



Accounting Standards Board

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17 December 2009

Dear Stig

Pro-active Accounting Activities in Europe (PAAinE): 'Performance Reporting: A European Discussion Paper' (DP)

This letter sets out the UK Accounting Standards Board's (ASB) comments on the above DP.

We welcome the publication of the above DP as a contribution to the performance reporting debate. It is particularly relevant given the IASB decision to delay consideration of some of the more contentious performance reporting issues in its project on Financial Statement Presentation – such as the existing basis for determining whether an item of income and expense is recognised in other comprehensive income or net income.

We welcome that the DP (in chapters 3 and 4) has usefully focused the debate on the important performance reporting issues by setting aside some of the less important issues that were clouding the debate. For example, we strongly support the DP's statements that:

- performance is a complex, multi-faceted issue that cannot be encompassed in one or a few numbers;
- key lines are very important for a variety of reasons, but whether these lines are the bottom line or somewhere else in the statement is not a major issue;
- the debate over one or two statements is peripheral as long as key lines that meet user needs are reported.

We note that chapter 5 of the DP provides a summary of disaggregation methods that have been considered in other performance reporting papers, but offers no new alternatives, aside from the business model disaggregation proposal. We consider that the business model disaggregation proposal is insufficiently developed and therefore we do not understand what is being proposed or how it will improve the quality of information in the financial statements.

Given the direction of the IASB's Financial Statement Presentation project towards a model based on the operating/investing/financing disaggregation, an approach supported by the ASB, we consider that the most useful way to move forward is to concentrate on making the most of this model.

We have responded to the questions asked in the Appendix to this letter.

Should you have any queries regarding our response please contact Melanie Kerr (+44 207 492 2428, m.kerr@frc-asb.org.uk.) or me.

Yours sincerely



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Appendix

Question 1: Do you think there is anything else in the development of existing standards (apart from that discussed in chapter 2) that should be taken into account when considering the way forward for performance reporting?

No.

Question 2: Do you agree with the observation in this chapter that, at the level at which standards are written, there is no generally agreed notion of what represents 'performance' and that in fact performance is a complex, multi-faceted issue that cannot be encompassed in one or a few numbers? If you do not, please explain your reasoning.

We agree. In our view, this is a statement of fact.

Question 3: Do you agree that key lines are still useful, though only because of their value as a basis for communication to the market and as a starting point for analysis and comparison? If you do not, please explain your reasoning.

Yes, we believe that key lines are useful for the reasons listed above. Again, we consider this a statement of fact.

We also consider that whilst a key line cannot encompass all aspects of performance, it can be an indicator of performance or summary measure. For example, a person's health cannot be boiled down to one or two measures because health is a complex and multi-faceted issue, however, measures such as body weight and blood pressure are still useful indicators in themselves. We believe the same is true of key lines and ratios.

Question 4: Do you agree that, in order to fulfil this function, it is important that there are clear principles that underpin what is included and excluded from the key line(s) (in order to make their content understandable) and those principles need to be such that the content of a key line is standardised to a fair degree (in order to ensure the necessary comparability).

We agree.

Question 5: This chapter discusses the need for standard setters to balance the competing demands of comparability and flexibility, in order to give users fairly consistent starting points for analysis, while allowing management to present income and expenses in a manner that reflects the particular circumstances of the entity. Has the range of approaches to flexibility and comparability given in the chapter been appropriately described? What do you believe would offer the best approach in practice?

We agree that the range of approaches is appropriately described. We consider that, in the approach to setting key lines, a degree of prescription is necessary but not so much that it would stifle the presentation of other useful and relevant information. In particular, we do not support an approach that prohibits preparers from presenting additional key lines.

On the basis outlined above, we would not support Option A. Looking at the remaining options as listed in paragraph 4.13, we consider that Option B *Standard-setter identifies certain key lines as mandatory and prescribes their content, but preparers are permitted to present additional key lines* offers the best approach in practice. This is consistent with our understanding that users of financial statements value the standard setter provided 'net income' measure as

well as other measures such as key performance indicators that provide insight into performance 'through the eyes of management'. In our view, it is most important for non-GAAP key lines to be reconciled to standard setter defined key lines so that they are transparent to users of financial statements.

We support the IASB's operating, investing, financing disaggregation approach, which results in required key lines without prescribed content. As such, our ideal approach is Option B with elements of Option C.

The 'net income' measure provided by standard setters does not necessarily need to be identical to the current definition of net income – we consider there is scope to improve the basis for calculation of this measure which may result in moving certain items of income and expense between other comprehensive income and a net income.

Question 6: This chapter finds no evidence that it is important for the "bottom line" of statement(s) of income and expense to be a key line. Do you agree that it is not important for the "bottom line" of statement(s) of income and expense to be a key line? If you do not, please explain your reasoning.

We agree that the bottom line does not necessarily need to be a key line but note that this may be the most logical place to enable users of financial statements to locate important measures such as net income easily. See also our response to question 7.

