Hong Kong Institute of
Certified Public Accountants
香港會計師公會

Meeting with Disclosure Initiative Advisory Panel
(via videoconference)

Date: 7 April 2020, Tuesday
Time: 10:00 a.m. – 12:15 p.m.

Members Present:	Kelly Kong, Jardine Matheson & Co., Limited Eros Lau, Deloitte Touche Tohmatsu Ernest Lee, Deloitte Touche Tohmatsu Cynthia Leung, Financial Reporting Council Cecilia Shek, Ernst & Young Catherine Tang, KPMG Elza Yuen, PwC
Staff in attendance:	Michelle Fisher, Deputy Director, Standard Setting, HKICPA Joni Kan, Associate Director, Standard Setting, HKICPA Katherine Leung, Associate Director, Standard Setting, HKICPA
Apologies:	Simon Riley, BDO Limited

1. Operating Category

- One panel member commented that the three proposed categories in the statement of profit or loss are named similarly to the three activities in the statement of cash flows, and this could cause confusion to readers of the Standards and users of financial statements. The Panel noted that the IASB is not seeking full alignment between the categories in the statement of profit or loss and the statement of cash flows. Panel members agreed that the IASB should explain more clearly the linkage and differences between each category in these two statements in the Basis for Conclusions.
- Most of the panel members agreed that the operating profit or loss is a common financial performance measure reported by entities and there is currently diversity in practice in the determination of operating profit or loss. They considered that a well-defined operating profit or loss will increase comparability between entities.
- However, panel members considered that the proposed description of the operating category is not clear and would involve judgement to apply. They did not agree with the IASB proposal to define the operating category as a default category noting that it would be difficult for an entity (especially for a conglomerate entity) to determine what income and expenses should be included in the operating category without a clear, direct definition.
- The Panel acknowledged that the IASB has tried to define the operating category directly but could not find a consensus on the definition. Accordingly, the IASB decided to describe the operating category as a default category, noting that it is simpler and involves less judgement to determine which income and expenses should be classified in the investing or financing categories.
- Though the operating category is a default category, Panel members observed that the proposed description includes a critical factor ‘entity’s main business activities’ to determine which income and expenses should be classified in the operating category. Panel members agreed that the IASB should define the ‘entity’s main business activities’ or provide guidance on determining the ‘entity’s main business activities’.

- One panel member noted that other areas of the ED also require judgement about an entity's 'main business activities'. For example determining whether income and expenses from investments arise in the course of an entity's main business activities (paragraph 48 of the ED) and determining if financing to customers is a main business activity (paragraph 51 of the ED). Consequently, determination of an entity's main business activities is an important factor in the classification of all three categories.
- One panel member mentioned that a manufacturing entity may use excess cash to invest in an investment property for rental income which may constitute large portion in the entity's income. There will be diversity in practice in the classification of the rental income if an 'entity's main business activities' is not properly defined. Some panel members commented that the IASB should clearly state the basis on how to consider main business activities e.g. by size, nature, amount, or frequency, etc.
- Two panel members suggested that the definition of the 'entity's main business activities' should be consistent with other standards, eg definition of business in IFRS 3 *Business Combinations*; operating segments in IFRS 8 *Operating Segments*; ordinary course of business in IFRS 15 *Revenue from Contracts with Customers*.

2. Operating Category: Application to financial entities

- The Panel noted that the IASB considers that an entity which provides financing to customers or invests as a main business activity may have difficulty in allocating income or expenses between the categories. Therefore, the IASB proposes to provide an accounting policy choice to classify in the operating category either (1) income and expenses that arise from financing activities, and from cash and cash equivalents, that relate to the provision of financing to customers; or (2) all income and expenses from financing activities and from cash and cash equivalents.
- Most of the panel members generally agreed that a financial entity should have the accounting policy choice. However, most of the panel members considered that allowing such an accounting policy choice for a non-financial entity that provides financing to customers as a main business activity, for example a manufacturing entity or property development entity, could distort its financial information.
- The Panel generally supported the staff's recommendation that instead of having an accounting policy choice, a viable alternative might be to have a impracticable exemption−ie require an entity that provides financing to customers as a main business activity to classify the income and expenses from financing activities and from cash and cash equivalents that relate to the provision of financing to customers in the operating category unless impracticable to do so. If it is impracticable to do this allocation, then all income and expenses from financing activities and all income and expenses from cash and cash equivalents would be required to be classified in the operating category.
- A panel member commented that paragraph 49(c) of the ED requires an entity to classify interest income and expenses on other liabilities in the financing category and paragraph B37 of the ED lists out such income and expenses. However, it is not clear how this interacts with paragraph 51(b) of the ED for an entity that chooses to present all income and expenses from financing activities and from cash and cash equivalents in operating category. It is not clear whether an entity should classify all the income and expenses that are required to be classified in the financing category, including those in paragraph 49(c) of the ED, in the operating category if the option in paragraph 51(b) of the ED is chosen.

3. Investing Category

- As the proposed description of the investing category includes income and 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. A panel member considered that it is difficult to apply the definition without clear guidance on the 'entity's main business activities'.

4. Financing Category

- Some panel members raised the following examples and recommended the IASB to clarify:
  1) Why interest expenses on lease liabilities are classified in financing category, however, the leased assets are used in the production of goods.
  2) How to classify the interest expenses on cloud storage.
  3) How to classify the effect of financing from a contract which has significant financing component under IFRS 15.

