EFRAG
European Financial Reporting Advisory Group

Instituto de Contabilidad y Auditoría de Cuentas

Summary of comments

PAAinE Discussion Paper

The Performance Reporting Debate What (if anything) is wrong with the good old income statement?

February 2009

About the PAAinE

EFRAG and the European National Standard Setters have agreed to pool some of their resources and work together more closely so that Europe as a whole can participate more effectively in the global accounting debate. It was agreed that this initiative should in the beginning concentrate on long-term pro-active work. The objective of the initiative is to stimulate debate on important items on the IASB agenda at an early stage in the standard-setting process before the IASB formally issues its proposals. The initiative has the joint ambitions of representing a European point of view and exercising greater influence on the standard-setting process. This initiative is known as the 'Proactive Accounting Activities in Europe' (or PAAinE) initiative.

Several projects have commenced under the PAAinE initiative, and this paper was the result of the PAAinE project that relates to the joint IASB/FASB project on Financial Statement Presentation.

Work carried out under the PAAinE initiative can take a number of different forms and the full objectives of the initiative are:

- to stimulate, carry out and manage pro-active development activities designed to encourage the debate in Europe on accounting matters and to enhance the quality of the proactive input to the IASB;

- to co-ordinate and resource monitoring work of IASB and FASB projects; and

- to try to ensure, as far as is practicable, that the messages Europe gives the IASB are consistent.

A further description of the PAAinE initiative is available on the EFRAG website (www.efrag.org).

A summary of the comments received in response to the PAAinE Discussion Paper on Performance Reporting *What (if anything) is wrong with the good old income statement?*

Introduction

1 The current performance reporting model was developed at a time when the assets employed were mainly inventory, machinery and buildings and the operating activity mainly manufacturing or retailing. As companies began to acquire more diverse assets and liabilities, carry out more complex operating and financing activities, and use more complex corporate structures, so the reporting model has had to be adapted to try to cope with the issues that these developments have created. However, although to date there have been only incremental changes to the performance reporting model, fundamental change is now a possibility. The prospect of making fundamental changes to the performance reporting model is already proving highly controversial, because many believe that, although the existing model is not flawless, the need for fundamental change has been neither demonstrated nor clearly articulated.

2 To encourage an early, comprehensive and fully informed debate on performance reporting within Europe, the Spanish standard setter, Instituto de Contabilidad y Auditoría de Cuentas (ICAC), and EFRAG decided to undertake their own work on the subject through the PAAinE initiative.

3 In November 2006 a PAAinE discussion paper on performance reporting was issued by the ICAC and EFRAG. The paper attempted to set the scene for the debate; the intention being that a second discussion paper would follow, the objective of which would be to evaluate the various arguments that are advanced in favour of or against fundamental change.

4 The first paper invited constituents' views on the matters raised. This summary attempts to analyse and summarise the comments received. What follows is a repetition of the questions asked in the first discussion paper, along-with an analysis of the comments received.

5 We would like to emphasise that neither the first paper nor the summary attempts to answer the questions raised in the first discussion paper; that is the purpose of the second discussion paper. Therefore the comments received on the questions listed below will be incorporated into the second discussion paper.

6 Appendix A contains a full list of respondents (as well as the related abbreviations used in this paper) but, to summarise:

(a) Comments were received from:

• Preparers and representative bodies of preparers	8
• Accounting firms	1
• Accountancy bodies	5
• Standard-setters	5
• Academics	1

(b) The responses were received from the following geographic areas:

• Denmark	1
• Germany	4
• Italy	2
• Netherlands	1
• Sweden	1
• Switzerland	1
• UK	6
• Pan-European	3
• Global	1

Analysis of the comments received per question

Question 1

Is there a need to have a key line in the statement(s) of income and expense that succinctly summarises entity performance, acts as a headline number in corporate communication and can be used as a starting point for further analysis? If so, what should this (or these) key line(s) represent?

