28 April 2011

Our ref: ICAEW Rep 49/11

Your ref:

Mme Françoise Flores
Chair
European Financial Reporting Advisory Group
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By email: commentletter@efrag.org

Chère Mme Flores

FINANCIAL STATEMENT PRESENTATION - PAPER

ICAEW is pleased to respond to your request for comments on *Financial Statement Presentation – Paper.*

Please contact me should you wish to discuss any of the points raised in the attached response.

Yours sincerely

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ICAEW REPRESENTATION

FINANCIAL STATEMENT PRESENTATION - PAPER

Memorandum of comment submitted in April 2011 by ICAEW, in response to EFRAG consultation paper *Financial Statement Presentation* published in October 2010.

Contents	**Paragraph**

INTRODUCTION

1. ICAEW welcomes the opportunity to comment on the consultation paper *Financial Statement Presentation* published by EFRAG.

WHO WE ARE

2. ICAEW operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, we provide leadership and practical support to over 136,000 members in more than 160 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. We are a founding member of the Global Accounting Alliance with over 775,000 members worldwide.

3. Our members provide financial knowledge and guidance based on the highest technical and ethical standards. They are trained to challenge people and organisations to think and act differently, to provide clarity and rigour, and so help create and sustain prosperity. We ensure these skills are constantly developed, recognised and valued.

MAJOR POINTS

4. In our response to the IASB on their discussion paper *Financial Statement Presentation* (REP 48/09) we raised a number of concerns with the IASB's proposals. The core messages of this response have not been addressed in the Staff Draft and therefore we would like to draw EFRAG's attention to the views we expressed at that time, many of which chime with the views expressed by EFRAG in this document. A copy of our letter REP 48/09 is attached as an appendix to this response and key messages from that document are reiterated below.

The purpose of the performance statements needs to be properly defined

5. The crucial issue to our mind is that before final decisions can be made about presentation the IASB needs to agree on the purpose of the performance statements and how gains and losses should be categorised therein. Companies and users of accounts place a great deal of emphasis on the income statement and on net income, and clear underlying principles in the reporting of gains and losses are therefore vital. Deferring consideration of issues relating to Other Comprehensive Income (OCI) and recycling continues to cause problems elsewhere as it has been difficult to assess the impact of other proposals, for example on hedging, pensions accounting and fair value changes, without knowing how the income statement will reflect such items. In particular, under pressure in various projects, the Board has demonstrated an unfortunate tendency to continue to use OCI as a convenient dumping ground for awkward gains and losses, and so it continues as a set of disparate information with no conceptual underpinning and no overall rationale as to whether or when items may be recycled from it into the income statement. This project was originally instituted to deal with these particular issues and so it is disappointing to see that the Staff Draft as it currently stands does not address these questions. We are nevertheless keen for the IASB to continue with a project on financial statement presentation in their post-2011 agenda, provided the conceptual underpinning it currently lacks is appropriately addressed.

Necessitating user adjustments to financial information impairs its comparability

6. A further concern to be addressed is the increasingly large series of adjustments commonly made by analysts to published numbers. Were information to be presented in a format that better addressed their needs, however, it is possible that the volume of these adjustments would be reduced. This is desirable. Comparability is impaired through this process of adjustment, which, being made outside the framework of the published accounts, results in different net figures being produced by different groups of analysts, and there is therefore

much to be gained by moving to a regime that presents financial information in a way that is more suited to user needs. In taking this project forward, the IASB should take into account the adjustments made by companies when reporting ‘pro-forma numbers’ to their investors, and should also devote significant resources to gaining a better understanding of what users want in terms of financial information.

7. This debate is of particular importance in the context of the wider discussions around the value and relevance of the annual report and financial statements document as a whole, the coherence of this document and the reduction of clutter within it. In the absence of a clear conceptual underpinning for the reporting of performance within the relatively objective framework of the primary statements, it is difficult to imagine how greater clarity may be achieved in the notes to the financial statements and the more subjective information presented as narrative disclosures.

Entities should have some latitude in choosing classification headings

8. In our consideration of the proposals, we have continually run up against the problem that the components of performance differ between entities and across industries, for example, the performance of a bank is likely to be best gauged using quite different measures to those applied to an oil extractor. International Financial Reporting Standards need to be constructed in such a way that they can be applied universally, and the financial statement presentation standard is no exception. To achieve this we believe that the standard should set down a series of principles that while establishing a consistent framework, can be tailored to the individual circumstances, and user needs, of each applying entity. Beyond this universal framework, the IASB may then wish to consider how best to address the specific needs of different sectors and whether any process for the production of sector specific guidance may be desirable.

The benefits of moving to a direct cash-flow model may not outweigh the costs

9. We do not believe the case has yet been made that a direct method of presenting operating cash flows will lead to more decision-useful information. The direct method generally does not represent the way businesses are managed and commonly does not feature in internal management information. Furthermore, its production is likely to be onerous as most accounting systems do not collate the information that would be required for a direct method cash flow statement. Having consulted a limited number of users during our deliberations on the discussion paper, we have found no evidence that users actually want a direct cash flow presentation, and importantly there is little specific information about how they would use the new information from the direct method, if they had it. An indirect approach that starts with operating profit in the operating section, reconciling to operating cash flows and with appropriate disclosures (particularly of working capital movements), would be much more straightforward for companies and appears to provide appropriate information. We do not believe that adopting a direct cash flow is justified when compared to the considerable costs that would be imposed upon preparers and the complete lack of any strong evidence for user demand for such a change. Whether a direct method would be better for users can only be determined by users, who, if they need a direct method, should make the case for it on a cost-benefit basis.

RESPONSES TO SPECIFIC QUESTIONS

General

Scope of the joint project

Do you share EFRAG's view that fundamental issues related to performance reporting should be given a higher priority on the IASB's agenda?

10. We strongly agree with EFRAG's conclusion that fundamental issues related to performance reporting should be given a higher priority by the IASB. As we set out in paragraph 5 above it is of the utmost importance that an appropriate conceptual underpinning be developed for performance reporting before the remaining elements of this project are further progressed.

Overall costs and benefits of a new presentation model

EFRAG seeks input from constituents, especially from users, on whether a new presentation model would result in significantly improved and more useful information.

EFRAG also seeks input from constituents on whether benefits of the new model would outweigh the costs associated with implementing and maintaining it.

11. It is not possible to provide an answer to this question at the current time. Following from our response to question 1 in paragraph 10 above, further development is necessary before the proposals can be assessed as an operable accounting standard.

Financial institutions, including insurance

EFRAG seeks input from constituents, especially from users, on whether the new presentation model would improve financial reporting overall for the banking and insurance industry.

Do you believe that separate proposals or special application guidance should be developed for the banking and insurance industry?

12. We believe that common accounting principles should apply across all industries and consequently that a single financial statement presentation standard should be developed for universal application. This does not mean that performance reporting should be expected to be generic to all organisations. Ultimately, the specific form in which financial information is presented should be that best suited to the requirements of the users of each individual set of financial statements, to the extent permitted within the standard's high-level principles. In assessing the performance or position of any particular entity, its specific circumstances, or those of the industry in which it operates, are likely to dictate the particular informational needs of users of its accounts. A good accounting standard should set a basic framework within which this information is presented while allowing adequate latitude for user requirements to be best addressed.

13. This is not to say that industry-specific guidance, to supplement the generic requirements of the accounting standards, could not usefully be provided. In the UK, a number of Statements of Recommended Practice (SORPs) have been created for specific industries. These SORPs sit below the accounting standards, supplementing their requirements, and are established by industry bodies close to users of sectoral financial information. We question whether the IASB is the right body to be setting detailed accounting requirements for the banking and insurance industries (or any other) and suggest that an approach similar to that taken in the UK may be more appropriate.

Core principles of financial statement presentation

Cohesiveness

Can you provide other examples of cases in which applying the cohesiveness principle at the category level may cause problems?

How would you propose to deal with such cases (e.g. provide additional guidance, provide some exceptions to the cohesiveness principle, or make the principle rebuttable)?

14. Like EFRAG we support the overall principle of cohesiveness but have concerns regarding its application. Although the principle can be applied very usefully in the case of the cash flow and income statements, it does not work in the same way for the balance sheet in terms of producing useful information. Segmental analyses, for example, are of high importance in reviewing profit and cash flows, but are of much less interest for the balance sheet. Furthermore, most non-financial companies do not manage their balance sheets in terms of the categories proposed in the Staff Draft, indeed the most commonly managed balance sheet metrics are cash and related measures such as working capital, which do not naturally fit at all with the proposed classification. As drafted moreover, the proposals imply a universal balance sheet-centric approach, but this is not appropriate for all or even many businesses– we do not believe that the balance sheet should be required to be taken as the starting point. Ultimately, our chief concern is that the proposed presentation requirements are too rigid and as such would detract from the usefulness of the information to users.

