BUSINESSEUROPE

International Accounting Standards Board (IASB)
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Canary Wharf,
London E14 4HD,
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30 September 2020

Dear Board Member,

Re: Exposure Draft ED/2019/7 - General Presentation and Disclosures (Primary Financial Statements)

BUSINESSEUROPE is pleased to provide comments on the exposure draft General Presentation and Disclosures (the ED). As a general overarching comment, we would state that we are disappointed with the proposals, which do not reflect what we originally understood was the nature of the project. From an initial approach, which was to enhance the usefulness of the presentation of the income statement by allowing management to include a limited number of key performance indicators on its face, the proposals have taken the direction of increased uniformity and a large utilisation of rules in the absence of clear principles. In our view, the increased uniformity of the income statement will lead to a greater recourse to other channels of financial communication and an increasing consideration that the IFRS financial statements are a mere exercise in compliance.

The lack of a clear principles-based approach to the income statement and the lack of definition of the essential notions of operating activities, functions and main business activities has led to an approach to the income statement which is very rules-based and in some instances will probably result in inconsistent or counter-intuitive classifications. We can see no compelling justification for the requirement for entities which have judged that the "by-function" approach is the most relevant to their activities being obliged to provide, in parallel, a "by-nature" presentation. The requirement will, in our view, prove to be very onerous for many of the entities which currently report primarily on the by-function basis. We are not convinced that information that the entity itself does not use for the management of the business should be provided merely because other users consider it to be essential for their purposes.

The approach to Management Performance Measures appears to consist of the Board defining what these are and then imposing a mandatory incorporation of those indicators which satisfy this definition in the notes to the primary financial statements. We think that this represents a reduction in the communication value of the corresponding

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performance measures by their relegation to a note and an arbitrary rejection of other valid indicators which the management might judge to be highly useful. In addition, regulators take a close interest in this area of reporting and we think it would be most productive to work with them rather than impose new requirements.

The proposed definition of unusual items is restrictive and will, in our view, be difficult to apply consistently in practice. We think that, rather than defining unusual items, the IASB should base its requirements on the principle of the highlighting of items "with limited predictive value" and provide guidance on how to identify and present such items.

As indicated above, we fear that the current proposals of the ED may have the counter-productive effect of reducing the primary financial statements to the status of a compliance document and leading to performance reporting being communicated by other vectors.

Please find our detailed comments in the appendix. If you require any further information on this matter, please do not hesitate to contact us.

Yours sincerely,

Erik Berggren
Senior Adviser
Legal Affairs Department

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APPENDIX

Question 1—operating profit or loss Paragraph 60(a) of the Exposure Draft proposes that all entities present in the statement of profit or loss a subtotal for operating profit or loss.

Paragraph BC53 of the Basis for Conclusions describes the Board's reasons for this proposal.

Do you agree with the proposal? Why or why not? If not, what alternative approach would you suggest and why?

We agree with the requirement to present a subtotal for Operating Profit. In our view, a great many companies already use a notion of operating profit or similar in their current financial reporting under IFRS. Operating profit is an important indicator of the performance of such companies and the use of such an indicator would in theory enhance the comparability of results among companies.

However, the usefulness of rendering this sub-total mandatory will depend largely on how it is defined and what analysis of the elements that make it up is allowed on the face of the statement of profit or loss (the income statement). We comment upon these aspects in our responses to questions below.

Question 2—the operating category Paragraph 46 of the Exposure Draft proposes that entities classify in the operating category all income and expenses not classified in the other categories, such as the investing category or the financing category.

Paragraphs BC54–BC57 of the Basis for Conclusions describe the Board's reasons for this proposal.

Do you agree with this proposal? Why or why not? If not, what alternative approach would you suggest and why?

We recognise the difficulties the Board has faced in trying to define the operating category and understand that it has decided not to provide a definition of this category. However, paragraph 46 of the ED does provide a definition of this category by default: "The operating category includes information about income and expenses from an entity's main business activities...that are not classified in (a) investing etc."