7 Eleven[1] respondents were convinced that key line items are valuable and necessary in financial reporting and communication. Five[2] respondents were not overly keen on key lines, and the remaining four respondents had mixed or no views on the matter.

8 Nevertheless, opinions were divided as to whether key lines frequently reported by companies should be incorporated into accounting standards or left to the discretion of management.

9 A summary of comments raised by respondents in favour of key lines follows:

> It seems that there are 2 key lines which are of particular relevance to reflect most entities' performance: Operating profit and Net income, on which entities communicate and which are basis for further analysis. (BusinessEurope)
>
> ...Both the operating profit and the Net income are solid bases (reflecting how business works, audited and well known) on which the entity communicates to explain the period performance on a standalone basis or combined with other indicators. (BusinessEurope)
>
> …The performance of a company should be assessed with a basket of measures. It would be helpful to define some further line items to reflect the overall performance of the company and to foster comparability between companies. However, in practice, one key line item, often net income, is focused on. As practice shows that the one key line changes over time and companies invent new key lines, it may be better to have defined, standardised line items than each company defining its own number(s) in the light of comparability. We note that consistent application is difficult to achieve. The net income notion is one of the line items for performance assessment and should continue to be focused at. (FEE)
>
> In our opinion there should be a well balanced combination of standardised key lines and key lines based on the management approach. Key measures such

[1] VW, GASB, OIC, DASB, SwissHoldings, FSR, SEAG, ABI, ACCA, FEE, BUSINESSEUROPE

[2] LSCA, ASB, ICAS, ICAEW, BDO

> as revenue, bottom line figure (net income) and a few (one or two) additional key lines should be standardized and required to be reported by all entities to allow comparisons between different companies. The standardised key lines should include a "before taxes" key line.
>
> The rest should be left to the discretion of the management. These additional key lines selected by the management should reflect the way the business is managed internally. (GASB)

10 Below is a summary of comments from respondents who did not wholly accept that a key line can summarise performance although they did acknowledge that a standardised key line, such as net income, would be a useful starting point

> Different users of the financial statements will have different needs and will therefore naturally focus on different aspects of performance, consequently we do not believe that there is a need for one key line summarising performance. Instead we believe there is a need for a more formal framework setting out a number of prescribed headings, such that users can make comparisons between companies on a consistent basis. For example, there should be consistency in what is included in headings such as operating profit and net income. (LSCA)
>
> We do not believe it is possible to distil the performance of a complex organisation into a single measure, and that therefore undue significance should not be placed on any one such measure. However, it would be naïve to believe that commentators on financial performance will not highlight single measures when reviewing financial performance. A well presented statement of financial performance would enable any earnings figures quoted by entities in their market communications to be reconciled back to the underlying statement of income and expense. The purpose of "key lines" in the statement of income and expense e.g. operating income, net income, etc is to provide a reconciliation point for earnings figures provided by the management of the entity. (ASB)
>
> It is not possible to summarise entity performance in one key line of the accounts, although they recognise that there is still a demand to have such a line. In their view, this line is demand-driven i.e. the market chooses which line they wish to focus on, and therefore cannot be dictated by standard-setters. A single line ultimately does become meaningful because it is used and relied upon. The financial statements should make clear the limitations of whichever line is chosen. (ICAS)

Question 2

What are the attributes of 'performance' in the context of financial reporting of an entity? Are there different types of performance (for example, management performance and entity performance) and if so, what are the types? What do they encapsulate and how can/should they be differentiated?

11 The use of the term "performance" within the context of financial reporting is widespread although many respondents associated different meanings to it and therefore diverging views existed with respect to the different types of performance. To summarise, there was no one coherent view on the attributes of performance amongst respondents.

12 Some respondents felt that there was a need for a definition but were unable to elaborate on a suitable basis for such a definition. Some felt that it was pointless trying to define it as no single measure serves unambiguously to explain the performance of an entity.

