EFRAG
European Financial Reporting Advisory Group

EFRAG Comment Letter

International Accounting Standards Board
7 Westferry Circus, Canary Wharf
London E14 4HD
United Kingdom

2 November 2020

Dear Mr Hoogervorst,

Re: IASB ED/2019/7 *General Presentation and Disclosures*

On behalf of the European Financial Reporting Advisory Group (EFRAG), I am writing to comment on the Exposure Draft *General Presentation and Disclosures*, issued by the IASB on 17 December 2019 (the 'ED').

This letter is intended to contribute to the IASB's due process and does not necessarily indicate the conclusions that would be reached by EFRAG in its capacity as advisor to the European Commission on endorsement of definitive IFRS Standards in the European Union and European Economic Area.

EFRAG welcomes that the IASB's ED is focused on improving how information is communicated in the financial statements. This project responds to a strong demand from users of financial statements and respondents to the IASB 2015 Agenda Consultation to undertake a project on primary financial statements. EFRAG particularly welcomes the IASB's proposals to address this request in an Exposure Draft rather than in a Discussion Paper.

EFRAG also agrees with the IASB's proposal to update current requirements through the issuance of a new IFRS Standard, even if the IASB focused on information about performance in the statement of profit or loss. Such an approach has the benefit of highlighting the importance and impact of the proposed changes on the presentation of financial statements across different industries.

EFRAG highlights that the main challenge of this project is to strike the right balance between satisfying the needs of users by providing a more harmonised structure and content of the statement(s) of financial performance, while also allowing management to convey its views of the entity's financial performance.

Summary of EFRAG's views on the ED

New subtotals and categories in the statement of profit or loss

In general, EFRAG welcomes the IASB's efforts to improve the structure and content of primary financial statements, as currently there is diversity in practice on the presentation of subtotals. In particular, EFRAG supports the IASB's proposals to present an operating, investing and financing category, subject to materiality considerations, as they have the potential benefit of reducing diversity in practice and improving comparability of financial statements. However, EFRAG considers that:

- it is key to have clear guidance on the notion of the 'entity's main business activity' or in the course of the 'entity's main business activity' (please see EFRAG's reply to Question 3 in Appendix 1);

- the IASB should consider, as part of the effects of these proposals, the interaction of the IASB proposals with existing regulatory frameworks on the presentation of financial statements;
- both the statement of financial performance and the statement of cash flows will have three different categories with similar labelling (operating, investing, and financing) even if they are not aligned. As long as the two statements are not aligned, EFRAG considers that it would be useful to use a different labelling in the two statements to avoid confusion. As further described below, EFRAG would encourage a separate project on IAS 7 *Statement of Cash Flows* to improve consistency with the new content and structure of the statement of profit or loss;
- the 'free' accounting policy choice in paragraph 51(b) of the ED (for entities that provide financing to customers), while being mainly useful as noted in paragraph BC66 of the Basis for Conclusions for banks, may result in the loss of relevant information for users, when used by non-financial institutions (e.g. manufacturer providing financing to customers);
- it would be useful to consider whether 'incremental expenses' related to financing activities should also be in the financing category, by symmetry, with expenses relating to investing activities;
- it would be useful to further consider the presentation of operating profit or loss when one or more line items between categories are immaterial;
- the IASB should further consider how its proposals should be applied in specific circumstances, including the interaction of the IASB's proposals with IFRS 17 *Insurance Contracts* and IFRS 9 *Financial Instruments*;
- that the IASB should consider how the proposals would have to be applied in the separate financial statements, and
- the IASB should provide more guidance and examples on the classification of foreign exchange differences and of fair value gains and losses on derivatives and hedging instruments to ease implementation.

Integral and non-integral associates and joint ventures

EFRAG's research[1], similar to the findings of other recent studies, has shown that there is diversity in practice on the presentation of the share of profit or loss of associates and joint ventures, which was presented either before or after the subtotal 'operating profit or loss' by the majority of the entities analysed by EFRAG in its early stage analysis. Thus, the IASB's proposal to require a subtotal of operating profit or loss that excludes this component has the potential of enhancing comparability.

EFRAG also welcomes the IASB's efforts to make a distinction between integral and non-integral associates and joint ventures as it would provide relevant information to users of financial statements and help them to easily distinguish between associates and joint ventures that are closely related to the entity's main business activities and those that are not.

However, EFRAG is concerned that the proposed separation of integral and non-integral investments would involve a significant degree of judgement, which would hinder comparability and relevance. With this in mind, EFRAG proposes the IASB to clarify or revisit the concept of integral, including its adjacent definitions of 'main business activity', 'generate a return individually and largely independently of the other assets of the entity' and 'significant interdependency'. Should the IASB go forward with the proposed

[1] The results of this EFRAG's research are presented in Appendix 2 of EFRAG Draft Comment Letter and form the basis for Early Stage Analysis (ESA).

definition, EFRAG suggests that the IASB expands the new proposed paragraph 20D of IFRS 12 *Disclosure of Interests in Other Entities* to widen the scope, to include additional indicators and more examples with the objective of reducing the level of judgement involved.

EFRAG considers that providing separate information on income and expenses from integral and non-integral associates and joint ventures is useful. However, EFRAG does not support the IASB's proposal to require an entity to present, on the face of the statement of profit or loss, a subtotal for 'operating profit or loss and income and expenses from integral associates and joint ventures'. Instead, EFRAG suggests that the IASB requires the presentation of the results of all associates and joint ventures below the subtotal 'operating profit or loss'. These would be presented in a separate line item before the subtotal 'operating profit or loss and income and expenses from associates and joint ventures' on the face of the statement of profit or loss. In addition, EFRAG suggests that the IASB requires the split between 'integral' and 'non-integral' in the notes to the financial statements. EFRAG also notes that, in accordance with paragraph 66 of the ED, entities can always make the split (within the subtotal that includes all associates and joint ventures) on the face of the statement of profit or loss if such split is considered useful.

EFRAG also recommends clarifying how the IASB's proposals would apply to subsidiaries, associates and joint ventures in the separate financial statements.

Roles of the primary financial statements and the notes, aggregation, and disaggregation

EFRAG welcomes the IASB's proposal to describe the respective roles of primary financial statements, the notes and the proposal for principles, and the general requirements on the aggregation and disaggregation, as a complement to the additional subtotals in the statement of profit or loss. EFRAG notes that having the principles and general requirements on aggregation and disaggregation of information in the financial statements, within a single place in the new standard, will improve clarity and consistency. Notwithstanding the above, EFRAG is of the view that some further clarifications on the principle of aggregation are necessary.

Analysis of operating expenses

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

However, EFRAG believes that it would be useful if the IASB clarified its primary objective for the presentation of expenses by nature or by function, including the role and scope of a mixed basis of presentation (i.e. clearly state what a mixed presentation basis is and when such a mixed presentation is allowed). EFRAG is also of the view that further guidance would be useful in a number of areas including to better describe the two methods and to provide a definition of presentation by-function.

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

Unusual income and expenses

EFRAG welcomes the IASB's efforts to define unusual income and expenses and to require entities to disclose such items in the notes, as such disclosure provides useful information to users of financial statements. However, EFRAG highlights that the definition of unusual items seems to be rather narrow, as it only focuses on whether expenses/income will occur in the future. Instead, EFRAG suggests that the IASB considers not only items that 'will not arise for several future annual reporting periods' (as expressed in the ED) but also items that presently occur in the business, but only for a limited period of time (e.g. those identified in paragraph B15 of the ED such as restructuring costs).

EFRAG also calls for the IASB to provide more implementation guidance for preparers. In particular, more guidance on the use of the terms 'several future annual reporting periods' and 'predictive value', which may involve significant judgement, and more guidance on how to report unusual amounts. Interactions with IFRS 8 *Operating Segments* and with the proposals on management performance measures should be further considered as well.

Management performance measures ('MPMs')

EFRAG agrees that non-IFRS measures are often used in practice and additional guidance could bring more transparency and consistency. EFRAG therefore welcomes the IASB's efforts to provide guidance on MPMs.

However, EFRAG considers that the definition of an MPM should be extended to include also measures related to the statement of financial position and ratios and should not be limited to the subtotals presented on the face of the statement of profit or loss. In addition, EFRAG invites the IASB to consider:

- making the definition of public communication narrower, limiting the scope to the MPMs presented in public communications released jointly with the annual or interim reports;
- excluding from the scope the performance measures required by regulators; and
- extending the scope to cover possible MPMs presented in the financial statements but not in other public communications.

EFRAG also suggests that the IASB considers whether a change of the formula of an MPM constitutes a change of an accounting policy in accordance with the guidance of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

EFRAG also considers that the IASB has not sufficiently articulated the link between MPMs and IFRS 8 and suggests that the IASB requires an explanation of how MPMs interact with performance measures already presented under IFRS 8.

With regard to the proposed amendments to IAS 34 *Interim Financial Reporting*, EFRAG has some concerns about requiring a reconciliation of the MPMs to the most directly comparable subtotal or total specified in IFRS Standards as such reconciliations, including the tax effect and non-controlling interest ('NCI') effect, can be costly, particularly when preparing interim financial statements at consolidated level (e.g. tax includes income tax of different subsidiaries and not transactions).

EBITDA

EFRAG acknowledges that EBIT and EBITDA are among the most used performance measures. During EFRAG's outreach activities mixed views were provided as to whether EBIT and EBITDA should be defined. As such measures have not been defined by the IASB, EFRAG considers that they should be included in the scope of the IASB's proposals regarding MPM disclosures (which requires reconciliation with the most directly comparable IFRS specified subtotal).

In addition, EFRAG suggests that the IASB clarifies the principle behind the list of measures not considered to be MPMs provided in paragraph 104 of the ED.

Statement of cash flows

EFRAG supports the IASB's proposal to require entities to use 'operating profit or loss' as the starting point for the indirect reconciliation of cash flows from operating activities in the statement of cash flows. This is because it specifies a consistent starting point for the indirect method of reporting cash flows from operating activities and reconciles the operating category in the statement of profit or loss with the operating activities in the statement of cash flows. EFRAG also supports the removal of options for the classification of interest and dividends in the statement of cash flows for non-financial entities, as it will improve consistency in presentation of similar line items and will better reflect the nature of the respective cash flows.

However, EFRAG suggests that the IASB has a separate project on IAS 7 with the objective of having a comprehensive review of the challenges that arise in practice (e.g. financial institutions) and improve consistency with the new content and structure of the statement of profit or loss.

