30 September 2020

IFRS Foundation
Columbus Building
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Via email: commentletters@ifrs.org

Dear Sir/Madam,

Re: The IASB's Exposure Draft on General Presentation and Disclosures

The Corporate Reporting Users' Forum (hereinafter referred to as CRUF) welcomes the opportunity to provide the IASB with our comments. The CRUF was established in December 2005 and we have been holding regular meetings since. CRUF Japan have prepared this comment letter based on discussions in CRUF meetings from December 2019 to June 2020, and have reflected input from other CRUFs globally. We have highlighted any contrasting views in our response. Our comments are based on our professional experience.

General Comments

We appreciate the IASB's efforts to improve the general presentation and disclosure of financial statements, particularly statements of financial performance, in order to enhance the usefulness for financial statement users. In particular, we strongly support the proposal in this Exposure Draft (ED) to include operating profit in the statement of profit and loss. This would provide much needed consistency and comparability across companies, industries and jurisdictions and help standardise financial analysis.

That said, we do not agree with all of the ED's proposals, and would like to suggest alternative solutions to some of them. For example, some CRUF participants propose defining the operating category more proactively than defining it as the default or residual category as in the ED, and include a proposal for doing so. Those participants propose defining it as "the category that includes income and expenses arising from a company's main business activities, except unusual income and expenses", and propose categories and subtotals on the P/L statement in accordance with this definition. These participants understand that it is complex to develop a definition of operating profit and it will lead to subjectivity and reduce comparability but they do think an attempt should be made to find a workable set of principles.

Others support the residual definition as a pragmatic solution to a difficult problem. By leaving “everything else” in the operating category, companies would be less likely to present “other” expenses in a non-operating category, where there is generally less scrutiny by users.

More details can be found below in our responses to each question.

Question 1 - 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 proposal.

Financial statement users, particularly analysts, worldwide have been seriously frustrated for many years by the lack of a requirement in IAS1 for a reporting entity to present operating profits on the statement of profit and loss.

Operating profit is used globally as a KPI for business segments and companies’ mid-term business plans. When valuing a company, financial statement users use operating profit as the most appropriate profit metric to assess the normal level of earnings power from the company's main business activities. When making investment decisions, we do not just analyse one company; we analyse multiple companies and compare them. Comparing a company's operating profit margin, derived by dividing operating profit by sales, against peers and over time is one of the most fundamental techniques of financial statement analysis. Accordingly, operating profit is an essential indicator of profitability when it comes to analysing and comparing the financial performance of companies.

Unfortunately, the lack of a consistent presentation of operating profit has forced us to use EBIT as an alternative to operating profit or to calculate it based upon our own definitions. Meanwhile, the preparers of financial statements recognise the importance of showing their normal level of earnings power to investors, and often disclose their operating profit or alternative performance measures under their own definitions.

Given the above needs of financial statement users requiring operating profit to be presented on the statement of profit and loss will make it significantly more useful to users.

Question 2 - 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?

CRUF participants are divided on the definition of operating profit.

Some CRUF participants would prefer that operating profit be defined explicitly. These CRUF participants would have preferred the IASB to do it systematically and think that from their research into operating profit definitions there must have been many common elements to company-specific definitions, and then the debate would have been about the uncommon ones. If the IASB were to proactively define operating profit, we propose categories and subtotals on the P/L statement in accordance with this definition. These participants also think this definition should exclude unusual income and expenses but are mindful that this would need guidance to limit the opportunity for companies to exclude expenses to paint a more favourable picture of their performance.

Other CRUF participants see the merit in operating profit being a residual amount and see the proposal as a pragmatic approach to a complicated issue. Having a default position to count items in unless they are investing or financing brings some discipline to the potential for management abuse of alternative measures. These CRUF participants support keeping all unusual items in operating profit but disclosing them in a separate note. By leaving "everything else" in the operating category, companies would be less likely to present "other" expenses into a non-operating category, where there is generally less scrutiny by users. This, combined with an assumption that this will result in better information/disaggregation in the notes, leads these CRUF participants to prefer the IASB's proposed approach.

Question 3 - 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?

CRUF participants have mixed views.

Profit targets

Some participants agree that operating profit should show the results of the company's main business activities. These participants believe that a company's "main business activities" should be those activities for which company management actively sets profit targets, with income and expenses arising from these activities to increase revenues or reduce costs under the direction and control of management.

Consolidation

When considering consolidated operating profit, management should judge the scope of a company's main business activities on a business unit-by-business unit basis. For example, if there is a financial subsidiary under a parent company that operates a non-financial business, it is appropriate that consolidated operating income shows the combined operating profit from the

parent company's non-financial business and from the financial subsidiary's financial business. If operating profit includes revenue from the financing division then the associated costs of financings should be classified as operating expenses. Finance divisions are typically separate entities, so splitting "total interest" (industrial and financial divisions) should not be a problem (it is often disclosed in the segment notes). The totals for a company's main business activities, if monitored by segment or subsidiary, should be simply summed up for consolidation.