13 The ICAEW spoke about the need for a well articulated definition of performance:

> There are certainly different types of performance that are important in the context of financial reporting of an entity. For example, performance of assets vs performance of the business, operating performance vs financing performance, and management performance vs entity performance. Management should ultimately be judged on how the entity performs, so if people believe there is a difference between the two, this needs to be highlighted and explained.
>
> ...It is difficult to see how any debate about the income statement can be conducted without a robust and accepted definition of performance...In the absence of an articulated definition of performance, the IASB implicitly views financial performance as the change in measured values between balance sheet dates. This change is quantified by aggregating the balances that result from the application of accounting standards, rather than attempting a more decision-useful measure of how the business has performed. Deriving performance from measurement bases is arguably approaching this aspect of financial reporting from the wrong angle: establishing the best measurement bases depends on deciding what is meant by performance and how it should be presented.

14 BusinessEurope and SwissHoldings explored three levels of performance and also raised their concerns over the failure of current performance reporting to adequately reflect the true performance of an entity:

> For industrial/commercial companies there are basically three levels on which performance needs to be looked at: 1) operating performance in its continuing operating activities, 2) the entity's global performance in generating and securing a surplus for shareholder and 3) the overall increase/decrease in the entity's net assets during the period.
>
> BusinessEurope believed that "although performance can theoretically be derived from the existing IFRS framework as the difference between income and expenses (ie. variations of assets and liabilities), and subtotals may be defined, the outcome is not satisfactory. It does not reflect the entity's own performance because current accounting conventions have introduced complexity since current standards include measurements based on hypothetical transactions or transactions which are not reasonably certain, and these hypothetical transactions can diverge significantly from the business model of the entity. As a consequence, the total income measured in conformity with current standards cannot meet expectations of the users because it includes elements that do not come from the economic business model of the entity.

Question 3

Is 'net income' (in its current form or a variation thereof) a meaningful and necessary notion? If so, what should it represent and how are items included in net income to be differentiated from other items of income and expense?

15 A significant majority of the respondents[3] found net income to be useful. A few respondents[4] thought that the concept is somewhat outdated/meaningless due to evolutions in accounting and should therefore be eliminated.

[3] VW, GASB, LSCA, ASB, DSGV, VOB, EAPB, BDO, Swiss Holdings, SEAG, FEE, BUSINESSEUROPE

[4] FSR, ACCA, ABI

16 Those in favour of net income made the following comments:

> Both the operating profit and the net income are solid bases (reflecting how business works, audited and well known) on which the entity communicates to explain the period performance on a standalone basis or combined with other indicators. (BusinessEurope)
>
> We think net income is useful and necessary. It derives its value from its widespread use and acceptance in practice by both preparers and users, like analysts. We see net income as a convention which is a key measure for the financial success of a company. It determines other key financial measures like Earnings per Share and Return on Equity. (GASB)
>
> Net income in its current form is a meaningful and necessary notion solely from the point of view of serving as a reference point for companies and users in the preparation of information for financial markets. It also provides a reconciliation point for Company defined non GAAP measures of earnings. (ASB)
>
> We do not believe that the notion of net income, as encapsulated by current income statements, is a concept that needs fundamental revision. We believe that increased focus is needed on items of income and expense outside net income and on analysis as to whether they : i) are conceptually and consistently sound treatments, in terms of measurement and recognition; ii) are of importance to user groups in assessing financial performance; and iii) should form part of net income in its current form.(BDO)
>
> We believe that 'net income' is a useful notion for some businesses, particularly those of a traditional manufacturing nature. We do not believe that it is a useful concept for all entities however; we would point out that for some businesses, changes in the value of particular assets may be equally important to understanding the performance of the entity yet these may not be reflected in the income statement.
>
> We therefore believe that a single statement of comprehensive income should be presented, and that this should draw a distinction between items by grouping together items with greater and lesser degrees of predictive value. It may well be that the concept of net income could be retained to describe the segment of the single statement of comprehensive income that encompasses those items of income and expense that possess greater predictive qualities. Where headings such as net income are presented, we believe that there should be common definitions underpinning them. (LSCA)