Disaggregation on the face of primary statements

Do you share EFRAG's concerns that the disaggregation requirements in the Draft ED might result in overly detailed primary statements?

Do you support EFRAG's proposal to specify the principles for disaggregation in the standard, which should be followed to determine the level of detail on the face of primary statements, or are you in favour of the rules, which would set the required level of detail for all entities?

What other alternatives would you propose to avoid primary statements becoming overly detailed?

15. We agree with EFRAG. As proposed, there is far too much detail on the face of the primary statements, which risks cluttering them and making performance harder to understand. We support EFRAG's suggestion of establishing principles for presentation in the primary statements and share their concerns that the required level of detail is excessive. As we set out in paragraph 8 the framework also should allow sufficient latitude for businesses to report their performance and position in a way conducive to facilitating an understanding of their particular circumstances, including the balance between statements and note disclosures and would suggest such a principles based framework as an alternative to the prescriptive proposals of the IASB. In devising such a framework the Board may wish to consider conducting a review of the information commonly provided to users in non-GAAP formats, eg. operating and financial reviews, analyst presentations, bank credit papers, etc. to determine how this information is used in practice and how it differs from IFRS presentational requirements.

Classification into sections, categories and subcategory

16. We do not agree with the Staff Draft's requirement that activities necessarily be classified by function. Entities should have sufficient latitude so they can select a treatment most appropriate for their circumstances. After all, different entities may have very different cost structures; for example a company providing professional services would have predominantly employee costs while for a manufacturer the largest category of expenditure may be raw materials. Consequently mandating a precise and generic format to be applied by both is unlikely to best meet the needs of users.

Definition of financing section and the "net debt" notion

Do you share EFRAG's view that equity should be a section on its own rather than form part of the financing section?

17. We agree. Equity is at the centre of many commonly used metrics and is a concept important to users' decision making. It is a residual and fundamentally different to other forms of financing.

Do you share EFRAG's view that the financing section should include all items (i.e., including assets) engaged in the activities related to management of the financial position?

18. While we agree that in some cases certain assets may be appropriate for inclusion in the financing section, we do not accept EFRAG's conclusion that the definition of this section should be made 'more specific'. In our view the Staff Draft is already too prescriptive; the level of specification should be reduced, not increased.

Do you share EFRAG's view that the definition of the financing section should be based on the notion of net debt?

19. We agree; net debt is a metric that is widely used and understood (including the variety of ways it may be measured in practice) and would provide an appropriate basis for the financing section. Preserving equity as a separate section would facilitate this.

Do you have concerns about the term "net debt" not being defined? Would this reduce comparability between entities?

20. We do not have any specific concerns regarding the lack of a definition of net debt. As we have set out above, it is better for the standard to set general principles which entities can then apply to their specific circumstances with appropriate disclosures. As the capital structures of businesses vary so too would the precise composition of their financing section, and indeed for this reason precise definition may be counter-productive. It may also be unnecessary: by way of analogy, IAS 1 *Presentation of Financial Statements* does not define capital and yet this does not pose any particular difficulties for disclosures around it.

If you do not agree with the proposals in the Draft ED in respect of the content of the financing section and you do not share EFRAG's view that it should be defined based on the notion of net debt, then what alternative approach would you propose?

21. We do not agree with the level of mandation proposed in the Staff Draft as set out in paragraph 18 above.

Classification of cash

In which category would you prefer to classify cash?

22. We agree with EFRAG that cash should not be required to be classified within the operating section. Rather, presentation should be consistent with the category within which cash is managed. The classification category selected should then be disclosed.

Objective and the bottom line of a cash flow statement, net debt reconciliation

EFRAG seeks input from constituents, especially from users, on whether a cash flow statement should provide information about changes in:

- **cash balance; or**
- **a net figure of assets and liabilities included in the financing section (i.e. "net debt" under EFRAG's proposal).**

Please provide arguments supporting your view.

23. In our view the best approach would be for the cash flow statement to reconcile to cash, rather than any other measure. Under UK GAAP, FRS 1 (Revised) *Cash flow statements* was originally converged with IAS 7 *Statement of cash flows*. But, after a number of years of experience in practice it was revised to take account of constructive suggestions from users that a reconciliation solely to cash was preferable to IAS 7's wider requirement to also include cash equivalents. Cash is a clear and relatively unambiguous marker, and the clarity of cash flow is improved where its focus is limited to a reconciliation of this single measure. A reconciliation of net debt is useful, but this is better provided as a separate note disclosure.

Other classification challenges – different sources of financing

EFRAG seeks input from constituents, especially from users, on whether the proposed approach to classification of different types of financing arrangements would result in decision-useful information.

Please provide arguments supporting your view.

24. We agree that the establishment of principles for the classification of different sources of financing could be useful, but we are concerned that as currently proposed the Staff Draft is too prescriptive in this regard. While clearly mindful of these principles, entities should have the latitude themselves to determine how best their sources of finance should be classified.

Statement of cash flows

Direct operating cash flows

Do you share EFRAG's disagreement with the removal of the option to present operating cash flows using the indirect method?

If you are in favour of the proposal to require the direct method for presenting operating cash flows, please:

- **state the shortcomings of the indirect method for presenting operating cash flows and explain how this affects your analysis;**
- **state whether, and if so how, the direct-indirect method proposed by the ED would address these shortcomings.**

25. We agree with EFRAG. It is not desirable to require use of the direct method for presenting cash flows. As explained in paragraph 9 above, we do not believe that the case has yet been made that the direct method would lead to a more decision useful presentation and therefore do not accept that the costs of transition will be outweighed by the expected benefits. We also agree with EFRAG's sentiment in paragraph 55 of the paper that it would be useful to mandate operating profit as the starting point for the cash flow – this simple measure would make a significant contribution to the improvement of comparability.

Disaggregating cash flows

Does information about different types of operating cash outflows (e.g. cash paid to suppliers, cash paid to employees, cash paid for advertising) have substantially different predictive values for users, and therefore should be presented separately? If yes, then please explain why? If not, would it be sufficient if information about cash outflows related to operating activities is presented as a single amount?

26. This information may be of value to the users, but whether that is the case or not will vary depending upon the circumstances of the entity in question. In some cases such a disclosure would amount only to clutter. Therefore entities should be allowed sufficient latitude to be able to make a reasoned decision as to whether this, or an alternative, level of detail is merited.

If you believe that information about operating cash outflows needs to be disaggregated, then please provide the preferred principle for disaggregation (e.g. recurring / non-recurring), and explain how this information would enhance your analysis.

27. Again, the level of disaggregation should be proportionate to user needs and is therefore a matter for the reporting entity to determine. As one example, utilities companies may wish to separate capital expenditure on renewals from that on expansion. This information would be of great interest to their particular users but would be much less relevant to many other entities while being potentially onerous to produce.

Does information about cash inflows and cash outflows need to be presented in multiple places (i.e. statement of cash flows, analysis of changes in assets and liabilities, information about remeasurements) or would it be sufficient if it is disclosed only once? If yes, then which disclosure would result in the most useful information?

28. EFRAG's concerns regarding the potential duplication of information are well founded, and we believe are a good indicator of the shortcomings of the overly prescriptive approach that is proposed. Were our suggestion heeded to limit the requirements of the standard to a set of principles underpinning presentation, then properly tailored information could be presented which would naturally avoid counter-intuitive results such as the duplication highlighted here. In some cases it may be desirable to refer to a certain piece of information in multiple places within the financial statements, but in such cases in should be made clear that the disclosure can be made by means of cross reference to a data item presented elsewhere within the document.

29. The issues raised in paragraphs 26 to 28 above could reasonable be considered as part of a wider review of disclosure and could therefore perhaps be suggested as points forward for the IASB's disclosure framework project.

Cash flow information for financial institutions, including insurance entities

Do you share EFRAG's view that statement of cash flows is of little value for the users of financial services and insurance entities' financial statements? What alternative approaches would you propose?

EFRAG seeks views from the users of financial services (including insurance) entities' financial statements on the following:

- **please specify the list of items of cash inflows and outflows, which is essential for your analysis (e.g. cash received from customers);**
- **please explain why the disclosure of these cash flow items is essential for the analysis.**

Do you share EFRAG's concerns about the netting proposals, should an entity choose to present a direct cash flow statement?