Sufficient guidance

Other CRUF participants think this may provide too much leeway for management discretion in what is included in operating profit. The scope of the main business activities would be judged on a company-by-company basis, so these participants would prefer that the new standard provides sufficient guidance so that it is clear what should be included and excluded to promote a standardised approach.

CRUF participants appreciate that the IASB's aims for these principles is for them to apply to all businesses and recognise that this suggestion may be challenging for businesses such as banks. These participants therefore propose to state explicitly that transactions of financial instruments by a non-financial company should not normally be regarded as part of the company's main business activities. This is because a preparer may define the company's main business activities as broadly as possible to recognise gains and losses from investing activities in the operating category. One important exception would be cases where a company has a department that specialises in the trading of financial instruments and routinely holds and trades them.

Phrasing

Some CRUF participants also suggested amending the phrase, "*generated in the course of* its main business activities" in paragraph 48 of the ED to "*arising from* its main business activities" (emphasis added). Those participants are concerned that the wording "generated in the course of its main business activities" would obscure the scope of operating income, with companies potentially including income from ancillary activities, like dividend income, in the operating category to make operating profit look better. They suggest amending the wording to limit the scope of the operating category more clearly.

Other ideas on defining the operating category

We would also like to make the following suggestions for the definition of the operating category:

- Require a preparer to disclose the scope of a company's "main business activities", which is not currently required in all jurisdictions. Financial statement users need to know what management regards as their main business; this is fundamental to our understanding of the statement of profit and loss.
- Some CRUF participants believe that companies should include the unwinding of discounts on pension liabilities and provisions in the operating category. This is because companies usually manage total post-retirement benefit expenses as part of their personnel expenses. Given this practice, we believe it would be more useful to present them in the operating category as expenses arising from the company's main business activities. Other CRUF

participants find merit in presenting them in the financing category to emphasise their nature as interest as proposed in the ED. This is because they do not believe that the unwinding of discount rates relate to operating profit and are concerned that this could lead to inconsistencies in arriving at enterprise value.

- Some CRUF participants suggest creating a fourth category ("miscellaneous category") in addition to the three categories of "operating", "investing" and "financing" set out by the ED. This new category would include those income and expenses that are not included in either of the three other categories, and not included in unusual income and expenses. Other participants believe this would complicate the profit and loss statement and worry that companies would present such "other" expenses into a non-operating category, where there is generally less scrutiny by users.
- Some other CRUF participants suggest that the three categories of "investing", "financing" and "miscellaneous" should be integrated into one category labelled as "non-operating category". They believe there is little benefit for non-financial companies to classify income and expenses not included in the operating category into "investing", "financing", or "miscellaneous" categories. They say that it should be good enough to present items such as "dividends received" or "interest paid" as individual items within the "non-operating category". They also believe that the main companies that would need a distinction between the "investing" and "financing" categories are those that actively manage portfolios of financial instruments as one of their main activities. If their suggestion is adopted, the following individual line items, at least, should be presented individually in the "non-operating category":
    - Main income and expenses arising from investing or financing activities,
    - Equity-method income or loss from affiliates,
    - Interest and dividend income,
    - Interest expense.

Question 4 - 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 don't agree.

Paragraph 51 of the ED permits two methods of classifying the operating category when financing is provided to customers as a company's main business activity. However, we think it would be appropriate to classify only income and expenses for providing financing to customers in the operating category. We would like to limit the operating category to include only income and expenses from a company's main business activities, unless it would be prohibitively expensive for the company to attempt to distinguish between income and expenses from the main business activities and those from the other financing activities. For the sake of consistency (and for operating margin to be meaningful) if revenue includes interest received on loans then operating expenses should also include interest paid on financing those loans. Typically a financing function is a separate legal entity, so it is possible to separate interest paid for this entity.

Question 5 - 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?

CRUF participants agree in principle but have some practical considerations.

We suggest stating explicitly that transactions of financial instruments by a non-financial company would not normally be regarded as part of a company's main business activities. This is because a preparer may define the company's main business activities as broadly as possible to recognise gains and losses from investing activities in the operating category. But some important exceptions would be cases where a company has a department that specialises in the trading of financial instruments and routinely holds and trades them, cases where a non-financial company holds financial instruments as part of their main business activity e.g. for currency hedging, and cases where the deferred gain or loss on derivatives on non-financial underlying assets are reversed.

Affiliates under the equity method may have similar main businesses to the consolidated group. That said, there are some compelling reasons that equity-method income or losses of the affiliates should be excluded from the operating category:

- In most cases, management of the parent company can neither exercise substantial control over their affiliates to proactively manage their budgets and performance, nor direct dividend policy
- Equity-method income of affiliates is on an after-tax basis, while operating profit is on a pre-tax basis
- It is a one-line consolidation item, so the operating profit margin can be distorted if it is included in operating profit, making consolidated financial statements less useful.

Meanwhile, examples of income and expenses from ancillary activities to the company's main business would include dividend income from shares held for strategic partnerships with counterparties of the business. A company does not manage the strategic shareholdings to maximise dividend income: it holds them to operate its main business smoothly. The dividend income from such investment is just incidental, and should not be regarded as coming from the company's main business activities. In addition, with strategic shareholdings we only see "dividend income" in the statement of profit or loss.