Other comments: presentation of revenue and costs in different business lines

EFRAG highlights that, currently, there is diversity in practice in how entities that operate business activities in different industries present their performance (e.g. a manufacturer providing financing to customers or entities operating both banking and insurance services). Some entities present information about their different business activities in the statement of profit or loss, as part of operating profit, by adding separate rows and allocating revenues and expenses reflecting the different business activities (as in paragraph IE11 of the Illustrative Examples). On the contrary, other entities present all income and expenses related to different business activities without any business activity distinction, accompanied by more detailed information in the segment reporting section in accordance with IFRS 8.

EFRAG considers that it could be useful if the IASB could further explain how entities with different business activities should prepare their financial statements, especially when considering the example provided by the IASB in paragraph IE11 of the Illustrative Examples. The IASB should consider providing further illustration on how the split between the operating/financing and investing categories should be done in this case. In addition, the need for consistency with the requirements in IFRS 8 should be considered together with the disclosure of judgement applied to allocate revenues and costs across business activities (e.g. in case of group internal transactions between businesses), when they are presented separately on the face of the statement of profit or loss.

Other comments: proposals on other comprehensive income

EFRAG does not consider that the IASB's proposals on other comprehensive income ('OCI') are a significant improvement as they simply modify the labelling of OCI line items. EFRAG considers that it will be difficult to significantly improve the communication and understandability of OCI without addressing the distinction between profit or loss and OCI and the role of recycling.

Other comments: effective date and transition

EFRAG recommends that consideration is given to the practicalities and timescales of implementation of IFRS 17 together with any new standards or amendments arising from the ED.

EFRAG considers that the proposed time of 18 to 24 months for a retrospective first-time application may not be sufficient, particularly if the IASB decides to proceed with all its proposals (e.g. disclosures by nature when presenting by function).

EFRAG has also provided additional suggestions to improve presentation in the primary financial statements in Question 14 *Other comments*.

EFRAG's detailed comments and responses to the questions in the ED are set out in Appendix 1 *EFRAG's responses to the questions raised in the ED*.

If you would like to discuss our comments further, please do not hesitate to contact Filipe Camilo Alves, Robert Stojek or me.

Yours sincerely,

Jean-Paul Gauzès

President of the EFRAG Board

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Appendix 1 - EFRAG's responses to the questions raised in the ED

Question 1 – operating profit or loss

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.

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

EFRAG's response

In general, EFRAG supports the IASB's efforts to improve the structure and content of primary financial statements, particularly the statement of profit or loss.

EFRAG highlights that 'operating profit or loss' is one of the most used subtotals and currently there is a lack of consistency in its use, labelling and definition. Thus, EFRAG supports the IASB's proposal to require all entities to present, on the face of the statement of profit or loss, the subtotal 'operating profit or loss' (with its consequent labelling), to reduce diversity in practice and improve comparability of financial statements.

Nonetheless, EFRAG calls for the IASB to further consider the presentation of required subtotals when one or more line items between categories are immaterial.

Improvements to the structure and content of the statement(s) of financial performance in general

1 EFRAG acknowledges that the structure and content of the statement(s) of financial performance vary even among entities in the same industry and that this might reduce the ability of users of financial statements to compare the financial performance of different entities. Therefore, EFRAG supports the IASB's efforts to improve the structure and content of primary financial statements, particularly on the statement of profit or loss, as the IASB's proposed improvements address issues that have high priority within the IASB's work plan.

2 Nonetheless, as further detailed in Questions 3 and 4 below, EFRAG highlights that in many jurisdictions regulators and national standard setters have specific presentation requirements in addition to those required by the IFRS Standards. EFRAG suggests that the IASB closely communicates with regulators on this topic to avoid a situation where entities will need to prepare different sets of financial statements to comply with IFRS and regulators' requirements.

3 EFRAG also highlights that both the statement of financial performance and the statement of cash flows are not aligned and will have three different categories with similar names (operating, investing, and financing). As a result, for example, the cost of an item of property, plant and equipment (e.g. depreciation expenses) would be included in the category 'operating profit or loss' while investments in long-term assets (e.g. property, plant and equipment) would be classified as investing activities in accordance with IAS 7. Similarly, 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 suggests using a different labelling from IAS 7 and to review the classification of integral associates and joint ventures to avoid confusion.

4 In addition, as further explained in Question 13 of our letter, EFRAG would encourage a separate project on IAS 7 to improve consistency with the new content and structure of the statement of profit or loss.

Operating profit or loss

5 With regard to the IASB's proposal to require all entities to present in the statement of profit or loss a subtotal for operating profit or loss, EFRAG highlights that 'operating profit or loss' is one of the most used subtotals and currently there is lack of consistency in its use, labelling and definition. The subtotal 'operating profit or loss' also plays an important role in investment and financial analysis decisions.

6 Thus, EFRAG supports the IASB's proposal to require all entities to present 'operating profit or loss' to reduce diversity in practice and improve comparability of financial statements. Nonetheless, on the basis of feedback received from its constituents, EFRAG understands that there are cases where one or more line items between categories or even a required subtotal would be immaterial. Considering this, the IASB should clarify whether, and if so, how entities should present their subtotals in such circumstances. For example:

(a) the investment amounts can be immaterial for entities that do and do not invest as part of their main business or in the course of their main business (if such investments are material, then it is likely that they will be presented in operating profit). Similarly, there may be cases where investments in associates and joint ventures are immaterial. In such cases, the subtotal 'operating profit or loss' would be equal to 'Profit or loss before financing and income tax' (this often occurs in practice). This would raise questions on which would prevail, or whether an entity has to present a line with an immaterial or even nil amount as it is a required subtotal (as is it the case for some national guidance on presentation in primary financial statements); and

(b) for banks and financial conglomerates, most of the income and expenses would be presented within the subtotal 'operating profit or loss'. Only the share of profit or loss of associates and joint ventures and unwinding of discount on pension liabilities and provisions would be presented outside of operating profit or loss (as in Illustrative Example II-3). If these items are not material, the subtotal 'operating profit or loss' would be equal to 'profit or loss before tax'. This would also raise questions on which would prevail or whether an entity has to provide both.

Question 2 – the operating category

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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.

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

EFRAG's response

EFRAG supports the IASB's proposal to define the 'operating category' as described in paragraph 46 of the ED. EFRAG notes that in paragraphs 46 and

B25-B31 of the ED, the IASB starts by defining the operating category positively and then introduces a residual element in its definition. This residual element is further explained in paragraphs BC54 and BC55 of the Basis for Conclusions.

In this context, EFRAG highlights the importance of having clear guidance on the notion of the 'entity's main business activity' or 'in the course of the entity's main business activity'.

EFRAG also considers that the IASB should further consider how its proposals should be applied in specific circumstances, including the interaction of the IASB's proposals with IFRS 17 *Insurance Contracts* and IFRS 9 *Financial Instruments.*

EFRAG highlights some challenges on the classification of foreign exchange differences and of fair value gains and losses on derivatives and hedging instruments and difficulties of the IASB's proposals in specific circumstances.

Finally, EFRAG suggests that the IASB considers how the proposals would have to be applied in the separate financial statements.

7 EFRAG supports the IASB's proposal to define 'operating profit or loss' and 'operating category' as described in paragraph 46 of the ED. The subtotal 'operating profit or loss' (or a variation of a similar concept) is widely used in practice and having a common definition would have the benefit of improving comparability between entities.

8 In particular, EFRAG notes that in paragraphs 46 and B25-B31 of the ED, the IASB starts by defining the operating category positively ('includes information about income and expenses from an entity's main business activities') and then introduces a residual element in its definition. This residual element is further explained in paragraphs BC54 and BC55 of the Basis for Conclusions. Such a definition is suitable to accommodate the needs of different business models, including those of financial institutions, and allow the use of additional subtotals within operating profit when deemed necessary (e.g. gross profit, net interest income, etc). Therefore, EFRAG considers that the outcome of the IASB's approach to define 'operating profit or loss' will provide useful information to users of financial statements.

9 Feedback from the outreach and comment letters shows that there are reservations on this approach to the definition. In particular, constituents observe that the combination of a positive definition and a residual element would result in presenting a complete picture of an entity's operations in one category, but at the same time would include in this category not only 'the entity's main business activity' (as per the positive definition), but also residual or ancillary activities (i.e. not part of the entity's main business activities).

10 Nonetheless, EFRAG notes that the in accordance with paragraph 42 of the ED, the ED requires entities to define and present additional line items or subtotals within operating profit and/or to use MPMs (e.g. 'adjusted operating profit' or 'core profit') if entities wish to present such minor or ancillary business activities separately within operating profit or loss.

11 In order to enhance the understandability of the resulting information, EFRAG considers that when entities choose to present on the face of the statement of profit or loss additional line items or subtotals for their residual or ancillary operating activities, specific disclosure should be required, including a narrative description of the nature of the entity's operations, its main business activities and residual or ancillary activities, as this would help users understand the classification of income and expenses in the different categories. In addition, the IASB should consider improvements to the interaction between the proposal in the ED and IFRS 8, by, for example, including minor or auxiliary business activities (i.e. not main business activities) as a different segment.

12 For possible improvements to the definition of investing and financing category, refer to Questions 5 and 6.

Clarifying the notion of the 'entity's main business activity' or 'in the course of the entity's main business activity'

13 In this context, EFRAG highlights the importance of having clear guidance, including definition, on the notion of the 'entity's main business activity' or 'in the course of the entity's main business activity' as the allocation of income and expenses to the operating category significantly relies on these notions and the use of such concepts might involve significant judgement. More specifically. further clarification is needed regarding:

(a) the notion of 'an entity's main business activities', especially when considering different levels of reporting entities in a group context (e.g. the IASB should clarify as to whether the classification made at a lower reporting entity level shall be maintained after consolidation of the entity/subgroup into the financial statements presented);

(b) when an entity is permitted or even required to reassess what constitutes its main business activities, including related disclosures and reclassification consequences (e.g. whether comparatives need to be adjusted);

(c) as already mentioned above, narrative disclosures with a description of the nature of the entity's operations and its main business activities would be useful to help users understand the classification of income and expenses in the different categories;

(d) the rationale for a different treatment of interest related to extended credit/debit terms for customers and suppliers; and

(e) the link between the concept 'main business activities' in the ED and IFRS 8, in particular how the notion of operating profit will interact with information presented under IFRS 8 (e.g. whether there is a need to present the operating profit by segments and reconciled with IFRS 8 information).

