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Comment letter: Exposure Draft ED/2019/7 General Presentation and Disclosures

Dear Mr Hoogervorst,

In response to your invitation, we are gladly taking the opportunity to comment on the Exposure Draft ED/2019/7 General Presentation and Disclosures.

At BASF, we create chemistry for a sustainable future. We combine economic success with environmental protection and social responsibility. More than 117,000 employees in the BASF Group work on contributing to the success of our customers in nearly all sectors and almost every country in the world. BASF has companies in more than 90 countries. We operate six Verbund sites and 361 additional production sites worldwide. Our Verbund site in Ludwigshafen, Germany, is the world's largest chemical complex owned by a single company that was developed as an integrated network. Our portfolio is organized into six segments: Chemicals, Materials, Industrial Solutions, Surface Technologies, Nutrition & Care and Agricultural Solutions. BASF generated sales of €59 billion in 2019. On behalf of BASF SE, Ludwigshafen, Germany, we are pleased to share our view on selected items of the Exposure Draft.

In general, BASF acknowledges the IASB's efforts to improve how information is communicated in the primary financial statements and the notes. However, there are critical aspects where we take a different view. In order to focus on our major concerns, we will limit our answers to the following questions:

- Question 2 — the operating category,
- Question 7 — integral and non-integral associates and joint ventures,
- Question 9 — analysis of operating expenses,
- Question 10 — unusual income and expenses and
- Question 13 — statement of cash flows.

Our detailed comments are set out in the Appendix to this letter. In case you have any questions or comments please do not hesitate to contact us.

Yours sincerely,

Stefan Schnell
Head of Group Reporting & Performance Management

Roland Brockmann
Head of Group Accounting & Reporting

Appendix

Structure of the statement of profit or loss

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?

Definition

1) BASF agrees with the definition as a default category, which includes income and expenses not classified in other categories.

2) However, we strongly propose not to commingle a vague positive definition (paragraph 46 of the Exposure Draft (ED): "includes information about income and expenses from an entity's main business activities") with the default concept. Considering entities with multiple business activities, the operating category being the default will also include minor and auxiliary business activities if these activities are not to be classified in other categories. Then the operating category provides a complete picture of an entity's operations but conflicts with the notion stated in paragraph 46 as quoted above.

3) BASF supports the proposal to obligatorily classify income and expenses generated in the course of an entity's main business activities not in the investing, but instead in the operating category (paragraph 48 of the ED). It is furthermore consistent that entities that provide financing to customers as a main business activity classify such income and expenses not in the financing, but in the operating category (paragraph 51 of the ED). The reclassification to the operating category based on the notion "in the course of an entity's main business activities" should as well be applied to integral associates and joint ventures. In Appendix A to the amended IFRS 12, integral associates and joint ventures are defined as being "integral to the main business activities of an entity". If so, they should also be included in the operating category. It is inconsistent and lacks a solid basis if income and expenses from investments made in the course of an entity's main business activities are to be classified in the operating category while integral associates and joint ventures are defined as a separate category and, thus, excluded from the operating category. We hereby refer to our comments on question 7 (paragraph 13) of this document).

Trade payables

4) Based on paragraphs B35 (c) and B39 (a) of the ED, the classification of income and expenses on trade payables is not derived consistently.

5) On the one hand, paragraph B35 (c) of the ED states that "income and expenses from financing activities include income and expenses on the following liabilities: […] trade payables (for example those negotiated on extended credit terms)". Given that it was decided to use the wording "for example" instead of "if", it is not clear whether the Board is only referring to trade payables with a financing component or to trade payables in general.

6) On the other hand, paragraph B39 (a) of the ED refers to exchange differences on trade payables not negotiated on extended credit terms that are to be classified "in the same category as the expenses for the purchase of the goods – that is, normally the operating category".

7) Our concern is that the IASB intended to split income and expenses on trade payables into different categories – financing category in case of extended credit terms and operating category in case of "regular" trade payables. However, irrespective of whether trade payables are negotiated on extended credit terms or not, the expenses for the purchase of goods will normally still be presented in the operating category. In other words, the classification of a payable as "trade" payable indicates that the operational background is considered as main driver for its existence. Hence, income and expenses on trade payables should not be split into different categories.

