ICAEW
REPRESENTATION 76/20

EFRAG DRAFT COMMENT LETTER ON IASB'S GENERAL PRESENTATION AND DISCLOSURES PROPOSALS

Issued 28 September 2020

ICAEW welcomes the opportunity to comment on EFRAG's Draft Comment Letter on IASB ED/2019/7 *General Presentation and Disclosures* published in February 2020, a copy of which is available from this link.

> We welcome the opportunity to consider and comment on EFRAG's draft comment letter on ED/2019/7 *General Presentation and Disclosure*. In ICAEW's draft response to the IASB, we broadly support the IASB's proposals but raise some concerns in several areas, in particular the proposals for: integral and non-integral associates and joint ventures; unusual income and expenses; and management performance measures. Our responses to EFRAG's specific questions are drawn from our draft response to the IASB.

This response of 28 September 2020 has been prepared by the ICAEW Financial Reporting Faculty. Recognised internationally as a leading authority on financial reporting, the Faculty, through its Financial Reporting Committee, is responsible for formulating ICAEW policy on financial reporting issues and makes submissions to standard setters and other external bodies on behalf of ICAEW. The Faculty provides an extensive range of services to its members including providing practical assistance with common financial reporting problems.

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KEY POINTS

SUPPORT FOR PROPOSALS

1. We welcome the opportunity to consider and comment on EFRAG's draft comment letter on ED/2019/7 *General Presentation and Disclosure*. In ICAEW's draft response to the IASB, we broadly support the IASB's proposals but raise some concerns in several areas, in particular the proposals for: integral and non-integral associates and joint ventures; unusual income and expenses; and management performance measures. Our responses to EFRAG's specific questions are drawn from our draft response to the IASB.

ANSWERS TO SPECIFIC QUESTIONS

Income and expenses from investments made in the course of an entity's main business activities

Question 1
[Para 32] For those in a regulated industry, would the IASB proposals in paragraph 48, for entities that invest in the course of the entity's main business activities, result in significant changes in practice that would be in conflict with regulation in your industry? Do you expect any additional challenges or significant costs?

2. We have not been made aware of any expected major additional challenges or significant changes for entities within regulated industries as a result of applying proposed paragraph 48.

Question 2
[Para 33] Do you consider that separating returns from investments made in the course of an entity's main business activities from those that are not will be difficult to make in practice? Please explain.

3. In our draft response to the IASB we note that assessing whether certain income and expenses should be classified in either the 'investing' or 'financing' category when they have been generated in the course of the entity's 'main business activities' will require judgement. While we broadly support the IASB's proposals, we have suggested that the ED should provide additional guidance to help entities determine when an activity is (one of) an entity's main business activity. We believe providing such guidance would help reduce confusion for preparers and the risk of a lack of comparability and transparency for users.

4. We also believe that when such a classification has been made, an entity should be required to disclose this fact along with information regarding the items 'reclassified'. It may be that this requirement could form part of proposed paragraph 99(b), which requires an entity to provide 'a description of the nature of the entity's operations and its main business activities.'

Entities that provides financing to customers as a main business activity

Questions 3
[Para 42] Do you consider that it is difficult or costly to allocate income and expenses from financing activities and from cash and cash equivalents to those that do or do not relate to the provision of financing to customers? Please explain.

5. In our draft response to the IASB we do not support the accounting policy option outlined in paragraph 51 of the exposure draft. In our view, when an entity has more than one main business activity, of which one is providing financing to customers, only the income and expenses arising from financing activities and cash and cash equivalents that relate to the provision of financing to customers should be classified in the operating category. We accept that this will require allocations to be made in certain cases. However, we think that entities should be required to make those allocations on a reasonable and consistent basis, supported by disclosure of the basis used.

6. When an entity only has one main business activity, which is providing finance to customers, we believe it should be required to present all income and expenses from financing activities, all income and expense from cash and cash equivalents, and all interest income and expenses on other liabilities (as set out in proposed paragraph B37) in the operating category. We believe this will improve comparability among entities whose only main business activity is providing finance to customers. It also avoids the situation, which would currently arise under the proposals, whereby an entity whose only main business activity is providing finance to customers would present only income and expenses on other liabilities within the financing category.

Question 4
[Para 43] For those that provide financing to customers as a main business activity and are in a regulated industry, would the IASB's proposals in paragraph 51 of the ED be in conflict with regulation in your industry? Do you expect any additional challenges or significant costs?

7. Although we have some reservations about paragraph 51 (see our response to question 3), we have not been made aware of any expected major additional challenges or significant changes for entities within regulated industries as a result of applying proposed paragraph 51.

The investment category

Question 5
[Para 57] Do you consider income and expenses from cash and cash equivalents (i.e. short term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value) as part of the entity's financing (paragraph 54 above) or investing activities (paragraph 55 above)? Please explain.