17 On the other hand, ACCA voiced its reservations over the use of net income:

> In principle profit for the year might not be meaningful as:
>
> - Certain items are not included (including revaluation gains, restatements of interests for foreign exchange rate changes, cash flow hedges, fair value changes in available-for-sale financial instruments, actuarial gains/losses) and it is not always clear the basis for choosing which goes where
>
> - A bottom line measure when there are mixed measurement bases (e.g. historical cost realised profits and also fair value changes) is not in itself going to have much meaning.

Question 4

Does the bottom line of a statement of income and expense bear more weight and significance than other lines of the statement simply by virtue of being at the bottom? Consequently, how many statements of income and expense should there be and why?

18 Eight[5] respondents agreed that the bottom line does not bear more weight and significance than other items, although some cautioned that this does not mean that users will not naturally tend to focus on the bottom line. Only two[6] respondents seemed sympathetic with the view that the bottom line bears more weight than other lines.

19 A majority of respondents had a preference for one statement of performance while a few felt that it was irrelevant and/or a minor issue. Of the 13 respondents who provided feedback on the necessity for one or multiple statements, 5[7] of them thought that there was a need for two statements. 8[8] respondents were in support of a single statement for various reasons, one of which was the view that "they failed to see why it would ever be necessary to have more than one statement provided that it includes those measures that investors find helpful and those measures reflect the business model and the way it is managed."

20 The ASB did not find the bottom line particularly relevant in obtaining an understanding of an entity's performance:

> Users should be encouraged not to think of a single "bottom line "as providing all information on the entity's performance. The financial performance of a reporting entity is made up of components that exhibit different characteristics in terms of, for example nature, function and relative continuity or recurrence. All these items are relevant to an assessment of financial performance and therefore need to be reported in the statement of financial performance. This assessment will carry greater weight than a line featuring at the bottom of a net income statement.
>
> Information needs to be presented in a way that focuses attention on the components of financial performance. If this is achieved then whether there is one or more than one statement of financial performance is not of fundamental importance.

21 BusinessEurope thought that the bottom line was a means to share among employees, customers, suppliers, financial analysts, shareholders and preparers a performance indicator of high quality. It added that:

> As seems to be corroborated by academic research, there is apparently some marginal tendency for users to pay more attention to a "bottom line". It is however disputable whether the focus is simply by virtue of it being at the bottom. While many users are under time pressure when using financial statements and may therefore take a "bottom line" as an easy starting point, most intelligent users would be highly unlikely to have such a focus if it wasn't giving them what they needed. Current investors can more easily access from the "bottom line" (net income) what the entity has actually achieved and secured for them with the funds which they have invested, without the effects of hypothetical surpluses and deficits which might have been achieved if

[5] VW, GASB, LSCA, ASB, ICAS, BDO, SEAG, ACCA

[6] BUSINESSEUROPE, Swiss Holdings

[7] BUSINESSEUROPE, BDO, SEAG, Swiss Holdings, VW

[8] EAPB, FSR, EAPB, ABI, ACCA, LSCA, VOB, ICAEW

somebody had picked up the phone on December 31. And since many (most?) other users wouldn't attribute much predictive value to items currently reported below "the bottom line" (OCI items) it presumably helps them to have a distinct line where such items are excluded. Furthermore, since preparers generally exclude OCI items for their internal analysis of business performance and focus on "the bottom line" of the current income statement, preparers and users are able to enjoy a common basis for communication.

Question 5

Is recycling needed? If so, what should it be used for and on what criteria should it be based?