5. Integral and non-integral associates and joint ventures

- Most of the panel members considered that the proposed definition of integral and non-integral associates and joint ventures is confusing and judgmental. Some panel members shared examples where an entity may have difficulties in making the distinction between integral and non-integral, eg, conglomerate with strategic and venture capital investments, and joint ventures that require unanimous consent on relevant activities. They recommended the IASB should provide more guidance on the distinction of integral and non-integral associates and joint ventures.
- One panel member noted that it was important for an entity to disclose if it changes the classification of the integral and non-integral associates and joint ventures[1].
- One panel member suggested that the classification requirements for the integral and non-integral associates and joint ventures should be included in the new IFRS standard *General Presentation and Disclosures* instead of IFRS 12 *Disclosure of Interests in Other* Entities to keep all the presentation requirements together. However, another panel member considered it is appropriate to keep them in IFRS 12 together with other disclosure requirements for associates and joint ventures.

6. Aggregation and disaggregation

- The Panel generally supported the proposed description of the roles of the primary financial statements and the notes and the proposed principles and general requirements on the aggregation and disaggregation of information.
- One Panel member suggested separating the presentation of write-down of inventories to net realisable value and the write-down of property, plant and equipment to recoverable amount in paragraph B15(a) of the ED considering their different nature/category of assets.

7. Analysis of operating expenses

- Panel members generally supported the IASB's proposed requirements and application guidance on the analysis of operating expenses, including the IASB's proposal to require an entity that provides an analysis of operating expenses by function in the statement of profit or loss to provide an analysis using the nature of expense method in the notes.

8. Unusual income and expenses

- Most panel members considered the proposed definition of unusual income and expenses is unclear and highly judgemental. One panel member considered that, because the definition is unclear, an entity would need to describe its accounting policy

[1] The ED proposes in new paragraph 20C of IFRS 12 that an entity shall disclose how the entity's relationship with the associate or joint venture has changed and the amount reclassified when an integral or non-integral associate or joint venture is reclassified.

clearly and consistently apply that policy to identify unusual income and expenses. One panel member observed that unusual items vary across entities and management might be bias on these items.

- Two panel members questioned why the identification of unusual income and expenses focused only on forward-looking information (future reporting periods). One of them recommended the IASB to elaborate why the past occurrence was not being considered[2], the other panel member considered such definition might led to loss of comparability and expressed concern on how these items would be audited.
- One panel member suggested that the identification of unusual income and expenses should be based on the nature and the amount, and management's rationale for such identification should be clearly disclosed in the financial statements as well as in the auditor's workpapers. Irrespective of whether such income and expenses are unusual or usual, any event or amount with significant impact to the financial statements should be appropriately presented and disclosed in the financial statements.
- The Panel generally agreed to recommend that the IASB provides more examples to illustrate the determination of unusual income and expenses. For example, during the financial difficulties of an entity due to the trade war or outbreak of COVID-19, certain additional costs that were incurred in the current year and similar costs might continue to be incurred in future years, but this is difficult to predict, and hence how to determine whether these costs would meet the proposed definition of unusual expenses.
- One panel member also suggested the IASB should clarify in the application guidance the meaning of 'several future reporting periods' within the definition.

9. Management Performance Measures (MPM)

- Some panel members raised concerns that the scope of MPM, which only focuses on subtotals of income and expenses, is too restrictive. One panel member recommended that the IASB should explain in the Basis for Conclusions whether other measures, which do not meet the definition of MPM, can be presented in the financial statements and whether the IASB has any plans to address these measures[3]. Another panel member noted that such a restrictive definition of MPM could reduce the benefits to the investors.
- Some panel members expressed concerns that the scope of public communications is too wide and may lead to audit difficulties. One panel member recommended that the public communications should be restricted to those published together with the annual report and covering the same reporting period as the audit.
- Two panel members also suggested the IASB to clarify the linkage of MPM with segment reporting under IFRS 8 and whether there would be any change to IFRS 8[4].
- One panel member agreed the proposed permission to disclose the adjusted earnings per shares in the notes to financial statements, but not to present in the primary financial statements.

[2] As explained in BC136 of the ED, the IASB does not require entities to consider whether a similar income or expense has occurred in the past. The occurrence of income or expense in the past does not necessarily indicate that similar income or expense will occur in the future.

[3] As explained in BC154 of the ED, the feedback from users of financial statements led the IASB to focus on improvements to the reporting of financial performance in the statement(s) of financial performance and related notes. Therefore, the IASB's proposed definition for MPM is limited to subtotals of income and expenses. Thus, other financial measures and non-financial measures are not MPM and would not be covered by the proposed disclosures.

[4] There are no proposed changes to IFRS 8 in the ED. As mentioned in paragraph B83 of the ED, in some cases, one or more of an entity's MPMs may be the same as part of the operating segment information disclosed by the entity in applying IFRS 8. In such cases, the entity may disclose the required information about those MPMs in the same note that it uses to disclose information about its operating segments providing it meets the stated disclosure requirements.

10. EBITDA

- One panel member suggested that the IASB should define EBITDA as there is diversity in practice in how it is calculated which leads to misleading use of such measure.
- Another panel member suggested that it is not necessary for the IASB to define EBITDA because MPMs would be clearly defined and disclosed in the financial statements.

11. Statement of cash flows

- The Panel generally supported the IASB’s proposed targeted improvements to the statement of cash flows and the proposed clarification of financing activities in IAS 7.

12. Further comments

- The Panel had no further comments on the proposals in the Exposure Draft.