

PRIMARY FINANCIAL STATEMENTS SUMMARY REPORT FIELD-TEST WORKSHOP WITH CORPORATES 7 July 2020



Introduction

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

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

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

The following companies participated in this workshop:

- ENI Group (Italy)
- Welding Alloys Polska (Poland)
- SAP (Germany)
- KWS (Germany)
- Vonovia (Germany)

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

Results of the field-test

Nicklas Grip, EFRAG TEG Vice-Chairman, welcomed participants to the workshop, introduced the speakers, and provided an overview of the agenda.

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

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

Nick Barlow, IASB Technical Staff, introduced the points for discussions for each topic (Appendix 1 – Slides for discussion)

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

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

One participant explained that in general the proposed requirements for the classification of income and expenses were clear and not difficult to apply. Applying the IASB proposals would mean the introduction of new subtotals, including operating profit or loss, and more disaggregation (e.g. split of the income from investments between two categories). This participant highlighted the challenges related to the allocation of income and expenses to the investing category when investments are not made in the course of the entity's main business activity (i.e. challenges of separating the returns from investments made in the course of an entity's main business activities from those that are not). For

example, investments in equity instruments held from a political or strategic perspective (i.e. not related to the entity's main business activities) and investments that serve directly the business model of the entity. Considering that the investing category represented an insignificant part of profit or loss, the participant questioned whether the effort required for the allocation income and expenses to the investing category was worthwhile.

Many participants referred to the challenges related to the IASB proposals on to the classification of income and expenses that arise from foreign exchange differences and hedging instruments. Participants recalled that in accordance with paragraph 56 of the ED, an entity shall classify foreign exchange differences included in profit or loss applying IAS 21 *The Effects of Changes in Foreign Exchange Rates* in the same category of the statement of profit or loss as the income and expenses from the items that gave rise to the foreign exchange differences.

These participants noted that this would be a significant change that would require considerable implementation costs and efforts. One participant detailed that they had multiple foreign currency exchange valuation accounts (e.g. loans, cash and cash receivables and trade receivables) which would have to be changed so that these accounts could be fully assigned to the operating, financing or investing category. Similar issues would raise on the classification of fair value gains and losses on derivatives and hedging instruments, as described in paragraph 57 of the ED.

To ease implementation, some participants called for more guidance and examples on the classification income and expenses. For example:

- more guidance on the classification of foreign exchange differences and of fair value gains and losses on derivatives and hedging instruments as proposed by the IASB in paragraphs 56 to 59 of the ED. For example, more guidance on the classification of gains or losses that arise from intercompany transactions in foreign currencies (e.g. intercompany loans/derivatives), including how to consider the different perspectives of the group and its subsidiaries.
- more guidance on where income and expenses that arise from foreign exchange differences, derivatives and hedging instruments should be allocated within operating profit or loss, particularly when presenting operating expenses by function. For example, if the foreign exchange differences arise from trade receivables, whether related income and expenses should be allocated to the line item 'cost of sales' or 'other operating expenses'.
- more guidance on the classification of specific income and expenses such as:
 - interest from extended payment terms to customers;
 - donations;
 - interest and penalties on income taxes;
 - acquisition-related costs incurred to affect a business combination;
 - gains or losses arising from the disposal of businesses and consolidated subsidiaries;
 - remeasurements of previously held interests in an associate accounted for using the equity method due to the obtaining of control over; and
 - gains or losses arising from the remeasurements of the lease liabilities.
- questioned whether there should be symmetry between the income statement and statement of cash flows on the classification of items related to foreign exchange differences and hedging instruments.

Aida Vatrenjak recalled that the operating category was a default category, thus if a specific income and expense did not meet the definition of the investing or financing category, it should be allocated to the operating category.

One participant also welcomed the reliefs provided by the IASB in paragraph 58 of the ED, which allows entities to classify gains and losses on derivatives not designated as hedging instruments in the investing category, as such relief would ease implementation and would avoid volatility within the subtotal operating profit or loss. However, this participant noted that the adoption of this relief could have unintended consequences especially when non-hedging derivatives are used, for risk management purposes to manage, for example, the net foreign currency risk on revenue (classified in the operating category) and interest expenses (classified in the financing category). In this case, in order to represent in the same category the gains or losses on the foreign exchange derivative and the net currency exposure arising from revenue and interest expenses, this participant suggested a relief to allow entities to classify foreign exchange differences that are managed on a net basis within the investing category.

Some participants noted that for the purposes of the field-test they had opted to include the new required subtotals, even if the line items between the different subtotals were not material (e.g. non-material integral and non-integral associates and associates, interest revenue from cash and cash equivalents and unwinding of pension liabilities). However, participants would welcome guidance on the interaction of the new proposed requirements and the notion of materiality. For example, where to allocate line items such as interest revenue from cash and cash equivalents and integral and non-integral associates and joint ventures when not material.

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

Some participants started by welcoming the IASB proposals to separately present and disclose integral and non-integral associates and joint ventures as the IASB proposals were aligned with how management was already considering them internally and provided useful information to users of financial statements.

Nonetheless, some participants considered that paragraph 20D of IFRS 12 *Disclosure of Interests in Other Entities* in the ED could be expanded and include more illustrative examples to avoid ambiguity and judgement involved in the determination of integral and non-integral associates and joint ventures. For example,

- when assessing whether there is a significant interdependency between an entity and an associate or joint venture (e.g. supplier or customer relationship), whether this interdependency is critical from the investor's perspective only or whether it could also be seen from the investee's perspective; and
- to clarify the meaning of 'having integrated lines of business with the associate or joint venture'.