For the operating margin to make sense, as a general rule, we should only include revenue and expenses which are fully consolidated. There is also the issue of mixing different types of profit for different types of investments (subsidiaries vs. JVs & associates vs. investments). For investments dividends are post-finance, post-tax distributed profits. Therefore, we do not believe it is appropriate to include such dividend income in the operating category.

Question 6

(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?

(a) We are split on this question.

Some CRUF participants agree with the proposal referred to in Question 6 (a) because the profit or loss before financing and income tax subtotal is close to EBIT, which is widely used in practice as an indicator of a company's earning power. On the other hand, others disagree because they believe it is not useful to include a "financing category" and present the corresponding subtotal.

CRUF participants agree that the key new subtotal is operating profit. Assuming that there are not too many lines between this new subtotal and profit before tax, it would be reasonable to leave other subtotals as MPMs which would be reconciled in the notes.

(b) Some CRUF participants don't agree. See our response to Question 3 on unwinding of discounts on pension liabilities and provisions.

Question 7

(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?

(a) CRUF participants are split on this question.

Some CRUF participants have observed a consistent upward trend in the share of equity-method income in consolidated group earnings in recent years as alliances and organisational structures become increasingly diverse. In such circumstances, management's judgment on whether to classify equity-method income as integral or not is useful information.

That said, we note that some participants disagree, saying that the ED does not define "integral" distinctly enough to provide useful information. Some CRUF participants think this introduces unnecessary complexity and confusion. If a preparer would like to define an MPM as operating profit plus income from certain joint ventures then this can be done, with the reconciliation in the MPM note. It does not need to be on the face of the profit or loss statement. We believe that more disclosure is needed on the financial performance and financial position of affiliates, as equity-method income is becoming increasingly significant.

(b) We don't agree.

We generally disagree with the proposal to present a subtotal of "operating profit and income and expenses from integral associates and joint ventures" in the statement of profit or loss.

First, there is an inconsistency in calculation because equity-method income is after-tax income, whereas operating profit is before tax. Second, the judgment of whether income is integral or not is highly arbitrary. The possible exception to this is for the insurance industry where investments might be made for the benefit of policyholders via an associate with the profits from the associate being part of the core return for the policyholders. Where this is the case then an operating profit including integral associates and joint ventures might be necessary.

Furthermore, we believe the operating category should exclude equity-method income or losses of affiliates and income and expenses from activities that are ancillary to the main business of the company. In our view, for operating margin to make sense, operating profit cannot include income from equity method investments. We would prefer the label "income from equity method investments" to "share of profit from associates and joint ventures" because it is shorter and by avoiding the word "profit" it is easier to recall that this is a post-financing, post-tax number.

With the exception above, we do not otherwise find it useful for financial analysis to present a subtotal that is the sum of operating profit and equity-method income from integral affiliates. We are concerned that presenting such a subtotal would make the structure of the statement of profit or loss unduly complicated, damaging comparability. We believe it is sufficient to disclose it as a Management Performance Measure (MPM) in the notes, if the preparer wants to show it as one of the key metrics of their financial performance.

(c) We don't agree.

We do not agree with the ED proposal to require an entity to provide information about integral associates and joint ventures separately from non-integral associates and joint ventures in paragraphs 53 (statement of profit or loss), 75 (statement of comprehensive income), 82 (statement of financial position) and the new paragraph 38A of IAS 7 (statement of cash flows).

As with the statement of profit or loss, the distinction between integral and non-integral may have some utility, but the judgment is highly subjective, so presentation as distinct items risks making the financial statements unduly complicated and less comparable.

We believe it is most appropriate to provide the distinction in the notes. We agree with the proposal to add the new paragraph 20E to IFRS 12.

Question 8

- **(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?

(a) We agree.

We agree with the ED proposal on the roles of primary financial statements and notes. That said, we are concerned that the statement of financial position tends to be overly abridged based upon the examples of the line items shown in paragraph 54 of IAS 1. The excessive aggregation of items allows companies to provide too little information, significantly damaging the usefulness of the

statement of financial position. We understand that it is out of the scope of this ED to review the relevance of the statement of financial position, given the time constraints. However, we strongly encourage the Board to explore improvement in the presentation of the statement of financial position through a review of the line items to be presented as a new workstream as part of the Primary Financial Statement Project.

The current statement of financial position has been simplified to a mere list of assets and liabilities. It is very difficult for financial statement users to adequately understand a company's financial position just from the statement of financial position. We hope that the information presented in the statement is expanded substantially, so that we can understand the changes in a company's financial position over the previous year organically and concretely just through analysis of primary financial statements, i.e. the statement of financial position itself.