14 This is further explained in Question 3 below.

Improvements to the definition of an operating profit or loss

15 EFRAG also suggests that the IASB should further consider how its proposals should be applied in specific circumstances:

(a) for entities that invest in the course of their main business activities, investments in associates and joint ventures that are part of an entity's investment strategy and where substantially all risks and rewards impact parties other than shareholders (e.g. investments that fund insurance liabilities included in the operating category) should be also presented in the operating category; and

(b) the interaction of the IASB's proposals with IFRS 17 and IFRS 9. In particular, consider the impact of requiring entities to present in operating profit or loss the changes in the current fulfilment value of insurance liabilities under IFRS 17 and the changes in fair value of financial assets under IFRS 9 (i.e. include in operating profit or loss the investment variances and economic assumption changes), particularly when comparing to entities that opt to use other comprehensive income (OCI). Also, the interaction between the operating and investing category and the presentation requirements in IFRS 17.

Definition of operating profit or loss in Appendix A of the new IFRS Standard

16 EFRAG recommends that the IASB includes definitions for each of the new categories – 'operating', 'investing' and 'financing' – in Appendix A of the new IFRS

Standard and highlights the importance of having clear and independent definitions of investing and financing categories.

Classification of foreign exchange differences and of fair value gains and losses on derivatives and hedging instruments

17 In the ED, the IASB proposes that an entity is required to classify foreign exchange differences and fair value gains and losses on derivatives and hedging instruments in the same sections of the statement(s) of financial performance as the income and expenses arising from the items that gave rise to the foreign exchange differences and the items hedged.

18 From a conceptual point of view, EFRAG sees merits in the IASB proposals on the classification of foreign exchange differences and of fair value gains and losses on derivatives and hedging instruments. Nonetheless, feedback from preparers shows that tracking exchange differences, hedging or risk mitigation activities related to the operating, investing, and financing categories can be burdensome and costly (as mentioned in paragraph BC285(b) of the Basis for Conclusions), and may outweigh the benefits of classifying the items in the sections of the statement(s) of financial performance. Thus, EFRAG considers that the IASB should consider further the cost/benefit profile of this proposal.

19 In addition, some preparers have reported possible resulting mismatches between different line items, if the aggregated result of underlying components and hedging/risk mitigation components is not presented in the same category. Thus, EFRAG suggests that the IASB clarifies how such requirements should be applied. More specifically, clarify the guidance on hedging instruments that hedge a group of items with offsetting risk positions when all hedge items are within one category (operating category) and allow the presentation of related gains and losses in that category (i.e. operating category).

Presentation in the separate financial statements

20 EFRAG highlights that the IASB’s proposals would also apply to separate financial statements. In particular, the IASB's proposals would apply to subsidiaries, associates and joint ventures in the separate financial statements, which may in some cases raise questions on where to present such income and expenses.

21 For example, it is not clear whether the parent company in its separate financial statements should classify:

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

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

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

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

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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.

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

EFRAG's response

EFRAG agrees with the proposal as it will enhance the comparability between entities and provide relevant information to users of financial statements.

Nonetheless, EFRAG calls upon the IASB to closely communicate with regulators on the interaction of the IASB proposals with existing regulatory frameworks, particularly those that exist across Europe (e.g. on the use of additional subtotals).

EFRAG also highlights the importance of clarifying the notion of the 'entity's main business activity' or 'in the course of the entity's main business activity', including illustrative examples of investments that are not made in the course of an entity's main business activities.

23 EFRAG agrees with the proposal as it will enhance the comparability between entities and notes that in a majority of cases income and expenses from investments made in the course of the entity's main business activities (e.g. dividends, interest received, rental income, etc.) are already part of the operating profit in the financial sector.

24 In many EU jurisdictions regulators have specific presentation requirements in addition to those required by the IFRS Standards. EFRAG suggests that the IASB closely communicates with regulators on this topic to avoid entities having to prepare different financial statements to respectively comply with IFRS and regulators' requirements. The IASB should consider, as part of the effects of these proposals, the interaction of the IASB's proposals with existing regulatory frameworks on presentation of financial statements.

Clarify the notion of the 'entity's main business activity' or 'in the course of the entity's main business activity'

25 EFRAG also highlights the importance of having clear guidance on the notion of 'in the course of the entity's main business activity' as the allocation of income and expenses to the operating category significantly relies on these notions and use of such concepts will involve significant judgement.

26 For example, it may be useful to clarify that paragraph B31 of the ED ('if, applying IFRS 8, an entity reports a segment that constitutes a single business activity, that may indicate that that business activity is a main business activity') also complements paragraph B27 of the ED.

27 It would also be useful to complement paragraph B27 of the ED with more examples of entities that invest outside of their main business activities or even mention the company's statutes, which typically define the business to be undertaken by the company. Such guidance could help management to decide when there is a need

for an entity to separate returns from investments made in the course of their main business activities from those that are not, as such a split may involve significant judgement.

28 EFRAG also considers that the IASB should clarify some aspects of the proposals to help implementation. In particular:

(a) how its proposals should be applied to investment entities. In many cases the investment entities get financing to finance assets under management. According to the IASB proposals, it seems that income and expenses from cash and cash equivalents (overdrafts) would be presented in the operating category while income and expenses from loans and borrowings would be in the financing. This raises the question of whether investments entities can classify within the operating category the financing activities made in the course on the entity's investment activities (i.e. whether income and expenses from loans and borrowings that are undertaken to finance the assets under management of the investment fund should be within operating together with income and expenses from investments and cash and cash equivalents); and

(b) provide illustrative examples of investments that are not made in the course of an entity's main business activities (e.g. investments made in order to meet capital requirements set by regulators).

29 EFRAG also highlights the challenges of applying these concepts to entities with multiple business activities, that include investing and financing activities, particularly when considering the perspectives of the legal entity (parent or a subsidiary) in the separate financial statements and of the group.

Separating returns from investments made in the course of an entity's main business activities from those that are not

30 EFRAG acknowledges that separating returns from investments made in the course of an entity's main business activities from those that are not can be challenging and, in some circumstances, costly. EFRAG notes that judgement would need to be applied, including in assessing materiality and, as explained above, illustrative examples would be helpful to support the implementation.

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

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

Paragraph 51 of the Exposure Draft proposes that an entity that provides financing to customers as a main business activity classify in the operating category either:

- income and expenses from financing activities, and from cash and cash equivalents, that relate to the provision of financing to customers; or
- all income and expenses from financing activities and all income and expenses from cash and cash equivalents.

Paragraphs BC62–BC69 of the Basis for Conclusions describe the Board's reasons for the proposals.

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

EFRAG's response

EFRAG agrees with the IASB's proposal for entities that provide financing to customers as a main business activity, as it provides relevant information to users of financial statements.

The 'free' accounting policy choice in paragraph 51(b) of the ED (for entities that provide financing to customers), while being mainly useful for banks, as noted in paragraph BC66 of the Basis for Conclusions, may result in the loss of relevant information for users, when used by non-financial institutions (e.g. manufacturer providing financing to customers).

EFRAG also highlights the importance to clarify the notion of the 'entity's main business activity' to support its implementation.

31 EFRAG agrees with the proposal as it will provide relevant information to users of financial statements and notes that in most cases income and expenses from financing activities made by an entity that provides financing to customers as a main business activity (e.g. net interest income) are already considered as part of the operating profit, particularly in the financial sector.

32 EFRAG acknowledges the concerns from banks and financial conglomerates about the presentation of the subtotal 'operating profit or loss' if (substantially) all income and expenses relate to main business activities (please see paragraph 6(b) above). Preparers are concerned that this subtotal would be artificial and not contribute to the relevance of the information. Nonetheless, to mitigate this concern, EFRAG notes that in accordance with paragraph 42 of the ED, the IASB requires entities to define and present line items and additional subtotals to illustrate the different component of the overall banking profitability (e.g. net interest income or net commission income, in line with the current practice) or allows to use MPMs (e.g. adjusted operating profit).

Accounting option on presentation in paragraph 51 of the ED

33 EFRAG acknowledges that the use of options in IFRS reduces comparability between entities, however, agrees with the IASB's argument in paragraph BC68 of the ED that in some cases, because of the difficulty to split income or expenses between the two categories, the allocation should not be required but should be permitted.

34 Even so, EFRAG questions the IASB's proposal to provide a 'free' accounting policy choice in paragraph 51(b) of the ED to non-financial institutions (e.g. manufacturer providing financing to customers). In accordance with paragraph 51 of the ED, such type of entities would not be required to present income and expenses from financing activities in a financing category, although in this case such information would provide relevant information to users of financial statements. Considering this, EFRAG suggests that the IASB restricts and introduces discipline on the use of paragraph 51(b) of the ED and does not allow a free option for the entities described above.

35 EFRAG considers that 51(b) is mainly useful, as mentioned in paragraph BC66, for banks that typically provide financing to customers and invest as part of their main business activities.

36 Finally, as already mentioned in Question 3 above, in many EU jurisdictions regulators have specific presentation requirements in addition to those required by the IFRS Standards. EFRAG suggests that the IASB closely communicates with regulators on this topic.

More implementation guidance

37 EFRAG considers that the IASB should provide additional guidance to help implementation. In particular, provide more guidance and examples on:

(a) financing activities that do not relate to the provision of financing to customers for entities that provide financial services (e.g. collection of funds from customers and investing these funds without as main business activity, without providing funding to clients); and

(b) additional guidance on determining what are the 'main business activities' of an entity, particularly for non-financial entities. EFRAG assesses that for non-financial entities, challenges will arise when deciding whether providing financing to customers is a main business activity or not (e.g. cases where an entity provides significant financing to customers but does not disclose it in a separate business segment under IFRS 8).

Question 5 - the investing category

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.

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

EFRAG's response

EFRAG supports the IASB's proposal to require the presentation of an investing category subject to materiality considerations (in accordance with paragraph 24 of the ED).

Nonetheless, EFRAG considers that the definition of the investing category is not sufficiently clear to ensure consistent and comparable application and that the IASB should better explain the interaction of paragraphs 45 and 60 (on the new requirements related to the categories and subtotals) with paragraph 24 of the ED which refers to the notion of materiality.

Finally, EFRAG is concerned about presenting gains and losses on derivatives in the investing category under certain conditions, particularly when referring to financial institutions.

Presentation of an investing category

38 Even though an investing category is currently not used in practice, EFRAG acknowledges that having a separate investing category may provide useful information to users of financial statements about the returns from investments that are not part of the entity's main business activities, particularly for non-financial institutions.

39 EFRAG notes that the separate investing category will only be used by entities that make investments outside of their main business activities. EFRAG also highlights that these entities will have to consider paragraph 24 of the ED which states that an entity does not need to comply with a specific presentation requirement (i.e.

investing category) if the information resulting from that presentation or disclosure is not material.

40 EFRAG notes that when the investing category is material and not made in the course of the entity's main business activities, presenting an overall subtotal of operating profit or loss (without separate presentation of the income and expenses from the investments) would not allow for a proper appreciation of the risks and diversification of the business model.

