Deutsches Rechnungslegungs Standards Committee e.V.

Accounting Standards Committee of Germany

DRSC

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Mr Hans Hoogervorst
Chairman of the
International Accounting Standards Board
Columbus Building
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Berlin, XX September 2020

Dear Hans,

IASB Exposure Daft ED/2019/7 *General Presentation and Disclosures*

On behalf of the Accounting Standards Committee of Germany (ASCG) I am writing to comment on the Exposure Daft ED/2019/7 *General Presentation and Disclosures* issued by the IASB on 17 December 2019 (herein referred to as 'ED'). We appreciate the opportunity to comment on the ED.

[TBD]

Our response to the ED questions is laid out in the appendix to this letter. If you would like to discuss our comments further, please do not hesitate to contact Ilka Canitz (canitz@drsc.de) or me.

Yours sincerely,

Andreas Barckow

President

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Appendix – Answers to the questions in the ED

Question 1 – operating profit or loss
Paragraph 60(a) of the Exposure Draft proposes that all entities present in the statement of profit or loss a subtotal for operating profit or loss. Paragraph BC53 of the Basis for Conclusions describes the Board's reasons for this proposal. Do you agree with the proposal? Why or why not? If not, what alternative approach would you suggest and why? do you suggest and why?

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Presentation of an operating profit or loss subtotal in the statement of profit or loss (paragraph 60(a))

We appreciate that the IASB proposes to require all entities to present in the statement of profit or loss a subtotal for operating profit or loss, as it provides users of financial statements with information about the entity's operating performance. 'Operating profit or loss' is one of the most used subtotals. However, entities calculate operating profit in different ways. The introduction of the new defined subtotal will reduce diversity in practice and improve comparability of financial statements across entities. Therefore, we agree with the proposal.

However, in our opinion, it is crucial that the new defined subtotal provides users with useful information about the entity's operating performance. Otherwise entities will continue to present information on alternative performance measures. Further, to ensure that the proposed new requirements are applied consistently across entities, it is essential that the guidelines are clear. In this context, we would like to summarize our conclusions on the proposals regarding the operating category as follows:

- The operating category should be defined directly.
- A principle-based guidance for classifying income and expenses to the operating category is lacking and further guidance is needed regarding the notion of '*an entity's main business activities*'.
- Income and expenses from 'non-core' or 'supplementary' activities of an entity that were incurred in the execution of its business model should also be classified in the operating category.
- The operating category should also include income and expenses of a 'customer-finance' business activity that is closely linked to the operating activities, effecting that a 'manufacturing' main business activity and the 'customer-finance' business activity have to be treated as one bundle of business activities (e.g. construction manufacturers that provide sales financing). Similar considerations apply to insurance services rendered as a by-product of the sale of products to customers.

- The guidance proposed for determining whether an entity provides financing to customers as a main business activity or invests in assets in the course of its main business activities is not sufficiently clear.
- The statement of cash flows should be aligned to the proposed new structure and content the statement of profit or loss.
- […]

For further details please refer to our answer to question 2 below.

Overarching comments concerning the questions 2-6

Alignment of the statement of cash flows with the statement of profit or loss (paragraphs BC30 and BC194 of the Basis for Conclusions)

We understand from paragraph BC30 of the Basis for Conclusions that – except for the classification of interest and dividend cash flows – the IASB is not seeking to further align the classification of the statement of cash flows with the statement of profit and loss. This means that under the current proposals, the proposed descriptions for the categories in the statement of profit and loss (i.e. '*operating*', '*investing*' and '*financing*') would be used inconsistently within the IFRS Standards because IAS 7 *Statements of Cash Flow* uses the same descriptions (i.e. cash flows classified by '*operating*', '*investing*' and '*financing*' activities) and there is no alignment with the classification in the statement of cash flows.

We regret that the IASB is missing the opportunity to further align the statement of cash flows with the statement of profit or loss. Using the same terms with a different meaning creates confusion and reduces understandability of the information provided in the primary financial statements. As the IASB itself explains in paragraph BC194 of the Basis for Conclusions, '*when alignment can be achieved, it can increase the understandability of the resulting information*'. In our opinion, further alignment can be achieved for the statement of cash flows and the statement of profit and loss, as both primary financial statements communicate information about transaction flows (i.e. account movements rather than account balances). Therefore, we suggest the IASB to align the categories of the statement of profit or loss with the corresponding categories of the statement of cash flows.

When investigating how to further align the classification of both primary financial statements, the IASB should consider all of the following matters:

- the proposals on the separate presentation of the new categories in the statement of profit or loss (paragraph 45 introduces six categories in the statement of profit or loss: *operating*, *investing*, *financing*, *integral associates and joint ventures*, *income tax*, and *discontinued operations*; however, in the statement of cash flows corresponding separate categories for cash flows from *integral associates and joint ventures*, *income tax*, and *discontinued operations* are lacking),
- the description and the content of the proposed new categories (i.e. an alignment of the content of the proposed new categories '*operating*', '*investing*' and '*financing*'; currently the ED is only proposing to align the definition of "*financing activities*' within the financing category),
- the proposed presentation requirements and principles for entities that provide finance to customers are their main business activity or invest in the course of their main

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business activities (currently these principles are not reflected by the ED for the statement of cashflows),
- the proposed new presentation requirements for specific items (e.g. the classification of fair value gains and losses on derivatives and hedging instruments in the statement of profit or loss), and
- current presentation requirements of IAS 7 (e.g. the presentation of income taxes differs between the statement of cash flows and the statement of profit or loss.

This means, the IASB should consider an alignment with regard to all six categories introduced by the proposed new paragraph 45:

- operating,
- investing,
- financing,
- integral associates and joint ventures,
- income tax, and
- discontinued operations.

For the reasons above, we suggest the IASB to extend the scope of the *Primary Financial Statements* project and to undertake a targeted review of IAS 7 in the light of the proposals on the new structure and content of the statement of profit or loss. Should the IASB decide not to align the categories of the statement of profit or loss with the corresponding categories of the statement of cash flows, we strongly recommend to use different terms when describing the new categories of the statement of profit or loss.