In order to increase the usefulness of the statement of financial position, we propose rethinking the degree of aggregation of line items presented in it as follows:

- Buildings, machinery, and land as distinct line items within PPE,
- Operating vs non-operating sections of the statement of financial position aligned with the definitions included in the statement of profit or loss (recognising that some change their nature (e.g. pension service cost becomes a non-operating liability once earned and the financing cost of this is non-operating in nature),
- Investment securities as a distinct line item within financial assets,
- Corporate bonds and borrowings as distinct line items within financial liabilities,
- Cumulative translation adjustments (CTA) as a distinct line item within accumulated other comprehensive income,
- Internally generated intangible assets and acquired intangible assets.

We understand that some may be concerned that the increase in line items might hamper understandability and comparability. We would counter, however, that appropriate disaggregation should result in more-faithful representation and that the increase in information provided by the statement of financial position should greatly enhance its relevance.

(b) We agree.

"Other" sometimes accounts for a large share of the breakdown of line items, and benefits from disaggregation are greatly reduced in such cases. We believe the ED proposal would appropriately address this problem, especially if there is an operating vs non-operating split.

Question 9 - 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.

Irrespective of whether a company selects the nature of expense method or the function of expense method to present its operating expenses on the statement of profit or loss, we believe it should be required to provide an analysis of its operating expenses using the other method in the notes.

We do not consider one of the two methods superior to the other. We are concerned that the ED proposal would provide preparers with an incentive to choose the nature of expense method, which is less onerous to them.

Ideally companies would provide a full matrix, showing expenses both by function and nature. If this is too costly, then a partial matrix, covering the majority of expenses would be much more helpful. One useful example would be employee costs which should be shown by function as they are often the largest expense for services and technology companies. Another useful example would be depreciation and amortisation expenses shown by function, as users need to remove depreciation and amortisation from R&D in order to capitalise R&D themselves. Similarly, users would like to see restructuring by function in order to understand the underlying trends.

Question 10

- **(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?

(a) CRUF participants have mixed views.

Some CRUF participants agree with defining unusual income and expenses. In calculating profit indicators that show normal profitability, we eliminate so-called temporary gains and losses that are not expected to occur under normal circumstances. The problem is that we have no choice but to rely on voluntary disclosures by the company for financial information on such temporary gains and losses.

These participants therefore enthusiastically welcome the ED proposal to define unusual income and expenses in the accounting standard and require disclosure. This would help to define a GAAP underlying profit number. However, there are a number of practical problems:

- Auditability – forward looking judgements are hard to audit. There are numerous macroeconomic assumptions which vary between companies and auditors which would change the view of what is likely to occur.
- Users' focus – different users have different time horizons and investment objectives. Equity analysts often value using a DCF in perpetuity and are interested in a normalised "usual" level of restructuring. Credit analysts have a shorter time horizon - the remaining life of the bond - and are interested in total restructuring, both "usual" and "unusual", to assess the risk of default.

Other CRUF participants, whilst finding the idea behind a GAAP "operating profit before unusual items" very appealing in theory, anticipate issues arising in practice. Instead, these CRUF participants propose defining a list of "potentially unusual items" (as outlined below in (d)) as required disclosure rather than tackling the definition of "unusual", which may be just too difficult.

(b) We don't agree with the proposal and CRUF participants have mixed views.

Some CRUF participants suggest that unusual income and expenses be presented in a new "unusual items category" in the statement of profit or loss, rather than in the notes. Furthermore, we suggest either:

- Presenting that category immediately above the profit before tax subtotal, with the main unusual income and expense items to be presented in the statement of profit or loss and detailed breakdowns and qualitative supplementary information to be disclosed in the notes; or
- Adopting a columnar approach to the statement of profit or loss with a column dedicated to unusual income and expense items which would be aligned with the relevant category to clarify their nature and facilitate analysis. Similar supplementary information would again be required.

By creating the "unusual items category" on the statement of profit or loss, operating profit will function as the measure of the normal level of profits that investors have been seeking. If disclosed in the notes, most financial statement users will have to use the information in the notes to make adjustments, deducting unusual income and expenses from operating profit. The same applies for the investing and financing categories. If so, there is no positive reason to disclose unusual items in the notes, and we think it would be more useful to present them in the statement of profit or loss.

Other CRUF participants believe the primary purpose of the statement of profit or loss is to show the performance in the period. In their view, operating profit (including unusual items) should be shown on the face of the statement of profit or loss and underlying profit (as defined by the company as an MPM) can be shown separately in a note. Showing the two together is confusing.

Furthermore, some CRUF participants think the issue is not just where management reports 'unusual items' but whether the adjustment is justifiable. Many users of accounts will come to their own conclusions about what should be counted or not and it should not be assumed that management can be trusted on this matter. These CRUF participants think the proposals help solve this problem by defining operating profit as the residual category.

(c) We do not agree.

We do not agree with the ED proposal for the following reason. We are concerned that there may be cases in which some income and expenses that appear to be unusual from long-term and qualitative perspectives might not be included in unusual income and expenses. Such cases would include losses caused by a series of earthquakes or other disasters over multiple years. We are concerned that such losses might not be included in unusual expenses.