8) BASF doubts the existence of benefits for the users of financial statements but foresees high implementation costs. The effects on trade payables should, therefore, be presented consistently in the operating category.

9) **Integral and non-integral associates and joint ventures**

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?

Definition

10) BASF welcomes the IASB’s proposal to distinguish between integral and non-integral associates and joint ventures.

11) BASF supports the definition of integral associates and joint ventures as being “integral to the main business activities of an entity” and hence not generating “a return individually and largely independently of the other assets of the entity” (Appendix A to the amended IFRS 12). BASF also supports that the opposite is defined for non-integral associates and joint ventures. The examples outlined in paragraph 20D of IFRS 12 provide useful guidance for assessing whether or not an associate or joint venture is integral while recognizing that there are a wide range of business relationships. This allows entities to apply the criteria based on their particular circumstances.

12) However, BASF strongly proposes to also include in paragraph 20D of IFRS 12 the integration of an associate and joint venture into operating segments (IFRS 8) as this provides a solid indication that an associate and joint venture is integral.

No need for a new category “integral associates and joint ventures” and a new subtotal “operating profit or loss and income and expenses from integral associates and joint ventures”

13) BASF does not support the IASB’s proposal to introduce a new category for integral associates and joint ventures and a new subtotal for “operating profit or loss and income and expenses from integral associates and joint ventures”. Integral associates and joint ventures are defined as being “integral to the main business activities of an entity” and as such, should be included in the operating category and in the subtotal “operating profit or loss”. Consequently, the subtotal “operating profit or loss and income and expenses from integral associates and joint ventures” should be removed from paragraph 60 of the ED (required subtotals). BASF justifies its position as follows:

   a. The share of profit or loss of integral associates and joint ventures represents an after-financing and after-tax figure, which does not change if it is presented as a separate category in the statement of profit or loss. The concerns raised in paragraph BC82 can be easily addressed as the line item “share of profit or loss of integral associates and joint ventures” is already part of the minimum line item requirements outlined in paragraph 65 of the ED. This allows stakeholders to identify their contribution to operating profit and loss and to adjust this figure if considered necessary for certain analysis.

   b. The category would only include a single line of primary information, making its function of a “total” redundant.

   c. Paragraph BC82 (c) states that because an “entity does not control the activities of associates and joint ventures as it controls the other activities […] in the operating category”, the share of profit or loss of integral associates and joint ventures should be presented separately from the results of an entity’s operating activities. However, the definition of the operating category does not address control over the activities. In Appendix A to the amended IFRS 12, integral associates and joint ventures are defined as being “integral to the main business activities of an entity”. As explained in paragraph 3) of this document, not including integral associates and joint ventures in the operating category is inconsistent and lacks a solid basis of argumentation.

   d. In addition, if the integral associates and joint ventures are, for example, integral to the reported operating segments, their results are regularly reviewed by the management together with the operating segment’s performance, not independently of the operating segment’s performance.

Roles of financial statements, aggregation and disaggregation

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?

Analysis of expenses classified in the operating category

14) BASF welcomes that paragraph 68 of the ED continues to require entities to analyze operating expenses using the method that "provides the most useful information to users of their financial statements" – either by-function or by-nature.

Disclosures

15) BASF strongly disagrees with the requirement outlined in paragraph 72 of the ED which states that "an entity presenting an analysis of expenses […] using the function of expense method shall also disclose in a single note an analysis of its total operating expenses using the nature of expense method".

16) The fact that the ED in the opposite situation does not require entities using the nature of expense method to disclose an analysis of their total operating expenses using the function of expense method implies that the Board favors the nature of expense method over the function of expense method.

17) The decision to present operating expenses either by-function or by-nature is explicitly not a free choice. It is the result of following the mandatory rules set out in the ED. Consequently, BASF does not see any reason to sanction entities that are using the function of expense method, if the presentation of operating expenses by function has proven to be superior for that particular entity. In addition to the doubtful additional value, the Board should consider the significant effort necessary to maintain a second cost accounting based on the nature of expense method.