41 Thus, EFRAG supports the IASB's proposal to require the presentation of an investing category, subject to materiality considerations (in accordance with paragraph 24 of the ED). Nonetheless, EFRAG considers that the IASB should better explain the interaction of paragraphs 45 and 60 (on the new requirements related to the categories and subtotals) with paragraph 24 of the ED which refers to the notion of materiality (please see paragraph 6 above).

Definition of an investing category

42 EFRAG highlights the complexity of the IASB's proposals on how to separate the investing and financing category, as such a distinction would be judgemental in nature. However, EFRAG considers that the ED proposes a convention for allocation of income and expenses to the three categories (operating, investing, and financing) and such proposal has the merits of supporting comparability of the resulting information.

43 Nonetheless, based on the feedback obtained, EFRAG considers that the definition of the investing category is not sufficiently clear to ensure consistent and comparable application. For example, clarifications are needed for:

(a) what constitutes 'entity's main business activities', including examples of investments that are not part of the entity's main business activities;

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

(c) how entities should classify specific items such as negative interest payments (including the rationale for considering some or all of these components as belonging to the investment category rather than the operating category);

(d) the interaction of the classification of exchange differences and hedging instruments with the chosen presentation of operating expenses (by nature or by function);

(e) the classification of exchange differences (e.g. exchange differences impact the statement of profit or loss but refer to intercompany loans that are eliminated in the consolidated financial statements); and

(f) the classification of hedging instruments (e.g. ineffective hedging portion and non-designated hedging instruments).

44 In addition, EFRAG considers that the IASB should include the definition of 'investing' category in Appendix A of the new IFRS Standard and highlights the importance of having clear and independent definition of investing category.

45 Finally, EFRAG acknowledges the feedback of some constituents, that consider as not pertaining to the main business activities, and thus to the operating category, some specific items, such as contingent consideration from business combinations, goodwill impairment losses, acquisition-related costs incurred in a business combination, the interests paid on investments, gains or losses arising from disposals of businesses and consolidated subsidiaries, remeasurements of

previously held interest in associate and joint ventures due to the obtaining of control over.

46 Nonetheless, as already explained in paragraph 10 above, EFRAG considers that these concerns can be mitigated by the use of MPMs, better disclosures and improved segment information.

Classification of fair value gains and losses on derivatives

47 EFRAG is concerned about presenting gains and losses on derivatives in the investing category under certain conditions (i.e. exceptions related to grossing up of gains and losses or the undue cost or effort), particularly when referring to financial institutions. This is because financial institutions might end up with an investing category just because of their hedging and risk management activities and it will be difficult to explain to users why some income and expenses from hedging and risk management activities have been presented as investments rather than in the operating and financial activities that they typically relate to.

48 In addition, EFRAG suggests that the IASB clarifies whether such items would end up being presented in the operating category when considering the IASB proposal to require entities to present in the operating category, income and expenses from investments made in the course of its main business activities (as in paragraphs 47-48 of the ED).

49 Regarding the classification of fair value gains and losses on derivatives, EFRAG considers that it would be useful to have a definition of 'risk management', to specify on how to deal with discontinuation of hedging positions and whether the results of risk mitigation will be categorised in the same way as hedge accounting.

50 Finally, some preparers have reported possible resulting mismatches between different line items if the aggregated result of underlying components and hedging/risk mitigation components is not presented in the same line. Thus, EFRAG suggests that the IASB clarifies how such requirements should be applied. More specifically, clarify the guidance on hedging instruments that hedge a group of items with offsetting risk positions when all hedge items are within one category (operating category) and allow the presentation of related gains and losses in that category (i.e. operating category).

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

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.

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

EFRAG's response

EFRAG supports the IASB's proposal to require and define 'Profit or loss before financing and income tax' and the 'financing category'. EFRAG highlights that the outcome of IASB's proposals is, to some extent, similar to the concept of Earnings Before Interest and Tax ('EBIT') and that there is a strong demand from users of financial statements to define and require the presentation of a subtotal equal or similar to EBIT.

However, as already mentioned above, EFRAG highlights the challenges of the IASB's proposals to make the distinction between the investing and financing category and calls for the IASB to provide additional guidance to help implementation.

EFRAG has considered that there are arguments to support a different classification of income and expenses from cash and cash equivalents and of time value of money that liabilities that do not arise from financing activities. However, EFRAG concurs with the IASB that the proposed classification in the financing category would provide a reasonable compromise.

Finally, EFRAG notes that in accordance with paragraph BC44 of the Basis for Conclusions, time value of money on liabilities that do not arise from financing activities can be seen either as a component of the operating category or of the financing category. EFRAG accepts the IASB's proposals as a practical approach to identify these components and recommends that the IASB requires a disaggregation in the notes to the financial statements on the main components of the line. Nonetheless, EFRAG would welcome the IASB to explain better the reasoning behind the IASB decision to present in the financing category the effect of the time value of money on liabilities that do not arise from financing activities.

EFRAG notes that it would be useful to consider whether incremental expenses related to financing activities should also be in the financing activities in symmetry with the treatment of expenses relating to investing activities.

Presentation of a financing category

51 EFRAG supports the IASB's proposal to require and define 'Profit or loss before financing and income tax' and the 'financing category'.

52 EFRAG highlights that the outcome of the IASB's proposals is, to some extent, similar to the concept of *Earnings Before Interest and Tax* ('EBIT') and that there is a strong demand from users of financial statements to define and require the presentation of a subtotal equal or similar to EBIT.

Definition of a financing category

53 As mentioned in Question 3, EFRAG highlights the challenges of the IASB's proposals to make the distinction between the investing and financing category, particularly when dealing with the classification of income and expenses from cash and cash equivalents. The feedback from EFRAG's consultation confirms that views are split on which of the approaches provides the most relevant information. For example:

(a) the IASB's approach to consider income and expenses that arise from cash and cash equivalents being related to the entity's financing allows the reflection of managements' intention in managing debt and equity financing;

(b) there might be considerable relevance in another possible approach where the financing category is linked to the management of liabilities that arise from financing activities (as described in IAS 7) and the investing category is linked to the management of investments in assets; and

(c) as the IASB notes in paragraphs BC40 of the ED, that most entities require some cash for operational purposes (for example, as part of working capital), thus it could be viewed more related to operating activities.

54 Considering the different views on the topic, EFRAG accepts the approach proposed in the ED. As noted in paragraph BC40 of the Basis for Conclusions, requiring entities to split cash and cash equivalents between amounts in the different categories could result in operational costs which would outweigh the benefits.

55 Finally, EFRAG notes that in accordance with paragraph BC44 of the Basis for Conclusions, time value of money on liabilities that do not arise from financing activities can be seen either as a component of the operating category or of the financing category. On the one hand, it can be argued that these income and expenses should not be classified in the financing category as they are not aligned with the overall principle of the financing category to be linked to financing activities. But on the other hand, EFRAG acknowledges that many users of financial statements consider such income and expenses to be similar to income or expenses from financing activities and would prefer such income and expenses not to be reflected within operating profit. (Please see detailed comments in paragraph 59 below).

Expenses related to financing activities

56 In accordance with paragraph 47 of the ED, entities would classify in the investing category incremental expenses incurred to generate income and income from investments. However, the ED is silent on incremental expenses related to the financing category.

57 EFRAG considers that it would be useful to clarify whether incremental expenses related to financing activities should also be in the financing category.

Additional guidance on the financing category

58 EFRAG considers that the IASB should provide additional guidance to help implementation; in particular, more guidance and examples on:

(a) the scope of 'other liabilities' in paragraph 49 (c) of the ED. For example, whether and to what extent provisions for uncertain tax positions are within the scope of other liabilities. The IASB should also clarify whether interest income and expenses on uncertain tax amounts are included in the same category; and

(b) clarify whether immaterial items from financing and investing activities can be presented within the operating category.

Income and expenses that reflect the effect of the time value of money on liabilities that do not arise from financing activities

59 EFRAG acknowledges that there are arguments for presenting income and expenses that reflect the effect of the time value of money on liabilities that do not arise from financing activities as operating or financing. For example, the unwinding of the discount on:

(a) *Net interest expense (income) on a net defined benefit pension liability (asset):*

(i) some argue that the net defined benefit liability is an operating liability and therefore the classification of the net interest should be in the operating category together with the service cost; and

(ii) some argue that such liabilities are in substance financing, because retaining them on statement of financial position instead of having defined contribution liabilities or insuring the underlying pension obligation is a financing decision.

(b) *Decommissioning liabilities, restoring and similar liabilities*:

(i) some argue that such liabilities are financing because an entity could make a funding decision to borrow money to transfer, fund or settle these liabilities. Also, in accordance with IFRIC 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities*, the periodic unwinding of the discount shall be recognised in profit or loss as a finance cost as it occurs; and

(ii) some argue that these are operating liabilities and that any interest on these liabilities is an operating cost as, for example, the counterparty is not a lending institution. The reasoning behind this view is that to settle the obligation may be unfeasible due to the non-existence of a market for such obligations, and the obligation therefore cannot be a substitute for the financing of the entity. Also, paragraph BC26 of IFRIC 1 notes that the IFRIC concluded that the unwinding of the discount on a decommissioning liability is not a borrowing cost for the purposes of IAS 23 *Borrowing Costs* because it does not reflect funds (i.e. cash) borrowed.

60 EFRAG is sympathetic to the arguments mentioned in paragraph BC44 of the Basis for Conclusions, that not all users consider that expenses that reflect the effect of the time value of money to be similar to income or expenses from financing activities and to address this issue, EFRAG understands that the proposal in the ED has been retained on a conventional basis. The IASB proposes a separate line within the financing category in order to offer a practical approach to identify these components.

61 Considering the above, EFRAG accepts the proposed approach and recommends that the IASB requires a disaggregation in the notes to the financial statements on the main components of the line. Nonetheless, EFRAG would welcome the IASB to explain better the reasoning behind the IASB decision to present, in the financing category, the effect of the time value of money on liabilities that do not arise from financing activities.

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

Question 7 – integral and non-integral associates and joint ventures

(a) The proposed new paragraphs 20A–20D of IFRS 12 would define ‘integral associates and joint ventures’ and ‘non-integral associates and joint ventures’; and require an entity to identify them.

(b) Paragraph 60(b) of the Exposure Draft proposes to require that an entity present in the statement of profit or loss a subtotal for operating profit or loss and income and expenses from integral associates and joint ventures.

(c) Paragraphs 53, 75(a) and 82(g)-82(h) of the Exposure Draft, the proposed new paragraph 38A of IAS 7 and the proposed new paragraph 20E of IFRS 12 would require an entity to provide information about integral associates and joint ventures separately from non-integral associates and joint ventures.