COVID-19 is impacting the world so fundamentally as to change even the structure of society. There are companies worldwide presenting financial performance excluding impacts from COVID-19 amid this environment. If COVID-19 eventually ends like an earthquake, unusual items may occur. However, if the social structure at that time has already been transformed by COVID-19, the unusual items today will become the new normal in practice. The definition of the unusual items should be reconsidered based on the attributes of the event that generates income and expenses, not simply based on the possibility of recognition in the following year.

(d) We agree.

As noted in (b), some CRUF participants suggest creating an "unusual items category" to present unusual items on the statement of profit or loss, rather than disclosing them in the notes. The "unusual items category" should be placed just above pre-tax profit or presented in a separate column aligned with the relevant income or expense category in which it arose. Only the main unusual items should be presented in the breakdown on the statement of profit and loss, with detailed analysis of the unusual items category disclosed in the notes, as proposed in paragraph 101 of the ED. Other CRUF participants suggest creating a list of "potentially unusual items" to be required disclosure. This would be an extension of the IAS 1 list of required line items. With such a list of "potentially unusual items" users, with varying time horizons and objectives, could assess for themselves what is likely to occur in future.

Question 11

> (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?**

(a) We do not agree.

We think that MPMs can be useful as measures of financial performance to provide financial statement users with management's views. That said, we do not agree with paragraph 104 of the ED, and propose deleting it. We strongly believe that accounting standards should not restrict disclosure of MPMs. If MPMs happen to be identical to the subtotals defined by the standards, disclosure of reconciliations can just be omitted. We believe that it is useful for financial statement users to know which KPIs management uses internally.

We also note that cash flow measures can act as MPMs in certain industries. We may need to consider this problem from that perspective.

(b) and (c) We have mixed responses to this question.

Some agree with some reservations. There have been concerns around alternative performance measures (APMs) because they are too diverse and can be defined too arbitrarily by management. Accordingly, financial statement users need to be very careful when they use APMs. The ED proposes requiring companies to disclose MPMs, when it is relevant to do so, in the notes with reconciliation to the closest line items in the statement of profit or loss. We expect this proposal to address users' concerns, so we expect the MPMs to provide more useful information than APMs. Some CRUF participants prefer MPMs (being APMs relating to the statement of profit or loss) to be in a note. The proposed requirement to provide a narrative is very welcome. For example, users want to know why management is treating some restructuring costs as unusual, but not all.

That said, some participants are concerned that the benefits of the MPMs may be muted if they are disclosed in the notes, particularly as some users rely on data aggregators rather than using the source documents. Instead, we propose to require companies to disclose MPMs just below the bottom line of the statement of profit or loss. MPMs are important financial information that explain the performance of a company, and it would be more convenient for the financial statement users if they are placed just below the statement of profit or loss. This would be similar to the proposal made by the Board to present the amount of total equity excluding goodwill as a

free-standing item just below the balance sheet, as proposed in the DP "Business Combinations – Disclosures, Goodwill and Impairment" published in March 2020.

Question 12 - 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?

(a) We agree.

We agree that the accounting standards do not have to define EBITDA uniquely, as various definitions already exist depending on its use. That said, we do not agree with paragraph BC173 of the ED, which points out the possibility that use as an MPM will be restricted. We think companies may well use EBITDA as an MPM, and we believe it is useful for financial statement users to know what measures management uses as KPIs, even if they happen to match subtotals defined by IFRS.

Question 13

- **(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?

(a) We agree with some reservations.

According to the ED's proposal, operating cash flow would include those residual expenses that cannot be included in either taxes, investing, or financing cash flow. While some CRUF participants suggest to proactively define the operating category on the statement of profit and loss rather than define it as the default category, we do not think the operating category and operating cash flow need to be rigidly interconnected.

Some CRUF participants think the presentation of the cash flow statement starting from net income is easier for financial statement users who have become used to it over many years and because it is consistent with US GAAP. They argue that it appears more intuitive for users of

financial statements to add back non-cash items to net profits, given that the indirect method entails compilation based on changes to line items in the statement of financial position. Other participants, again who have become used to it, prefer to start from operating profit so that they can derive an operating free cash flow more readily where the only adjustments should be operating working capital and fixed asset movements rather than tax, interest, dividends etc. For users who have a global focus, inconsistencies in starting points for the cash flow statement are problematic because depending on where you start you get a different answer for free cash flow from operations, which is an important financial analysis metric.

(b) Our views are split on this question.

Some agree because they believe it is natural to include gains and losses from investing and financing activities in the respective categories rather than including them in operating cash flow.

Others disagree because they prefer to maintain consistency with US GAAP practices. These participants are far more supportive of the IASB position and would encourage a review of the rest of the financial statements to determine how more cohesiveness can be pursued.

Question 14 - 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. A consolidated group, whose parent company is a non-financial company, may provide such financial services as banking, insurance and investment management. We propose to require such a group to prepare and present separate statements of profit or loss for its financial and non-financial operations in addition to the consolidated statement of profit and loss. We believe such a group should provide investors with three different statements of profit or loss for the financial operations, non-financial operations, and the consolidated group, because all of these three should be relevant for investors' economic decisions. For example, an automotive company is often valued in two parts: industrial operations and the financing division.