Some participants also highlighted the importance of classifying integral and non-integral associates and joint ventures based on the management's views over the investees. For example, these participants suggested a distinction more focused on whether these are investments that generate individually and largely independent returns, regardless of any supplier or customer relationship, or on the basis of management judgement on whether it is within the 'main business activity' or 'core business' of the company.

Tom Scott asked the participants that had classified associates and joint ventures as non-integral, whether these associates and joint ventures were truly independent of the main entity. One participant who had classified its associates and joint ventures as non-integral explained that when applying

paragraph 20D of IFRS 12 ED, none of the examples applied to them. However, if the examples provided in paragraph 20D were considered from the investee perspective, the result would be different.

TOPIC 3: Analysis of expenses

In general, participants expressed different experiences when applying the IASB's proposals.

Participants that presented their analysis of operating expenses by function provided the following comments:

- One participant called for more guidance for those who use the function of expense method. In particular, this participant referred to the significant judgments involved on the allocation of some income and expenses to the by function presentation, particularly when taking into account the notion of materiality (e.g. how to allocate income and expenses that arise from foreign exchange differences to the different line items by function or alternatively whether such income and expenses should be simply included in 'other expenses'). Another participant was also concerned about the allocation of some items (e.g. 'foreign exchange differences') to the function line items.
- Some participants noted that they already computed information about the analysis of total expenses by nature, so preparing this analysis would not be costly. One participant noted that, in order to the analysis of operating expenses by nature to be the same as the total operating expenses, reconciling items such as changes in inventories would be required. Both participants expressed concerns with having 'other operating expenses' in by-nature analysis. For example, one participant explained that they would have both "other operating expenses" in by function and by nature analysis, which are not the same, and which could also raise XBRL issues.
- One participant also called for the IASB to clarify the link between paragraphs B46 and B15 of the ED.

Participants that presented their analysis of operating expenses by nature did not experience significant changes nor expressed significant concerns. Nonetheless, participants provided the following comments:

- One participant questioned whether in accordance with paragraph 65 of the ED, entities using the nature of expense method had to present the 'cost of sales' line item;
- One participant had not experienced difficulties and considered that a mixed basis approach should only be used in limited situations. In particular, when companies present an analysis of expenses by function, these companies can always disclose and disaggregate their expenses by nature in the disclosures. The use of a mixed basis approach could negatively impact the relevance and comparability of the income statement.

Nick Barlow clarified that companies that use the nature of expense method would not be required to present the 'cost of sales' line item.

TOPIC 4: Management performance measures

One participant explained that they had no difficulties in identifying the management performance measures (MPMs) in public communications outside financial statements and had not relabelled their non-IFRS management-defined performance measures. However, this participant highlighted that the computation of the income tax effect as required in paragraph 106(c) of the ED could be complex for adjustments related to constant currency performance measures for which the company was not able to calculate. This participant also referred to the variety of disclosures already required in respect of Alternative Performance Measures (APMs) and non-GAAP measures (SEC, ESMA Guidelines on

APMs, local GAAP requirements), which were currently presented within the management report. Considering this, the participant was considering whether it would link the disclosures on MPMs to the information already provided in management report.

One participant explained how they had applied the IASB proposals on MPMs. The participant noted that when disclosing MPMs, they had considered the key performance measures presented in the management commentary and in public communications with investors. He also noted that currently in Europe companies were already applying ESMA guideline on APMs, which would ease implementation, and that the IASB proposals would have the benefit of having the MPMs being audited. However, this participant considered that the scope of MPMs should be widened to include measures related to the balance sheet. This participant considered that the key performance indicators need to be bridged to key segment numbers in accordance with IFRS 8 *Business Segments*.

Some participants noted that they currently disclose, or disclosed in the field-test, the MPMs together with other management performance measures that did not meet the IASB definition of MPM. One participant explained that they had included in the disclosures a full set of performance measures used by management that they considered would faithfully represent the financial performance of the entity. In the view of the participant, a complete set of performance measures, and not only those that meet the definition of MPMs, were important to explain how management operated its business (e.g. operating profit or loss is an important performance measure which would not meet the definition of an MPM). If companies were only able to present the MPMs that would meet the IASB's proposed definition then, in the view of the participant, companies would present very few MPMs or even none, which would not provide a complete picture to users of how management operates its business.

TOPIC 5: Unusual income and expenses

One participant considered that the IASB proposals were clear and no significant issues with implementation. All information available and no significant changes to the IT systems.

However, some participants considered that the application of the IASB proposed definition of unusual income and expenses would involve a significant degree of judgement and discretion in determining future occurrence of income and expenses. More specifically, these participants:

- considered that significant judgements were required to interpret the meaning of 'several future annual reporting periods'. For the fieldwork purposes, the participant had used a time horizon of three years (i.e. the number of comparative reporting periods presented for the profit and loss account);
- considered that under the proposals, it is unclear whether entities would classify the entire amount or only the portion in excess of the reasonably expected amount as unusual; and
- questioned how unusual items would be monitored and considered by the auditors.

These participants called for more application guidance to ease implementation. For example, more guidance on the meaning 'several' to ensure consistent application and consideration of whether an event had occurred in the past or it was included in management budget.

Finally, one participant noted that some special items already considered to calculate non-GAAP measures by the Group met the definition of unusual income or expense.

One participant noted that unusual income and expenses could be identified by a comparison with the budget but questioned what is outside the reasonable range of outcomes.

TOPIC 6: Statement of Cash Flows

Participants noted that in accordance with the IASB proposals, both the statement of financial performance and the statement of cash flows were going to have three different categories with similar labelling (operating, investing and financing) even if they are not aligned. These participants considered that this would be confusing both for preparers and users of financial statements and suggested the IASB to either align the two statements or use different labelling, with explanation of the differences.

Close of the meeting

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

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