Paragraphs BC77–BC89 and BC205–BC213 of the Basis for Conclusions describe the Board’s reasons for these proposals and discuss 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?

EFRAG's response

EFRAG welcomes the IASB's efforts to make a distinction between integral and non-integral associates and joint ventures as it would provide relevant information to users.

However, EFRAG is concerned that the IASB's proposed definition would involve significant judgement and, therefore, proposes that the IASB clarifies or revisits the concept of integral, including its adjacent definitions of 'main business activity', 'generate a return individually and largely independently of the other assets of the entity' and 'significant interdependency'. Should the IASB go forward with the proposed definition, EFRAG suggests that the IASB expands the new paragraph 20D of IFRS 12 to widen the scope of integral associates and joint ventures, include additional indicators and more examples with the objective of reducing the level of judgement involved.

EFRAG does not support the IASB's proposal to require an entity to present, on the face of the statement of profit or loss, a subtotal for 'operating profit or loss and income and expenses from integral associates and joint ventures'. Instead, EFRAG suggests that the IASB requires the presentation of the results of all associates and joint ventures below the subtotal 'operating profit or loss'. These would be presented in a separate line item before the subtotal 'operating profit or loss and income and expenses from associates and joint ventures' on the face of the statement of profit or loss. In addition, EFRAG suggests that the IASB requires the split between 'integral' and 'non-integral' in the notes to the financial statements.

Finally, EFRAG recommends clarifying how the IASB's proposals would apply to subsidiaries, associates and joint ventures in the separate financial statements.

Presenting the share of profit or loss of equity accounted investments below the subtotal operating profit or loss

62 EFRAG understands from users' feedback that the presentation of a subtotal of operating profit or loss net of this component provides useful information and will allow for more comparability regarding the operating line. Therefore, EFRAG supports the IASB's proposal to present the share of profit or loss of equity accounted investments below the subtotal 'operating profit or loss'.

Definition of integral associates and joint ventures

63 EFRAG welcomes the IASB efforts to separate the share of profit or loss of integral and non-integral associates and joint ventures, as this could provide relevant information to users of financial statements and help them to distinguish between associates and joint ventures that are closely related to the entity's main business activities and those that are not.

64 However, as confirmed by the feedback received, EFRAG is concerned that the proposed definition would involve significant judgement and raise more questions than answers. In addition, on the basis of the feedback received, preparers consider that the current definition excludes from the integral category some investments that management regards as belonging to their main business activities. Examples include:

(a) investments in entities operating in the markets where the acquisition of control by a foreign entity is generally not possible, nor it is feasible to achieve operational integration; nevertheless, management sees these investments as integral to their business;

(b) investments in entities not using the brand name of the reporting entity for business reasons but nevertheless seen as integral to the reporting entity's business;

(c) in groups with sub-holdings, how to deal with entities that are considered integral in a subgroup (e.g. whether an associate that is integral to a subsidiary should also be reported as integral in the consolidated financial statements of the parent entity); and

(d) investments in entities belonging to the same operating sector as the reporting entity (parent or significant consolidated subsidiaries), where there is no integrated business, but seen as integral to the reporting entity's business.

65 Therefore, should the IASB decide to proceed with its proposals, it should consider clarifying or revisiting the conceptual dividing line between integral and non-integral associates and joint ventures, including anchoring such definition to the concept "main business activity".

66 In addition, clarifications would be welcome on the following concepts: 'generate a return individually and largely independently of the other assets of the entity' and 'significant interdependency' between the entity and an associate or joint venture.

67 To support a better understanding of the split performed by management, the IASB could also consider linking the disclosure of the assumptions supporting the split to the illustration of the main business activity/activities.

68 Finally, EFRAG suggests that the IASB provides more guidance (e.g. indicators) and examples to foster a consistent application of the proposals. The IASB should consider expanding the new paragraph 20D of IFRS 12 to widen the scope of integral associates and joint ventures to address, for example, joint arrangements in capital intensive industries, start-ups, co-operations in research and development, co-operations (minority positions) in foreign markets, etc. and to include additional indicators and more examples with the objective of reducing the level of judgement involved when making a distinction between integral and non-integral entities.

Separate presentation on the face of the statement of profit or loss

69 EFRAG does not support the IASB proposal to require an entity to present on the face of the statement of profit or loss the subtotal 'operating profit or loss and income and expenses from integral associates and joint ventures'. During EFRAG's outreach activities, EFRAG noted, particularly from users of financial statements, that the IASB's proposed requirement to present the subtotal 'operating profit or loss and income and expenses from integral associates and joint ventures' would give undue prominence to the concept of integral associates and joint ventures. This is particularly, when considering that such concept would be highly judgemental and, as such, would not add significant information value to the statement of profit or loss.

70 Instead, EFRAG suggests that the IASB requires the presentation of the results of all associates and joint ventures below the subtotal 'operating profit or loss'. These would be presented in a separate line item before the subtotal 'operating profit or loss and income and expenses from associates and joint ventures' on the face of the statement of profit or loss. In addition, EFRAG suggests that the IASB requires the split between 'integral' and 'non-integral' in the notes to the financial statements. This would allow users to make their decisions regarding the classification of an entity's interests in associates and joint ventures. Finally, EFRAG notes that in accordance with paragraph 66 of the ED, entities can always make the split (e.g. within the subtotal that includes all associates and joint ventures) on the face of the financial statement if such distinction is considered useful.

71 EFRAG also notes that equity accounted investments (associates and joint ventures) may need to be reported in the operating category in the circumstances illustrated in paragraph 15(a) of this letter and suggests that the IASB works on further refinement of the definition of integral and non-integral when substantially all risks and rewards from the investments impact other parties than the shareholders (e.g. creditors, policyholders).

Separate financial statements

72 EFRAG also recommends clarifying how the IASB's proposals would apply to associates and joint ventures in the separate financial statements.

73 For example, if an entity elects to account for its investments in associates and joint ventures at cost in its separate financial statements, this will raise the question of whether the classification of its investments as integral or non-integral will apply.

74 Similarly, for subsidiaries accounted at the equity method in the separate financial statements this will raise the question of whether the classification of its investments as integral and non-integral will apply.

75 More examples are provided in paragraphs 20 - 22 of this letter.

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

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.

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

EFRAG's response

EFRAG welcomes the IASB's efforts to improve the general requirements on disaggregation as a complement to the created additional subtotals in the statement of profit or loss. EFRAG notes that having the principles and general requirements on aggregation and disaggregation of information in the financial statements within a single place in the new standard will improve clarity and consistent application across entities. Notwithstanding the above, EFRAG is of the view that some further clarifications on the principle of aggregation are necessary.

Roles of the primary financial statements and the notes

76 EFRAG welcomes the IASB proposal of providing additional guidance on the respective roles of the primary financial statements and notes. EFRAG considers that defining the roles can help define the boundaries between the notes and the primary financial statements. In EFRAG's view, the term 'primary financial statements' is generally well understood and EFRAG has not heard of major concerns raised by constituents.

77 However, EFRAG recalls that in its comment letter on Discussion Paper DP/2017/1 *Disclosure Initiative - Principles of Disclosure*, EFRAG expressed concern that the proposed role of the primary financial statements focuses too much on the elements (assets, liabilities, equity, income, expenses). More specifically, EFRAG has concerns that the description noted in paragraph 20(a) of the ED may be too narrow. Instead, EFRAG considers that the defined role of the primary financial statements should focus on the overall position, performance, cash flows and stewardship of the entity, rather than the individual line items.

Aggregation and disaggregation

78 EFRAG welcomes the IASB's efforts to improve disaggregation as a complement to the additional subtotals, particularly when dealing with groups of line items that have dissimilar characteristics and if the disaggregation leads to the disclosure of material information.

79 EFRAG considers that having the principles and general requirements on aggregation and disaggregation of information in the financial statements in a single place within the new standard (paragraphs 25-28 and paragraphs B5-B15 of the ED) will bring clarity and improve consistent application, especially when dealing with large residual balances and 'other' balances both in the statement of financial position and statement(s) of financial performance.

80 EFRAG also supports the IASB's decision not to introduce a quantitative threshold for the disaggregation of a group of items. EFRAG is of the view that principle-based rather than a rule-based guidance should be developed to address the over-aggregation of line items.

81 Notwithstanding the above, EFRAG is of the view that some further clarifications on the principle of aggregation are necessary. In particular, it is unclear:

(a) how the principles of (dis)aggregation relate to the use of comparatives. I.e. an entity:

(i) would (not) need to retain the amount of detail presented in prior year financial statements (if it has concluded that another level of aggregation or disaggregation was appropriate); or

(ii) may change its presentation (including a restatement of the comparative information presented).

(b) how an entity can avoid that the application of the proposals in paragraphs 27 and 28 of the ED leads to presentation and disclosure of immaterial items obscuring the presentation of relevant information.

82 EFRAG notes that with regard to presentation of goodwill the proposals in the ED and the IASB Discussion Paper *Goodwill and Impairment* are not aligned. EFRAG is of the view, as explained in paragraph 104, that the unique nature of goodwill requires that any impairments thereof should be presented separately on the face of the income statement.

Question 9 - analysis of operating expenses

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.

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

EFRAG's response

EFRAG supports in principle the IASB's proposal to continue requiring entities to present an analysis of expenses using either by-function or by-nature method,

based on whichever method provides the most useful information to the users of financial statements.

However, EFRAG believes that it would be useful if the IASB clarified its primary objective for the presentation of expenses by nature or by function, including the role and scope of a mixed basis of presentation (i.e. clearly state what a mixed presentation basis is and when such mixed presentation is allowed). EFRAG is also of the view that further guidance would be useful in a number of areas including to better describe the two methods and to provide a definition of presentation by-function.

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

Presenting the analysis of operating expenses either by function or by nature

83 In EFRAG's outreach activities, EFRAG gathered evidence that both the nature of expense and the function of expense methods can provide useful information to users of financial statements. EFRAG understands that, in line with paragraph BC110 of the Basis for Conclusions, a by-nature method may be more helpful for users in forecasting operating expenses, while a by-function method may be considered more helpful for the calculation of some performance metrics. Feedback from the comment letters shows that European users consider the presentation by nature as more important than the presentation by-function, while other international users would consider the two equally important.

84 Considering the above, EFRAG supports the IASB's proposal to continue requiring entities to present an analysis of expenses using either a by-function or a by-nature method, based on whichever method provides the most useful information to the users of financial statements.

Enhanced definitions needed

85 EFRAG understands from the outreach feedback that a better description of the by-function and by-nature methods is needed, particularly if the IASB decides to proceed with its proposals to not allow a mixed presentation basis. EFRAG notes that a definition of 'by-function' is missing.