30. We do not agree with EFRAG's underlying assumption here that the presentation standard should aim to prescribe different frameworks tailored to the needs of specific industries. Although the Directives do specify a distinct format for the primary statements of banks and other financial institutions, it would be best for international standards not to attempt to replicate this prescriptive approach. The standard would be better to set out high level principles that can be applied appropriately to all entities and then leave the detailed application of these to individual circumstances. Such an approach should address the concerns identified here by EFRAG. Please refer to our answer in paragraphs 12 and 13 above for further information on this.

Information about remeasurements

Do you share EFRAG's concerns about the lack of a principle underlying the definition of remeasurements and the duplication of the disclosure requirements?

31. Like EFRAG we agree with the overall objective of the proposed disclosure on remeasurements. We agree that there is merit in presenting this information in a single location. However, such a note should not be repetitious of data that is already presented elsewhere - rather cross-references should be made to the original information.

What information about remeasurements would you find useful? EFRAG seeks input from constituents, especially from users, on the following:

- **do you support the proposed objective for the disclosure on remeasurements, or do you believe that it should be further clarified or amended (consider how you use information about remeasurements);**
- **please specify the principle you employ for distinguishing between items with different predictive value;**
- **please indicate the most useful location for the information about remeasurements.**

32. We welcome EFRAG's appeal to users in this regard as their needs should ultimately determine the final composition of this note.

Analysis of changes in assets and liabilities

Do you share EFRAG's concerns about the proposals on the analysis of changes in assets and liabilities?

33. We share EFRAG's concerns here. Please see paragraph 8 above which articulates our concerns regarding the excessively prescriptive nature of the draft standard.

Comparative information for changes in classification following a change in use

Do you share EFRAG's view about the requirement to reclassify comparative information for a change in presentation, following the change in the entity's activities?

34. We agree, comparative information should not have to be reclassified merely because the composition of an entity's activities happens to change from one year to the next. The restatement of comparative information can be an extremely time consuming process, which ultimately may be of dubious value. Past events cannot be altered regardless of the effort expended in realigning the reporting of them. The presentation in any particular period should be based on the facts and circumstances pertaining at that time; those circumstances are likely to be different in subsequent years but it would not be right to go back and reopen previously reported information merely because the underlying circumstances happen to differ in this way. We therefore suggest that it would be preferable for this requirement to be removed from the draft standard.

Implementation costs and timeline

Please provide an estimate of costs to implement this proposed standard, that includes estimates of the following:

a) Systems costs (software and consulting)

i. Changes to the consolidation and reporting systems

ii. Changes to sub-ledger systems

iii. Other system changes (please explain)

b) Business process change costs

i. Documentation of new business processes and controls

ii Accounting policy documentation

iii Training of employees

If you are not able to provide an accurate quantitative cost estimate, please provide a qualitative assessment.

Please provide a summarised implementation timeline that contains your best estimate of expected activities and the time required to complete those activities.

Please provide an estimate of costs to maintain the financial reporting using the new presentation model.

35. We believe that a reasonably specific cost-benefit analysis cannot accurately be assessed until the proposals have been further developed as suggested in this response.

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THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND AND WALES

20 April 2009

Our ref: ICAEW Rep 48/09

Your ref:

Sir David Tweedie
The International Accounting Standards Board
30 Cannon Street
London EC4M 6XH

By email: commentletters@iasb.org

Dear David

FINANCIAL STATEMENT PRESENTATION

The Institute of Chartered Accountants in England and Wales is pleased to respond to your request for comments on the Discussion Paper *Preliminary Views on Financial Statement Presentation*, published in October 2008.

Please contact me if you would like to discuss any of the points raised in the attached response.

Yours sincerely

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THE INSTITUTE
OF CHARTERED
ACCOUNTANTS
IN ENGLAND AND WALES

ICAEW Representation

ICAEW REP 48/09

FINANCIAL STATEMENT PRESENTATION

Memorandum of comment submitted in April 2009 by The Institute of Chartered Accountants in England and Wales, in response to the International Accounting Standards Board Discussion Paper 'Preliminary Views on Financial Statement Presentation', published in October 2008.

Contents | **Paragraph**

INTRODUCTION

1. The Institute of Chartered Accountants in England and Wales (the Institute) welcomes the opportunity to comment on the International Accounting Standards Board Discussion Paper *Preliminary Views on Financial Statement Presentation*, published in October 2008.

WHO WE ARE

2. The Institute operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, the Institute provides leadership and practical support to over 130,000 members in more than 140 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. The Institute is a founding member of the Global Accounting Alliance with over 700,000 members worldwide.

3. Our members provide financial knowledge and guidance based on the highest technical and ethical standards. They are trained to challenge people and organisations to think and act differently, to provide clarity and rigour, and so help create and sustain prosperity. The Institute ensures these skills are constantly developed, recognised and valued.

4. Our members occupy a wide range of roles throughout the economy. This response was developed by the Financial Reporting Committee of the Institute, which includes preparers, analysts, standard-setters and academics as well as senior members of accounting firms.

MAJOR POINTS

Welcome for the Discussion Paper

5. We welcome this Discussion Paper, which addresses important issues and lays a useful foundation for further debate. We agree, for example, that the boards are correct to concentrate on cash, and with the proposal to classify assets and liabilities as short-term or long-term rather than make a classification based on operating cycle. However, we believe that the boards have failed to address a number of important issues, and we have reservations about the proposed presentation format, which we believe is over-detailed. We set out our major comments below in paragraphs 6 - 15, and address the specific questions raised in the Discussion Paper in paragraphs 18 et seq below.

Business/industry sectoral issues

6. In our consideration of the proposals, we have continually run up against the problem that financial institutions do not fit into the same overall model on presentation as ordinary corporates. We have tried to highlight specific factors where appropriate, but we wonder whether there is a fundamental need to look at corporates and financial institutions in a more radically different way than in the DP. There is also very little material that addresses the issues facing distinct business or industry sectors, beyond financial institutions. We believe that the Discussion Paper should have given at least a high-level consideration of sectoral issues, to examine, for example the limits to comparability between sectors. While we do not think the boards should institute their own process for dealing with the problems of specific business sectors, we would hope that over time market practice within sectors might converge, thus aiding comparability between peer companies.

Issues not dealt with

7. We understand why the boards have limited the scope of the proposals; an incremental approach provides the best chance of progress in line with the 2011 target for the roadmap. However, we believe a number of issues ought to be dealt with sooner rather than later. In particular, the boards need to agree on the purpose of the income statements or statement of comprehensive income and how gains and losses should be categorised therein before final decisions can be made about presentation. Companies and users of accounts place a great deal of emphasis on the income statement and net income and clear underlying principles in the reporting of gains and losses are therefore vital. Deferring consideration of issues such as Other Comprehensive Income (OCI) and recycling continues to cause problems elsewhere as it is difficult to assess the impact of other proposals, for example on hedging, pensions accounting and fair value changes, without knowing how the income statement will reflect such items. This project was originally instituted to deal with these particular issues and it raises questions about the use of the boards' limited resources and priorities to have issued a Discussion Paper that does not address these questions when there are other pressing matters for the boards to address.

8. If implemented, the proposals might lead to some duplication of information. An analysis of the effect on existing requirements would have been useful, and an indication of where the new proposals would replace them.

Management approach vs users' needs

9. We see merit in the management approach to classification, as reflecting the way an item is used within an entity is likely to provide useful information to users of the financial statements. Comparability will be achieved even if the same item is shown in different ways by different entities where that reflects the fact that it is being used or managed in different ways. These differences between entities should be where users gain most information. (It is important that users understand that comparability is the aim here, not uniform consistency; although they may argue that they need greater *consistency* at the primary statement level.)

10. We nevertheless believe more guidance is required on the application and limitations of this approach if satisfactory comparability between entities is to be achieved (see our detailed answers to question 5 in paragraphs 28 - 34 below). We believe that there is a risk that the approach could lead to insufficient comparability between entities where different views are taken about identical items when these are used in the same way in all businesses. So, for example, the boards might ultimately seek to limit the management approach in certain respects, perhaps by requiring some items to be categorised in a certain way when otherwise it would involve too much guesswork or arbitrariness (eg, cash, defined benefit pensions and perhaps certain liabilities) to decide to which category the figures should be allocated. The standard might establish a presumption that an item should be dealt with in a given way in a particular business, but permit an alternative if the circumstances warrant it. This would be supplemented by note disclosure about the key decisions.

11. Notwithstanding the above, we consider also that the boards have in fact diverged from the management approach in circumstances where they believe users' needs would be better served by an alternative approach and, while we do not necessarily oppose this, the Discussion Paper presents no real evidence for what users actually want. See, for example, our comments about direct and indirect cash flows in paragraph 15 below and in our detailed answers to question 19 in paragraphs 65 - 71 below. The boards should diverge from the management approach only where an empirically based and properly articulated assessment of users' needs shows it to be necessary. Overall, we believe that the boards need to be clearer about why they think users do want certain information.