To further enhance understandability, we recommend the IASB to include a definition of the new categories – ‘*operating*’, ‘*investing*’ and ‘*financing*’ – in Appendix A of the new IFRS Standard. Currently, such definitions are missing.

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?

Proposed definition of the ‘operating category’ as a residual category (paragraphs 46, BC54 and BC55 of the Basis for Conclusions)

We regret that the IASB is proposing to define the operating category as a residual category. Since the operating profit or loss subtotal is one of the most commonly subtotals analysed by investors and the objective of the ED is to increase comparability by requiring entities to

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present new defined subtotals (such as the *operating profit or loss*), we strongly advise the IASB to define the operating category directly.

We understand that the IASB's was not seeking to propose a direct definition because previous attempts at developing a direct definition were not successful and defining operating profit or loss as a default category is simpler (ref. paragraph BC57 of the Basis for Conclusions). We agree with the IASB's view – if all other categories are described clearly – defining the operating category as a residual category would result in a faithful representation of the operating profit or loss subtotal.

However, the IASB should ensure that the operating category is not 'blurred' with income and expenses from 'non-operating' activities, simply because these items do not meet the definition of the investing and financing category. Therefore, we recommend the IASB to investigate which items – other than those that relate to an entity's main business activities – will be classified to the operating category based on the proposed residual definition. Nevertheless, in the light of the IASB's objective of introducing the new defined subtotal *operating profit or loss*, we believe that the operating category should be defined directly.

We recognize that the IASB is proposing in paragraph 46 a classification principle for the operating category: '*The operating category includes information about income and expenses from an entity' main business activities'*. However, as the term '*main business activities*' is not defined by the IASB, it is unclear which items of income expenses should be reported in the operating category.

Therefore, we encourage the IASB to provide a positive, principles-based definition of the operating category. As a starting point for a positive definition of the 'operating category' the IASB might consider:

- A list of items that currently are and/or should be included in the operating category could serve as a basis for developing a positive description of the operating category.
- The IASB might link the description of '*an entity's main business activities*' to the determination of operating segments according to IFRS 8 (i.e. operating segments in accordance with IFRS 8 determine the operating category).

The notion of 'an entity's main business activities' is unclear (paragraph 46)

We do not agree with the proposed classification principle that the operating category should only include information about income and expenses from an entity' *main* business activities'. Instead, as explained below, we propose the IASB to apply a different approach by clarifying that also income and expenses *from 'non-core' or 'supplementary' activities of an entity that were incurred in the execution of its business model* should also be classified in the operating category.

The term '*an entity's main business activities*' is not defined in the ED. Therefore, it is unclear which items of income and expenses should be classified in the operating category. As a result, entities might face difficulties in deciding whether an item should be classified to the operating category.

Further, we have some objections regarding the notion of *'an entity's main business activities'*:

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- The ED does not provide any further guidance whether – and under which circumstances – a business activity that is not reported as a segment (e.g. operating segments that do not meet the quantitative thresholds in paragraph 13 of IFRS 8 and, thus, are combined with other operating segments or are reported within an 'all other segments' category) can be considered as a main business activity. Consequently, it may be difficult for entities with multiple business activities to determine their main business activities.
- Further, it is not clear whether income and expenses arising from activities that, applying paragraph B31 of the ED, are not an entity's main business activity, shall be classified to the operating category. This applies for 'ancillary' or 'non-core' business activities. Considering for example a subsidiary which operates an advertising agency, which is included in the consolidated financial statements of a bank (business activity: customer-finance). In this case, it is not clear from the proposals whether the revenues from the business activity of the subsidiary (i.e. the advertising agency) shall be classified in the operating category of the group's consolidated financial statements.
- The guidance proposed for determining whether an entity provides financing to customers as a main business activity is not sufficiently clear. In our view, the current proposals might result in an inconsistent classification by those entities for which the sale of products is the 'main business activity' and the realisation of interest income is a by-product of that activity (e.g. construction manufacturers that provide sales financing). In these instances, the entity's business activities are clearly focussed on the production and sale of products, but sales financing is common within that industry. We render the view that in these instances the 'customer-finance' business activity is linked to the operating activities, effecting that the 'manufacturing' main business activity and the 'customer-finance' business activity have to be treated as one bundle of business activities. Similar considerations apply to insurance services rendered as a by-product of the sale of products to customers.

In our opinion, income and expenses arising from these supplementary activities should be presented in the operating category as well. However, under the current proposals, these activities might not be covered by the proposed concept of an 'entity's main business activities' – although income and expenses of these activities arise from the entity's customer relationship and are often negotiated as a bundle of services.

Therefore, we propose the IASB to apply a different approach. We believe that *income and expenses arising from the activities of an entity in executing its business model* should be classified in the operating category. As a result, an entity's main business activities and its 'supplementary' or 'non-core' business activities should be presented in the operating category. Further, we recommend the IASB to require entities to separately present in the operating category income and expenses from:

- an entity's main business activities (i.e. its 'core' activities),
- a subcategory for an entity's supplementary activities (i.e. its 'non-core' or 'ancillary' activities),
- a subcategory for an entity's supplementary activities – related to 'investing' activities (e.g. insurance services provided as a by-product of goods sold), and

- a subcategory for an entity's supplementary activities – related to 'financing' activities (e.g. sales financing of the goods sold or leases).

Following that classification principle, we agree with the IASB's proposal of classifying interest revenue from trade receivables to the operating category; however, as explained above, with a different reasoning.

It should be noted that paragraph B35(c) proposes to classify income and expenses on trade payables to the financing category. This difference in classification of interest revenue from trade receivables (operating category) on the one hand and interest expenses on trade payables (financing category) on the other hand is not convincing. In our opinion, it would be more consistent to assume that both trade payables and trade receivables are linked to the operating activities of the company, so that income and expenses on both items need to be presented within the operating category. We therefore recommend the IASB to consistently classify both, interest expenses on trade payables and interest revenue from trade receivables, to the operating category.