86 When considering the definitions, EFRAG recommends the IASB to consider the need to depict how the business model is actually put in place, particularly when key operations are externalised and the relevant cost of externalised services may have a relevant informative content from a by-function perspective (e.g. banks that currently report some expense line items that cannot be clearly classified as by-nature or by-function, such as cost of risk).

Deciding which method of expense analysis provides the most useful information

87 Paragraph 68 and B45 of the ED emphasises that the selection of the method is not a free choice and includes a set of indicators to help entities assess which method provides the most useful information to the users of their financial statements. EFRAG understands that the ED aims at strengthening the existing requirements, as users have raised concerns that companies may not choose the method that provides the most useful information in all circumstances.

88 EFRAG considers that the list of factors proposed by the IASB in paragraph B45 can be helpful for entities to determine whether a by-function or by-nature method

provides the most useful information to users. However, EFRAG has gathered concerns about the application of paragraph B45. It is noted that the proposed indicators information in B45 (a) and (b) are neither supporting the nature of expense nor the function of expense method, as internal reports and communication to investors focus on items of income and profit rather than on expense items. Therefore, in practice, the third proposed indicator 'industry practice' (paragraph B45(c)) will likely be the predominant factor. Also, the proposals do not provide guidance for situations where one or more indicators support the nature of expense method, but other indicators support the function of expense method.

Clarification needed on the mixed presentation

89 In paragraph B46 of the ED the IASB explains that an entity shall not provide an analysis of expenses classified in the operating category using a mixture of the nature and the function of expense methods.

90 However, EFRAG notes that the strict prohibition of a mixed approach would raise a number of questions:

(a) in paragraphs 65, B15, and B47 of the ED, the IASB seems to contradict this principle by requiring minimum line items to be presented on the face of the statement of profit or loss regardless of this choice, leading to a mixed presentation (e.g. use of the line item ‘cost of sales’ in by-nature presentation or use of ‘impairment of trade receivables’ in by-function presentation as stipulated in paragraph IE6 of the Illustrative Examples);

(b) the paragraphs 65, 71, B15 and B47 of the ED together with the presentation requirements in IFRS 9 and IFRS 17 would impose a mixed presentation basis for those applying IFRS 17; and

(c) the IASB proposals would raise significant challenges for financial conglomerates which have to present in a single statement of profit or loss the banking and insurance activities. This is because banks generally report on a by-nature basis, while insurers generally report on a by-function basis (both providing the most useful information to their users with regard to their respective activities). When combining both activities into one entity – a financial conglomerate – the prohibition to use a mixed approach would oblige an entity to choose a method in terms of presentation, which would override the most useful information replacing it with – by definition – less useful information.

91 Considering this, EFRAG believes that it would be useful if the IASB clarified its primary objective for the presentation of expenses by nature or by function, including the role and scope of a mixed basis of presentation (i.e. clearly state what a mixed presentation basis is and when such mix presentation is allowed).

92 EFRAG also notes that paragraph B47 of the ED the IASB does not specifically mention paragraph B15 of the ED which may also give rise to the separate presentation in the statement(s) of financial performance of line items of income and expense by nature. Therefore, EFRAG suggests that the IASB includes the reference to paragraph B15 directly in paragraph B47 of the ED for clarity purposes.

93 Finally, as mentioned in Question 14, EFRAG would welcome more guidance on presentation for entities with multiple business activities, including guidance on the analysis of expenses in such circumstances.

Disclosing by-nature when presenting by-function - disclosures

94 While EFRAG supports the principle of a separate disclosure by-nature of the expenses classified in the operating category when presenting on the face of the statement of profit or loss the expenses in the operating category by-function, EFRAG understands that the cost/benefit assessment of the requirement is a source

of concerns for preparers. Accordingly, EFRAG suggests that the IASB considers a more fine-tuned approach.

95 In particular, EFRAG has gathered evidence that, while it is feasible for some entities that present by function to develop information on a by-nature basis in the disclosures, for many others providing information by nature in the disclosures (that would have to match the total operating expenses presented by function in the face of the statement of profit or loss) would involve important costs as their existing systems do not capture such information. EFRAG recalls that there are users that consider the analysis of expenses by nature as essential information (please see paragraph 83 above).

96 To address this issue, EFRAG's outreach has further shown that both users and preparers have showed willingness to arrive at a more balanced outcome (e.g. providing a partial presentation by nature of some operational expenses).

97 Considering this, EFRAG requests the IASB to further extend its cost and benefit analysis by, for example, further investigating which information about operating expenses by nature is fundamental for users of financial statements and whether the costs of providing such information would not outweigh the benefits for users.

98 Finally, EFRAG requests the IASB to further clarify whether and how the proposed requirement in paragraph 72 of the ED is to be applied when entities are required to present on a mixed basis (in accordance with paragraph 65 of the ED and IFRS 17).

Further guidance needed

99 On the basis of the feedback obtained by stakeholders, the following topics may need further guidance.

Definition of by-function

100 As discussed in paragraph 85 above, EFRAG requests the IASB to define the by-function approach more clearly.

Cost of sales and administrative expenses

101 In order to enhance comparability and understandability of the gross profit from sale of goods item, EFRAG proposes the IASB to develop a definition of the cost of sales line item (for example (i) by defining whether this line item refers to past, current or future sales, (ii) whether amortisation of capitalised development costs are included) and require entities to disclose how that line item is composed. This would align with the similar requirement that is set in IFRS 15 with regard to revenues.

102 For the same reasons, EFRAG asks the IASB to develop additional guidance about the item 'administrative expenses' including disclosures on the composition of that item. In addition, it would be useful to explain how such an item could be applied not only in a by-function approach but also in a by-nature approach.

Split of operating expenses by business lines and linkage to IFRS 8

103 EFRAG has been informed that a breakdown of operating expenses by business lines would be useful information to users in determining the valuation of companies they analyse. Hence, EFRAG requests the IASB to consider how the proposals on operating expenses would relate to the requirements of IFRS 8.

Impairment of goodwill – restructuring costs

104 EFRAG notes that the unique nature of goodwill requires that any impairments thereof should be presented separately on the face of the income statement. Similar as what the ED already proposes in paragraph 82 with regard to the presentation of goodwill in the statement of financial position.

105 Also, EFRAG would welcome further guidance on the possibility of using a mixed approach when dealing with restructuring costs.

Addressing changes in estimates (retrospective)

106 EFRAG notes there is uncertainty on how the requirements can be applied retrospectively if an entity concludes that it needs to change its method of expense analysis. EFRAG suggests that changes in the presentation of the method of expense analysis are a change in accounting policies in accordance with IAS 8.

Question 10 - unusual income and expenses

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.

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

EFRAG's response

EFRAG welcomes the IASB's efforts to define unusual income and expenses and to require entities to disclose such items. In EFRAG's opinion, the proposals would result in useful information provided to users and will reduce the diversity in practice of providing financial information about unusual income and expenses.

However, EFRAG highlights that the definition of unusual items seems to be rather narrow, as it only focuses on whether expenses/income will occur in the future. Instead, EFRAG suggests that the IASB considers not only items that will not arise for several future annual reporting periods (as expressed in the ED) but also items that occur presently in the business, but only for a limited period of time (e.g. those identified in paragraph B15 of the ED such as restructuring costs). Thus, EFRAG would suggest that entities are required to provide disclosures of the items identified in paragraph B15 of the ED.

EFRAG notes that the translation of term 'unusual' may raise issues in some jurisdictions.

Finally, EFRAG considers that it would be useful to clarify whether entities can present unusual items on the face of the financial statements by specifically referring to 'unusual line items' and 'unusual subtotals' within the categories defined by the IASB or with the use of columns. EFRAG also calls for the IASB to provide more implementation guidance (e.g. the terms 'several future annual reporting periods' and 'predictive value' may involve significant judgement, and more guidance on how to report unusual amounts).

Definition and disclosures of unusual items

107 Currently, entities often disclose unusual or similarly described expenses and income in order to exclude them from information about underlying or normalised

earnings. However, users of financial statements express concerns that the way entities provide this information varies significantly. It is often not clear how or why items have been identified as unusual.

108 EFRAG therefore acknowledges that information about unusual items is relevant for users of financial statements and that currently there is diversity in practice on how entities provide such information. EFRAG notes the findings of the ESMA Report *On the use of Alternative Performance Measures and on the compliance with ESMA APM Guidelines* (ESMA32-334-150) (ESMA APM Report). In its report, ESMA points to the most common adjustments to APMs items are restructuring and impairment costs. EFRAG notes, however, that the ESMA APM Report only covers entities that are required to apply ESMA APM Guidelines[2].

109 Therefore, EFRAG welcomes the proposals to introduce a definition of unusual income and expenses, guidance to help entities identify unusual income and expenses, and to require entities to disclose such items in the notes to financial statements, in a single place.

110 However, EFRAG highlights that the scope of the IASB's definition seems to be rather narrow, particularly when considering B67 of the ED, as it only focuses on whether expenses/income will occur in the future. This would restrict the number of unusual items identified and, consequently, limit the usefulness of the disclosures.

111 Instead, EFRAG suggests that the IASB considers not only items that will not occur in the future (as expressed in the ED) but also items that are occurring presently in the business, but only for a limited period of time (e.g. those identified in paragraph B15 of the ED such as restructuring costs). Such information would be useful to users of financial statements to forecast future cash flows and identify any disruptions in the earnings trend.

112 Furthermore, there may be a tendency for preparers to continue to focus on unusual expenses rather than unusual income. Thus, EFRAG considers that the explanations in paragraph BC130 of the basis for Conclusions on neutrality in relation to equivalent reporting for unusual income and expense are relevant and could be reflected in the final standard. In this regard, EFRAG would welcome a strong principle from the IASB to define unusual items.