Proposed formats

12. In our view the proposed level of detail on the face of the primary statements will not serve to improve communication. The proposed presentation model draws too much information into the primary statements, with the effect that the overall picture is obscured. We realise that interim financial statements are due to be covered in a later phase of the project, but we are concerned that the level of detail may also have knock-on implications for interims.

13. We do not believe the boards have made the case that a mandatory single statement of comprehensive income is to be preferred, on the basis that the major issues noted in paragraph 5 above have not been addressed. We refer the boards to the discussion paper recently published by EFRAG and European national standard setters under the Pro-active Accounting Activities in Europe (PAAinE) banner. This specifically addresses the central questions in relation to the income statement, net income and OCI and recycling. We urge the boards to take forward this work to deal with these issues, without which this project will never be complete. (See paragraphs 51 - 53 below).

14. We agree with the boards that reconciliations can be useful in revealing the composition of certain items. However, there are dangers in attaching too much importance to them as they will often contain summary amounts that users will not understand, for example a net accrual movement. We note also that the boards have rejected the comprehensive income matrix on page 164. In our view, this would be the most useful presentation (although with much less detail) as it gives all the appropriate items with the fewest columns. We believe it deserves further consideration (see paragraph 88 below).

Direct vs indirect cash flows

15. We do not believe the case has yet been made that a direct method of presenting operating cash flows will lead to more decision-useful information. The direct method does not represent the way businesses are managed, and certainly most accounting systems do not collate the information that would be required for a direct method cash flow statement. Having consulted a limited number of users during our deliberations, we have found no evidence that users actually want a direct cash flow presentation, and importantly there is little specific information about how they would use the new information from the direct method, if they had it. An indirect approach that starts with operating profit in the operating section, reconciling to operating cash flows and with appropriate disclosures, would be much more straightforward for companies and appears to provide appropriate information. Whether a direct method would be better for users can only be determined by users, who, if they need a direct method, should make the case for it on a cost-benefit basis. We trust that field testing will make the position clearer. (See paragraphs 65 - 71 below.)

ANSWERS TO DETAILED QUESTIONS

Chapter 2: Objectives and principles of financial statement presentation.

Q1 Would the objectives of financial statement presentation proposed in paragraphs 2.5–2.13 improve the usefulness of the information provided in an entity's financial statements and help users make better decisions in their capacity as capital providers? Why or why not? Should the boards consider any other objectives of financial statement presentation in addition to or instead of the objectives proposed in this discussion paper?

If so, please describe and explain.

16. We believe that each of the three objectives of cohesiveness, disaggregation and liquidity, are interesting and should be explored further. We do not believe that the boards have fully explored their implications or properly articulated the dependent principles. As a result, while the proposed model certainly presents a great deal of useful information, it also omits and obscures some, and does not ultimately provide a coherent picture.

Cohesiveness

17. We believe that, for non-financial institutions, although cohesiveness can be applied very usefully in the case of the cash flow and income statements, it does not work in the same way with the balance sheet in terms of producing useful information. The discussion in paragraphs 2.56 et seq acknowledges that conceptually all liabilities are sources of financing for an entity's various activities. Consequently, most non-financial companies do not 'manage' their balance sheets in terms of the given categories for balance sheet items. In fact, companies manage working capital, but this does not appear at all on the proposed balance sheet (calling into question whether the proposals can in fact reflect what is truly a "management approach"). Other items monitored by management also do not appear in the balance sheet as presented, including much useful liquidity information. As a result, a number of key ratios that are balance sheet led would not be apparent. We suggest that what is proposed for the balance sheet would in fact be more useful in a reconciliation in the notes. In fact, the boards seem to accept that full cohesiveness is not achievable, and so have supplemented it with a reconciliation objective.

18. This indicates to us that cohesiveness, whilst a useful objective, is being applied too rigidly in the approach advocated in the DP. There are some specific examples of where cohesiveness is difficult to apply, perhaps the most obvious of which is defined benefit pension costs. The current proposed presentation of pensions in the balance sheet is to show a net asset or liability, which is to be shown in the operating section as it relates to employee remuneration and it is not a financial asset or liability. However, the extent to which the entity funds the pension obligation is a financing decision; hence, to apply the cohesiveness principle in too rigid a fashion by putting all gains and losses through operating in the income statement and cash flow statement would lose valuable information on financing represented by the expected return on plan assets and the interest charge (the unwinding of the discount). Similarly, dividends payable on equity shares (discussed further at paragraph 25 below) are proposed to be shown as a financing liability in the statement of financial position, but will not be shown as financing items in the income statement. It is also problematic they will be shown as a financing cash flow in the cash flow statement, even though they arise from equity instruments. (This confusion may arise, however, from the problems still to be satisfactorily settled in the question of the distinction between debt and equity.)

Disaggregation

19. The boards' model brings a lot of information into the primary statements. To say that disaggregation of line items is required 'to the extent that this will enhance the usefulness of the information in predicting the entity's future cash flows' does not provide sufficient guidance on what is required in practice. In fact the level of disaggregation apparently envisaged by the boards, as shown in the examples in the DP, is too great. There is far too much detail on the face of the statements, risking cluttering up the primary statements and making performance harder to understand. Clarity should not be sacrificed to the disaggregation objective, particularly when users want to see clear messages in the financial statements and are very able and experienced in using the notes to the financial statements to fill in the details.

20. Disaggregation should not only be focussed on helping to assess future cash flows. It is also about assessing the past performance of the business and the stewardship of management. The approach to discontinued operations, discussed in paragraphs 26 and 27 below, continues to be an example of too much of a focus on future cash flows at the expense of reporting properly the whole of the period's performance.

Liquidity and financial flexibility

21. There is undoubted merit in this objective, particularly in current economic conditions. We have commented on some of the aspects of the proposals for the balance sheet in paragraph 17 above. We are not sure that financial flexibility can really be described as an objective of financial reporting when it is about the ability to *alter* future cash flows. We think this is not fully achievable within the present accounting model and it is more appropriate for relevant information to be given in the narrative report, where management can discuss future business risks and uncertainties and the extent to which they can build in contingency plans and build flexibility into their business model so as to be able to move quickly if circumstances require. We would expect the boards to consider carefully the type of information required in relation to liquidity in conjunction with the current proposals for IFRS 7 in this area. The standards should dovetail and be consistent in their requirements.

Q2 Would the separation of business activities from financing activities provide information that is more decision-useful than that provided in the financial statement formats used today (see paragraph 2.19)? Why or why not?

22. Overall, we believe that the separation of business activities from financing activities will provide better (ie, more decision-useful) information. We think this represents, broadly speaking, how many users analyse financial statements and use them to judge the performance of the entity. There is a further requirement to separate operating and investing activities within the business category (see question 9).

23. Many balance sheet items will be difficult to split into operating and financing categories (eg, cash and bank overdrafts could be deemed to relate to operating or financing or both). The boards will need to consider whether it is best simply to mandate where they go, or whether choice should remain, including whether balances are split. We note if an entity cannot clearly identify an asset or liability as relating to operating, investing or financing activities, the entity should presume that the asset or liability relates to its operating activities (paragraph 2.35). We regard this as a satisfactory approach.

24. We query the usefulness of the proposed presentation for banks and insurers as most assets and liabilities will be classified in the operating category (paragraph 2.79). We question whether this will aid clarity or meaning to the financial statements of banks and strongly recommend the boards liaise further with financial institutions and their stakeholders to ensure

that the finalised proposed structure of the financial statements is useful for the users of their financial statements.

Q3 Should equity be presented as a section separate from the financing section or should it be included as a category in the financing section (see paragraphs 2.19(b), 2.36 and 2.52–2.55)? Why or why not?

25. We believe that equity should be shown separately from the financing section. Furthermore, we believe that in the cash flow statement dividends payable on equity instruments belong in a separate equity section rather than in financing as proposed. The boards have not yet resolved some of the fundamental questions about the distinction between debt and equity; although dividends on equity instruments, once formally approved, become liabilities, they nevertheless arise from and relate to an equity instrument.

Q4 In the proposed presentation model, an entity would present its discontinued operations in a separate section (see paragraphs 2.20, 2.37 and 2.71–2.73). Does this presentation provide decision-useful information?

Instead of presenting this information in a separate section, should an entity present information about its discontinued operations in the relevant categories (operating, investing, financing assets and financing liabilities)? Why or why not?