Within this context, we think that further clarification is also needed as to whether all income and expenses from an asset (or a liability) shall unilaterally be classified to the same category (e.g. whether all income and expenses from trade receivables shall be presented in the operating category) or whether an entity may be required to present income and expenses from one asset (liability) in more than one category.

Furthermore, it is not clear, whether the examples provided in paragraphs B33 (operating category), B32 (investing category) and B34-B37 (financing category) are exhaustive or whether these paragraphs only illustrate items that typically would be classified in each of the categories. Also, we question whether the classification of the items listed in these paragraphs is mandatory or whether an entity – depending on its specific facts and circumstances – may reach to another conclusion. For example, according to paragraph B32, income and expenses from investment property would be included in the investing category (except when paragraph 48 requires the entity to classify them in the operating category). However, an automotive manufacturer might earn rental income from leased dealerships which are accounted for as investment property. As an automotive manufacturer's main business activity consists in the production and sale of vehicles, and vehicles are sold by dealerships, it may be concluded that rental income from leased dealerships should be classified in the operating category.

The ED also lacks requirements as to the circumstances under which a change in presentation regarding the classification of an item of income and expense to the categories is allowed. However, IFRS Standards contain specific requirements that may result in a change in presentation (e.g. transfers according to paragraph 57 of IAS 40). However, with the exception of the proposed requirements in paragraphs 20B and 20C of IFRS 12 addressing changes in classification of associates and joint ventures as 'integral' or 'non-integral', requirements regarding changes in classification are lacking.

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Question 3 – the operating category: income and expenses from investments made in the course of an entity's main business activities
Paragraph 48 of the Exposure Draft proposes that an entity classifies in the operating category income and expenses from investments made in the course of the entity's main business activities. Paragraphs BC58–BC61 of the Basis for Conclusions describe the Board's reasons for this proposal. Do you agree with the proposal? Why or why not? If not, what alternative approach would you suggest and why?

Income and expenses from investments classified in the operating category (paragraph 48)

We agree with the proposal to require an entity to classify in the operating category income and expenses from investments generated in the course of its main business activities. In our opinion, specific requirements are needed for the presentation by entities that, in the course of their main business activities, invest in assets (such as insurers).

However, we do not agree with the proposal in paragraph 48 to prohibit an entity to classify income and expenses from associates and joint ventures in the operating category – if such income and expenses incurred in the course of its main business activities. As explained in our answer to question 7, we suggest the IASB that for entities that, in the course of their main business activities, invest in associates and joint ventures, the presentation of income and expenses from these associates and joint ventures should be classified in the operating category.

Further, we are concerned that an entity might face difficulties in assessing whether income and expenses from investments arise *'in the course of its main business activities*', especially for entities with more than one business activity.

Furthermore, as explained in our overarching remarks preceding questions 2-6, to increase the understandability of the statement of cash flows, we suggest the IASB to reflect the proposals in IAS 7 *Statement of Cash Flows*. This means, the IASB should also include in IAS 7 a requirement to present in the cash flows from operating activities cash flows from investments generated in the course of its main business activities.

Determining whether income and expenses from investments arise in the course of an entity's main business activities (paragraphs B28 and B31)

As explained above, we support that the IASB is proposing specific presentation requirements regarding the classification of income and expenses by entities that, in the course of their main business activities, invest in assets. However, as explained in our answer to question 2, we render the view that the proposed classification principle is to narrow: If, an 'investing' business activity is closely linked to another main business activity (e.g. insurance services rendered as

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a by-product to goods sold), income and expenses from these 'ancillary' business activities should be presented in the operating category as well.

We note that, though the terms

- ‘an entity’s main business activities’,
- ‘in the course of an entity’s main business activities’, and
- the ‘operating category’

determine which income and expenses should be classified in operating profit or loss, these terms are not defined by the IASB. Even though the IASB is providing some guidance on how to determine ‘an entity’s main business activities’ (ref. paragraphs B27, B29 and B31), we are concerned that entities might face difficulties in assessing whether income and expenses from investments arise in the course of its main business activities.

For example, paragraph B31 explains that if, applying IFRS 8 *Operating Segments*, an entity reports a segment that constitutes a single business activity, that may indicate that that business activity is a main business activity. In our opinion, reporting a segment that constitutes a single business activity is a considerably high ‘threshold’ to be taken for a ‘main business activity’. In addition, it is unclear, whether business activities that do not constitute an operating segment might be considered as an entity’s main business activity: For example, a car manufacturer that has captive insurance and financing activities may report a segment ‘automotive manufacturing’ and a segment ‘financial services’ (by combining information about the insurance and financing activities). Furthermore, it should be noted, that according to paragraph 2 of IFRS 8, only entities whose debt or equity instruments are traded in a public market are required to disclose information about segments. Therefore, the guidance provided in paragraph B31 is not helpful for those entities that are not required to disclose segment information.

We understand from paragraph 27 that examples of entities the IASB had in mind when developing the requirements include, but are not limited to, investment entities as defined by IFRS 10, investment property companies and insurers. However, in practice, especially for entities with more than one business activity (i.e. ‘conglomerate’ entities that have many different business activities), it might not be straightforward to assess which business activities constitute a ‘main business activity’. Consequently, we believe that further guidance should be developed to help entities in determining their ‘main business activities’.

Furthermore, we believe that income and expenses from ‘ancillary’ or ‘supplementary’ business activities should also be presented in the operating category. As a result, income and expenses from investments should also be classified in the operating category, if these ‘investing’ activities are closely linked to the entity’s main business activities. As explained in our answer to question 2, we would therefore propose to clarify that *income and expenses arising from the activities of an entity in executing its business model* should be classified in the operating category.

