Ernst & Young Global Limited
Becket House
1 Lambeth Palace Road
London SE1 7EU

Tel: +44 [0]20 7980 0000
Fax: +44 [0]20 7980 0275
www.ey.com

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European Financial Reporting Advisory Group
13-14 Avenue des Arts
B-1210 Brussels
Belgium

Dear Sir / Madam

Performance Reporting - A European Discussion Paper

The global organisation of Ernst & Young is pleased to respond to the European Financial Reporting Advisory Group (EFRAG) and Instituto de Contabilidad y Auditoría de Cuentas (ICAC) Discussion Paper on performance reporting (‘*Performance Reporting – A European Discussion Paper*’) as part of the Pro-active Accounting Activities in Europe (PAAinE) initiative.

We believe that the Discussion Paper focuses attention on a number of increasingly important issues regarding performance reporting. Certain of the issues in the Discussion Paper are presently being addressed by the International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board (FASB) with respect to their joint project on Financial Statement Presentation. The Boards have recently been deliberating the responses to their joint discussion paper issued in October 2008 (‘*Preliminary Views on Financial Statement Presentation*’) and intend to issue an exposure draft on a new financial statement presentation standard during the second quarter of 2010 to replace IAS 1 *Presentation of Financial Statements* and IAS 7 *Statement of Cash Flows*. However, as you have noted in the Discussion Paper, there are important issues with respect to performance reporting that are not presently reflected in the IASB/FASB discussion paper or in current deliberations on the responses thereof. It is these issues that we intend to focus on in our response to the Discussion Paper.

What is Performance?

We support the consideration of such fundamental questions being raised in the Discussion Paper such as ‘What is performance?’ and ‘What does it represent?’ within the development of the IFRS Framework for the Preparation and Presentation of Financial Statements (the Framework) as well as within the development of standards themselves. However, with respect to the types of performance measures contemplated in the Discussion Paper (eg, management vs. entity performance and financial vs. non-financial performance), we believe that discussions within the development of the Framework and standards should be limited to ‘entity performance’ and ‘financial performance’. While the term ‘performance’ within the context of financial statements may someday encompass many of the broader concepts being considered in the Discussion Paper, our view is that performance reporting within the context of the current financial statement model should focus on the financial performance of the entity itself. While this view may change over time, we believe that extending discussions with standard setters outside of these boundaries does not make sense in the near term. We would like to point out that the IASB's Exposure Draft on Management Commentary (issued June 2009) could serve as an initial platform to deliberate topics related to 'management performance' and 'non-financial performance' as the exposure draft proposes IFRS guidance on the use of such performance measures and indicators as useful information that would complement financial statements.

Because financial statements are intended to appeal to a broad group of users, we believe that the development of a performance reporting framework should also follow this objective. However, as is often the case with financial reporting objectives, there is a tension among the qualitative characteristics of financial statements (eg, understandability, relevance, reliability and comparability). As the IFRS Framework suggests, there is a balancing effort that is required in applying these characteristics in meeting the overall objectives of financial reporting. Thus, the objectives of performance reporting cannot be considered in isolation of other financial reporting objectives. As a result, the degree of flexibility (which aligns to relevance) vs. prescription (which aligns to comparability) to be achieved in performance reporting will have to be carefully considered. Proposed changes to the IASB Framework should help address this issue by establishing 'relevance' and 'reliability' as *fundamental* characteristics of financial statements with the other characteristics serving as *enhancing* characteristics.

Feedback on the usefulness of performance measures included within IFRS 8 *Operating Segments* would also be relevant to this issue. Due to the recent adoption of IFRS 8 by reporting entities, it is unclear to us whether the additional performance reporting information that is required under this standard will fulfil the needs of users who expressed greater interest in understanding the performance of operating segments 'through the eyes of management'. We believe that this feedback would be relevant to a discussion of performance reporting and are hopeful that the IASB would consider such feedback as part of any future discussion on reporting financial performance.

Possible models for disaggregating income and expense

In our comment letter to the IASB/FASB discussion paper on financial statement presentation, we expressed support to classify the statement of comprehensive income into a business and financing section, including further disaggregation into operating and investing segments as part of the business section as well as debt and equity in the financing section, as the primary model for disaggregating the statement of comprehensive income. We believe that this type of disaggregation model achieves the objective of separating the central activities of a reporting entity from the 'other' activities, which we understand from surveys conducted by you, as noted in the Discussion Paper, is useful to financial statement users. This manner of classifying income and expense items would also increase the level of cohesiveness of the 'flow' statements as such classification would be aligned with IAS 7 regarding the presentation of cash flow information.

