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IFRS 18 Draft Endorsement Advice – Cover Note & Summary of Feedback received on DEA

Objective

1 The objectives of the session are:

(a) to consider the feedback received in response to EFRAG's Draft Endorsement advice (DEA) on the IFRS 18 *Presentation and Disclosure in Financial Statements*, published on 15 November 2024 with a comment period ending on 26 March 2025;

(b) to finalise the EFRAG's Endorsement Advice and recommend it for approval to EFRAG FRB.

Structure of the cover note

2 This cover note contains:

(a) Background information

(b) Overview of outreach feedback after the publication of the DEA;

(c) Summary of outreach feedback and EFRAG Secretariat analysis;

(d) Overview of comment letters received;

(e) Summary of comment letters' feedback and EFRAG Secretariat analysis;

(f) Updates to Appendix 3 – Potential effects on competitiveness

(g) Agenda papers (FEA, clean and track changes);

(h) Question to EFRAG FR TEG, and

(i) Next steps.

Background information

3 On 9 April 2024, the IASB issues IFRS 18 *Presentation and Disclosure in Financial Statements*. The link to the Accounting Standard can be found here. Shortly after, on 29 April 2024, EFRAG received an Endorsement Advice Request from the European

Commission. The European Commission did not request EFRAG to assess any additional topics, therefore the typical endorsement advice structure is followed.

4 EFRAG´s DEA was prepared based on extensive outreach activities with a wide range of stakeholders. To prepare the outreach EFRAG organised several educational sessions/events in order to improve the quality of feedback. Outreach was conducted to gather inputs and views on the assessment of the technical endorsement criteria, cost and benefit analysis and effects on the economy. An overview to the outreach activities performed can be found in the following document.

5 The DEA was published on 15 November 2024. Stakeholders were invited to submit comments by 26 March 2025. EFRAG's preliminary conclusion was that IFRS 18 satisfies the criteria for endorsement for use in the EU, and therefore recommended IFRS 18 for its endorsement.

Overview of Outreach Feedback after the publication of the DEA

6 Since the publication of EFRAG's DEA, the Secretariat performed the following outreach activities:

(a) EFRAG User Panel on 28 November 2024

(b) ESBG meeting 03 December 2024

(c) EFRAG IAWG Webcast Meeting 5 February 2025

(d) EAA Workshop on IFRS 18 Meeting 24 February 2025

(e) EFRAG FIWG Webcast Meeting 28 February 2025

(f) EFRAG TEG-CFSS Webcast Meeting on 10 March 2025

Summary of Outreach Feedback after the publication of the DEA

7 Overall positive feedback was collected by EFRAG on the DEA as participants of various outreaches were generally satisfied with how stakeholders' views, including those from preparers and users, were presented.

8 Members of the User Panel supported the DEA and considered comparability to be the most important criterion. The members expressed that they had no doubt about the IFRS 18 enhancing the comparability compared to the existing standard IAS 1. Overall, they assessed that IFRS 18 would bring major improvements in relation to financial reporting. They critically discussed the concept of a useful structured summary. They confirmed the technical endorsement criterion assessments included in the DEA by recognising the existing views of the preparers of financial statements. Specifically, in relation to issues addressed by financial institutions they confirmed the users' views included in the DEA.

9 ESBG confirmed that the issues raised by the banking industry were properly reflected in the DEA. Members of the Financial Instruments working group confirmed the alignment with the DEA and noted no new issues identified by the banking industry in relation to the assessment of the technical endorsement criteria and for the assessment of costs and benefits.

10 Members of the Insurance Accounting working group stated that they continue to agree with the current drafting of the DEA and that there were no new matters that came to their attention. However, members reiterated that the costs associated with the

implementation of IFRS 18 were significant (issue with the FX impacts that needs to be split following the item they relate to, impact of IFRS 18 provision on the cash flow statement, especially for the insurance industry having to allocate majority of the cash flow items into the operating category). Members commented that following the recent implementation of the industry-specific IFRS 17 *Insurance Contracts* standard, that IFRS 18 was not deemed to bring significant improvements in terms of relevance, albeit at significant associated cost. In addition, they again highlighted the impact of the presentation of the at-equity result for the insurance industry.

11 Academics and participants of the EAA workshop provided overall positive feedback on IFRS 18. They didn't identify any conceptual matters to be addressed as potential research topics and focused on the application matters, for example, potential research assessing impact of IFRS 18 on various aspects of presentation in financial statements and its impact on value management. Another topic would be the use of MPM´s. They discussed how to operationalise in their research the intended improvements for transparency, relevance comparability and decision usefulness.