26. We agree that discontinued operations should be shown separately, but not in a separate section. We prefer a presentation approach that is similar to that in the old IAS 35, where discontinued operations were generally shown separately on a columnar basis, but disaggregated across each relevant line item. We particularly dislike the IFRS 5 approach, which requires discontinued operations to be disclosed as a single amount in comprehensive income. This amount therefore becomes a quasi-extraordinary item, despite extraordinary items having been rightly banned under IFRS.

27. The IASB's decision to abandon the IAS 35 approach in favour of the quasi-extraordinary item treatment available under US GAAP was not a move towards higher quality reporting. IFRS 5 downplays the stewardship aspect of financial reporting, where management should be held accountable for *all* the gains and losses arising in the period. We urge the boards to take the opportunity offered by this project to reconsider the approach to discontinued items under IFRS. The boards also should simply mandate where held-for-sale items should be reported that do not qualify as discontinued operations.

Q5 The proposed presentation model relies on a management approach to classification of assets and liabilities and the related changes in those items in the sections and categories in order to reflect the way an item is used within the entity or its reportable segment (see paragraphs 2.27, 2.34 and 2.39–2.41).

(a) Would a management approach provide the most useful view of an entity to users of its financial statements?

28. We see merit the management approach. In principle, classifying assets and liabilities in a manner that best reflects the way an item is used within an entity is likely to provide the most useful information to users of the financial statements. See however our comments in paragraphs 9 and 10 above.

29. We question whether the management approach as mandated by the standard is the way that management of many entities would tend to think about their business. Management are likely to be focussed on flows of income and expense and cash; but the DP methodology requires them to look at assets and liabilities first. Calling this a “management approach” may

therefore be a misnomer. We wonder whether corporates would be more likely to "backfill" the approach by looking first at how they consider items of income and expense and cash flows and allocate these first, then work back to the balance sheet. This may be different for financial institutions, where management are likely to be more focussed on the balance sheet as the primary driver of value.

30. There is some anecdotal evidence that management have changed the way they report segmental information to the board in reaction to the requirements of IFRS 8. It would be most unfortunate if, in this more extreme case, management altered the way they managed assets and liabilities merely to achieve a certain financial reporting result.

(b) Would the potential for reduced comparability of financial statements resulting from a management approach to classification outweigh the benefits of that approach? Why or why not?

31. Overall we do not believe that the potential for reduced comparability of financial statements resulting from a management approach to classification outweighs the benefits of that approach. In particular, paragraph 2.27 of the DP is reasonably strict as to how the analysis should be done. Although there are areas where judgement would have to be applied, management are required to allocate assets and liabilities based on how they are used in the business. They have discretion how to use assets and liabilities in the business, but then no discretion as to how to report them.

32. We believe it is important to acknowledge the impact of the management approach, and in particular the limitations on comparability, which exist anyway. Comparability between different business sectors is only achievable at a high level and across only certain aspects of performance, and it is arguably of less importance than intra-sector comparability. Comparability within sectors is potentially achievable to a much greater extent, although some lack of comparability is inevitable, even within sectors, because of the way companies are managed. That said, such information about the different ways in which companies are run is useful. But users will need to accept that the same assets and liabilities will be reported differently in different businesses and that comparability is still being achieved because the assets and liabilities are being managed in a different way.

33. More guidance may be required on how management should approach its classification decisions - for example, in relation to allocations to operating or investing activities - before consistent implementation can be achieved. Most importantly, however, there must be clear allocation principles that companies can apply and auditors can use as the basis for their work in this area. Results of the field testing should help to determine whether the principles are clear enough and whether any additional guidance is required. This is an area where industry sectors may need to consider agreement amongst themselves on allocations of specific items, to the extent that this remains consistent with the management approach for each entity.

34. Another issue, which may be more difficult to deal with, is the extent to which period-to-period comparability will be at risk, as management changes and reorganisations lead to movements between categories on a regular basis within an entity. However, the fact that the classification is an accounting policy, which has to be fully explained in note disclosures, should mitigate against this.

Q6 Paragraph 2.27 proposes that both assets and liabilities should be presented in the business section and in the financing section of the statement of financial position. Would this change in presentation coupled with the separation of business and financing activities in the statements of comprehensive income and cash flows make it easier for users to calculate some key financial ratios for an entity's business activities or its financing activities? Why or why not?

35. As noted above, we are not convinced that the balance sheet fits into the cohesion principle for a corporate, in that the cohesion principle is much stronger across the income and cash flow statements only. The proposed approach would fragment the statement of financial position and in our view users may lose more useful information than they have gained. We are not clear that it would make it easier to calculate some key financial ratios; this might be true, but the format could make the calculation of others harder. For example, it will be much more difficult to look at and calculate ratios for working capital and net current assets, which are key for many types of business. For non-financial institutions, it might be better to focus on the relationship between the statements of comprehensive income and cash flows and leave the balance sheet relationship to be described in the reconciliation. This would leave the current balance sheet presentation primarily intact.

Q7 Paragraphs 2.27, 2.76 and 2.77 discuss classification of assets and liabilities by entities that have more than one reportable segment for segment reporting purposes. Should those entities classify assets and liabilities (and related changes) at the reportable segment level as proposed instead of at the entity level? Please explain.

36. We think there are problems that may arise if entities having more than one reportable segment classify assets and liabilities at the reportable segment level. Although this will reflect the purpose for which they are held by the segment, and accords with the management approach, it will not always be helpful to the user of the entity financial statements. As noted in the Discussion Paper, classification at the entity level would be 'less complex' and therefore easier to achieve, and we do not believe that it will be unduly burdensome for most entities. Consider, for example, a reportable segment that is the treasury operation of a group. Its categorisation of operating versus financing may look very different at the reportable segment level (mainly operating, like a financial institution) to the way it would look from an entity perspective (mainly financing, like a corporate). Similarly, certain assets could have a different use in the segment from the group. For example, a head office might be used for operations at an segment level, but be considered by management at the entity level to be an investment property within a property portfolio.

Q8 The proposed presentation model introduces sections and categories in the statements of financial position, comprehensive income and cash flows. As discussed in paragraph 1.21(c), the boards will need to consider making consequential amendments to existing segment disclosure requirements as a result of the proposed classification scheme.

For example, the boards may need to clarify which assets should be disclosed by segment: only total assets as required today or assets for each section or category within a section. What, if any, changes in segment disclosures should the boards consider to make segment information more useful in light of the proposed presentation model? Please explain.

37. We suggest that the IASB will need to carry out a post-implementation review of IFRS 8 to determine how effective it is in practice, as well as analysing how consistent it is with the proposals in this Discussion Paper. As noted, there may be a case for requiring disclosure of category totals of assets and liabilities at segment level, but this would only seem feasible in the context of the "through the eyes of management" approach in IFRS 8 if they are reported to the Chief Operating Decision Maker (CODM).

Q9 Are the business section and the operating and investing categories within that section defined appropriately (see paragraphs 2.31–2.33 and 2.63–2.67)? Why or why not?

38. We are generally content with the definitions. They set out principles that are consistent with the management approach. The field testing should indicate whether the principles are clear enough and there is sufficient guidance to avoid a free for all would result,.

39. This is probably the categorisation split where movements between categories could be common. We noted this problem above: we would not advocate constraints on movements between categories period to period, because companies quite reasonably change the way their business is structured and run and for some companies this might happen relatively frequently. However, full disclosure should be required of such changes and consideration needs to be given to the extent to which restatement of comparatives will be feasible.

40. We think there is also a potential conflict in the overall principle stated for the investment category, which seems to be a core/non-core distinction with operating, but that the return envisaged would be in the form of "interest, dividends or increased market prices". These do not sit easily together as non-core activities could encompass those that generate trading income and expense, whereas a return of dividends and so on seems to envisage simply investment of surplus cash to achieve a return of this nature. The boards should be clearer as to whether the investing activity can encompass trading operations.

41. There is also the issue of how to deal with assets that have a multiple purpose, for example where a head office is also viewed as an investment property by management. Would it be necessary to classify according to the primary purpose?

Q10 Are the financing section and the financing assets and financing liabilities categories within that section defined appropriately (see paragraphs 2.34 and 2.56–2.62)? Should the financing section be restricted to *financial assets* and *financial liabilities* as defined in IFRSs and US GAAP as proposed? Why or why not?

42. We do not agree with the definitions. We do not agree that the financing section should be restricted to 'financial assets' and 'financial liabilities' as defined in IFRSs. While liabilities not classified as operating liabilities will generally be financial liabilities, this does not appear to be a basis for excluding non-financial items from the financing section. Management may well view certain non-financial liabilities as a source of finance, so to exclude them arbitrarily from the financing section is a clear divergence from the management approach, which may not be justified. A specific example that may mean a loss of helpful information would be the extent to which a defined benefit pension liability is being funded (see paragraph 18 above); where it is, the funding element is a long-term financing transaction that may be considered alongside (and assessed as being interchangeable with) other long-term funding sources.