8. We observe that income from cash and cash equivalents, when viewed in isolation, meets the IASB's proposed definition of investing because the returns are generated individually and largely independently of other resources. However, we acknowledge the IASB's comments in BC44 that, for many companies, cash and cash equivalents represent a reasonable proxy for excess cash and the temporary investments of excess cash. We also observe that many investors use a net debt approach when analysing companies. We therefore agree, on balance, with the IASB's proposal that the income from cash and cash equivalents be classified as financing activities. We also agree with the IASB's observation in BC40(c) that requiring the income from cash and cash equivalents to be split between two or more categories would impose undue cost or effort.

Question 6
[Para 63] How costly would it be to track whether exchange differences relate to the entity's main business activities, investing activities or financing activities? Please explain

9. While we are unable to comment in detail on the expected costs, we understand that tracking exchange differences would involve 'tagging' every monetary line item in the balance sheet according to which category it relates in the income statement, and amending the foreign exchange translation routine to separately classify the foreign exchange remeasurement according to that classification. On this basis, we would anticipate initial costs to be moderate and ongoing costs to be minimal.

Profit or loss before financing and income tax and the financing category

Question 7
[Para 76] Do you consider income and expenses that reflect the effect of the time value of money on liabilities that do not arise from financing activities (as in paragraph B37 of the ED) as part of the entity's financing or operating activities? Please explain.

10. As noted in our response to questions 3 and 4 above, when an entity's only main business activity is providing finance to customers, we believe it should be required to present all income and expenses from financing activities, all income and expense from cash and cash equivalents, and all interest income and expenses on other liabilities (as set out in proposed paragraph B37) in the operating category.

11. However, when an entity has more than one main business activity, of which one is providing financing to customers, only the income and expenses arising from financing activities and cash and cash equivalents that relate to the provision of financing to customers should be classified in the operating category. In this case, interest income and expenses on other liabilities (as set out in paragraph B37) would continue to be classified in the financing category. In our view, this would reflect the substance of this charge, as the time value of money charge reflects a financing cost.

Integral and non-integral associates and joint ventures

Question 8
Do you consider that the IASB needs to expand the new paragraph 20D of IFRS 12, for example to include additional indicators, to reduce the level of judgement involved when making a distinction between integral and non-integral entities? Please explain.

12. In our draft response to the IASB we suggest that a better alternative to distinguishing integral and non-integral associates and joint ventures would be to develop a 'management perspective' approach. This would require management to assess and identify whether it views an associate or joint venture as integral, for management to explain why it has reached this conclusion and to explain any changes in presentation from prior periods ie, any change from integral to non-integral, and vice-versa. Income and expenses from identified 'integral' associates and joint ventures would then be separated out from those arising from other associates and joint ventures as suggested in the exposure draft. In our view, this approach would avoid the risk of arbitrary classifications being made which do not reflect the underlying operations of the entity.

13. If, however, the IASB maintains the proposed approach outlined in the exposure draft, we agree that the criteria set out in paragraph 20D of IFRS 12 should be clarified.

Question 9
Considering that the IASB is proposing the subtotal 'profit before financing and income tax', which includes the result of associates and joint-ventures on a net basis, do you consider that it would be useful to separately present or disclose the income tax related to associates and joint-ventures accounted for under the equity method?

14. We do not believe that this is a matter that should be addressed as part of this project. If considered important, we suggest it is considered further as part of a separate project.

Analysis of operating expenses

Question 10
[Para 121] Do you consider that it is useful to have disclosures by nature in single note when an entity presents its expenses within operating profit or loss by function (i.e. when an entity assesses that presentation by function provides the most useful information)? Do you anticipate that such information will be costly to provide? Please explain.

15. While we are not able to comment in detail on the expected costs of providing this information, we understand that there is strong demand from users for such information (as noted in BC111) and therefore, on balance, we support this proposal.

Question 11
[Para 122] Do you consider that it is useful to have in the statement of profit or loss: (a) a strict presentation either by nature or by function (no mix); (b) a general presentation by nature or by function together with limited additional requirements as suggested in the ED by the IASB; or (c) a mix presentation basis (no restrictions). Please specify why.

16. We note that the proposed requirement in paragraph 68 of the ED for classification of expenses by nature or function applies only to operating expenses. We believe it is preferable to require presentation of operating expenses either by nature of by function (i.e. no mix). In our draft response to the IASB we suggest that more guidance is needed to explain how individual costs might be separated out under the function of expense method. For example, to explain how impairment of goodwill might be split and presented between different functions, perhaps with an identified default category when splitting such costs between functions is not feasible.

Management Performance Measures

Question 12
[Para 185] What is your assessment of the overall costs and benefits of the IASB's proposal on the calculation of the income tax effect and the effect on non-controlling interests for each item disclosed in the reconciliation as required by paragraph 106(b)?