The consequence of this definition by default is that the ED has to provide a host of rules (in paragraphs 47 to 59 and in B25 and following) about where items have to be classified. In our view, there is a high probability that this will lead to a standard which will be difficult to interpret and will require a high degree of judgement in its application. As an example of the complexity caused by this combination of a definition by default and a rules-based approach, one could cite the way the notion of returns from assets "that are generated individually and largely independently of other resources" is used.

Non-integral associates and joint ventures, which by the IFRS definition, generate "a return individually and largely independently" of the other assets, must be shown in the investing category (paragraph 47/48) and never in the operating category. Integral associates and joint ventures are classified below operating profit in a specific line above the investing category. At the same time, if the entity "invests in financial assets that generate a return individually and largely independently..." in the course of its main business activities, then these must be excluded from the financing activity and classified in the operating category (paragraph 48, 52, BC60 and BC71). The criteria of generating returns individually and largely independently appears therefore to be a justification for including the item in, or excluding it from, "operating", "investing" or "financing" at the same time, with only the unclear (and undefined) concept "in the course of its main business activities" making the difference.

The lack of a definition of "main business activity" is a major handicap in this area, as it is a notion which is relied upon heavily in the ED to justify specific rules for the treatment of individual items, as indicated in the example above. If the determining factor for the classification in "operating" is indeed the use of an asset or liability in the "main business activity", then it is essential that this notion be defined in the standard. In addition, it is important for the understanding of the proposals to explain whether "a main business activity" implies that an entity can have more than one main business activity (and we think that this is the case in reality), and to explain the distinction made between "a main business activity" and "in the course of its main business activity(ies)". As an alternative, it is necessary, in our view, to provide a definition of what is intended to be included in the operating category.

The proposed definition by default of the operating category means that most of the significant individual events of the entity are included in it. These would include restructuring costs, disposals or impairment of individual non-current assets, impairment of goodwill, etc. If the entity has determined that the by-function approach is the most appropriate, then under paragraph B46 these items would have to be included in the most relevant function and could not be presented separately even though that might be what is required by proposed paragraphs 42, 66 and B15. In contrast, items of a relatively minor and recurrent nature, such as impairment losses on trade receivables, if material, must be shown as a separate line item. The relegation to the notes of the financial consequences of such significant events, as mentioned above, on the grounds of a perceived comparability, appears to us to have the opposite effect, that is, that potentially important information is not brought to the attention of the user with sufficient emphasis.

Furthermore, the examples of functions given in the proposals are simplistic and do not confront some kinds of events which are faced periodically by companies. Therefore, with a narrow definition of functions, without an underlying principle of what a function is, and the in view of the Board's apparent abhorrence of the concept of "other expenses", the heading "administrative expenses" will inevitably become a dumping-ground for volatile and unrelated items, such as gains and losses on disposals of businesses and the impairment of goodwill. This will not help investors or management to communicate clearly with one another.

It is in order to facilitate the reading of the income statement that many entities today present sub-totals and additional line items to isolate these events. This is in compliance with the requirements of current paragraphs IAS1.85 and 97-98. We think that these current requirements provide useful, relevant, and hence, valuable information for users and should not be discarded (or restricted only to cases where a presentation by nature of expense is selected) as the IASB seems to be proposing to do.

Question 3—the operating category: income and expenses from investments made in the course of an entity's main business activities Paragraph 48 of the Exposure Draft proposes that an entity classifies in the operating category income and expenses from investments made in the course of the entity's main business activities.

Paragraphs BC58–BC61 of the Basis for Conclusions describe the Board's reasons for this proposal.

Do you agree with the proposal? Why or why not? If not, what alternative approach would you suggest and why?

Whilst we agree in principle with this requirement, we think that it will entail the application of a great deal of judgement and hence more guidance would be helpful. We note that paragraph B27 cites only investment entities, investment property companies and insurers as examples of entities which could be affected.

As an example of an area where guidance is needed, we would cite the fact that many other types of entities invest in start-up entities developing specialised technology that the reporting entity may wish to make use of later. We think that such investments might be considered to have an operating nature and therefore would appropriately be classified in the operating category. However, the degree of influence held by the reporting entity may be such that equity-accounting might be required, thus excluding the (negative) returns from the main body of the operating category.