12 EFRAG TEG-CFSS members noted no new matters, however, they provided additional insights in relation to the implementation costs incurred by preparers when transitioning to IFRS 18. For example, one member shared that the IT systems needed to undergo significant changes to be able to correctly reflect the accounting of foreign currency gains or losses specifically related to tax and VAT transactions, as these transactions are always denominated in the local currency (which may be different from the functional and bookkeeping currency of the company).

EFRAG Secretariat analysis

13 With relation to the costs noted by the financial institutions, the EFRAG Secretariat considers that the paragraphs 150 and 151 of Appendix 3 summarises the matters noted by the constituents and no changes to these paragraphs are recommended. However, the EFRAG Secretariat suggests changing its current drafting in paragraph 117 of Appendix 3 highlighting significant costs noted by the insurance industry.

14 With relation to the matter raised by EFRAG TEG-CFSS member, the EFRAG Secretariat suggests expanding paragraph 27 of Appendix 3 of the endorsement advice to incorporate this additional feedback provided.

Overview of comment letters received

15 At the time of writing, EFRAG has received 12 comment letters: five letters from national standards setters, three letters from organisations of preparers, two letters from preparers and two letters from other stakeholders / independent consultants. The summary of the respondents is included within Appendix 1 and letters can be found here.

Summary of comment letters' feedback

16 Majority of the respondents (ten) agreed with EFRAG's assessment that IFRS 18 meets the technical criteria for endorsement, is conducive to the European public good and can be therefore recommended for EU endorsement.

17 One of the ten respondents noted above, while generally agreeing with EFRAG's assessment, noted that IFRS 18 will introduce significant changes to the Statement of Profit or Loss, specifically with the introduction of the investing and financing categories. This

respondent noted that the requirements could lead to presenting certain items of income and expenses in distinct categories than those most relevant from the management's perspective. Such a mismatch (from management's perspective) may imply some difficulties to communicate on the subtotal 'profit or loss before financing and income tax' and an increase in the use of management performance measures outside the primary financial statements. Besides, in this respondent's view, certain judgment will be allowed to management in some cases when applying new principles (i.e., when classifying income/expense in certain categories or when applying aggregation/disaggregation principles) potentially affecting comparability.

18 One respondent, insurance industry preparers organisation, acknowledged EFRAG's IFRS 18 DEA in support of endorsing the standard and one other stakeholder did not clearly indicate their position.

19 Several constituents, mainly representing financial institutions, noted that despite the fact that the IASB reached the right balance on many topics, some issues remain unresolved, and / or the mitigating solutions offered by IFRS 18 are not satisfactory. Some respondents also provided additional insights on IFRS 18 related costs.

20 The EFRAG Secretariat notes that the comments regarding overall assessment provided by the respondents are incorporated in various parts of EFRAG's endorsement advice and does not suggest any additional changes. Specific comments provided by the respondents are included and analysed below.

Classification of income and expenses for equity-accounted investments

Feedback received

21 Two constituents representing financial institutions preparer organisations noted the key issue regarding the mandatory classification in the investing category of income and expenses from associate and joint ventures accounted for using the equity method. They highlighted that such investments are often integral part of insurers' operations, core component of the net financial result and represent a key performance indicator under IFRS 17 *Insurance Contracts*. As such, IFRS 18 proposed presentation fails to reflect the business reality of financial institutions, creates a disconnect between the financial reporting and business performance, could be misleading to stakeholders of banks and insurance companies, thus reducing relevance.

EFRAG Secretariat analysis

22 The EFRAG Secretariat acknowledges the issues raised by the industry and notes that these issues are reflected in paragraphs 28-37 of Appendix 2 of the DEA. Considering the users feedback, the conclusion reached when assessing the relevance criterion was that relevant information can still be provided either with a defined subtotal on the face of the profit or loss, or by measuring such investments at fair value and presenting the remeasurement gains or losses within the operating category, or by providing additional information in the notes. As EFRAG User Panel (see above) confirmed the users view in December 2024. The conclusion reflected in the DEA was discussed both with the User panel and the IAWG. As such, the EFRAG Secretariat believes that the issue was sufficiently assessed and does not recommend any changes to the conclusion reached in the endorsement advice.

Fair value option under IAS 28 paragraph 18

Feedback received

23 Two constituents representing financial institutions preparer organisations noted the limited effectiveness of the possible reassessment of the fair value option under IAS 28 paragraph 18. The respondents stated that the ability to apply fair value accounting depends on the structure of the holding or features of the insurance contract, rather than the insurer's business model.