17. We support the proposed requirement for an entity to disclose the 'income tax effect and the effect on non-controlling interests' for each item included in the reconciliation between a Management Performance Measure (MPM) and the most directly comparable IFRS subtotal or total. As noted in the Basis for Conclusions to the ED, this information will be beneficial to users of financial statements to calculate and analyse earnings per share measures alongside any information already provided in accordance with IAS 33 Earnings Per Share.

18. In our response to the IASB, we also note that as the scope of IAS 33 is limited to listed entities. We believe the proposed disclosure requirement in paragraph 106(d) should also be limited to those entities required to, or voluntarily, applying IAS 33.

Question 13
[Para 186] What is your assessment on number of MPMs that will need to be disclosed by entities under the IASB's proposals? Please indicate which MPMs you have identified.

Question 14
[Para 187] What is your assessment on the relevance of the MPMs identified (is it too much? too little? which additional ones?) ?

Question 15
[Para 188] Do you agree with the scope of the IASB's proposals? If not, which alternative (Alternative 1 or Alternative 2 above) would you prefer so that financial statements remain relevant?

19. We have combined our responses to questions 13, 14 and 15 below.

20. In our draft response to the IASB, we broadly support the proposed definition for MPMs but outline concerns with the reference to subtotals that are 'used in public communications outside financial statements'. In our view, this proposed criterion is too broad and could have implications on the number and relevance of MPMs captured.

21. In our view, it would be very challenging in practice to identify all public communications and all potential measures. For example, it is not clear how far back in time a company would need to go when identifying measures that have been used in public communications (would it be limited to the comparative period or would entities be expected to go further back?) or how far forward in time management would need to look to future expected publications and presentations. We also believe this would lead to challenges for auditors ie, how far back/forward to look to assess whether the appropriate measures have been identified.

22. We believe it would be more appropriate and realistic for the criteria to refer to any subtotals of income and expenses that are used within the 'annual / interim reporting package' eg, the annual report or interim report, and results announcements/investor presentations relating to the same period as the annual or interim report. Appropriate definitions and explanations would be required within IFRS – we suggest it might be helpful to refer to the ESMA guidelines on APMs in this respect. We believe this would provide a more manageable boundary and would still capture key measures used by management to communicate the entity's performance.

23. We also believe that further clarity is needed with regards to proposed paragraph 105, which states that MPMs shall (a) faithfully represent aspects of the financial performance of the entity to users of financial statements; and (b) be described in a clear and understandable manner that does not mislead users.

24. We assume that the intention of paragraph 105 is to ensure that MPMs included in the financial statements are described appropriately. However, it might also be interpreted as being a 'filter' which would prevent the inclusion of MPMs that, although used by management to communicate the performance of the business, are not considered to

'faithfully represent aspects of the financial performance' of the entity. If, as we have assumed, the IASB's intention is to ensure that any MPMs included in the accounts are appropriately labelled, this should be clarified in the standard. It might, for example, be helpful not to refer to faithful representation, which has a wider meaning within IFRS.

25. On balance, the approach outlined in alternative 2 within the EFRAG comment letter appears to be more aligned with our position, albeit subject to the further considerations discussed above.

Question 16
[Para 189] Do you agree with EFRAG's suggestion to apply the MPM requirements also to the non-GAAP performance measures, presented within financial statements, that may not satisfy the proposed criteria of MPMs (e.g. adjusted revenues and ratios)?

26. No, we believe the proposed definition for MPMs, which would exclude some performance measures such as ratios, is more appropriate.

Question 17
[Para 190] The ED is introducing more structure in the presentation requirements, including a requirement to present on the face of the income statement a new subtotal named "operating profit or loss", which will become an IFRS defined measure. Entities that currently use a performing measure labelled "operating profit or loss" on the face or in the notes will be forced to either

i. change the label for their performing measure and continue to use both the old measure and the new IFRS defined "operating profit", or to
(ii) discontinue the pre-existing performance measure, replacing its use with the new IFRS defined "operating profit or loss".

ii. In the context described above, do you believe that the IASB's proposals on the structure and content of the statement of profit or loss will lead to an increased number of MPMs?

27. No, broadly speaking, we do expect the IASB's proposals to lead to an increased number of MPMs.

On Other Matters

Question 18
[Para 250] Do you agree that the IASB should consider providing more guidance for the presentation of revenues and costs when they are allocated to different business activities on the face of the statement of profit or loss, including consistency with IFRS 8 and disclosure on judgement applied in the allocation process?

28. We agree that the IASB should provide specific guidance on the presentation of revenues and costs on the face of the statement of profit or loss when an entity has reclassified income and expenses to the operating category from either the investing category, the financing category, or both. This additional guidance should explain the interaction with the guidance on segment reporting in IFRS 8.