2. Paragraph 42 requires companies to present additional subtotals when they are relevant. The ED proposes the presentation of several subtotals including operating profit, and we are concerned that the requirement in paragraph 42 would just make the presentation of the statement of profit or loss overly complex, damaging the understandability of the statement. In addition, the objectives of paragraph 42 could overlap with those of the MPMs. Hence, we suggest deleting paragraph 42.

3. We expect the proposals of this ED to be finalised as a new IFRS standard, labelled as IFRS X (X being the latest number in the IFRS series upon finalisation). While we recognise that this might be outside of the scope of this current outreach project, we would like to propose systematic renumbering of existing IFRS standards now that major amendments have largely run their course. The Board has been amending old standards in order of priority, and renumbering them. As a result, while each standard has a systematic internal

structure, the numbering of the IFRS standards themselves has become too messy and unsystematic for stakeholders to use. We are forced to go back and forth when we need to look over matters relating to several standards. Thus, we propose renumbering existing IFRS standards in a more systematic and structured way upon finalisation of the ED, taking the new standard for primary financial statements as the starting line.

Appendix

Current practices in the South African market

Well before the IFRS Foundation embarked on its improvements project related to primary financial statements the JSE sought to introduce a "sustainable" earnings measure better suited for relative analysis across companies and sectors on the JSE.

This "sustainable" earnings measure has been named "Headline Earnings".

This was at the behest of the South African analyst, investment and preparer communities as well as financial institutions (interested parties).

These interested parties found earnings per share (EPS) calculated under IAS 33 less useful as it includes all earnings, including those related to the re-measurement of an entity's asset and liability base (defined as the "platform").

The prime concern raised by interested parties to surveys, led by The South African Institute of Chartered Accountants (SAICA), was that markets driving the re-measurement of an entities "platform" are highly volatile.

In addition, the measurement basis underpinning these re-measurements are more often than not, subject to significant management judgement and bias. In particular, where a transparent and liquid market for the asset or liability does not exist.

Interested parties believed, that headline earnings should exclude items that relate to the capital platform of an entity such as the revaluation of certain assets (e.g. investment property), which are included in the earnings calculated in terms of IAS 33.

But to maintain comparability across sectors and entities, a defined calculation was required.

To achieve this objective SAICA through the Accounting Practices Committee (APC) introduced the "Headline Earnings" circular.

In fact, all entities listed on the JSE, through the JSE listing requirements are required to apply the latest version of the circular.

The core objective of the circular is to isolate "sustainable" earnings related to the main operating/trading activities of an entity.

The circular is predominantly rules based to eliminate management bias and judgement that might arise through a more principle's based calculation.

The background to the circular (Section A: Background) delves into the history of the circular in more detail.

The SA CRUF issued the following comment document in response to changes to prevailing rules introduced to the latest version (Circular 1/2019)

We have included this to give colour on how the South African market currently arrives at an earnings number that reflects performance from main trading and operating activities.

This is not meant to detract from our main responses on the IASB's Exposure Draft on General Presentation and Disclosures, but highlight current practices in the South African market. We believe the ideas set out in the South African response to the Headline earnings per share circular remain relevant and should be considered by the IASB in refining the requirements with regards to "Unusual items" and "Management performance measures"

Revised Standard on Headline Earnings Per Share Measure

Objective and core principle

1. The objective of this standard is to improve performance comparisons between different entities in the same reporting period and between different reporting periods for the same entity.
2. The core principle of this standard is to provide an earnings measure that is representative of the entity's *headline earnings* from its *ordinary business activities* in the period.

Scope

In accordance with the objective and core principle, this standard is not applicable to:

- measures defined or specified by the applicable financial reporting framework, such as revenue, profit or loss or earnings per share;
- physical or non-financial measures such as number of employees, number of subscribers, sales per square meter (when sales figures are extracted directly from financial statements) or social and environmental measures such as greenhouse gases emissions, breakdown of workforce by type of contract or by geographic location;
- information on major shareholdings, acquisition or disposal of own shares and total number of voting rights;
- information to explain the compliance with the terms of an agreement or legislative requirement such as lending covenants or the basis of calculating the director or executive remuneration.

Headline earnings is not intended to be a positive statement on the going concern status of an entity.

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Calculation of headline earnings per share and the identification of non-recurring items

3. **Headline earnings per share is calculated by adjusting the basic earnings number in terms of IAS 33 for non-recurring items (net of the corresponding tax and non-controlling interest) and dividing this amount by the number of shares used in the determination of basic earnings per share in accordance with IAS 33.**
4. An event or transaction shall be considered *recurring* if it does not fall into the definition of *non-recurring* and satisfies one or both of the following conditions:
    a) If, in the previous 5 years, a similar event or transaction has been noted, **or**
    b) If, in the foreseeable 2 years, a similar event or transaction is expected to occur.