Question 7: In chapter 4, the paper observes that there is no evidence that it is important for the "bottom line" of statement(s) of income and expense to be a key line. Assuming that is correct, do you agree that it follows that the number of performance statements provided is not particularly important either. And thus that the one or two performance statements debate is a non-issue; the real issues relate to the key lines. Do you agree with this analysis and conclusion? If you do not, please explain your reasoning.

We agree that requiring one or two performance statements is not a significant issue, and therefore we consider that the option for two statements should be retained. In our response to the IASB's Financial Statement Presentation Discussion Paper we noted the following:

'As comprehensive income continues to be divided into net income and other comprehensive income components, we consider that it does not make sense at this stage to remove the option to report these two components using two statements. In our response to the 2007 ED of Amendments to IAS 1 Presentation of Financial Statements: A Revised Presentation we observed that many entities will see the two-statement presentation as more consistent with user expectations and general practice, given the current focus on net income as an important measure of performance. As such, we consider that the option to report comprehensive income using one or two statements should be retained.'

In the DP the primary rationale for eliminating the choice to present comprehensive income in one or two statements is to improve comparability. In our view, the choice regarding one or two statements does not result in significant incomparability between entities. Many of the other proposals in the DP have a far more significant impact on comparability than this option.'

We are aware that the IASB is considering expediting removal of the option to present two performance statements. We will re-evaluate our position on the one or two statement issue in our response to any new Exposure Draft from the IASB.

Question 8: Do you agree that recycling is mainly an issue if a realised/unrealised split is the main disaggregation criterion for the statement(s) of income and expense, that therefore recycling is really a secondary issue and that the main issue is which disaggregation model should be used? If you do not, please explain your reasoning.

Recycling has arisen as a means of achieving certain objectives within the current disaggregation model and the need for recycling depends on the model being used and the objectives of that model. For example, the realised/unrealised model does not require recycling unless the objective is that all gains flow through the realised category eventually. In our view, gains and losses should be reported only once, in the period in which they arise.

Question 9: Would the issue of recycling on its own affect your decision as to the best approach to disaggregation? Please explain your reasoning.

We do not support recycling and would like to see an approach that does not require the use of this mechanism to achieve its objectives.

Question 10: Do you have any comments on the basic models of disaggregation presented in this chapter? Are there any other broad types of model that would have been worth exploring?

In our view chapter 5 effectively discusses three different types of models:

- Predictive value models (recurring/non-recurring)
- Business activity models (business model, core/non-core, operating/investing/financing); and
- Stage of earning process models (realised/non-realised, holding/non-holding)

We note also that part of what makes a business activity model useful is that it separates an entity's main operating activities, which presumably have higher predictive value to investors, from other more peripheral items of income and expense – on this basis there are actually only two types of models discussed in the DP.

These seem to be the common models discussed in other papers on performance reporting, as such, we consider that the discussion in chapter 5 is a useful summary but could have gone further. We would have preferred to see consideration of some other options, including using the current basis for net income as a starting point, as investors seem to find this key line useful.

Question 11: Is the discussion of the advantages and disadvantages of each disaggregation model fair and complete? If not, how could it be improved?

We consider the discussion of the advantages and disadvantages of each model is reasonable, although, we would have preferred to see the discussion of similar models grouped together along the lines discussed above – as it is, there is repetition in the text due to similar models having similar advantages and disadvantages.

We do not consider that the explanation of the business model approach to disaggregation in the DP is clear. The explanation that it is a 'disaggregation model that separates items of income and expense derived from assets or liabilities that are being managed on a basis that envisages a different realisation or settlement scenario to that underpinning the way those assets or liabilities have been measured from other items of income expense' needs to be

explained in a way that is understandable. In addition, more detail is required to enable us to understand what is being proposed and how this is expected to improve financial statement presentation. In our view, this model appears to be only partially developed and may be possible for non-operating assets and liabilities, but not comprehensive enough to encompass all types of income and expense.

Question 12: Which of the models of disaggregation – or combinations of models – do you favour and why do you believe it meets the needs of users better than the alternatives?

We believe that a disaggregation model designed to assist users in predicting future cash flows is likely to be the most useful. However, the difficulty achieving any level of comparability between entities for any such models examined in the DP erodes their value to users and makes using them as a basis for setting a standard problematic and perhaps not possible.

Many users express satisfaction with the current notion of net income, it is those that seek to underpin the existing concept of net income with principles who wish to examine new disaggregation models. As such, this issue should be approached by considering if it is possible to use a principled approach to disaggregation that could practically form the basis for setting an accounting standard whilst simultaneously providing users with information that is at least as valuable to them as the current notion of net income. On this basis, we do not consider any of the proposals in this chapter present a workable way forward, in developing the 'ideal' disaggregation model, which in practice will never be achieved.

Given that, we think that future research should focus on developing the operating, investing, financing approach that the IASB suggested in its Financial Statement Presentation DP, which the ASB supported in its response of 5 March 2009.