24 Further, one respondent suggested that paragraph 64(a) and B58 of IFRS 18 should clarify that the required classification from financing to operating category of the income and expenses from liabilities arising from investment contracts recognised applying IFRS 9 applies not only to those with participation features but also to those without participation features. This should be especially applicable for insurance companies which issue such investment contracts with or without participation features as part of the operating business.

EFRAG Secretariat analysis

25 The EFRAG Secretariat outlined the issue in paragraphs 70-74 of Appendix 2 of the DEA. To provide additional insight and better represent the issue raised by the constituents, the EFRAG Secretariat <u>suggests expanding paragraph 74 of Appendix 2</u> including comments about contracts with or without direct participating features or held for solvency purposes. However, based on the assessment performed and considering the feedback obtained from users of financial statements, the EFRAG Secretariat does not recommend any changes to the overall assessment of relevance criterion as such.

Management-defined Performance Measures (MPMs)

Feedback received

26 One respondent representing financial institutions preparer organisation questioned the scope of the MPMs being limited to subtotals of income and expenses and the divergence of scope with ESMA's Alternative Performance Measures (APM) Guidelines, potentially misleading users of financial statements, who may assume that the most useful information is included within the MPMs, whereas for banking and insurance industry this may not be the case. The same respondent also stated that the guidance within IFRS 18 was not very clear as it relates to the determination of MPMs.

27 Another two constituents from a banking sector expressed the need for a clearer distinction between MPMs that are adjusted subtotals, where reconciliation including income tax and NCI effects is useful, and MPMs that are simple non-adjusted subtotals, for which such disclosures are not relevant. According to these respondents, a subtotal which is derived from a straightforward aggregation of IFRS-compliant line items (e.g. interest and fee income less interest expense) and is not intended to reflect adjusted performance, should not be subject to reconciliation requirements, as they would provide no meaningful information to users while adding complexity and increasing preparation costs.

EFRAG Secretariat analysis

28 With regard to the scope divergence between IFRS 18 and ESMA's APM Guidelines, the EFRAG Secretariat notes that paragraph 49 of Appendix 2 of the DEA acknowledges that the scope of the MPMs is limited to a sub-population of performance measures, however, the preparers of financial statements are allowed to include additional disclosures about

other alternative performance measures within the same single note of financial statements, thus limiting potential misunderstanding of users. In addition, the EFRAG Secretariat recommends expanding the paragraph 119 of Appendix 2 to incorporate the matter raised by the respondent within the section treating understandability criterion.

29 With regard to the subtotals which are direct and simple non-adjusted subtotals, the EFRAG Secretariat notes that paragraph B123 of IFRS 18 specifies that the subtotals similar to gross profit are not MPMs and therefore are not subject to MPM-related requirements. However, to reflect the issues raised by two respondents, the EFRAG Secretariat suggests expanding paragraph 54 of Appendix 2 of the endorsement advice outlining the IASB's consideration of relevance when providing guidance in paragraph B123 of IFRS 18 and situations where this measure may not fully address the issues raised by the respondents

Other matters

Feedback received

30 One respondent agreed with EFRAG's note in paragraph 100b of Appendix 2 of the DEA that IFRS 18 does not provide enough guidance about how financial conglomerates should prepare their financial statements and questioned the impact on comparability of financial statements. Further, this respondent noted ambiguity regarding whether a bank's investing activities qualify as one of its main activities, which can impact both separate and consolidated financial statements.

31 One respondent agreed with EFRAG's note in paragraph 55 of Appendix 3 of the DEA that almost all of the income and expenses for banks would be classified in the operating category, potentially impairing relevance of the information brought by the subtotal "Operating profit".

32 One respondent stated that it was unclear whether a bank's investing activities qualify as one of its main activities. While banks are not mentioned in paragraph B31, they are referenced in paragraph BC138 as entities with two main activities.

33 One respondent questioned the relevance of presenting income and expenses that reflect the effect of the time value of money on liabilities that do not arise from financing activities within financing category rather than operating.

34 One respondent argued that the structure introduced by IFRS 18 (three activities within the statement of profit or loss: operating, investing and financing) is misleading and does not provide useful information to investors. This respondent also noted that classifying interest expenses under financing activities misrepresents liquidity and financial risk.

EFRAG Secretariat analysis

35 The EFRAG Secretariat notes that the assessment of an entity's main business activity is discussed in paragraphs 39-42 of Appendix 2 of the DEA. The Secretariat does not recommend any changes to the current drafting, as the DEA discusses the overall matter (without specifying issues for banks), as we understand that the matter may be relevant to all industries.