Another example of a need for further guidance would be that of the disposal of non-financial investments which were originally held for purposes judged to be of an operating nature but whose purpose changed as the result of a strategic decision. Where should the holding gains or losses of such a disposal be included?

Question 4—the operating category: an entity that provides financing to customers as a main business activity Paragraph 51 of the Exposure Draft proposes that an entity that provides financing to customers as a main business activity classify in the operating category either:

• income and expenses from financing activities, and from cash and cash equivalents, that relate to the provision of financing to customers; or

• all income and expenses from financing activities and all income and expenses from cash and cash equivalents.

Paragraphs BC62–BC69 of the Basis for Conclusions describe the Board's reasons for the proposals.

Do you agree with the proposal? Why or why not? If not, what alternative approach would you suggest and why?

We understand that the IASB has provided this accounting policy choice to avoid complexity.

However, we are not convinced that the accounting policy alternatives required by paragraph 51 provide the most relevant approach for entities whose main business activity is not customer financing but for which this activity is "an important activity performed in the course of their main business activities" (to use the wording of paragraph BC60 on investing activities). To take the example of a car manufacturer which also provides finance to customers to purchase its cars "as a main business activity": this entity is required to show interest income from customers in "operating" and transfer at least the income and expenses related to customer financing to the operating category. If it cannot easily isolate all the interest income and expense related to customer financing, it has the policy choice of transferring all income and expenses from financing activities and cash equivalents to the operating category. The latter policy choice would appear to result in no financing category being presented and we wonder whether this would provide the most relevant and useful information in the case of the manufacturing entity which also has a significant customer financing activity. In our view, a better alternative for entities which are not financial institutions (that is, are not covered by the examples given in paragraph BC70(a)-(c)), would be to transfer all the income and expenses from the customer financing activity into the financing category.

We note that the discussion about the financing category refers to income and expenses from assets and liabilities related to an entity's financing. It is unclear whether this should include overhead or operational expenses from dedicated functions such as a Treasury management department. Paragraph B37 does not make this clear, although the list of examples consists only of items which are similar in nature to interest. It would be helpful if additional guidance were provided in order to avoid all doubt.

Finally, we presume that the definition of "customer" provided in IFRS 15 (A party that has contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities in exchange for consideration) applies here, and that therefore if the manufacturing entity finances not only those who have purchased its own output but also those who purchase from other manufacturers, these would be customers for the purposes of this ED.

Question 5—the investing category Paragraphs 47–48 of the Exposure Draft propose that an entity classifies in the investing category income and expenses (including related incremental expenses) from assets that generate a return individually and largely independently of other resources held by the entity, unless they are investments made in the course of the entity's main business activities.

Paragraphs BC48–BC52 of the Basis for Conclusions describe the Board's reasons for the proposal.

Do you agree with the proposal? Why or why not? If not, what alternative approach would you suggest and why?

As discussed in our response to Question 2, we think that the use of the notion of generating "a return individually and largely independently of other resources held by the entity" is potentially confusing. We find the requirements very "rules-based" in this area and suggest that the Board re-consider whether the use of principles alone might not be more helpful.

Question 6—profit or loss before financing and income tax and the financing category

(a) Paragraphs 60(c) and 64 of the Exposure Draft propose that all entities, except for some specified entities (see paragraph 64 of the Exposure Draft), present a profit or loss before financing and income tax subtotal in the statement of profit or loss.

(b) Paragraph 49 of the Exposure Draft proposes which income and expenses an entity classifies in the financing category.

Paragraphs BC33–BC45 of the Basis for Conclusions describe the Board's reasons for the proposals.

Do you agree with the proposals? Why or why not? If not, what alternative approach would you suggest and why?

While we are not opposed to making the sub-total "profit or loss before financing" mandatory, we do not agree with the way financing has been defined in the ED.

Profit or loss before financing is a useful performance indicator which is provided by many entities at present. However, its usefulness depends largely, of course, on what is included in the financing category. In our view, an important performance indicator for many companies is the cost of net debt, which reflects the way companies manage their financing. We understand that the IASB does not wish to standardise this indicator but we think that the current practice of companies providing their own definition of net debt is a satisfactory approach and should be allowed to be used here. In our view, a presentation which reflects the way the company is managed provides relevant and useful information.