22 Respondents seemed divided on the need for recycling within financial statements. Of the 20 respondents, six[9] disagreed with the concept of recycling, seven[10] agreed (with certain caveats) while the balance of the respondents either held mixed or no views on the matter.

23 Some respondents noted that recycling techniques were poorly understood and/or rather confusing. Some argued that all changes in net assets reflect the performance of an entity, so such changes should be reported once only, as and when they occur. Yet recycling results in the same gains/losses being recognised twice in the performance statements. On the other hand, some argued that recycling had a role to play in certain presentation models as long as it is underpinned by robust principles.

24 Proponents of recycling used the following main arguments:

> Given our preference for the two-statement approach and the importance of the realisation principle we see recycling as necessary. (GASB)
>
> So long as key lines and subtotals are reported, and hypothetical transactions included, recycling is absolutely indispensable to maintaining their integrity and meaningfulness. (Swiss Holdings & BusinessEurope)
>
> As long as there are different recognition criteria in the balance sheet and income statement, some kind of recycling is needed. (FEE)
>
> We believe that recycling is a necessary technique to differentiate trend in earnings from spurious gains and losses. Recycling should therefore be maintained as a separate category of gains and losses. (DASB)

25 Opponents of recycling used the following main arguments:

> No sound and verifiable criteria can be envisaged to decide what must be presented in the income statement and what within equity. The lack of rationale for recycling in existing IFRSs, the difficulties in developing a principle to award a different presentation for certain items of income and expenses, and the opportunities for arbitrages, suggest it is better to get rid of it. Items of income and expenses must be shown within one statement and changes in equity—other than those due to the net result for the period—must only come from transactions with owners. (OIC)
>
> Recycling is confusing and in principle gains and losses should be shown only once, although there may be items under current IFRS - such as measurement

[9] OIC, LSCA, ASB, ICAS, ICAEW, FSR

[10] VW, GASB, DASB, Swiss Holdings, BusinessEurope, FEE, BDO

> differences on hedging derivatives, which we do not believe are true gains and losses - that are required to be recycled. We accept, for example, that there is a difference between a revaluation and a sale of an asset. However, this difference may be dealt with sufficiently by helpful alignment of the income statement and the cash flow statement. (ICAEW)

Question 6

Which of the following disaggregation criteria both have merit and are capable of being implemented? How would you define the terms used in those criteria and what are the pros and cons of using the criteria for disaggregation purposes?

- *Disaggregation by function;*
- *Disaggregation by nature;*
- *Fixed vs. variable;*
- *Recurring vs. non-recurring;*
- *Certain vs. uncertain;*
- *Realised vs. unrealised;*
- *Core vs. non-core;*
- *Operating vs. non-operating;*
- *Sustainable vs. non-sustainable;*
- *Operating vs. financing vs. other;*
- *Controllable vs. uncontrollable;*
- *Based on actual transactions vs. other;*
- *Cash flow vs. accruals;*
- *Re-measurement vs. before re-measurement;*
- *Holding gains and losses vs. non-holding gains and losses.*

26 Our analysis of the comments received indicates that, of the disaggregation criteria listed, disaggregation by function, disaggregation by nature and operating/financing/other—which is in fact a particular type of functional split—are the approaches most favoured by respondents. Such disaggregations are thought to be most useful and practical, and less judgemental. While many respondents found merit in the other disaggregation criteria listed, they questioned whether they could be implemented effectively. The overriding concern seemed to be the high degree of subjectivity believed to be involved in making such splits. In some cases concerns about how the terms could be sufficiently precisely—which is related to the judgement/subjectivity concern—were also mentioned.

27 In particular, there was general agreement on the overall objective—present the information that maximises its usefulness in making predictions about the future—but a range of views as to how that might be done. For example, the LCSA said:

> We believe that the income statement or statement of comprehensive income should be structured in such a way as to draw a distinction between those items of performance with greater degrees of predictive value and those with lesser predictive value. In making this distinction, we believe that one of the main factors to consider will be whether an item of income or expense arises from a change in the fair value of an underlying asset or liability; the inherent volatility associated with recognition of items at fair value diminishes the predictive nature of the financial statements and merits separate presentation.