We are not in favour of other models proposed in the Discussion Paper as primary models for disaggregation (eg, the business model approach, core/non-core or non-holding/holding model) due to the subjectivity that would be required in classifying certain of the income and expense items. Such subjectivity would lead to a loss of understandability of financial statements and lower comparability among peer companies. As the Discussion Paper points out, income statement disaggregation models should also consider multiple levels of disaggregation beyond a single, primary model. We believe that current IFRS reflects this multi-level disaggregation as evidenced by the classification of certain income and expense items as 'recurring vs. non-recurring' (eg, discontinued operations or impairment disclosures in the notes to the financial statements) and 'realised vs. unrealised' (eg, fair value gains on financial assets or foreign currency translation differences). We believe that these are appropriate secondary disaggregation criteria and are not convinced that there are benefits to considering these secondary criteria as primary criteria. In addition, we believe there will be further emphasis by the IASB in the future regarding the presentation of additional information regarding 'recurring/non-recurring' and 'realised/unrealised' income and expense items. One example of this is the result of recent IASB/FASB deliberations on the financial statement presentation discussion paper which has resulted in a tentative conclusion that will require additional information in the statement of comprehensive income representing the amount of re-measurements of assets and liabilities that are reflected in income or expense. Such information may be viewed as both unrealised and non-recurring by users and, based on feedback to the IASB, is important information to be presented prominently within financial statements.

Key lines, bottom lines and recycling

We share EFRAG's view that the current performance reporting model is more reflective of a time when 'net income' represented all (or nearly all) recognised income and expenses as essentially equivalent to 'comprehensive income'. However, with the increasing complexity of business and the reliance in IFRS on the re-measurement of assets and liabilities on a current basis, presentation of the re-measurement differences (as well how and whether such differences are to be subsequently recognised in net income) has been an issue that has not been clearly, or consistently, dealt with in IFRS. We believe that the determination of key lines and bottom lines, which provide decision useful information, is dependent on a comprehensive approach for such reclassification adjustments.

We supported the IASB's intention to address these issues in the Financial Statement Presentation project however, as noted in the EFRAG Discussion Paper, the IASB/FASB discussion paper on financial statement presentation did not, in fact, address these important issues.

Instead, the IASB/FASB discussion paper proposed that entities be required to present all income and expense items in a single statement of comprehensive income without addressing the more substantive issues regarding the principles for recognition of OCI items and recycling. As a result of the deliberations on the IASB/FASB discussion paper subsequent to the issuance of the EFRAG Discussion Paper, the IASB has tentatively concluded to require a single statement of comprehensive income. We do not perceive significant benefits to a single statement approach if reclassification adjustments continue to be required, particularly since the Boards have decided to retain the presentation of ‘profit or loss’ and ‘earnings per share’ as required performance measures. As long as reclassification adjustments are still required, the determination of key lines, bottom lines and performance measures cannot be resolved in a satisfying manner as reclassification adjustments significantly affect the performance measures when they occur.

It is worth noting that the IASB has begun to deliberate the basis for reporting items in OCI as well as discussing how and whether certain items should recycle from OCI into profit or loss. The impetus for this discussion includes a number of projects currently being worked on by the IASB and we support the Board’s efforts at developing a principled framework for determining what goes into OCI (as well as what items recycle through profit or loss over time).

We believe that the definition of certain key lines and bottom lines, together with appropriate disaggregation, enhances the usefulness of financial statements and enables the users to collect or recreate the information they need. We support the use of the current set of performance measures required in IFRS (eg, profit or loss, earnings per share, other comprehensive income, and total comprehensive income) as well as the ability to include additional line items, headings and subtotals (when such presentation is relevant to an understanding of the entity's financial performance). We believe there is sufficient understandability in the current performance reporting model and that the prescribed items (and additional items) meet users’ needs as they can add or subtract various line items within the statement of comprehensive income (and related notes) in constructing whatever financial performance measures they deem appropriate.

Should you wish to discuss the contents of this letter with us, please contact Sven Hayn on +49 (40) 36132 12277 or John Guess on +44 (0) 207951 5201.

Yours faithfully

Ernst & Young