43. There are a number of other issues, including:

● It will be often be difficult to distinguish operating and financing financial assets. Items such as cash might be classified by management as an operating asset in trading segments, but a financing asset at treasury or group level.

● It will often not be practicable to allocate liabilities, although it is not clear anyway that allocation leads to useful information. However, information about long-term funding is clearly useful.

44. Another aspect is in relation to allocation of staff costs. Although it may be possible to argue that all staff costs are operating costs, it seems more appropriate to allocate investing and financing staff costs because management will manage on that basis. The model appears to default staff costs to operating, although more clarity is needed on whether this is mandated or merely a presumption.

Chapter 3: Implications of the objectives and principles for each financial statement.

Q11 Paragraph 3.2 proposes that an entity should present a classified statement of financial position (short-term and long-term subcategories for assets and liabilities) except when a presentation of assets and liabilities in order of liquidity provides information that is more relevant.

45. We note that the boards are proposing to remove the 'operating cycle' basis for determining whether an item is current or non-current, so that a classified statement of financial position will invariably be based on a one-year distinction. We support this proposal, which accords with usual practice.

(a) What types of entities would you expect not to present a classified statement of financial position? Why?

46. We expect that financial institutions such as banks and insurance companies will typically continue to present a statement of financial position in order of liquidity rather than a classified statement. Liquidity is an important issue, as has recently been demonstrated. We would expect the boards to consider carefully the type of information required in relation to liquidity in conjunction with the current proposals for IFRS 7 in this area. The standards should dovetail and be consistent in their requirements.

(b) Should there be more guidance for distinguishing which entities should present a statement of financial position in order of liquidity? If so, what additional guidance is needed?

47. We do not believe that more guidance is required for distinguishing which entities should present a statement of financial position in order of liquidity; if it is not relevant it should not be given. It is not clear that a problem has arisen from the existing level of guidance, so nothing further is needed. Further prescription as to which entities might do so would be unhelpful, as it would not address new types of businesses as they arise. Market forces should serve to harmonise practice across sectors if there are initial differences; standard setters need only address this if it fails to occur in practice.

Q12 Paragraph 3.14 proposes that cash equivalents should be presented and classified in a manner similar to other short-term investments, not as part of cash: Do you agree? Why or why not?

48. We agree that cash should be shown separately in the balance sheet. There seems no good reason for there to be a separate cash equivalent category, which could simply be combined with the short-term investments category, although some entities may wish to disclose separate amounts.

Q13 Paragraph 3.19 proposes that an entity should present its similar assets and liabilities that are measured on different bases on separate lines in the statement of financial position: Would this disaggregation provide information that is more decision-useful than a presentation that permits line items to include similar assets and liabilities measured on different bases? Why or why not?

49. We do not support disaggregation of similar assets and liabilities measured on different bases on separate lines on the face of the primary statements, because this will lead to unhelpful and confusing clutter. However, we agree that this is useful information, which should be disclosed in the notes. Contrary to the views expressed in paragraph 3.20 of the DP, we think that users prefer clean, uncluttered statements that can give clear messages and are used to referring to the detailed breakdown and explanations in the notes to the financial statements.

50. Some clarification is necessary of what the boards mean by different measurement bases. Is an asset held at impaired historical cost different to one held at unimpaired historical cost? Our view is that a broad (but well-defined) split between current values and historical values might be the one that users are really interested in; any further distinctions are unlikely to be of such interest to them, although preparers could be given the latitude for further disaggregation within the note disclosure.

Q14 Should an entity present comprehensive income and its components in a single statement of comprehensive income as proposed (see paragraphs 3.24–3.33)? Why or why not? If not, how should they be presented?

51. As we pointed out to the ED of the Phase A change to IAS 1, this proposal appears premature because the boards are putting forward a mandatory single statement before they have addressed certain key issues, which centre on the need for clear and robust guidance as to how, on a principled basis, specific items should be allocated to net income and OCI, whether the category of OCI should continue to exist and whether recycling is permitted or required and so on. Although we recognise the time constraint of 2011 to which the boards are working, these fundamental issues have been known about since the project began and yet continue to be deferred.

52. Overall we can live with the requirement that entities should be required to present components of recognised income and expense in a single statement, on the basis that it is probably useful for all gains and losses to be shown in one place. But our acceptance is mainly because the split between net income and OCI is currently merely a "page break" issue as there is no principle articulated as to what should be in one or the other. We are nevertheless concerned at the proposals because we find it impossible to debate the question of the number of statements on a conceptual or practical basis until the fundamental issues relating to the income statement are dealt with – the boards are thus asking the wrong question at the wrong time. In particular, they are requiring a further change to financial statement presentation without solving any of the fundamental problems.

53. We refer the boards to the discussion paper recently published by EFRAG and European national standard setters under the Pro-active Accounting Activities in Europe (PAAinE) banner. This specifically addresses the central questions in relation to the income statement, net income and OCI and recycling. We urge the boards to take forward this work to deal with these issues, without which this project will never be completed in a satisfactory fashion.

Q15 Paragraph 3.25 proposes that an entity should indicate the category to which items of other comprehensive income relate (except some foreign currency translation adjustments) (see paragraphs 3.37–3.41).

Would that information be decision-useful? Why or why not?

54. We agree that the information would be decision-useful, but note that this issue only arises because of the failure to address properly how items should be allocated to Other Comprehensive Income (OCI) and net income, as noted in paragraphs 51 - 53 above, leaving the current situation in place, which has developed ad hoc over time. We suggest that the boards should have gone further in exploring the potential consequences of abandoning OCI; it would be helpful to know how the field-testers would have dealt with it.

55. We believe it will generally be straightforward for entities (and the field testing may bear this out) to classify OCI items to one of the other categories (although pensions may still cause problems as noted at paragraph 18 above). Foreign currency translation adjustments will have

to be dealt with eventually, although we agree with excluding them from the question here. It may be that these amounts have to continue as a separate category, or the boards could simply require them to be allocated to one category with separate line item disclosure.

Q16 Paragraphs 3.42–3.48 propose that an entity should further disaggregate within each section and category in the statement of comprehensive income its revenues, expenses, gains and losses by their function, by their nature, or both if doing so will enhance the usefulness of the information in predicting the entity's future cash flows. Would this level of disaggregation provide information that is decision-useful to users in their capacity as capital providers? Why or why not?

56. We agree that this disaggregation would provide decision-useful information.

57. We infer from paragraphs 3.42 and 3.44 a presumption on the part of the boards that the primary disaggregation will be by function: an entity should disaggregate income and expense items by function and then disaggregate the items in that disaggregation-by-function further by nature, in both cases to the extent that disaggregation will enhance the usefulness of the information in predicting the entity's future cash flows. An entity that does not disaggregate by function should nevertheless disaggregate by nature to the extent that this will enhance the usefulness of the information.

58. We note the following:

● disaggregation of income and expenditure by nature is more consistent with a direct approach to cash flows; and

● the management approach tends towards arbitrary allocations, so it might be preferable to move towards classification by nature rather than function in the income statement.

59. In view of this, and given that we infer that the boards expect in practice disaggregation by both nature and function, there may be a case for establishing by nature as the default classification for primary disclosure. In any event, preparers should have the option - which they do appear to have under the proposals - to present what they regard as most useful. If management uses a by nature disaggregation for internal reporting purposes, this would seem to provide a clear pointer to this being the more useful presentation for external reporting, extending the principle of the management approach. If users have good reason to prefer disaggregation by function, they should make clear why it is important to them. However, our anecdotal understanding is that users actually prefer a by nature approach.

60. Regardless of which approach is adopted, we would not support a requirement to show the secondary disaggregation on the face of the statement of comprehensive income. Again, there is a risk of cluttering up the primary statements and obscuring their key messages. This information should be allowed to be presented in the notes (as envisaged by paragraph 3.46).

Q17 Paragraph 3.55 proposes that an entity should allocate and present income taxes within the statement of comprehensive income in accordance with existing requirements (see paragraphs 3.56–3.62).

To which sections and categories, if any, should an entity allocate income taxes in order to provide information that is decision-useful to users? Please explain.

61. We believe there is a clear division of views in relation to tax allocation between categories between (at least some) users and most preparers. Preparers argue that allocation of tax between different categories of gains and losses (no matter how many there are) is so arbitrary as to be meaningless and potentially actively misleading. They rightly point out the

distorting effects of brought forward losses, truing up of actual tax amounts paid each period and in particular how intra-group tax arrangements can affect the overall tax result. Some users, on the other hand, argue that in their models they wish to allocate tax to operating and financing and that they are right to do so because each transaction within a category has tax consequences (and even may have been entered into for tax purposes), and the result is more useful information. In relation to the arbitrary nature of allocation, they argue that at least any such exercise done by the company is bound to be less arbitrary, given management's more detailed internal knowledge, than their own attempts at allocation.