28 Certain criteria are viewed as simply being not realistic, useful or unworkable. For example, the LCSA thought the controllable/non-controllable split is unworkable.

> We do not believe that it is appropriate to make a distinction between controllable and uncontrollable events, as we believe that all elements of performance are the responsibility of management. As mentioned above, we believe that the appropriate place for management to discuss events which it believes to be outside its control is in the management commentary section of the annual report.

29 Some commentators thought it difficult to comment on the disaggregation criteria listed.

> We are not convinced that listing possible disaggregation criteria in this way is necessarily the best approach. Much of the information listed is of potential value to users, even though not all of it would ideally be included in the income statement. We suggest that a more fruitful approach might be to limit the income statement to the presentation of recognised gains and losses disaggregated into operating vs. financing vs. other items, with other disclosures in the notes, the management commentary or separate statements such as the segmental report. (ICAEW)

> In our opinion, it is difficult to find many relevant disaggregation criteria that distinguish in presenting income and expense in two statements or within one statement, since it is not possible to apply these criteria consistently or to enforce these criteria. Some criteria might be useful within a statement (e.g. function, nature, operating/financial). Some might be useful for supplementary commentary or disclosure (e.g. recurring/non, controllable/non). Some criteria are difficult to define (“realised/unrealised”; “certain/uncertain”, “sustainable/non-sustainable”, “re-measurement”, etc.) and therefore not reliable or enforceable. (FEE)

30 The ICAS does not think that any conclusions on disaggregation criteria can be drawn by standard setters.

Question 7

Are the current IFRS provisions in relation to the netting of items of income and expense appropriate? What (if any) are the specific areas where the current requirements allow information essential for analysis to be concealed or, alternatively, do not permit netting where it would result in more useful information?

31 Of the twenty respondents, twelve[11] respondents believed that the current IFRS provisions in terms of netting are appropriate, while five[12] respondents expressed certain reservations, some of which have been mentioned below. (Three respondents did not comment.)

> We do not consider current IFRS netting provisions to be appropriate. There are examples in practice where the current provisions result in an inappropriate presentation that does not reflect the substance of the economic transaction in question. For instance, for the service businesses showing gross travel expenses reimbursed by the customer as part of revenues results in a decreased usefulness of operating margin ratios. (GASB)

> The problem with the current netting requirements is the lack of consistency between the criteria that must be fulfilled to offset items in the income statement and those that required for items in the balance sheet. For example, interest income and expenses are often presented net; however, interest-bearing financial assets and liabilities may be offset when stricter criteria are met. (OIC)

[11] VW, LSCA, ASB, VOB, ICAS, ICAEW, EAPB, BDO, Swiss Holdings, SEAG, ACCA, BusinessEurope

[12] GASB, OIC, FSR, ABI, FEE

> We are not aware of any fundamental problems with the application of IAS 1 in this respect. However, the offsetting in the income statement involves some ambiguities, in particular IAS 1.35. For example, it is not clear whether gains from foreign currency translation from one currency can be netted with losses from foreign currency translation resulting from another currency. (FEE)

> It should be made a minimum requirement that any netted items are specified in the notes. However, we believe in general that the access to netting should be specified in more detail than is the case today in the existing rules. (FSR)

Question 8

What is the underlying nature of the adjustments made by entities when reporting non-GAAP measures in their communications with the markets? What are the adjustments seeking to achieve? Please provide specific examples illustrating this. Should any of these non-GAAP measures be incorporated into the IFRS financial reporting model? If that would be desirable, is it feasible and how should it be done?

32 Opinions were divided on extent to which non-GAAP measures should be standardised. However, many of the respondents felt that a standardised definition and disclosure of EBITDA might be worthy of consideration in view of its widespread use and supported the need for a reconciliation between GAAP and non-GAAP measures.