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Question 4 – the operating category: an entity that provides financing to customers as a main business activity

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

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

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

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

Income and expenses from financing activities, and from cash and cash equivalents classified in the operating category (paragraph 51)

We agree with the proposal to require an entity that provides financing to customers as a main business activity to classify in the operating category income and expenses from financing activities, and from cash and cash equivalents. In our opinion, specific requirements are needed for the presentation by entities that provide financing to customers as a main business activity (such as banks).

[...]

However, we note that the IASB is not proposing consequential amendments to IAS 7 *Statement of Cash Flows*. As explained in our overarching remarks preceding questions 2-6, to increase the understandability of the statement of cash flows, we suggest the IASB to reflect the proposals on the presentation by an entity that provides financing to customers as a main business activity in IAS 7. This means, the IASB should also include in IAS 7 a requirement to present in the cash flows from operating activities cash flows financing activities, and from cash and cash equivalents.

Determining whether an entity provides financing to customers as a main business activity (paragraphs 29 and B31)

As already explained in our answer to the questions 2 and 3, in our opinion, the notion of '*an entity's main business activities*', '*in the course of an entity's main business activities*', and the '*operating category*' are unclear.

It should be stressed that the proposed requirements should result in a consistent application in practice. However, the guidance proposed for determining whether an entity provides financing to customers as a main business activity (i.e. '*when the difference between interest income and the related interest expense is an important indicator of operating performance*')

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is not sufficiently clear in this respect. We understand from paragraph B29 that examples of entities the IASB had in mind when developing the requirements include, but are not limited to, banks and entities that have captive finance activities (such as car manufacturers). However, the link between the proposals of the ED and the requirement to separately account for a significant financing component in accordance with paragraph 60 sqq. of IFRS 15 is not addressed by the ED.

In our view, the current proposals might result in an inconsistent classification by those entities for which the sale of products is the 'main business activity' and the realisation of interest income is a by-product of that activity. For instance, this applies to the following entities that earn interest income in the course of their main business activity:

- automotive manufacturers (regarding sales financing of the products sold or leases)
- construction manufacturers (regarding sales financing)
- rail companies (infrastructure financing)

In these instances, the entity's business activities are clearly focussed on the production and the sale of products, but sales financing is common within the respective industry. We believe that in these instances the 'customer-finance' business activity is linked to the operating activities, effecting that the 'manufacturing' main business activity and the 'customer-finance' business activity have to be treated as one bundle of business activities. As explained in our answer to question 2, we therefore suggest that interest income and expenses from financing activities that are closely linked to a manufacturing activity (or another business activity that is presented within the operating category) should be classified to the operating category, even if the criteria in paragraphs B29-B30 are not met.

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Question 5 – the investing category
Paragraphs 47–48 of the Exposure Draft propose that an entity classifies in the investing category income and expenses (including related incremental expenses) from assets that generate a return individually and largely independently of other resources held by the entity, unless they are investments made in the course of the entity's main business activities. Paragraphs BC48–BC52 of the Basis for Conclusions describe the Board's reasons for the proposal. Do you agree with the proposal? Why or why not? If not, what alternative approach would you suggest and why?

Presentation of an investing category (paragraph 45(b))

We agree with the IASB's objective that information about returns from investments that are generated individually and largely independently of other resources held by an entity should be communicated outside operating profit or loss. However, we question whether the introduction of a separate category is justified.

According to paragraph 47, the objective of the investing category is to communicate information about returns from investments that are generated individually and largely independently of other resources held by an entity. The IASB explains in paragraph BC49 of the Basis for Conclusions that '*information about the income or expenses arising from such assets would provide useful information to users of financial statements who often analyse returns from an entity's investments separately from the entity's operations*.'

Whilst we agree with the reasoning that information about returns from investments should be presented outside the operating category, we believe that only few items of income and expenses will regularly be presented in the investing category (such as fair value gains and losses on derivatives and interest and dividend income from financial assets). The question therefore arises whether the presentation of a separate the presentation of a separate category is justified.

Furthermore, as explained in our overarching remarks preceding question 2-6, to increase the understandability of the statement of cash flows, we suggest the IASB to align the description and the content in statement of cash flows with the proposed new structure of the statement of profit or loss. This means, the IASB should also reflect the proposals on the new investing category in IAS 7 *Statement of Cash Flows* and limit the presentation of cash flows from investing activities to cash receipts from (and cash payments to acquire) assets that generate returns individually and largely independently of the entity's other resources. Consequently, we believe that cash receipts from the sale of (and cash payment to acquire) property, plant and equipment and intangible assets should be presented within the cash flows from operating activities, as corresponding income and expenses from these assets (e.g. depreciation, amortization and gains/losses from the disposal of these assets) are presented within the operating category of the statement of profit or loss.

The principle for classifying income and expenses in the investing category is unclear (paragraphs 47-48)

In our opinion, the principle for classifying income and expenses in the investing category is unclear. Although paragraph B32 is providing some guidance regarding which items of income and expenses typically would be included in the investing category, we think that further guidance is needed.

Firstly, it should be noted that the classification principle in paragraph 47 (*income and expenses from assets that generate a return individually and largely independently of other resources held by the entity*) is not explained further. Therefore, it might be difficult for entities to assess whether an item of income or expense should be classified in the investing category. By contrast, regarding the classification of associates and joint ventures, the IASB is providing additional guidance to help entities assess whether an associate or joint venture is 'integral' or 'non-integral' to an entity's main business activities (ref. proposed new paragraph 20D of IFRS 12).

Secondly, it is unclear whether the examples provided in paragraph B32 <u>must</u> be presented in the investing category or whether an entity – depending on its specific facts and circumstances – may reach to another conclusion. For example, it is not clear, whether income and expenses on investment property should be presented in any case in the investing category or whether

(and, if so, under which circumstances) an entity may classify income and expenses on investment property in the operating category (even if the entity does not operate a business model under which it invests in assets in the course of its main business activities). Therefore, we recommend the IASB to develop further guidance regarding the classification of income and expenses in the investing category.