The difficulty we see with the proposals of the ED is that the definition provided by the IASB includes not only the financing of the reporting entity (its treasury and financing function) but also other items of a "financing" nature (such as the unwinding of the discount on long-term operational provisions), while excluding some investments of a short-term nature (other than cash and cash equivalents) which are in fact an integral part of the financing activity. Thus valid treasury-management techniques may not be eligible to be shown as financing under the proposed rules; for example, an entity's strategy involving taking advantage of cheap loans in anticipation of planned future projects and investing the temporarily excess cash in short-term non-cash investments would result in the latter being shown as investment income rather than as financing. We think that this is inappropriate.

Question 7—integral and non-integral associates and joint ventures

(a) The proposed new paragraphs 20A–20D of IFRS 12 would define 'integral associates and joint ventures' and 'non-integral associates and joint ventures'; and require an entity to identify them.

(b) Paragraph 60(b) of the Exposure Draft proposes to require that an entity present in the statement of profit or loss a subtotal for operating profit or loss and income and expenses from integral associates and joint ventures.

(c) Paragraphs 53, 75(a) and 82(g)–82(h) of the Exposure Draft, the proposed new paragraph 38A of IAS 7 and the proposed new paragraph 20E of IFRS 12 would require an entity to provide information about integral associates and joint ventures separately from non-integral associates and joint ventures.

Paragraphs BC77–BC89 and BC205–BC213 of the Basis for Conclusions describe the Board's reasons for these proposals and discuss approaches that were considered but rejected by the Board.

Do you agree with the proposals? Why or why not? If not, what alternative approach would you suggest and why?

We are not convinced by the proposals in this area.

We think that the use of a sub-total "operating profit or loss and income and expenses from integral associates and joint ventures" should be voluntary rather than compulsory. In some entities the distinction between integral and non-integral may be arbitrary or of no real use, and in other entities the integral activities may be so closely related to the main business activities of the "parent" that their exclusion from the main operating result might be meaningless.

We think that there are entities which invest in equity-accounted entities which are integral to their main business activities and in equity-accounted entities which are incidental to the main business activities, and that in some instances and jurisdictions this distinction may be of use. In cases where the distinction is important, we think that the clear labelling of the type of equity-accounted entity is sufficient. We do not think that it is necessary or useful to have strict rules about the presentation of such elements in the statement of profit and loss.

In particular, if an entity considers that an integral equity-accounted entity is an important part of its operations, we do not see why it should be prohibited from including it in a clearly labelled line-item within its operating profit and loss category. This optional presentation would help reduce the clutter on the face of the income statement and enable the entity to present a single operating result sub-total, while allowing analysts to identify and deal with such items as they see fit. We think that in such entities the message that this equity-accounted result is part of the operational result is important.

Conversely, if an entity considers that the control aspect (or lack thereof) of the relationship with the equity-accounted entity is paramount, then it should not be precluded from presenting this separately from its operating result and adjacent to the non-integral equity-accounted entities.

We think that rigid rules in this area will lead to clutter and unhelpful uniformity.

Furthermore, if the degree of independence between the parent and the integral/non-integral equity-accounted entity changes, will it be permitted to reclassify those entities? If the distinction is valid then reclassification should be allowed, but without making changes to information presented in comparative periods.

Finally, as discussed in our responses to questions 2 and 5, we find the use of the condition of the generation of "a return individually and largely independently of other assets" in the definitions of integral and non-integral equity-accounted entities to be confusing. This is because the same condition is used in a combination of paragraphs 47 and 48 to mandate the inclusion of investments in the operating category. In these paragraphs, it is the use of the investments in the course of the main business activity which is the determining factor. This confusion indicates that the principles for the presentation of the income statement require further consideration.

Question 8—roles of the primary financial statements and the notes, aggregation and disaggregation

(a) Paragraphs 20–21 of the Exposure Draft set out the proposed description of the roles of the primary financial statements and the notes.