33 Four[13] of the respondents thought that incorporating non-GAAP measures into IFRS could be desirable in order to achieve comparability of such indicators of performance, although they did acknowledge that a balance needed to found between comparability and flexibility. The other twelve that commented on the issue were not so sure.

34 BDO was one of those arguing that financial reporting standards should address the use of non GAAP measures. Its reasoning was as follows:

> Financial reporting standards should be drafted to ensure sufficient detail in the financial statements on the performance of entities, to enable the preparer or user to derive non-GAAP measures appropriate to their circumstances. Financial reporting standards should address the use of non GAAP measures in the context of the explanation of their derivation and a requirement to reconcile such measures with GAAP equivalents. Any potential use of non-GAAP measures should be restricted to those that are required in order that financial statements show a true and fair view of an entity's operating performance, with a clear prohibition on any presentation that could be regarded as placing undue emphasis on a particular result and, in particular, on any presentation that could be regarded as misleading."

35 The main reasons given for not incorporating non-GAAP measures into IFRSs were as follows:

> The nature of these adjustments is to help users understand what is happening to the underlying business by taking out the impact of volatility and adjusting for non recurring items. Common items adjusted for are impairment charges, restructuring costs exceptional items and fair value re measurements. The Board does not believe that these non GAAP measures should be incorporated into IFRS as these measures are generally specific to entities. (ASB)

[13] ABI, OIC, SEAG, LSCA

> In our opinion non-GAAP measures should remain non-GAAP measures and should not be standardized and incorporated into IFRSs. However, as noted above, we believe that key lines in the income statement should be reported based on the management approach. We do not consider such key lines as non-GAAP measures. Any measures however that are neither widely used (and as such required to allow comparisons across companies) nor based on the management approach (and as such in line with the reporting entity's internal reporting) should not be reported in financial statements under IFRS. ... Furthermore we would like to point out that non-GAAP measures presented in financial statements should be reconciled to the GAAP measures when their calculation scheme cannot be immediately understood from the income statement. (GASB)
>
> We are of the opinion that non-GAAP measures should not be defined in the financial reporting model. Companies will continue to develop new non-GAAP measures and non-GAAP measures depend on the industry. Companies need to be allowed to include non-GAAP measures in the narrative financial reporting. However, non-GAAP measures need to be clearly labeled and separated from measures required by the IFRSs. Transparency needs to be provided, in that non-GAAP measures should be reconciled to the figures in the financial statements. (FEE)

36 The ICAEW commented on the lack of consistency in practice with respect to non GAAP measures:

> Companies frequently provide non-GAAP measures that exclude large and/or non-recurring items. However, there is no real consistency of approach in practice, although some specific non-GAAP measures are prevalent in certain industries. In our view, non-GAAP measures should be provided on whatever basis management judges to be the most appropriate in the circumstances, rather than according to prescribed criteria.
>
> We would only expect the standard setter to set certain parameters surrounding disclosures and approaches to non-GAAP measures, for example that the criteria adopted should be stated and explained and that all non-GAAP measures shown should be reconciled to GAAP. We would also expect a standard setter to require restatement of comparative period non-GAAP measures if management changed its approach in any period. Other regulators might also specify that the information should be audited as to the underlying facts and to confirm that management has indeed presented the information according to the criteria it has laid down; however, the auditor would not be responsible for forming an opinion on the appropriateness of the non-GAAP measure(s).

Question 9

In determining the optimum degree of standardisation of the reporting formats, what is the right balance between comparability and flexibility? In other words, is the level of standardisation in the current IAS 1 appropriate or should more precise formats be prescribed? If the latter, what are the specific areas that should be more stringently prescribed?