   This is the case regardless of whether or not the previous or expected occurrence is material in the view of management.
5. This standard is based on an "apply or explain" model. Paragraph 4 explains the requirements for identifying *recurring* items in order to determine the headline earnings measure.
6. If in management's view, the requirements in par 4 do not provide a useful measure of earnings, and in management's view, the event or transaction should be treated differently to comply with the objective and core principle of this standard, then management may treat the event or transaction differently only if the following has been complied with:
    a) The event or transaction in question must be recognised and measured in terms of IFRS;
    b) Management should disclose the nature of the event or transaction in question, in a clear and understandable way;
    c) Management must disclose clear and specific reasons why, in their view, this standard does not accurately portray the economic reality of the entity when disclosing headline earnings;

   The determination of whether an event or transaction represents a non-recurring item requires judgement and will often be influenced by the industry in which the entity operates. The following factors alone are not indicative of an adjustment that is required to determine headline earnings per share:
    d) Volatility;
    e) Cyclicality;
    f) Seasonality.
7. Paragraph 6 is expected to be used only in extremely rare circumstances.

~~8. In making the judgement required to identify non-recurring items, management shall consider:~~
    ~~a) The past frequency of the item being considered;~~
    ~~b) The likelihood of a future occurrence of the item being considered; and~~
    ~~c) The way in which management considers the item when preparing its internal budgets and performance.~~

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9. ~~In considering the factors in paragraph 5, management shall place more reliance on past frequency than the likelihood of future occurrences and management's view of the item.~~

Presentation and disclosure

10. Headline earnings per share should be calculated and presented consistently each period unless there has been a relevant change in the business.
11. If the manner in which the entity calculates earnings changes in the period, the entity shall:
    a) Restate the comparative headline earnings for the previous five financial reporting periods.
    b) Disclose what has changed in the calculation and an explanation of why this change results in a headline earnings measure that is more aligned with the core principle.
12. In complying with this standard, the following shall be disclosed:
    a) A clear and explicit description of each adjustment made in arriving at the headline earnings figure, including the rationale for events or transactions identified as non-recurring;
    b) A reconciliation of headline earnings to the earnings amount in accordance with IAS 33;
    c) The reportable segment, in accordance with IFRS 8 Operating Segments, to which the particular adjustment relates; and
    d) The impact of tax and non-controlling interest for each *non-recurring* item.

Appendix A

Defined terms

Headline earnings — The net earnings of an entity that can be reasonably expected to be generated in a consistent manner into the foreseeable future.

IAS — International Accounting Standard

IFRS — International Financial Reporting Standard

Non-recurring items — Events or transactions that:

- **a)** Do not form part of the ordinary business activities of the entity; and
- **b)** Are not representative of the headline earnings of the entity for the foreseeable future; and
- **c)** Do not meet the conditions of paragraph 4.

Ordinary business activities — Those events that routinely occur in the industry in which the entity operates because they are commercially expected for an entity that operates its business in that industry.

Recurring items — Events or transactions that are not considered non-recurring as defined and satisfy one or both of the conditions in paragraph 4.

Appendix B

Application guidance

Example 1(a)– Fair value gains and losses on agricultural produce

Entity A is involved in planting vines, harvesting grapes and producing wine. The grapevines are biological assets that continually generate crops of grapes. The grapes are measured at fair value less cost to sell at each reporting period.

Should the fair value gain or loss be included or excluded from headline earnings?

Harvesting grape crops is part of the ordinary business activities of Entity A. The fair value thereof is determined annually and would therefore be a recurring item in the entity's earnings. The fair value gain or loss should therefore be **included** in headline earnings in accordance with paragraph 4.

Example 1(b) – Gains and losses relating to policyholder liabilities

Insurer B is a life insurance company. Based on actuarial calculations policyholder liabilities have increased substantially in the current year, resulting in a significant loss for the entity. These losses are regularly incurred by Insurer B.

Should the loss be included or excluded from headline earnings?

Writing insurance policies is part of the ordinary business activities of Insurer B. The remeasurement of policyholder liabilities is determined on an ongoing basis and would therefore be a recurring item in the entity's earnings. The loss relating to remeasurement of policyholder liabilities should therefore be **included** in headline earnings in accordance with paragraph 4.

Example 2(a) – Charges relating to long-term empowerment transactions

Entity C operates mines throughout Southern Africa. In order to comply with local empowerment legislation Entity C has implemented a Black Economic Empowerment ("BEE") share scheme. In accordance with IFRS 2 *Share-based payments* the entity recognises a share-based payment expense over the duration of the scheme. The last time Entity C incurred a similar expense was 7 years ago. A similar expense is not expected for the next 2 years

Should the expense be included or excluded from headline earnings?

Although the entity would not expect the BEE expense to be part of its headline earnings, in order to maintain its licence to operate, Entity C is required to enter into share-based payment transactions. Application of the guidance in paragraph 4 would result in the share-based payment expense being identified as a non-recurring item and would be excluded from headline earnings. However, in management's view to comply with the objective and core principle of this guideline, management would like to **include** the share-based payment expense in headline earnings in terms of paragraph 6. This would be allowed if management complies with the requirements of paragraph 6.