Implementation of the IASB's definition

113 EFRAG would welcome additional guidance to help implementation of its proposals:

(a) EFRAG highlights that the terms 'several future annual reporting periods' and 'predictive value' will involve significant judgement and requests the IASB to further consider and test the use of such terminology, particularly against situations or events such as the covid19 pandemic. For example, regarding some costs such as restructuring costs (that may be present for more than one year) questions will raise on where the limit would be when identifying the affected future periods. EFRAG suggests that the IASB articulates a clear principle for 'limited predictive value';

(b) EFRAG also considers that the IASB should clarify (particularly in paragraph B69 of the ED) whether the whole amount should be recognised as unusual or only the incremental part of it (i.e. costs are outside the range of reasonably expected outcomes and not predictive of future costs) when the amount varies significantly from previous periods. For example, if an entity has litigation expenses, whether a major litigation would be considered as an unusual item in its entirety or whether an entity should only consider the excess amount

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[2] ESMA APM Guidelines became applicable in all EEA countries except Croatia, Denmark and Iceland in July 2016.

when comparing to the amounts of litigation expenses that are inside the range of reasonably expected outcomes. This is relevant when considering, for example, loan impairment losses (normal vs unusual due to covid19);

(c) clarification of the definition of unusual income and expenses: EFRAG notes that it is not completely clear whether the proposal requires income or expenses with limited predictive value to be similar both in type and amount, or fulfilling one of these two criteria is sufficient to meet the definition of unusual. This is because paragraphs B68 ('consider both the type of the income or expense and its amount') and B69 ('Income and expenses that are not unusual by type may be unusual in amount') of the ED seem to be contradictory;

(d) EFRAG suggests that the IASB reconsiders paragraph 101 of the ED so that the information provided on the note on unusual incomes and expenses adheres to the materiality principle, such as significant unusual items;

(e) EFRAG suggests that the IASB considers linking its proposals with IFRS 8. More specifically, entities with multiple business activities should be allowed or even required to analyse and identify unusual income and expenses on a segment level; and

(f) the practice to adjust subtotals of profit or loss to eliminate non-recurring items is widespread. When such MPM is used, the new disclosure of unusual income and expenses may result in offering two different presentation approaches to the same topic. EFRAG suggests the IASB to better articulate how the disclosure on unusual items would interact with MPMs that are adjusted subtotals of profit or loss.

114 To provide more discipline into the implementation of this requirement, EFRAG suggests that the IASB considers requiring disclosures, illustrating how the definition of unusual items has been implemented by the management.

115 EFRAG also highlights that the classification of unusual income and expenses, based on future expectations rather than on past occurrences, may create implementation issues. For example, a discontinued item of income or expenses (as defined in IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*), with a historical pattern, may likely fall into the definition of unusual income and expenses. In other words, the criteria of unusual income and expenses are likely to capture discontinued operations, operations of a disposed subsidiary, disposed joint operations, or other items of income and expenses related to a ceased or disposed operations.

116 EFRAG notes that the translation of term 'unusual' may raise issues in some jurisdictions as it carries more meanings than intended by the IASB, including activities potentially not allowed by the by-laws.

117 Finally, to complement the IASB's proposal on unusual expenses and income, EFRAG would suggest that entities are required to provide disclosures on the items identified in paragraph B15 of the ED, as these are the most common adjustments to performance measures, often commonly understood as unusual.

118 We acknowledge that in the IASB's Snapshot, the IASB explains that applying its proposals, unusual items would not be presented in a separate category in the statement of profit or loss. Instead, unusual items would be presented together with 'usual' income and expenses in their respective categories in the statement(s) of financial performance, according to their nature, function, or other characteristics.

119 However, EFRAG considers that it would be useful to clarify whether entities can present unusual items on the face of the financial statements by specifically referring to 'unusual line items' (e.g. unusual litigation) and 'unusual subtotals' (e.g. operating

profit before unusual items) within the categories defined by the IASB or with the use of columns (as in paragraph 110 of the ED for MPMs).

Question 11 - management performance measures

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?

EFRAG's response

EFRAG agrees that non-IFRS measures are often used in practice and additional guidance could bring more transparency and consistency in their use. EFRAG therefore welcomes the IASB's efforts to provide guidance on MPMs.

However, EFRAG considers that not only subtotals on the face of the statement of profit or loss but also other measures, such as indicators of financial position or ratios, should be included in the scope of this requirement. In addition, EFRAG invites the IASB to consider:

- **making the definition of public communication narrower, limiting the scope to the MPMs presented in public communications released jointly with the annual or interim reports;**
- **excluding from the scope the measures that are required by the regulators; and**
- **extending the scope to cover possible MPMs presented in the financial statements but not in other public communications.**

EFRAG questions also the cost/benefit profile of the requirement to present the split of tax and NCI components for all the items when a performance measure is adjusted.

Finally, EFRAG considers that the IASB has not sufficiently articulated the link between MPMs and IFRS 8 and suggests that the IASB requires an explanation of how MPMs interact with performance measures already presented under IFRS 8.

Information about management performance measures ('MPMs')

120 EFRAG agrees that non-IFRS measures like MPMs or APMs are often used in practice and additional guidance could bring more transparency and consistency in their use. EFRAG recalls that many users consider non-IFRS measures useful for

assessing a company's business and performance and that users have called for more transparency and consistency in their use. That would include clear labelling as MPM, disclosing calculation formulas, providing comparative figures and reconciliations with IFRS defined subtotals, etc.

121 EFRAG therefore welcomes the IASB's efforts to provide guidance and require additional disclosures on the use of MPMs, particularly when they are presented within the financial statements.

Scope of the IASB's proposals on MPMs

122 EFRAG considers that not only subtotals on the face of the profit or loss but also other measures, such as indicators of the statement of financial position or ratios, should be included in the scope of this requirements. This would allow entities to present a complete depiction of the entity's performance. During EFRAG's outreach activities, EFRAG noted that many preparers felt that limiting the scope of MPMs would not provide a complete picture of the entity's performance and that users requested a more complete picture of the entity's performance measures.

123 EFRAG acknowledges the importance of the issues related to presenting non-IFRS performance measures in public communication, such as management reports, ad-hoc disclosures, and prospectuses.

124 However, EFRAG suggests limiting the definition of "public communication" to the communications released together with the annual and/or interim reports. This would reduce the risk of the disclosures being incomplete and the cost required to identify and present the information.

125 Furthermore, EFRAG suggests that the measures required by a regulator (e.g. in the financial sector) should not be in the scope of the proposed MPM disclosure requirements, as such measures are already defined and subject to the imposed obligatory regulations. In EFRAG's opinion requiring the disclosure and reconciliations as if they were MPM will provide information that is already available and therefore redundant.

126 If the IASB, however, does not subscribe to the suggestions laid above, EFRAG proposes the IASB to consider allowing the entities to cross reference to other parts of financial reports, the management report or other public communication.

127 EFRAG is sympathetic towards the arguments provided in paragraph BC151 of the Basis for Conclusions where the IASB explains that including MPMs in the financial statements would make them subject to the same requirements regardless of the entity's jurisdiction; would improve the discipline with which they are prepared; and improve their transparency as such an approach would have the benefit of bringing into the financial statements some MPMs that would be audited.

128 EFRAG suggests that the IASB considers introducing the same disclosure requirements for non-MPMs presented within financial statements but not in other public communication. The IASB would though need to appropriately amend paragraph 103 of the ED.

129 Finally, EFRAG considers that the guidance in paragraph 104 of the ED exempting some of performance measures from the requirement to provide reconciliation in the notes (e.g. gross profit), seems to be made based on a rules-based rather than on a principle-based approach.

Change in measurement of MPMs

130 EFRAG notes that MPMs often change over time. EFRAG therefore suggests the IASB to clarify whether changes in the use of MPMs or their calculation would constitute a change in an accounting policy and, consequently, whether entities may only change when it results in the financial statements providing reliable and more

relevant information and, consequently, the appropriate guidance of IAS 8 would apply.

Disclosing tax and NCI effect in reconciliation

131 EFRAG expresses sympathy for the proposed requirements to disclose tax and NCI effects for all the adjustments in the MPM reconciliation as this would bring more transparency in the usage of management performance measures. However, based on the feedback received during the field test with preparers, EFRAG raises concerns related to balancing costs and benefits of this requirement. Consequently, EFRAG suggests that the IASB reconsiders this requirement, such as to limit it to income tax and NCI effects only if an entity presents an adjusted Earnings Per Share (EPS ratio based on the MPM).

132 With specific reference to the benefits, EFRAG challenges the real possibility of achieving robust guidance in respect to disclosing tax and NCI effects. Namely, EFRAG considers the feedback from preparers about the complexity of the requirement, which may result in the need to use proxies, particularly when the group operates in various tax regimes. In effect, the use of proxies may result in lower relevance of the disclosed financial information. EFRAG, therefore, questions whether the resulting information would actually be reliable without an entity incurring incremental operational efforts to collect the required information and to prepare reliable financial information.

133 Finally, EFRAG questions auditability of this information, in particular when proxies are used.

Interactions with IFRS 8

134 EFRAG considers that the IASB has not sufficiently articulated the link between MPMs and IFRS 8 and suggests that the IASB requires an explanation of how MPMs interact with performance measures already presented under IFRS 8.

Illustrative Examples

135 EFRAG welcomes the IASB's efforts to provide illustrative examples on disclosing MPMs. However, EFRAG notes that the example, provided in *Illustrative Examples* on MPMs*,* is not clear. According to the ED, such disclosures should clearly state what are the adjustments used to reconcile an MPM with the most directly comparable subtotal or total specified by IFRS Standards, and what is the effect of each the reconciling adjustments on income tax and non-controlling interest. While the presentation of the adjustments used to reconcile the MPM is clear, the presentation of effect of the adjustments on income tax and non-controlling interest is not. In EFRAG's opinion, such a disclosure should clearly label all the reconciling adjustments and their effects on income tax and non-controlling interest using the clear labels. In the example, however, the income tax and non-controlling interest effects are mixed with the reconciliation of other MPMs and, furthermore, with the disclosure on unusual items.

136 EFRAG, therefore, suggests the IASB to reconsider the structure of the example and the way it provides information on MPMs and unusual items.

Question 12 – EBITDA

Question 12 – EBITDA

Paragraphs BC172–BC173 of the Basis for Conclusions explain why the Board has not proposed requirements relating to EBITDA.

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

EFRAG's response

EFRAG acknowledges that EBIT and EBITDA are among the most used performance measures. During EFRAG's outreach activities mixed views were provided as to whether EBIT and EBITDA should be defined. As such measures have not been defined by the IASB, EFRAG considers that they should be included in the scope of the IASB's proposals regarding MPM disclosures (which requires reconciliation with the most directly comparable IFRS specified subtotal).

In addition, EFRAG suggests that the IASB clarifies the principle behind the list of measures not considered to be MPMs provided in paragraph 104 of the ED.

Definition of EBIT, EBITDA, and other similar measures

137 EFRAG acknowledges the reasons provided by the IASB not to define EBIT, EBITDA, or similar measures. During EFRAG's outreach mixed views were provided on whether the IASB should define EBIT or EBITDA.

138 EFRAG highlights that EBIT and EBITDA (earnings before interest, tax, depreciation and amortisation), are among the most common performance measures used by users of financial statements. Considering that EBIT and EBITDA have not been defined by the IASB, EFRAG considers that they should be under the scope of the IASB's proposals on MPMs, when presented in the financial statements (which requires reconciliation with the most directly comparable IFRS specified subtotal).

