals of income and expenses that:

- a) are used in public communications outside financial statements;
- b) complement totals or subtotals specified by IFRS Standards; and
- c) communicate to users of financial statements management's view of an aspect of an entity's financial performance.

Definition

One participant noted that for them no significant judgements had been required to identify MPMs. The most detailed information on the company performance could be found in their management report and their Alternative Performance Measures (APMs) report. Generally, the performance measures were being used on consistent basis across all channels. They had not identified additional performance measures for which

disclosures would be required under the proposals. Nonetheless, this participant noted that the company would need to relabel their MPM 'operating profit' which it currently uses in order to explain operating performance and additional disclosures would be required under the current proposals (i.e. income tax & NCI effects).

Another participant had identified 63 Key Performance Measures' (used in their management reports) and only four of these had met the definition of an MPM. They feared that only using these four MPMs and reconciling these with IFRS subtotals to demonstrate performance, the information to users would not be complete. Overall, they had encountered no problems in identifying the MPMs.

One participant currently used 'operating result' as an MPM. This labelling would conflict with the subtotal 'operating profit or loss' as defined by the IASB. It was unclear to them whether the subtotal 'operating income' was an MPM, which was a subset of 'operating result'. The operating income include items like net interest income, net fee income and trading results, which are examples of subtotals similar to gross profit which are not MPM. Even when such items were individually not considered to be an MPM, clarification was necessary whether a combination of these items would be identified as an MPM.

Aida Vatrenjak answered that these items were being excluded because the information about the NCI and tax effects would not be useful for these items.

Income Tax effect and the effect of NCI

One participant had identified the tax and NCI effects but had used a simplified approach. This participant noted that the cost and effort of computing the tax and NCI effects was very high. They sought further guidance on what meant by a 'reasonable pro-rata allocation'. In particular, on how simplified the approach could be and what the aim of the information provided would be as well as on what types of analysis the IASB is expecting to determine such a 'reasonable pro rata allocation'.

One participant agreed that the identification of tax and NCI effects was very high because the inputs are based on national tax ledgers which are based on local GAAP and local legislation. For NCI effects the calculation would be less burdensome but would still require system changes. They also considered that a pro rata allocation may not be seen as reasonable to all users. They noted that this information is nice to have for users but too burdensome for preparers.

Aida Vatrenjak explained this information was highly sought by users as they do their own calculations of adjusted profit and profit per share. Currently not enough information is available for them to do so. They would have sufficient information with one high level ball-park number on respectively tax and NCI effects.

TOPIC 5: Unusual income and expenses

The ED proposes to introduce a definition of unusual income and expenses; and proposes requiring all entities to disclose unusual income and expenses in a single note. The ED also proposes application guidance to help an entity to identify its unusual income and expenses.

One participant noted the definition of unusual income and expenses was too restrictive and the concept 'do not arise for several future annual reporting periods' will require significant judgement. During the year they have several corporate transactions that could or could not be unusual. In order to identify the unusual ones, they used an internal threshold (larger than 10% of group result). They would appreciate more guidance on how to identify such unusual items.

One participant noted the difficulty of determining the number of future periods (i.e. relating to the next two, five or ten years) that should be considered when assessing the requirement 'do not arise for several future annual reporting periods'. Also, more guidance should be provided regarding the expected frequency of an item that leads to the consideration of an item as unusual. E.g. how to deal with an event when it is anticipated to occur twice in the next five years in 20X0 and when it is anticipated to occur four times in the next five years.

Aida Vatrenjak expected that it may be difficult to estimate precisely when a future income or expense may arise, i.e. whether it happens within 3 or 5 years. The purpose of the guidance was not to identify items that are recurring at regular intervals.

One respondent had not identified unusual income or expenses in the previous two periods analysed in the field-test but noted additional guidance would be welcomed. For example, clarification would be welcomed with respect to the question whether income and expenses that are not expected by type and amount (or either by type or amount as suggested in BC131 of the ED) to recur in the future as well as with respect to the question of how many future reporting periods shall be taken into account in this assessment.

Sue Lloyd noted that in the context of COVID-19 one could see long-lasting effects over more than one reporting year which include both changes in the fair value of financial assets measured at FVPL and changes in ECL of loans. While these effects may be long-lasting, they would not necessarily be identified as unusual. However, in 2020, one could argue that due to the sudden occurrence and spike in impairment losses those could be identified as unusual.

TOPIC 6: Statement of Cash Flows

The ED proposes to require an entity to use the operating profit or loss subtotal as the starting point for the indirect method of reporting cash flows from operating activities. The ED also proposes to reduce the presentation alternatives currently permitted by IAS 7 and to require that, in the statement of cash flows, an entity classifies interest and dividend cash flows in a particular way.

One participant noted that in general the cash flow statement did not provide useful information about financial institutions.

One participant noted that the statement of cash flows is not very important for insurers. However, they would conceptually find it useful to align the categories between the statement of cash flows and the statement of profit or loss.

Aida Vatrenjak noted users were not demanding cohesion between cash flow statement and statement of profit or loss. Users are interested in CAPEX in the investing cash flows and depreciation in the operating profit. With cohesion such classification would not be possible. She questioned whether a different labelling could help in clarifying this. She wondered if it was a genuine problem, as the statements served different purposes. Sue Lloyd asked whether the concern was limited to labelling only or whether there was a more fundamental concern.

In the fieldwork no major issues were identified in relation to general guidance on aggregation and disaggregation.

Close of the meeting

Jens Berger, thanked participants for their participation in the field-testing of the IASB proposals included in the Exposure Draft ED/2019/7 *General Presentation and Disclosures* (ED) and for the time devoted to the preparation of the workshop, including the preparation of:

- The statement of profit or loss and the statement of cash flows before and after recasting to reflect the proposals in the ED;
- Selected note disclosures affected by the proposals;
- A completed IASB questionnaire covering the recasting and the application of specific aspects of the ED proposals;
- A completed EFRAG questionnaire covering specific areas of European interest.