When improving the guidance proposed, the IASB should consider whether income and expenses on:

- non-consolidated subsidiaries, and
- venture capital investments and investments in start-up companies

should be classified in the operating category or the investing category. In our opinion, income and expenses on such investments should be classified in the operating category if the activities of these investments are closely related to the company's main business activities. However, when considering the guidance proposed in paragraph B32(a), income and expenses from such financial assets would need to be presented in the investing category.

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

(a) Paragraphs 60(c) and 64 of the Exposure Draft propose that all entities, except for some specified entities (see paragraph 64 of the Exposure Draft), present a profit or loss before financing and income tax subtotal in the statement of profit or loss.
(b) Paragraph 49 of the Exposure Draft proposes which income and expenses an entity classifies in the financing category.

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

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

Presentation of a profit or loss before financing and income tax subtotal in the statement of profit or loss (paragraphs 60(c) and 64)

We agree with the proposal that entities shall present a profit or loss before financing and income tax subtotal in the statement of profit or loss, as it allows users of financial statements to analyse an entity's performance independently of how that entity is financed. Currently, EBIT is one of the most commonly used descriptions for a measure. However, entities use different EBIT measures in practice and there is no consensus about what EBIT represents. Therefore, we support the IASB's proposal of a subtotal '*profit or loss before financing and income tax*' that is comparable between entities.

However, the IASB '*<u>decided not to describe the proposed subtotal as EBIT</u> because such a description would imply that all interest is excluded from the subtotal, and that the subtotal only excludes interest and tax and nothing else. <u>This may not be the case</u> <u>and so the description</u>*

would be misleading.' (ref. paragraph BC47 of the Basis for Conclusions). Regarding that statement, we wonder whether entities are prohibited from labelling the new defined subtotal as an EBIT subtotal. Further, we question whether entities would be allowed to use the description 'EBIT' for entity-specific measures (i.e. management performance measures). In our view, entities should be allowed to retain their (entity-specific) descriptions of measures that they currently use in public communications, provided that it is clear that that measure is not an 'IFRS defined measure'.

Income and expenses from cash and cash equivalents (paragraphs 49(a) and B34)

[TBD]

Income and expenses on liabilities arising from financing activities (paragraphs 49(b) and B35-B36)

[TBD]

Interest income and expenses on other liabilities (paragraphs 49(c) and B37)

[TBD]

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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?

Proposed definition of 'integral' and 'non-integral' associates and joint ventures' (proposed new paragraph 20D of IFRS 12)

We support the proposal to differentiate between 'integral associates and joint ventures' and 'non-integral associates and joint ventures'. In practice, entities currently apply different accounting policies with respect to the presentation of the share of the profit or loss of associates and joint ventures accounted for using the equity method. While some entities present the share of the profit or loss of associates and joint ventures within 'operating profit or loss' in the statement of profit or loss, other entities apply a different approach and present income and expenses from associates and joint ventures outside 'operating profit or loss'. Thus, we believe that the proposal will improve comparability across entities.

However, determining which associates and joint ventures are integral to an entity's main business activities requires significant judgement. We are therefore concerned that in practice entities will face difficulties in distinguishing between 'integral' and 'non-integral' associates and joint ventures on a consistent basis.

Whilst we agree with the distinction of *'integral'* and *'non-integral'* associates and joint ventures, we believe that the proposed definition of *'integral'* is too narrow in terms of a 'significant interdependency' between the entity and an associate or joint venture.

For example, the proposed definition of 'integral' associates and joint ventures might not cover:

- associates and joint ventures that are operated largely independently but that are active in the same line of business as the reporting entity (i.e. both – the associate or joint venture and the reporting entity – share the same main business activity),
- associates and joint ventures in a start-up phase, and
- research and development co-operations that have been entered into in order to develop new business opportunities or technologies and that will contribute in the future to the entity's cash flows.

In these instances, the associate or joint venture might not be classified as 'integral'. For example, associates and joint ventures in a start-up phase and R&D co-operations, are setting up a new business, and thus, do not have integrated lines of business or a supplier or customer relationship with the entity. In addition, start-up companies are often granted a certain entrepreneurial autonomy. Hence, they are not integrated into the same corporate structures as other group entities. However, in practice, these associates and joint ventures are often considered as 'strategic' holdings.

Therefore, we would propose another definition of 'integral': An associate or joint venture should be classified as 'integral' if the business activity of the associate or joint venture is closely related to the main business activities of the group (i.e. both entities – the associate or joint venture and the reporting entity – share one main business activity).

Proposed presentation of the share of the profit or loss of 'integral' associates and joint ventures in the statement of profit or loss (paragraphs 53 and 60(b))

We do not agree with the proposal to introduce a new category '*integral associates and joint ventures*' and to require entities to classify income and expenses from integral associates and joint ventures in a separate category. As a result, income and expenses from integral

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associates and joint ventures will not be presented within the operating category solely because these investments are structured as associates and joint ventures.

Instead, we prefer the alternative approach discussed by the IASB in paragraph BC82 of the Basis for Conclusions, i.e. requiring entities to classify the share of profit or loss of integral associates and joint ventures in the operating category. This approach is more consistent with the view that integral associates and joint ventures are closely related to the entity's main business activities.

As explained in paragraph BC82 of the Basis for Conclusions, the IASB rejected this approach because many users of financial statements analyse the results of investments in associates and joint ventures accounted for using the equity method separately from the results of an entity's operating activities. It should be stressed that also under the alternative approach the information needed for such an analysis is directly available for users as the IASB is proposing two minimum line items in paragraphs 65(a)(iii) and 65(a)(iv) for the share of the profit or loss of associates and joint ventures in the statement of profit or loss. Thus, users are provided with the information required to eliminate the share of the profit or loss of integral associates and joint ventures from operating profit or loss, should they decide that an adjustment is more useful.

For the same reason, we do not agree with the proposal in paragraphs 60(b) to present in the statement of profit or loss an additional subtotal for the '*operating profit or loss and income and expenses from integral associates and joint ventures*'. In our opinion, a separate subtotal – especially in combination with the requirements in paragraphs 65(a)(iii) and 65(a)(iv) of two separate line items – gives undue prominence to the share of the profit or loss of associates and joint ventures.