Example 2(b) – Charges relating to once-off empowerment transactions

Entity C operates retail stores throughout Southern Africa. In order to comply with local empowerment legislation Entity C has implemented a Black Economic Empowerment ("BEE") share scheme. In accordance with IFRS 2 *Share-based payments* the entity recognises a share-based payment expense once-off in the year that the transaction occurs. The entity has not entered into similar transactions previously, and is not required by legislation to enter into regular transactions of this kind, nor does it intend to for the next 2 years.

Should the expense be included or excluded from headline earnings?

In order to maintain its licence to operate, Entity C is required to enter into a share-based payment transaction. The transaction is however non-recurring because the type of transaction is not expected to occur again, and has never occurred in the past. The share based payment expense would therefore **not** be part of the ordinary business activities of Entity C and should be **excluded** from headline earnings in terms of paragraph 4.

Example 3(a) – Acquisitions in the technology industry

Entity D renders services in the technology industry. In order to remain competitive the entity generally enters into several business combinations during the year, for which it incurs transaction costs.

Should the transaction costs be included or excluded from headline earnings?

While Entity D's main business is the rendering of technology-related services, it needs to enter into business combinations in order to remain competitive. These types of transactions are also undertaken on a recurring basis. Acquisitions would therefore be part of its ordinary business activities and therefore transaction costs should be **included** in headline earnings in terms of paragraph 4.

Example 3(b) – Acquisition by a retailer

Entity E is a clothing retailer. The entity entered into its first business combination in seven years and incurred significant transaction costs relating to the acquisition. The entity does not expect to enter into any business combinations in the near future.

Should the transaction costs be included or excluded from headline earnings?

Entity E has no history of entering into recurring business combination transactions and does not intend to enter into any business combinations in the near future. These transactions would not be considered part of Entity E's ordinary business activities and the transaction costs would therefore be **excluded** from headline earnings in terms of paragraph 4.

Example 4(a) – Impairment of infrastructure

Entity F is a telecommunications network operator and owns significant physical infrastructure assets throughout Africa. In the current year, due to the unprecedented introduction of enhanced infrastructure assets in the market, Entity F recognised a significant impairment charge relating to its infrastructure. Entity F has appropriately updated its useful lives and residual values and does not expect a similar impairment in the next 2 years.

Should the impairment charge be included or excluded from headline earnings?

It would not be expected that impairment charges would be recorded on a recurring basis relating to infrastructure with a relatively long useful life. Rather, it would be expected that the useful lives and residual values be adjusted following an impairment event. The impairment charge is therefore not part of the ordinary activities of Entity F and should therefore be **excluded** from headline earnings in terms of paragraph 4.

Example 4(b) – Impairment of loan book

Bank G has a variety of different loan books. During the year there was a significant impairment charge recognised relating to the low value personal loan book due to changes in the economic environment. Bank G recognises impairment losses relating to its loan book on a recurring basis, however has never recognised such a significant impairment in a single year.

Should the impairment charge be included or excluded from headline earnings?

Impairment of a loan book would take place every year as part of Bank G's ordinary business activities. The charge should not be excluded merely because it is abnormally large. The impairment charge should therefore be **included** in headline earnings in terms of paragraph 4.

Example 4(c) – Write-down of inventory to net realisable value

Retailer H operates fashion retail stores throughout Southern Africa. During the year the write down of a significant amount of high end goods resulted in an abnormal charge in the income statement. Retailer H regularly writes items down to net realisable value because the trends in the industry tend to be volatile, however has never recognised such a significant charge in a single year.

Should the write-down to net realisable value be included or excluded from headline earnings?

Write-down of inventories to net realisable value would take place every year as part of Retailer H's ordinary business activities. The charge should not be excluded merely because it is abnormally large or because the industry is volatile. The impairment charge should therefore be **included** in headline earnings in terms of paragraph 4.

About the Corporate Reporting Users' Forum (CRUF)

The CRUF was set up in 2005 by users of financial reports to be an open forum for learning about and responding to the many accounting and regulatory changes that affect corporate reporting. In particular, participants are keen to have a fuller input into the deliberations of accounting and audit standard setters and regulators. CRUF participants include buy and sell-side analysts, credit ratings analysts, fund managers and corporate governance professionals. Participants focus on equity and fixed income markets. The Forum includes individuals with global or regional responsibilities and from around the world, including Australia, Canada, France, Germany, Hong Kong, India, Japan, New Zealand, South Africa, UK and USA.

The CRUF is a discussion forum. Different individuals take leadership in discussions on different topics and in the initial drafting of representations. In our meetings around the world, we seek to explore and understand the differences in opinions of participants. The CRUF does not seek to achieve consensus views, but instead we focus on why reasonable participants can have different positions. Furthermore, it would not be correct to assume that those individuals who do not participate in a given initiative disagree with that initiative. This response is a summary of the range of opinions discussed at the CRUF meetings held globally. Local country differences of opinion are noted where applicable.

Participants take part in CRUF discussions and joint representations as individuals, not as representatives of their employer organisations. Accordingly, we sign this letter in our individual capacity as participants of the Corporate Reporting Users' Forum and not as representatives of our respective organisations. The participants in the Forum that have specifically endorsed this response are listed below.

Signatures

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