(b) Paragraphs 25–28 and B5–B15 of the Exposure Draft set out proposals for principles and general requirements on the aggregation and disaggregation of information.

Paragraphs BC19–BC27 of the Basis for Conclusions describe the Board's reasons for these proposals.

Do you agree with the proposals? Why or why not? If not, what alternative approach would you suggest and why?

As discussed in our response to Question 2 above, we think that the rigidity with which the ED has defined the requirements for the presentation of the income statement is inconsistent with the requirements for aggregation and disaggregation laid out in paragraphs 25-28 and 42 of the ED. The prohibition of the "mixed" by-function and by-nature approach to the presentation of operating expenses is a particular obstacle to respecting these principles, particularly when combined with a narrow view of what a "function" is (see our reply to question 9).

The list of items in paragraph B15 is indeed relevant to understanding the performance of a business, and we think that it is appropriate for many of these items to be presented on the face of the statement of profit or loss, even when a classification of expenses by function is used. It is not clear from the current draft of the standard that this would be prohibited, although some have interpreted this list as applying only when a presentation by nature of expense is used. If the latter is the intention of the Board, it should be stated clearly; if it is not, then that should also be explained. Leaving the current ambiguity will only lead to potential disputes between preparers, auditors and regulators, with each party able to point to a requirement of the standard to support its views.

Although we agree with the principles laid out in the paragraphs referred to in the question, we do not think that the rules-based approach to application adopted by the Board is the best way to achieve these objectives. We are deeply concerned that the result will be a) the relegation of the statement of profit or loss to a rigid compliance exercise, devoid of explanatory power, and b) the proliferation of additional management performance measures to compensate for this lack of flexibility and relevance.

Question 9—analysis of operating expenses Paragraphs 68 and B45 of the Exposure Draft propose requirements and application guidance to help an entity to decide whether to present its operating expenses using the nature of expense method or the function of expense method of analysis. Paragraph 72 of the Exposure Draft proposes requiring an entity that provides an analysis of its operating expenses by function in the statement of profit or loss to provide an analysis using the nature of expense method in the notes.

Paragraphs BC109–BC114 of the Basis for Conclusions describe the Board's reasons for the proposals.

Do you agree with the proposals? Why or why not? If not, what alternative approach would you suggest and why?

We do not agree with the proposals.

In our view, the definition of a function in paragraph 70 is missing an underlying principle. It hints at this with the words "according to the activity to which the item relates" but should be reinforced or clarified. We would suggest guidance along the following lines:

"*The function of expense method allocates and combines operating expenses according to the purpose for which they have been incurred. It answers the question 'why has the company incurred this cost?', rather than the question 'what cost has been incurred?', which relates to the nature of the expense.*"

The example of cost of sales should be complemented with another, less simplistic example, for restructuring expenses:

"*Another example is of restructuring, a functional line that combines expenses of various natures which are incurred to change the scope or manner of operating a business such as: termination benefits, impairment of property, plant and equipment and/or goodwill, onerous contracts, and (potentially) refunds of government grants.*"

We think that this principle-based view, particularly with regard to restructuring costs, will reduce some of the pressure for the mixed presentation, since it recognises that recurring costs have nothing to do with the costs of the products sold or distributed in the current period and therefore including these costs in those functional headings a) obstructs communication and b) does not faithfully represent the function of the cost.

The choice between a by-function and by-nature presentation has long been available to entities and we think that it is appropriate. The requirement in IAS1.104 to provide certain additional information about the nature of expenses when the by-function approach is used has also long been accepted, and companies have set up their systems to cater for this. The information provided is additionally the result of a judgement based on materiality. However, the proposals of the ED are a requirement for those entities that present on a by-function basis to provide additionally a complete analysis of its expenses using the by-nature presentation. The equivalent is not required for entities opting for the by-nature approach, thus making it clear that the by-nature approach is the preferred approach of the Board.