Subtotals specified by IFRS Standards that are not MPMs

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

140 The IASB proposes, therefore, to specify a list a such subtotals, that would not be considered MPMs, would not require reconciliation, and would be a starting point for reconciliation of MPMs.

141 EFRAG agrees that providing a reconciliation for such measures would not provide additional information because their purposes and relationship to totals or subtotals specified by IFRS Standards are well understood and would usually be apparent from their presentation in the statement of profit or loss.

142 However, the drafting of paragraph 104 of the ED, which specifies those subtotals, is not clear. The description of the measures, included in the list, may be misleading and the reasons to include or exclude measures from the list are unclear, indicating that the list is rules-based. Further proof of that is that users of financial statements[3] challenged the IASB's proposal to exempt from the MPM's disclosure requirements

[3] EFRAG User Panel members

the subtotal 'operating profit or loss before depreciation and amortisation' as EBITDA typically excludes impairments from assets that are amortised or depreciated.

143 As mentioned in the paragraph above, since the list in paragraph 104 of ED seems to be made on a rules-based rather than on a principle-based approach, EFRAG suggests the IASB to clarify its wording by providing a principle that would assist preparers when assessing whether or not a measure satisfies the condition to be considered as an MPM.

Question 13 - statement of cash flows

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 operating 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?

EFRAG's response

EFRAG supports the IASB's proposal to require entities to use the 'operating profit or loss' as the starting point for the indirect reconciliation of cash flows from operating activities in the statement of cash flows, as it specifies a consistent starting point for the indirect method of reporting cash flows from operating activities. It also reconciles the operating category in the statement of profit or loss with the operating activities in the statement of cash flows.

EFRAG supports the removal of options for the classification of interest and dividends in the statement of cash flows for non-financial entities. This will improve consistency in presentation of similar line items and will better reflect the nature of the respective cash flows. EFRAG observes that some of those line items will be classified into different categories in the statement of cash flows and the statement of profit or loss.

However, EFRAG suggests that the IASB has a separate project on IAS 7 with the objective of having a comprehensive review of the challenges that arise in practice (e.g. financial institutions) and improve consistency with the new content and structure of the statement of profit or loss.

Finally, EFRAG would welcome guidance on the presentation of arrangements where an intermediate is used to pay trade receivables (i.e. supply-chain financing arrangements or reverse factoring).

Starting point for the indirect method of reporting operating cash flows

144 EFRAG supports the IASB's proposal to require entities to use the same starting point for the reconciliation of operating cash flows in the statement of cash flows using the indirect method as currently there is diversity in practice.

145 EFRAG also supports the IASB's proposal to use the operating profit or loss subtotal as the starting point for reconciliation. EFRAG considers that there are pros and cons for using either profit after tax or operating profit or loss. However, considering

that the definition of the operating category in the statement of profit or loss is not aligned with the definition of operating activities in the statement of cash flows, such reconciliation becomes even more relevant as it will provide a link between the two statements. In addition, EFRAG assesses that it will reduce the number of necessary adjustments to the line items that have an investing or financing nature.

Classification of interest and dividend cash flows

146 EFRAG supports the removal of options in IAS 7 for the classification of interest and dividends and the introduction of additional guidance for the definition of financing activities. EFRAG expects that this will bring more consistency in presentation of similar line items and will better reflect the true nature of the respective cash flows.

Other improvements to the statement of cash flows

147 EFRAG welcomes the IASB's efforts to make targeted improvements to IAS 7, however we consider that there is a need for a separate project on IAS 7 with the objective of having a comprehensive review of the challenges that arise in practice, particularly in regard to some financial institutions (e.g. banks and life insurers) where the statement of cash flows is not considered useful. Therefore, EFRAG suggests that the IASB:

(a) makes further research work on having a statement of cash flows that is structured differently for financial institutions to ensure that it provides relevant information to users and mentioned in EFRAG's Discussion Paper *The Statement of Cash Flows: issues for Financial Institutions* issued in 2015 (here);

(b) considers the issues raised in the UK FRC discussion paper *Improving the Statement of Cash Flows* (here); and

(c) improves consistency and eliminate current presentation inconsistencies between the statement of financial performance and the statement of cash flows in this separate project on IAS 7 (e.g. interest revenue from cash and cash equivalents is classified in the financing category in the statement of profit or loss, whereas all interest received is classified as cash flows from investing activities in the statement of cash flows as explained in paragraph BC197 of the Basis for Conclusions).

Question 14 - other comments

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?

IASB proposals on the presentation of other comprehensive income

148 EFRAG acknowledges that the use of OCI and recycling has already been comprehensively discussed as part of the IASB's project on *Conceptual Framework for Financial Reporting*. However, EFRAG notes that OCI and recycling are still often not well understood by investors and consequently, not used by them.

149 In addition, some respondents to the 2015 IASB's Agenda Consultation stated that the Primary Financial Statements project would provide the IASB with an opportunity to analyse aspects of performance reporting that in their view, the Conceptual Framework project has failed to address or has not addressed satisfactorily (for example the definition of financial performance or profit or loss, the distinction between profit or loss and OCI).

150 Therefore, EFRAG regrets that the IASB has not discussed this topic further to clarify which items of income and expense should be presented in profit or loss and which in OCI, as well as on the role of recycling.

151 In addition, EFRAG does not consider the IASB's proposals significantly improving the current requirements as they simply modify the labelling of OCI line items. EFRAG considers that it will be difficult to significantly improve the communication and understandability of OCI without addressing the distinction between profit or loss and OCI and the role of recycling.

152 Finally, EFRAG highlights that relevant information about OCI is also provided in the statement of financial position (e.g. separate components of equity), thus any future discussions on OCI should also consider the statement of financial position and its interaction with the statement of financial performance.

Interaction of the IASB's proposals on the statement of profit or loss and the statement of other comprehensive income

153 EFRAG highlights that the IASB's ED is silent with regards to the use of new categories within the statement of other comprehensive income even though there are transactions and events where the income and expenses have to be allocated to both the statement of profit or loss and other comprehensive income (e.g. hedging activities).

154 For presentation purposes, an entity is required to allocate the income and expenses to the different categories in the statement of profit or loss. However, the IASB's ED is silent on whether the statement of other comprehensive income should provide any information in regard to which category of the statement of profit or loss items of OCI may be recycled in the future.

IASB's proposed amendments to other standards

155 In regard to the proposed amendments to IAS 34, EFRAG has some concerns about requiring a reconciliation of the MPM to the most directly comparable subtotal or total specified in IFRS Standards, including the effect of tax and non-controlling interests (NCI) separately for each of the differences between the MPM and the IFRS measure at interim financial statements.

156 This is because, MPM reconciliations, including tax effect and NCI effect can be costly, particularly when preparing interim financial statements at consolidated level (e.g. tax includes income tax of different subsidiaries and not transactions).

157 As mentioned above, EFRAG would prefer that the IASB would limit the scope of its requirements to MPMs. EFRAG considers that a narrower scope would reduce significantly the costs mentioned in paragraph above.

Other primary financial statements

158 EFRAG welcomes the IASB's efforts to improve how information is communicated in the financial statements, with a focus on information about performance in the statement of profit or loss.

159 EFRAG considers that there is still room to improve primary financial statements. In particular, EFRAG considers that the IASB should consider in the future potential improvements to the statement of changes in equity, statement of cash flows and statement of financial position.

Statement of financial position

160 EFRAG assesses that the IASB should consider requiring, through minimum line items or subtotals, disaggregation of equity on the face of the statement of financial position to clearly identify and differentiate different subclasses of equity (e.g. ordinary shares and financial instruments that could be settled by issuing ordinary shares – implementation guidance).

161 In addition, EFRAG considers that it would also be useful to have a definition of debt, a key metric for users of financial statements, and related disclosures.

The statement of changes in equity

162 EFRAG considers there is a need to improve the statement of changes in equity to increase comparability and understandability for users of the financial statements, particularly on information related to separate components of equity related to other comprehensive income, information about other classes of equity instruments/shares and equity-like instruments and extended information about capital management. EFRAG considers that the IASB should look for improvements to the statement of changes in equity, particularly when considering that the IASB is not likely to address this issue within the *Financial Instruments with Characteristics of Equity* (FICE) project.

Other comments: presentation of revenue and costs in different business lines

163 EFRAG highlights that currently there is diversity in practice on how entities that operate business activities in different industries present their performance (e.g. a manufacturer providing financing to customers or entities operating both banking and insurance services). Some present information related to the different business activities in the statement of profit or loss as part of operating profit, by adding separate rows and allocating revenues and expenses (as in paragraph IE11 of the Illustrative Examples). On the contrary, others present all income and expenses related to different business activities without any business distinction, accompanied by a more detailed information in the segment reporting provided in accordance with IFRS 8.

164 EFRAG considers that it could be useful if the IASB could further explain how entities with different business activities related to different industries should prepare their financial statements, especially when considering the example provided by the IASB in paragraph IE11 of the Illustrative Examples. The IASB should consider whether there is a need to provide further illustration on how the split between the operating/financing and investing categories in this case. In addition, the need for consistency with the requirements in IFRS 8 should be considered together with the disclosure of judgement applied to allocate revenues and costs across business activities (e.g. in case of group internal transactions between businesses), when they are presented separately on the face of the statement of profit or loss.

Effective date and transition

165 EFRAG recommends that consideration is given to the practicalities and timescales of implementation of IFRS 17 together with any new standards or amendments arising from the ED.

166 EFRAG considers that the proposed time of 18 to 24 months for a retrospective first-time application may not be sufficient, particularly if the IASB decides to proceed with all its proposals (e.g. disclosures by nature when presenting by function).

Reverse factoring

167 Currently, in IFRS Standards, there is no specific reference to reverse factoring, however, there are accounting standards requirements that are relevant in determining the appropriate accounting policies (IFRS 9, IAS 1 *Presentation of Financial Statements*, IAS 7). Applying these standards requires significant judgement, particularly, as reverse factoring arrangements can differ significantly.

168 Therefore, EFRAG would welcome specific reference whether this type of liabilities should be presented as trade payables or as a financial debt/borrowing (from bank) in the statement of financial position. Similarly, EFRAG would welcome guidance on whether payments related to reverse factoring is best presented as an operational cash flow or a financing cash flow in the statement of cash flows.

169 Furthermore, better disclosure requirements are necessary in situations such as reverse factoring where an intermediate is used to pay trade receivables (supply-chain financing arrangements).

170 In those arrangements, the classification of such transactions as trade creditors is included in working capital changes and forms part of the operating cash flows instead of representing a financing liability in the financing cash flows. This reduces the transparency of information by smoothing operating cash flows and understating borrowings.

171 EFRAG acknowledges that the IFRS Interpretations Committee is currently discussing this topic and any clarifications on this topic would be welcomed.