Proposed presentation for entities that, in the course of their main business activities, invest in associates and joint ventures in the statement of profit or loss

Unlike the general presentation requirement for income and expenses from investments that are generated in the course of a entity's main business activities, paragraph 48 includes a prohibition of classifying income and expenses from 'non-integral' associates and joint ventures in the operating category. This means, that entities that invest in associates and joint ventures in the course of their main business activity (e.g. insurers, private equity entities, and holding companies) cannot classify the share of profit or loss of associates and joint ventures in the operating category, even though the share of profit or loss of associates and joint ventures was generated in the course of their main business activities.

In our opinion, such a presentation does not provide useful information to investors, as it means income and expenses from (integral and non-integral) associates and joint ventures will not be presented within the operating category solely because these investments are structured as an associate or joint venture that are accounted for using the equity method:

- For an insurance entity, the proposed requirements regarding income and expenses from associates and joint ventures would result in a presentation that undermines the link between the investment return on its assets and its insurance finance income or expenses, as required by IFRS 17 *Insurance Contracts*.

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- For a private equity entity, the proposed requirements would result in an inconsistent presentation of the investments returns generated in the course of its main business activities: Applying the investment entity exception, investments in subsidiaries would be measured at fair value through profit of loss in accordance with IFRS 9. In accordance with paragraph 48 of the ED, the investment returns, and fair value gains and losses on these investments would be presented within the operating category. By contrast, income and expenses from associates and joint ventures accounted for using the equity method shall not be classified in the operating category, even though these investments are held for the same purpose, i.e. returns from capital appreciation, investment income, or both. Conversely, paragraph 18 of IAS 28 incorporates an accounting policy choice to measure at fair value through profit or loss an investment in an associate or a joint venture that is held by an entity that is a venture capital organisation, or other qualifying entity on an investment-by-investment basis. Applying paragraph 48 of the ED, the investment returns, and fair value gains and losses on associates and joint ventures measured at fair value through profit or loss would be presented within the operating category.

We therefore suggest the IASB that for entities that, in the course of their main business activities, invest in associates and joint ventures, the presentation of income and expenses from these associates and joint ventures should follow the proposed general principle in paragraph 48, i.e. classified in the operating category. It should be noted that also under this alternative approach the information about income and expenses from (integral and non-integral) associates and joint ventures is directly available for users as the IASB is proposing two separate line items for the share of the profit or loss of associates and joint ventures in the statement of profit or loss.

Furthermore, as explained in our overarching remarks preceding question 2-6, we recommend the IASB to align the presentation in the statement of cash flows with to the new presentation requirements in the statement of cash flows. Consequently, we recommend the IASB that cash flows regarding associates and joint ventures should be presented in statement of cash flows within the same category as the corresponding income and expenses are presented in the statement of profit or loss. This means for entities that, in the course of their main business activities, invest in associates and joint ventures, cash receipts and cash payments regarding these associates and joint ventures should be presented in the operating category. This approach would be consistent with our recommendation that – for entities that, in the course of their main business activities, invest in associates and joint ventures – income and expenses from associates and joint ventures should be reported in the income statement in the operating category.

Introduction of the new defined terms 'integral' and 'non-integral' associates and joint ventures

In the ED, the IASB is introducing the new defined terms '*integral*' and '*non-integral*', which classify associates and joint ventures according to whether (or not) a '*significant interdependency*' between an entity and the associate or joint venture exists. These two terms supplement other terms and definitions used throughout IFRS Standards, such as the classification of investees by type of influence (i.e. '*subsidiary*', '*joint ventures*', and '*associates*' as defined by IFRS 10, IFRS 11 and IAS 28).

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As explained in our answer to question 2, the IASB should ensure that the proposed new terms are consistent with the terms used by other IFRS Standards. With respect to the proposed definitions of '*integral'* and '*non-integral*', it should be ascertained that the proposed terms fit into the context of other terms already used throughout IFRS Standards and are consistent with other concepts and terms introduced by the ED (such as '*an entity's main business activities'*, '*operating'* and '*investing')*.

For example, it should be noted that:

- Paragraphs BC5.25 and BCE.67 of IFRS 9 are referring to 'strategic' (equity) investments.
- Paragraphs 23-29 of IAS 21 (1993) included a classification of foreign operations as either '*foreign operations that are integral to the operations of the reporting enterprise*' or '*foreign entities*'. This classification used similar terms and indicators as the IASB is proposing in the ED for the classification 'integral' and 'non-integral' associates and joint ventures: For example, paragraph 24 of IAS 21 (1993) stated: '*A foreign operation that is integral to the operations of the reporting enterprise carries on its business as if it were an extension of the reporting enterprise's operations.*' Paragraph 26 of IAS 21 (1993) included indicators for the classification of a foreign operation as either a 'foreign entity' or an 'integral foreign operation'. For example, '*a significant degree of autonomy from the activities of the reporting enterprise*' or the fact that '*transactions with the reporting enterprise are not a high proportion of the foreign operation's activities*' would indicate that a foreign operation is not integral to the operations of the reporting entity.

We observe that there is a high similarity between the definition of a 'non-integral' associate and joint venture (as proposed by paragraph 20D of IFRS 12) and a 'foreign entity' (as defined by IAS 21 (1993)). We therefore question whether this was the intention of the IASB.

Proposed requirements to present information about integral associates and joint ventures separately from non-integral associates and joint ventures

We agree with the proposals in paragraphs 53, 75(a) and 82(g)–82(h) of the ED, and the proposed new paragraph 20E of IFRS 12 that require an entity to provide information about integral associates and joint ventures separately from non-in18ergal associates and joint ventures.

Proposed presentation of income and expenses from integral associates and joint ventures (paragraph B38)

We also agree with the proposal in paragraph B38 that impairment losses and reversals of impairment losses on integral associates and joint ventures and gains and losses on disposals of integral associates and joint ventures should be presented in the same category as the share of profit or loss of integral associates and joint ventures. In our opinion, this presentation would result in a faithful representation of the categories, as defined by the IASB in paragraph 45 of the ED.