Entities that report by function, and we think that this represents a majority in many jurisdictions, have chosen this approach for sound reasons, including the fact that it represents the way the entity is managed, represents the most usual approach in the industry concerned and is often the most comparable with international competitors. In many cases, an exhaustive analysis by nature is not required by management and the ED's proposals would result in the collection of information that is not used internally. While it is largely the case that the basic set of accounting records used by individual legal entities in a group will contain details by nature of expense, at least for local fiscal purposes, this detail can be "lost" once local charts of accounts are addressed into a consolidation reporting system. Modifications to enable the consolidation system to recover the detail required by a "by-nature" presentation could be wide-ranging and time-consuming to put in place. We think that this requirement for reporting on the two bases will require a fundamental revision of the consolidation systems and a consequent increase in costs, without a clearly compelling justification in terms of benefits provided.

We think that entities may be able to provide some additional detail in this area without having to go through the effort required to provide the double reporting proposed in the ED. This information must however be relevant and useful, and not just "nice to have". We would encourage the Board to consult in detail with preparers and users to identify what the essential requirements are and to ensure that an appropriate cost/benefit balance is achieved by this. The current approach of IAS 1 may well represent the best approach from the cost/benefit viewpoint.

Finally, we think that the specific nature of goodwill requires that any impairments thereof should be presented separately on the face of the income statement. The Board has recognised the unique nature of goodwill in this ED by requiring separate presentation in the balance sheet (paragraph 82(d)), and we consider that the same approach is needed with regard to the statement of profit or loss. Indeed, we cannot propose an appropriate function in which to allocate impairment of goodwill, as it is certainly not a cost of sales, marketing or research and development, as goodwill impairment is often the result of a number of factors in combination. To include it under a catch-all "administration expenses" will result in that heading becoming a meaningless heading, equivalent to "other expenses" in all but name, which paragraph 27 seeks to prohibit. The wording of paragraph B47 would prohibit the separate presentation of impairment of goodwill unless paragraph 65 is amended to require its presentation regardless of the method of analysis used. We strongly recommend such an amendment.

Question 10—unusual income and expenses

(a) Paragraph 100 of the Exposure Draft introduces a definition of 'unusual income and expenses'.

(b) Paragraph 101 of the Exposure Draft proposes to require all entities to disclose unusual income and expenses in a single note.

(c) Paragraphs B67–B75 of the Exposure Draft propose application guidance to help an entity to identify its unusual income and expenses.

(d) Paragraphs 101(a)–101(d) of the Exposure Draft propose what information should be disclosed relating to unusual income and expenses.

Paragraphs BC122–BC144 of the Basis for Conclusions describe the Board's reasons for the proposals and discuss approaches that were considered but rejected by the Board.

Do you agree with the proposals? Why or why not? If not, what alternative approach would you suggest and why?

We think that it is important to provide users with information that allows them to identify and predict trends in the activities and results of the entity and thus inform their investment decisions. The isolation of material items which may differ in terms of frequency, potential for gain or loss and predictability is well established in IFRS (IAS 1.98 and 101). Providing such information on the face of the profit or loss account seems to us to respond to the principles of the role of the primary financial statements and of useful and relevant aggregation and disaggregation.

Some entities present such information at a high level on the face of the primary statements and others in management commentary, with details in notes as deemed appropriate. The choice of the location of the information is a matter of judgement made by the management in the light of the type of event and circumstances, and the practice in the sector or jurisdiction in which the entity operates. We think that this is the best approach as it will provide relevant information in a way which is easily accessible and comprehensible to users. In our view, therefore, preparers should be allowed to continue to present such information in the place and format that they judge best suited to their circumstances. At the very least, provision of this information on the face of the primary statements should be explicitly permitted.

We are also opposed to the definition that the IASB is proposing. Although it may be less restrictive than the comparable US GAAP definition, we think that it will result in difficulties in interpretation. Take the example of restructuring, which typically can take more than one year to complete, or indeed may occur on an irregular (but perhaps relatively frequent) basis. One could argue that all restructuring is the same type of event but a specific restructuring exercise may have a significantly different cost and that therefore, even if it arises every two or three years it is still an unusual event because it is not of the same amount. In other instances, management may judge that there will not be an event of similar type and amount for several future annual periods, but then is confronted with economic circumstances which force it to put into place a further restructuring effort two or three years later. Is the second event disqualified from being an unusual event because of the first? Will the first have its categorisation as "unusual" modified retrospectively because of the unforeseen second event?