62. We have sympathy with both views. We suggest that, in the long run, presentation of a single tax number with full disclosure in the notes to the financial statements of allocation to categories would be best, although this is also dependent on sorting out the OCI/net income issue as at the moment net income is presented after tax. We particularly agree that tax on operating profits is useful information that should be disclosed and the boards should work with field testers and through further consultation to find out whether it is possible for most types of entity to give fuller breakdowns of their total tax charge.

Q18 Paragraph 3.63 proposes that an entity should present foreign currency transaction gains and losses, including the components of any net gain or loss arising on remeasurement into its functional currency, in the same section and category as the assets and liabilities that gave rise to the gains or losses.

(a) Would this provide decision-useful information to users in their capacity as capital providers? Please explain why or why not and discuss any alternative methods of presenting this information.

63. We agree that presenting foreign currency transaction gains and losses in the same section and category as the assets and liabilities that gave rise to the gains or losses will provide decision useful information. While this might be correct in principle, we also accept that practical difficulties are likely to arise - for example, in relation to net hedges that cover exposures in more than one category. Allocation is consistent with the cohesiveness principle, but the ease with which it may be achieved may vary. Further work should be done in assessing whether allocation to the relevant category will be too arbitrary in some situations, for example in relation to foreign exchange hedges that cover exposures in more than one category.

(b) What costs should the boards consider related to presenting the components of net foreign currency transaction gains or losses for presentation in different sections and categories?

64. There are also likely to be problems when translating local currency financial statements into the functional currency and the cost of dealing with this and the usefulness of the resulting information should be investigated further. This again relates to how items are allocated across categories and the extent to which estimation is used (similar to the arguments about allocating tax). However, we note that this question on cost is one the boards should be asking in relation to *all* the proposals in the DP, not just a few of them, and in each case it must be measured directly against benefits. If the benefits are dubious, because of arbitrary allocation problems, then the cost of carrying out such allocations may outweigh the benefits and allocation of the relevant gains and losses to one category may be the better answer.

Q19 Paragraph 3.75 proposes that an entity should use a direct method of presenting cash flows in the statement of cash flows.

(a) Would a direct method of presenting operating cash flows provide information that is decision-useful?

65. There is no doubt that a direct method of presenting operating cash flows provides decision-useful information. The more important question is whether there is a mandate to move from the status quo. Does the direct method meet users' needs better than the indirect method, and do the costs to preparers of the direct method justify mandating it?

66. We are not convinced that a direct method of presenting operating cash flows would lead to more decision-useful information in the context of the cost of providing it as the indirect method also produces decision-useful information (particularly as it helpfully links back to profit or loss). This question ultimately needs to be determined by users, who, if they assert that they need to see operating cash flows on a direct basis, should make the case for it. A good indirect method cash flow statement, which reconciled operating profit to operating cash flow, and with appropriate disclosure, might well be sufficient for users' needs.

67. The indirect approach would seem to be more consistent with the management approach: businesses are not usually managed on a direct cash flow basis, so some allocations could not be made on the basis of existing information systems and would not therefore be reliable.

68. This question may nevertheless vary by sector. For example, analysts have indicated that the current indirect cash flow statement, which is the nearly universal format chosen by insurers outside Australia, is not useful to them, although a small minority of the analysts used it for their forecasting activity. Insurance analysts have indicated a mild preference for the direct method

69. Two other interesting observations have emerged in relation to insurance companies:

(a) The importance of linking actual cash paid/received with estimates. In an industry where profits are primarily the outcome of complex management judgments, analysts strive for a form of reporting that can help them to assess how effective the estimation process has been. A few analysts suggested an asset development approach that is very similar to the alternative reconciliation note produced in the DP for the illustrative banking entity. A direct cash flow statement is naturally part of this form of reporting, whilst an indirect form of cash flow is not.

(b) The importance of reporting cash generation effectively in the context of insurance is possible only if the underlying capital structure is taken into account. Particularly in the life insurance sector there are funds within the reporting entity that would lock in cash amounts to comply with regulatory capital requirements. What analysts seek is the cash generation that would be available for shareholder distribution. This needs to be separated from the cash generated within funds that would not immediately be available for dividend payment. This would not be identified through the operating/investing/financing categorisation.

(b) Is a direct method more consistent with the proposed cohesiveness and disaggregation objectives (see paragraphs 3.75–3.80) than an indirect method? Why or why not?

70. We do not believe that the direct method is either more or less consistent with the cohesiveness objective than the indirect method. While paragraph 3.78(a) points out that the direct method helps users to relate information about operating assets and liabilities and operating income and expenses to operating cash receipts and payments, paragraph 3.79 sets out the advantages of the indirect method, which seem to us to be equally valid indicators of cohesiveness. It is not possible to say one is more consistent than the other. Given the mix of users' views, it also seems not possible to assert that the direct method is more or less consistent with the disaggregation objective than the indirect method.

(c) Would the information currently provided using an indirect method to present operating cash flows be provided in the proposed reconciliation schedule (see paragraphs 4.19 and 4.45)?

Why or why not?

71. We do not believe that the reconciliation schedule would provide all the information available from applying the indirect method. We have already noted in paragraph 58 above that disaggregation of income and expenditure by nature is more consistent with a direct approach to cash flows. As envisaged by the boards, income and expenditure would not necessarily be disaggregated by nature (ie, only when it will enhance the usefulness of the information in predicting the entity's future cash flows). However, disaggregation by nature would be a prerequisite to providing the same information as the direct method. Disaggregating the income statement on a by function basis would make it easier to arrive at the information provide by the indirect method.

Q20 What costs should the boards consider related to using a direct method to present operating cash flows (see paragraphs 3.81–3.83)? Please distinguish between one-off or one-time implementation costs and ongoing application costs. How might those costs be reduced without reducing the benefits of presenting operating cash receipts and payments?

72. Given that companies do not generally have the systems to support a direct method of presenting operating cash flows, and would have to implement them for the purpose, a clear statement of benefits to users seems vital, as noted above. Only preparers can provide the boards with information on the cost of implementing new systems and the costs of ongoing capture of the information after detailed analysis, and information from field testers would be a good starting point. Obviously the costs will vary substantially, depending on the nature and complexity of the organisation. It would appear from our preparer members that collecting the information from indirect data is unlikely to be cost effective, that complex organisations will find collecting the data difficult and the new information would be purely for compliance and of no other benefit to the company.

Q21 On the basis of the discussion in paragraphs 3.88–3.95, should the effects of basket transactions be allocated to the related sections and categories in the statement of comprehensive income and the statement of cash flows to achieve cohesiveness? If not, in which section or category should those effects be presented?

73. No. In our view, users would not be best able to understand the effects of basket transactions on the basis of allocations. This is an area where pragmatism will need to be applied. We favour presenting in a separate section (Alternative C), with disaggregated information in the notes.

Chapter 4: Notes to financial statements.

Q22 Should an entity that presents assets and liabilities in order of liquidity in its statement of financial position disclose information about the maturities of its short-term contractual assets and liabilities in the notes to financial statements as proposed in paragraph 4.7? Should all entities present this information? Why or why not?

74. We broadly agree with this proposal, which will mainly be an issue for banks and insurance companies, subject to our points below. The main point is to match the disclosures with what is now in IFRS 7, without either duplicating requirements or requiring disclosures that are similar but not quite the same.

75 We do not fully understand the terms 'contractual assets' and 'contractual liabilities', which do not appear to be defined in IFRS literature. We do not therefore understand the implications of limiting disclosures to 'contractual' items.

76. Although the Discussion Paper leaves flexibility in determining the appropriate level of detail to provide in a schedule related to short-term contractual assets and liabilities, paragraph 4.9 and Illustration 2A suggest that there should be three groupings of maturities - on demand, three months or less and three to 12 months. The effect seems to be that entities that have chosen not to present a 12-month split actually have to disclose more information about the maturity of short-term assets and liabilities (ie, on demand and a three-month split) than if they had simply chosen to present short- and long-term maturities. This makes no sense. Equally, exempting entities from the additional disclosures because they have presented short- and long-term maturities is illogical: if the information is sufficiently useful to be provided at all, it should be provided by all entities.