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?

Definition

18) The IASB acknowledges that it is common practice to use unusual or similarly described expenses (or income). Some entities include them in the statement of profit or loss or in the notes, others adjust for these when calculating their defined performance measures. As they provide information that is useful for forecasting future cash flows of an entity, they are of importance for investors. The IASB, however, expresses concerns that the current provision of such information varies significantly between entities and that it is often not clear why and how items have been determined as unusual. It is therefore appreciated that the IASB separately considers and defines transactions or other events that are all within the scope of ordinary business activities but are unusual in terms of their amount and occurrence.

19) The definition itself is rather restrictive as it only focuses on income and expenses that are not expected to arise for several future annual reporting periods. It neglects the fact that certain measures or programs may span limited future reporting periods. In paragraph B71 of the ED restructuring programs impacting several future periods are exemplarily mentioned. It is stated that an entity would normally not classify such program-related expenses as unusual. This, however, leads to a situation where the expenses of the final year of occurrence would qualify as unusual, whereas the expenses of the first year would not. BASF suggests the IASB to expand the proposed definition by items that presently and for limited future periods impact the reporting entity.

20) In our view, it is of equal importance to highlight that a faithful assessment of unusual income and expenses can only be achieved if the management and steering of operating activities are taken into account. Entities with multiple business activities should be allowed to analyze and identify unusual income and expenses on a segment level (IFRS 8), considering that each segment is steered according to a business model specific to its objective, customer groups, innovation and investment focus. Thus, the IASB should clarify that the assessment of unusual income and expenses comprises the level of operating segments.

Disclosures

21) BASF strongly disagrees with the requirement outlined in paragraph 101 (d) of the ED which states that "an entity shall […] disclose an analysis of the included expenses using the nature of expense method, when an entity presents an analysis of expenses in the statement of profit or loss using the function of expense method". We hereby refer to our comments on question 9 (paragraphs 15)-17) of this document).

Statement of cash flows

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?

22) BASF understands that with the proposed amendments to IAS 7, the Board intended to make only limited changes to the statement of cash flows. However, the proposed amendments will require significant changes for preparers if:
- the current starting point for the indirect method of reporting cash flows from operating activities is the final line item of the statement of profit or loss, as it is the case for BASF, and
- the classification option currently applied for classifying interest and dividends does not conform to the new paragraph 34A of IAS 7.

No need for a consistent starting point for indirect method of reporting cash flows from operating activities/ No need to eliminate the classification options for interest and dividends

23) BASF disagrees with the Board's proposal to require all entities to use the same starting point for the indirect method. It implies that the IASB expects the results for reporting cash flows from operating activities to be different when different starting points are used. In our view, it will not improve the quality of the information provided to the users of financial statements.

24) BASF also disagrees with the Board's proposal to remove the classification options for interest and dividends. Presenting dividends paid as cash flows from financing activities will most likely not have a significant impact. However, if the classification option currently applied for dividends received, and interest paid and received does not conform to the new paragraph 34A of IAS 7, removing the classification options would require significant changes.

25) Going further up in the statement of profit or loss using the operating profit or loss as the new starting point for the indirect method and implementing a mandatory classification for interest and dividends that does not conform to an entity's current classification will increase the scope of reporting on cash effective changes on balance sheet item level. In addition, as the categories of the statement of profit or loss are not fully aligned with the cash flow activities, further specific adjustments will become necessary. For example, an entity would need to allocate income and expenses presented in the financing category of the statement of profit or loss to the cash flows from operating activities to be able to indirectly derive the cash effects (e.g., unwinding of discount on pension liabilities and provisions).

26) An entity's current set up may need to be revised substantially with a significant increase of manual efforts or with the necessity to install a complex technical solution.

Separate presentation of cash flows from integral and non-integral associates and joint ventures

27) BASF agrees with the proposal to present the cash flows from integral and non-integral associates and joint ventures separately.

28) However, in case the classification options for interests and dividends are removed, we strongly propose that dividends received from integral associates and joint ventures are classified as cash flows from operating activities to reflect that these cash flows are generated by activities that are integral part of an entity's operations.