However, as explained above, we are of the opinion that the share of profit or loss of integral associates and joint ventures should be classified in the operating category. Consequently,

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impairment losses and reversals of impairment losses on integral associates and joint ventures and gains and losses on disposals of integral associates and joint ventures should be presented in the operating category, as well.

Presentation in the statement of cash flows (proposed new paragraphs 16©, 16(d) and 38A of IAS 7)

We do not agree with the proposal that cash flows from the acquisition and disposal of, as well as dividends received from 'integral' associates and joint ventures shall be classified as cash flows from investing activities in the statement of cash flows.

As explained in our overarching remarks preceding questions 2-6, we recommend the IASB to align the presentation in the statement of cash flows with the new proposed categories of the statement of profit or loss. Therefore, should the IASB decide to retain the proposal on introducing a separate category '*integral associates and joint ventures*' in the statement of profit or loss, we believe that cash receipts and cash payments related to these associates joint ventures should be presented in a separate category in the statement of cash flows, too, and IAS 7 should be amended consequentially. However, should the IASB decide to adopt the alternative approach discussed in paragraph BC82 of the Basis for Conclusions (i.e. presentation in the operating category), we believe that the corresponding cash receipts and cash payments related to integral associates joint ventures should be presented as cash flows from operating activities.

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

(a) Paragraphs 20–21 of the Exposure Draft set out the proposed description of the roles of the primary financial statements and the notes.
(b) Paragraphs 25–28 and B5–B15 of the Exposure Draft set out proposals for principles and general requirements on the aggregation and disaggregation of information.

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

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

Proposed description of the roles of the primary financial statements and the notes (paragraphs 20–21)

We agree with the proposed description of the roles of the primary financial statements and the notes. In our view, as already explained in our comment letter to DP/2017/1 *Disclosure*

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Initiative – Principles of Disclosure, the proposals reflect the common understanding and terminology already used in practice in our jurisdiction.

However, we have noticed that the proposed definition of the primary financial statements in the proposed new paragraph 11 of the ED does not include the comparative information in respect of the preceding reporting period. This becomes particularly relevant in the context of the proposed new principles for aggregation and disaggregation. Proposed new paragraph 25 states:

> *"An entity shall present in the primary financial statements or disclose in the notes the nature and amount of each material class of assets, liabilities, income or expense, equity or cash flow. To provide this information an entity shall aggregate transactions and other events into the information it discloses in the notes and the line items it presents in the primary financial statements. […]"*

Within this context, the question arises whether the principles for aggregation and disaggregation apply only to the presentation of the current reporting period or also to the comparative information presented in accordance with the proposed new paragraph 34 of the ED (i.e. paragraph 38 of IAS 1 respectively). We therefore suggest the IASB clarify that:

- the definition of the primary financial statements includes the comparative information presented, and
- the principles for aggregation and disaggregation need to be applied to the primary financial statements including the (minimum) comparative information presented.

Proposed principles and general requirements on the aggregation and disaggregation of information (paragraphs 25–28 and B5–B15)

We agree with the proposed principles and general requirements on the aggregation and disaggregation of information. In our opinion, the proposed principles and guidelines on aggregation and disaggregation are straightforward and reflect the common understanding in our jurisdiction.

Though we welcome that the IASB is proposing general principles and requirements, we doubt that merely introducing an overarching principle is sufficient to change entities' practice.

Firstly, we doubt that entities have not understood the current requirements on the disaggregation of information in the primary financial statements and the notes; rather, many may simply have sought to bypass the necessary use of judgment involved and may therefore present – as a practical expedient – the same amount of detail as in prior years.

Secondly, there are no specific disclosure requirements that require entities to disaggregate operating expenses presented in the statement of profit or loss (e.g. cost of sales, selling, general and administrative expenses, etc.) into categories in the notes. This means, unlike e.g. paragraph 114 of IFRS 15 that requires entities to '*disaggregate revenue from contracts with customers into categories that depict how the nature, amount, timing and uncertainty of revenue and cash flows are affected by economic factors*', there is a lack of similar disclosure requirements on the disaggregation of operating expenses reported in the statement of profit or loss. Thus, if the IASB's intention is to require entities to disaggregate specific expense line

items (e.g. cost of sales, selling, general and administrative expenses, etc.) in the notes, we doubt that the introduction of a general principle will achieve this objective.

Thirdly, we notice that the proposed principles on the aggregation and disaggregation of information shall be applied to each of the primary financial statements. However, the IASB decided not to consider changes as part of the project to the statement of changes in equity (ref. paragraph BC13 of the Basis for Conclusions) and to the statement of cash flows (except for limited changes to the statement of cash flows to improve consistency in classification by removing options; ref. paragraph BC12 of the Basis for Conclusions). Therefore, in our opinion, it is not clear whether the IASB expects entities to change their presentation in the statement of cash flows and in the statement of changes in equity.

For the reasons above, we doubt that the proposed principles and general requirements on the aggregation and disaggregation of information will lead to significant changes in the practice of presentation in the notes and the primary financial statements. Whilst we agree with the substance of these principles, we believe that they are too generic and do not provide clear guidance on which additional information should be disclosed in the notes or which line items should be presented in the primary financial statements.

Furthermore, we regret that the current proposals do not reflect the impact of structured electronic reporting technologies that could remove many of the presentation issues addressed by the IASB (including the lack of disaggregation in primary financial statements).

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?

Requirements 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 (paragraphs 68 and B45)

Whilst we understand that the IASB aims to reduce the use of judgement in determining whether the nature of expense method or the function of expense method should be used, we do not consider that the proposals will achieve the desired objective and therefore we disagree with the proposals. As explained in more detail below, we doubt that the proposals will 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. Hence, we do not believe that the proposals will lead to significant changes in practice regarding the presentation method selected.