In addition, the restrictiveness of the definition will probably lead to the creation of new categories of items which management believes it needs to identify to enhance understanding of performance among users.

We think that neither the definition nor the prohibition of identifying "unusual" events in the primary statements will be helpful. What would be more useful, in our view, would be to state the principle that expenses and income with limited predictive value should be highlighted, and to require management to define such items in a consistent and stable way over time, to provide details sufficient to allow users to understand the impact, and to allow management to present such items in the location it judges to be the most appropriate.

Question 11—management performance measures

(a) Paragraph 103 of the Exposure Draft proposes a definition of 'management performance measures'.

(b) Paragraph 106 of the Exposure Draft proposes requiring an entity to disclose in a single note information about its management performance measures.

(c) Paragraphs 106(a)–106(d) of the Exposure Draft propose what information an entity would be required to disclose about its management performance measures.

Paragraphs BC145–BC180 of the Basis for Conclusions describe the Board's reasons for the proposals and discuss approaches that were considered but rejected by the Board.

Do you agree that information about management performance measures as defined by the Board should be included in the financial statements? Why or why not?

Do you agree with the proposed disclosure requirements for management performance measures? Why or why not? If not, what alternative disclosures would you suggest and why?

We disagree with this proposal.

We were favourably inclined towards the IASB's initial reflection about the possibility of allowing preparers some scope to include management indicators on the face of the income statement, albeit with fairly stringent rules about how this should be done. Such an approach would have provided a prominent place for some indicators deemed by management to best represent the performance of the entity and would have been accompanied by the reliability that an audit requirement can bring. In contrast, the increased structure imposed on the income statement and the relegation of the IFRS-defined MPMs to the notes clearly sends the message that the MPMs are of lesser importance, in spite of their usefulness to investors. From discussions between our members and users, we think that performance indicators used by management are an important factor in financial communication and warrant being presented with sufficient prominence that users can easily find them.

We are uncertain about whether it is logical for an accounting standard setter to incorporate into the financial statements performance indicators which it has decided are outside its scope, that is, non-GAAP measures, and to impose definitions, reconciliations and other requirements to accompany these. The proposed definition of management performance measures (MPMs) for IFRS financial statements is very narrow and would, in our view, probably lead to the question of how companies should deal with the other alternative measures which they use to explain their performance. Such measures often involve elements of the balance sheet or cash flow statement, as well as ratios and other computed indicators based on various elements. These performance indicators are presented within or outside the financial statements, depending upon the regulatory regime in place. We think that it is not helpful to incorporate on a mandatory basis a few elements while leaving a potentially larger number of indicators without a place in the financial statements, since the latter would be implicitly excluded.

We note that, in general, it is regulatory bodies rather than accounting standard setters that issue guidelines on the use of alternative performance measures, such as the management performance measure defined in the ED. Major regulatory authorities such as ESMA in the European Union and the SEC in the USA have their own requirements for the use and disclosure of alternative performance measures, and European companies listed in both jurisdictions already have to comply with these differing requirements. We think that the introduction of a further set of requirements by the IASB is very unhelpful, both for preparers, who would have to produce a variant on their current reporting, and for users, who would have to understand why the reported measures are presented differently in the different sets of filings. We note that the Board was made aware of the issue of different jurisdictions' imposing of different requirements (as referred to in paragraph BC276, for example) in the process of developing the ED. If the Board wishes to harmonise and thus reduce the number of conflicting requirements, then we think that it should work with the regulators to achieve this. We are not convinced that the definition of a further set of requirements as proposed in the ED will contribute to the resolution of this issue.

We remain convinced that the current approaches accepted or imposed by certain regulators, which involve, inter-alia, a clear definition drawn up by the entity which has to be applied on a consistent basis and explained in a transparent manner, will be the most useful.

Over the years, many companies have devoted a great deal of effort to improving the alignment between their internal management reporting and the externally reported financial statements prepared in compliance with the requirements of the relevant jurisdiction. The closer the two are aligned and the more transparent the reconciling items between the two become, the easier it is for management to communicate with analysts on a mutually beneficial basis. We think that requirements of IFRS 8 have facilitated this, and that the only enhancements that could be provided would be to permit the segment reporting to be presented with more prominence than at present or to allow scope for the presentation of some MPMs on the face of the income statement, as envisaged at one point in the project.