36 Further, the EFRAG Secretariat notes that the matter of classification of income and expenses from other liabilities is discussed in paragraphs 43-47 of Appendix 2 of the DEA and, considering the feedback from users, does not recommend changes to the conclusion reached on the topic.

37 With regard to the structure of the statement of profit or loss and the introduction of three activities, the EFRAG Secretariat notes that the paragraph 123 of Appendix 2 of the DEA includes related considerations and <u>does not recommend any further changes</u>.

Cost considerations

Feedback received

38 Several respondents provided additional comments and considerations with relation to the implementation and on-going costs associated with IFRS 18. One respondent stated that entities are still assessing the significance of cost that might occur.

39 Two constituents representing financial institutions preparer organisations noted high costs and reduced cost-benefit ration related to the disclosure of the expenses by nature when presenting by function. Indeed, these respondents noted that for their industry the presentation of expenses by nature would not provide clear added benefits, but the costs associated with such presentation were significant. One of these respondents agreed with EFRAG's assessment in paragraph 33 and 94 of Appendix 3 of the DEA.

40 One constituent quoted significant burden to provide reconciliation required for MPMs, especially regarding tax and NCI effects.

41 One constituent noted that for a financial conglomerate, there are costs of splitting income and expenses from investment activities between the operating and investing sections (with regard to main business activity) and the costs associated with such a split would be very high as they would be challenging to automate and would require specific analysis for each reporting period.

42 Another respondent (independent consultant / other stakeholder) noted several implementation costs already considered in EFRAG's DEA and suggested considering other indirect costs, such as costs incurred by the state and educational institutions as a result of IFRS 18.

EFRAG Secretariat analysis

43 The EFRAG Secretariat believes that the majority of the topics raised in the comment letters is already addressed in the Appendix 3 of the DEA, however <u>suggests expanding paragraph 31 of Appendix 3</u> of the endorsement advice to incorporate considerations highlighted by one of the respondents with regard to the split of income and expenses from investment activities between the operating and investing sections for an entity with specified main business activity.

Questions for EFRAG FR TEG

Question for EFRAG FR TEG
44 Do you have any questions or comments on the feedback presented?
45 Do you agree with the changes proposed in the endorsement advice letter?

Updates to Appendix 3 – Potential effects on competitiveness

46 Although constituents did not provide feedback on Appendix 3 *'Potential effects on competitiveness'* section, the EFRAG Secretariat enhanced this section comparing IFRS 18 requirements with US GAAP and SEC guidance. These revisions that were considered necessary by the EFRAG Secretariat primarily aim to clarify the rationale behind considering

both US GAAP and SEC guidance in the comparison, as well as to offer additional details on specific requirements under US GAAP and SEC guidance.

47 In its assessment, the EFRAG Secretariat used the opportunity of availability of a US GAAP specialist to verify the statements made in Appendix 3.

Questions for EFRAG FR TEG

Question for EFRAG FR TEG

48 Do you agree with the changes proposed in the endorsement advice letter in Appendix 3 related to the 'Potential effects on competitiveness' section?

49 Do you recommend the letter for approval to EFRAG FRB?

Agenda Papers

50 In addition to this 07-01 cover note, agenda papers for this session are:

(a) Agenda paper 07-02 – Final Endorsement Advice (in track changes)

(b) Agenda paper 07-03 – Final Endorsement Advice (clean version)

Next steps

51 Subject to and following the recommendation of EFRAG FR TEG, the EFRAG Secretariat will present the final endorsement advice to EFRAG FRB at 29 April meeting asking for the approval.

Appendix 1: List of respondents by country and by type

Table 1: List of respondents

Name of respondent	***Country***	***Type / Category***
Dr. Heinz Wittmann	Germany	Other
Autorité des Normes Comptables (ANC)	France	National Standard Setter
Danish Accounting Standards Committee (DASC)	Denmark	National Standard Setter
CFO Forum	Europe	Preparer Organisation
WSBI – ESBG	Europe	Preparer Organisation
Société Générale	France	Preparer
Malta Institute of Accountants	Malta	National Standard Setter
Accounting Standards Committee of Germany (ASCG)	Germany	National Standard Setter
Fédération Bancaire Française	France	Preparer Organisation
Audrey Alamy	France	Independent consultant
EDF	France	Preparer
Instituto de Contabilidad y Auditoria de Cuentas (ICAC)	Spain	National Standard Setter