37 Although seven[14] respondents felt that the current IAS 1 was "broadly" appropriate, most qualified this statement with recommendations on how it could be enhanced further (for example, more precise definitions of certain line items). For example, the LCSA believed that:

[14] LSCA, ASB, SwissHoldings, SEAG, ACCA, FEE, BUSINESSEUROPE

> The current level of standardisation in IAS 1 is broadly appropriate, but additional material needs to be developed to address the use of headings within IFRS financial statements. As mentioned above, we believe that the reporting formats should be defined in terms of headings for total items, specifically operating profit and (where presented) net income. In drawing up these definitions, we recommend that a framework is drawn up which sets out core principles to be followed in terms of what companies should be trying to achieve.

38 ICAS described the current income statement as very “free form” and thought more standardisation was needed:

> The format of the income statement under IFRS is currently very free-form, which does not lend itself well towards achieving comparability and consistency. There is a case therefore for introducing clearer definitions into IFRS e.g. a definition of operating profit. UK company law sets a highly prescriptive format for financial statements – we believe that the optimal balance is somewhere between this and the current flexibility under IFRS. A total lack of standardisation clearly does not promote global consistency although we recognise that companies within a particular industry will attempt to report in a way that is comparable with others in the same industry. Prescription in financial reporting formats should only be to a degree whereby there is a set of overarching principles rather than detailed rules.

39 BDO commented on the need to enhance IAS 1 as follows:

> The level of standardisation currently demanded by IAS 1 needs enhancement. The requirements of that standard are too simplistic to deal with current complexities of financial reporting and many have viewed it as permitting flexibility of presentation that, in our view, is excessive.

40 Both Swiss Holdings and Business Europe felt that a minimum format is necessary, they went on to add that:

> IAS 1 seems to work reasonably well and can be taken as a practical basis, though the elimination of “operating profit” in the “improvements” project was a retrograde step. Further, IAS 1 should take more account of the accounting process when it requires by-nature information on operating expenses, since it is extremely difficult in accounting and reporting systems which are based on functions to determine (e.g.) personnel expenses reflected in P&L when their separate identity has been lost on the way through inventories and, with self-constructed assets, PP&E and intangible assets. Otherwise, preparers should retain the flexibility within the minimum format to structure the data in the most informative way to permit understanding of the entity’s performance in all its diversity.

Appendix A – List of respondents and related abbreviations

List of respondents		Abbreviation	Classification	Country
1	Volkswagen	VW	Preparer	Germany
2	Professor Guiseppe Ceriani & Beatrice Frazza	Ceriani Frazza	Academic	Italy
3	German Accounting Standards Board	GASB	Standard-setter	Germany
4	Organismo Italiano di Contabilitá	OIC	Standard-setter	Italy
5	Dutch Accounting Standards Board	DASB	Standard-setter	Netherlands
6	London Society of Chartered Accountants	LSCA	Accountancy body	UK
7	Accounting Standards Board	ASB	Standard-setter	UK
8	Finanzgruppe Deutche Sparkassen-und Giroverband	DSGV	Preparer Group	Germany
9	Bundesverband Offentlicher Banken Deutschlands	VOB	Preparer Group	Germany
10	The Institute of Chartered Accountants of Scotland	ICAS	Accountancy body	UK
11	The Institute of Chartered Accountants in England and Wales	ICAEW	Accountancy body	UK
12	European Association of Public Banks	EAPB	Preparer Group	Europe
13	BDO International	BDO	Accounting firm	Global
14	Swiss Holdings		Preparer Group	Switzerland
15	Foreningen af Statsautoriserede Revisorer	FSR	Standard-setter	Denmark
16	Swedish Enterprise Accounting Group	SEAG	Preparer Group	Sweden
17	Association of British Insurers	ABI	Preparer Group	UK
18	Association of Chartered Certified Accountants	ACCA	Accountancy body	UK
19	Federation des Expert Comptables Européens	FEE	Accountancy body	Europe
20	BusinessEurope		Preparer Group	Europe