Paragraph BC155 implies that management performance measures (MPMs) can be subtotals of income and expenses that are based on accounting policies which do not comply with IFRS standards. However, the definition and requirements for MPMs laid out in the Appendix A and in paragraphs 103 to 110 of the proposed standard do not state this clearly. If it is the Board's intention to include MPMs based on accounting policies other than those of IFRS, this should be made explicit in the definition and the requirements.

In conclusion, we think that, on balance, the Board should not attempt to define MPMs or to regulate their incorporation in the financial statements, but rather leave this area to be dealt with by the relevant regulator.

Question 12—EBITDA Paragraphs BC172–BC173 of the Basis for Conclusions explain why the Board has not proposed requirements relating to EBITDA.

Do you agree? Why or why not? If not, what alternative approach would you suggest and why?

EBITDA is an important performance indicator for many entities. The Board's approach to MPMs, as we have discussed in the response to Question 11, means that EBITDA is not an MPM, as defined, and the question is thus left open as to whether it may be included in the financial statements or not.

In our view, the Board should not venture into the area of regulating performance indicators but instead leave this to the regulator in each jurisdiction.

Question 13—statement of cash flows

(a) The proposed amendment to paragraph 18(b) of IAS 7 would require operating profit or loss to be the starting point for the indirect method of reporting cash flows from operating activities.

(b) The proposed new paragraphs 33A and 34A–34D of IAS 7 would specify the classification of interest and dividend cash flows.

Paragraphs BC185–BC208 of the Basis for Conclusions describe the Board's reasons for the proposals and discusses approaches that were considered but rejected by the Board.

Do you agree with the proposals? Why or why not? If not, what alternative approach would you suggest and why?

Whilst we think that harmonisation can be helpful for users, we are aware that opinions are very divided on this issue, even though they are based upon the experience of discussions with users.

Some of our members use the operating profit as the starting-point as this means that there are fewer items to be adjusted for and this, in their view, makes for a simpler and clearer reconciliation. Others prefer to start with net profit or loss for the year, as they think that the reversing-out of elements provides users with more useful and transparent information.

In summary, we think that there is no compelling argument for the imposition of a single starting-point and the current optional approach should be maintained.

Finally, we find that the amendments made to the text of IAS 7 Statement of cash flows are particularly difficult to follow and thus open to different readings. We think that it would be helpful if the Board were to redraft this guidance to facilitate understanding.

Question 14—other comments Do you have any other comments on the proposals in the Exposure Draft, including the analysis of the effects (paragraphs BC232–BC312 of the Basis for Conclusions, including Appendix) and Illustrative Examples accompanying the Exposure Draft?

1. We interpret the proposals relating to the requirement for a "by-function" presentation of expenses to be accompanied by detailed disclosure of expenses by nature, without the reciprocal also being the case, to be a clear indication that the IASB prefers the "by-nature" presentation. We do not understand why the IASB has now adopted this preference.

   We think that most major groups of companies actually use the by-function approach as this is much more closely aligned with the way the business is managed, and hence will probably provide more comparability with other entities in the same sector and provide useful information about how different commercial and industrial sectors differ in the way they are organised. The by-nature approach may provide superficial comparability in the shape of uniformity, but we do not believe that this is better information.

   This is an instance where there is a risk that the requirements diverge so widely from the management approach that the IFRS reporting could become a mere exercise in compliance.

2. Some of our members report that their main business activities are so diverse that analysts look to the segment reporting under IFRS 8 as their primary source of information. At present, such entities have sufficient flexibility to present their primary income statement such that that the segment reporting ties into it in a

fairly straightforward way facilitating the reconciliation between the two with the minimum of explanation. An approach to the presentation of the primary financials which is too rigid, such as that proposed by the Board, would require further reclassifications, disclosures and explanations in order to reconcile the segments into the Group. This would potentially represent an obstacle to easy comprehension and comparison.

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