77. The Discussion Paper proposes to require entities to use contractual maturity dates in preparing short- and long-term maturity schedules. The recent amendments to IFRS 7 *Financial Instruments: Disclosures* require entities to disclose non-derivative liabilities analysed by both contractual and expected maturity dates (if the entity manages liquidity on the basis of expected maturities) and a maturity analysis for derivative financial liabilities based on how the entity manages the liquidity risk associated with such instruments. We supported these proposed amendments to IFRS 7, commenting that 'a maturity analysis based on the expected cash flows rather than the contractual terms is ... more useful to a user.' We believe the same considerations apply to the statement of financial position. Furthermore, we would be concerned if the basis required by IFRS 7 were to differ from that required for financial statement presentation

78. Overall, we are not convinced that the boards have satisfactorily established a framework for the presentation and disclosure of short- and long-term assets and liabilities. Allowing a choice of presentation and then requiring the alternative information to be disclosed evades the issue. There should be an onus on entities to consider whether it is useful to disclose the alternative information. The boards should aim for consistent principles financial statement presentation, and then look to individual standards to make more specific provisions in line with the core principles.

Q23 Paragraph 4.19 proposes that an entity should present a schedule in the notes to financial statements that reconciles cash flows to comprehensive income and disaggregates comprehensive income into four components: (a) cash received or paid other than in transactions with owners, (b) accruals other than remeasurements, (c) remeasurements that are recurring fair value changes or valuation adjustments, and (d) remeasurements that are not recurring fair value changes or valuation adjustments.

(a) Would the proposed reconciliation schedule increase users' understanding of the amount, timing and uncertainty of an entity's future cash flows? Why or why not? Please include a discussion of the costs and benefits of providing the reconciliation schedule.

79. We think the idea of a reconciliation has benefits and could increase users' understanding of the financial statements and the relationship between items in the individual statements. However, the reconciliation as proposed is too detailed and includes many items of no real informational value. Its primary benefit is probably to highlight the use and effects of fair values, in particular disaggregating them from accruals. But much of the accruals information consists of summary numbers that are meaningless without further explanation (although we doubt any user would want even more information). In spite of some academic research, we query the usefulness of much of the informational value of seeing the cash flow and accruals

movement of many of the lines shown. For the key process of communication between company and user, embodied in financial statements, it goes too far.

80 There are other issues, combining practical difficulties with cost/benefit considerations. Full reconciliation by nature and then by function could be very difficult and costly and it would be interesting to know how the field testers managed this issue. The reconciliation proposed would only really work if the direct method were used for the cash flow statement and, as noted above, it is not clear that the benefit to users of the direct method outweighs its cost to preparers. A good indirect method cash flow statement, which reconciled operating profit to operating cash flow, might well be sufficient for users' needs.

81. It is certainly not clear that disaggregation of all lines to this level of detail is useful. Overall, we believe the reconciliation should be amended and scaled back to what is likely to be manageable both to understand and prepare and which focuses on the key areas of interest. One example of an item of interest would be a reconciliation of net debt, which users seem persistently to request but which, strangely in our view, is not discussed at all in the DP.

82. In particular for financial institutions, because we think the primary driver will be the balance sheet, and the cash flow statement is largely irrelevant, we think the alternative reconciliation in Appendix B to the DP, which reconciles balance sheet to balance sheet, is much more appropriate to financial institutions. We believe that, through the field testing and further consultation, the boards should explore this issue with the financial sector. It would be counterproductive to require the same type of reconciliation for financial institutions as for corporates if it produces much less useful information. However, our views above would also apply to the reconciliation example in Appendix B: it needs to be scaled back to focus on the key items of interest. Even for non-financial institutions, a balance sheet to balance sheet reconciliation might be useful and this ought to be investigated.

(b) Should changes in assets and liabilities be disaggregated into the components described in paragraph 4.19? Please explain your rationale for any component you would either add or omit.

83. We agree in principle that changes in assets and liabilities should be disaggregated into the components described in paragraph 4.19. As noted above, we are not convinced that the full disaggregation envisaged in the Discussion Paper and set out in the Toolco example is adding useful information in relation to all items. It is the remeasurement columns (D and E) that are likely to provide the most useful information (although see our comments in relation to question 26 on the use of column E). Only the larger, longer term accruals are likely to be of great interest to users.

(c) Is the guidance provided in paragraphs 4.31, 4.41 and 4.44–4.46 clear and sufficient to prepare the reconciliation schedule? If not, please explain how the guidance should be modified.

84. Overall, we feel that the guidance contains too much of the kind of information that would be found in a Basis for Conclusions - that is, too much information about why the boards reached the decision they did rather than providing application guidance. We also found some difficulty in matching the examples to the text.

85. Flexibility will be needed for different businesses to adopt different presentations in order to highlight the most useful information and avoid the expense of gathering data of little or no decision-usefulness. In terms of the structure of the reconciliation, we would have like to have seen the boards explore other layouts. Perhaps cash and accruals could be sub-totalled, with a column for remeasurements. Recurring and non-recurring remeasurements could be separated

by column or line as appropriate. We believe it is important that the guidance is not prescriptive, and allows entities to adopt the most appropriate presentation for the circumstances.

86. We note that the Toolco example is inconsistent in its treatment of impairments. The loss on obsolete and damaged inventory impairment is treated as a non-recurring valuation adjustment, while the bad debt impairment of receivables is treated as an accrual. Paragraph 4.34(b) sates (rightly) that accrued revenue from credit sales is not an accrual attributable remeasurement, and we assume that is why the bad-debt impairment is dealt with in the accruals column. However, in our view, the bad debt provision is a remeasurement.

Q24 Should the boards address further disaggregation of changes in fair value in a future project (see paragraphs 4.42 and 4.43)? Why or why not?

87. Yes. But while further disaggregation should be dealt with in a future fair value standard, the principles should be dealt with in financial statement presentation. Although paragraph 4.43 states that recognition and measurement issues are outside the scope of the project, we believe it is necessary to address them in order to deal with problems such as recycling and the treatment of fair value gains and losses.

Q25 Should the boards consider other alternative reconciliation formats for disaggregating information in the financial statements, such as the statement of financial position reconciliation and the statement of comprehensive income matrix described in Appendix B, paragraphs B10–B22? For example, should entities that primarily manage assets and liabilities rather than cash flows (for example, entities in the financial services industries) be required to use the statement of financial position reconciliation format rather than the proposed format that reconciles cash flows to comprehensive income?

Why or why not?

88. Yes - different reconciliation formats are required for different entities, and the boards should consider alternative formats. We noted in paragraph 82 above that there is a case for reconciling the opening and closing balance sheets, particularly for financial institutions. We also believe that the comprehensive income matrix is worthy of consideration. All of this will depend on the objective of the reconciliation(s) and the extent to which entities are thus permitted flexibility in addressing the objective. It would appear to us that the statement that is the primary focus of preparers and users as it represents the primary driver of value for the business ought to dictate which approach to reconciliation is best undertaken by different entities.

Q26 The FASB's preliminary view is that a memo column in the reconciliation schedule could provide a way for management to draw users' attention to unusual or infrequent events or transactions that are often presented as special items in earnings reports (see paragraphs 4.48–4.52): As noted in paragraph 4.53, the IASB is not supportive of including information in the reconciliation schedule about unusual or infrequent events or transactions.

(a) Would this information be decision-useful to users in their capacity as capital providers? Why or why not?

89. Information about unusual or infrequent events or transactions can be decision-useful to users, because it helps to identify what is recurring and/or sustainable in the income stream and is thus helpful in predicting future cash flows.

90. We do not, however, support disclosure of unusual or infrequent items in a memo column in the reconciliation schedule. The memo column is by definition not reconciling, and clearly diverges from the cohesiveness objective. Having said that, we would not necessarily

preclude it. It should be up to the entity to decide which items deserve additional explanation and the most appropriate way of making the disclosure. The important thing is to ensure that extraordinary items and quasi-extraordinary items continue to be outlawed. Quite outside the context of the reconciliation (because such disclosure could simply be a note to the statement of comprehensive income), we would in principle support allowing entities to disclose additional information if it would be useful to users, but we would not prescribe specific methods of disclosure and we would not include a memo column in any examples.

(b) APB Opinion No: 30 *Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions,* contains definitions of *unusual* and *infrequent* (repeated in paragraph 4.51): Are those definitions too restrictive? If so, what type of restrictions, if any, should be placed on information presented in this column?

91. As we do not advocate placing information a memo column, we do not see a need for definitions. We endorse the approach in IAS 1, which bans 'extraordinary items' and requires an entity to provide additional disclosures when compliance with the specific requirements in IFRSs is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance. We would be concerned at any approach based on an attempt to define unusual and infrequent.

(c) Should an entity have the option of presenting the information in narrative format only?

92. Yes, although narrative comments will almost certainly need to include quantitative information in order to be of any use.

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