We understand from the proposals that the IASB aims to strengthen the existing requirements, as investors have raised concerns that, in practice, companies may not choose the method that provides the most useful information in their circumstances (ref. IASB, *Snapshot: General Presentation and Disclosures*, p. 9). Consequently, the IASB emphasises that the selection of the method is not a free choice and provides a set of indicators to help entities assess which method provides the most useful information to the users of their financial statements.

However, the IASB does not make clear, under which circumstances the method selected by entities, in practice, did not provide the most useful information to the users of the financial statements. In our opinion, it is unclear, under which circumstances entities should have reached to another conclusion when selecting their presentation method in the statement of profit or loss. Therefore, we doubt that the proposed requirements would achieve the desired objective, as the objective itself is unclear.

Further, we question whether the proposed indicators in paragraph B45 are appropriate to help entities assess which method provides the most useful information in their circumstances. We have received feedback from our constituents claiming that the proposed indicators '*information about the key components or drivers of the entity's profitability*' (paragraph B45(a)) and '*the way the business is managed and how management reports internally*' (paragraph B45(b)) are neither supporting the nature of expense nor the function of expense method in their circumstances, as internal reports and communication to investors focus on items of income and profit (i.e. revenue, EBIT and EBITDA, profit before tax) rather than on expense items. Therefore, in practice, the third proposed indicator '*industry practice*' (paragraph B45(c)) will likely be the predominant factor, as only uniform industry practice enables comparisons across entities. However, current presentation practice might vary across entities within the same industry, as other factors have an impact on an entity's selection of the presentation method (e.g. the size of the company, whether the entity is operating nationally or internationally, or whether the entity's domicile is in a jurisdiction that is not familiar with the nature of expense or the function of expense method). Furthermore, the proposals do not provide guidance for situations where one or more indicators support the nature of expense method, but other indicators support the function of expense method.

It should be noted that if, applying the proposed new requirements, entities might need to change their presentation method, these entities might not be able to easily generate their statement profit and loss using the other presentation method. Changing the presentation method results in extensive changes regarding the entity's accounting systems and processes (e.g. allocating costs to functions) which is coupled with considerable implementation costs.

For the reasons above, we do not believe that the proposals will 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. Further, we question whether there is a need for strengthening the requirement that entities shall select the method that provides the most useful information to the users of their financial statements. As the IASB is proposing to require entities using the function of expense method to disclose in the notes an analysis of their total operating

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expenses using the nature of expense method, this means, that the information necessary to compare both methods would be available for the users of financial statements.

Another issue the IASB might want to consider when improving the guidance proposed relates to changes in the presentation of the method of expense analysis. If an entity concludes that it needs to change its method of expense analysis, it should be clear that a change in presentation is to be applied retrospectively. Therefore, we suggest the IASB to clarify that changes in the presentation of the method of expense analysis are a change in accounting policies in accordance with IAS 8 *Accounting policies, changes in accounting estimates and errors*.

Additional disclosure requirements for entities presenting an analysis classified in the operating category using the function of expense method (paragraph 72)

We do not agree with the proposal in paragraph 72 to extend the disclosure requirements for entities that currently present their analysis of operating expenses by function in the statement of profit or loss.

According to the paragraph BC111 of the Basis of Conclusions, '*this proposal reflects feedback from users of financial statements that analysing expenses using the function of expense method can lead to a loss of useful information. Information is lost because functional line items combine expense items with different natures that respond differently to changes in the economic environment, making it difficult for users to forecast future operating expenses*.' However, in our opinion, the predictive value of some expense items under the nature of expense method might be low. Considering the Illustrative Example (Part I, Note 1), we question whether disclosures regarding the '*reversal of inventory write downs*', '*impairment of property, plant and equipment*', '*impairment losses on trade receivables*', '*gains (losses) on derivatives*', and '*other miscellaneous expenses*' provide information that is more relevant for forecasts than a presentation by function.

It should be stressed that current paragraph 104 of IAS 1 already requires entities classifying expenses by function to disclose additional information on the nature of expenses, including depreciation and amortization expense and employee benefits expense. This means that under current IFRS the most important expense items are already to be disclosed by nature. Therefore, in our opinion, it is unclear, which additional information the IASB is seeking to be disclosed and whether a disclosure of *total* operating cost by nature provides users of financial statements with information needed to forecast future operating expenses of the entity. However, requiring entities to disclose their total operating cost by nature is a significant change for entities that currently use the function of expense method which will be costly to implement. We therefore encourage the IASB to investigate further, which information about operating expenses by nature is needed by users of financial statements.

We note that there are different views regarding the cost and benefits of providing information about operating expenses by nature and the counterargument to the information wishes raised by users are reflected by concerns of preparers: We have received feedback from preparers from our constituency that the information needed to disclose their total operating expenses by nature cannot easily be obtained from their accounting systems. Some entities told us that they are unable to track the original nature of the expenses once the expenses have been

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allocated to functions, because their accounting systems are not designed for this purpose. This is often the case for large multinational companies that internally allocate a large number of items of income and expense to various functions or cost centres. As a result, the proposal to disaggregate total operating expenses by nature is costly to implement for entities that currently present their analysis of operating expenses by function in the statement of profit or loss. Such entities will have to adjust their accounting systems to enable them to obtain the information about the nature of inputs used. Implementation costs will be especially significant for large multinational groups with a diverse ERP system landscape. We therefore doubt that the benefits of having information about the operating expenses by nature will exceed the costs of implementation.

We also have received feedback that gathering information about expenses by nature might especially be difficult to implement for group entities from foreign jurisdictions that are not familiar with the nature of expense method, as a presentation of expenses by nature is not allowed under the relevant national accounting framework (e.g. US GAAP). Therefore, it might be particularly difficult to adapt accounting systems in foreign jurisdictions that are not familiar with the nature of expense method, as it means to start from scratch. For instance, following an acquisition of a US subsidiary during the reporting period, the acquirer would need to adapt the accounting systems of the acquiree until the end of the reporting period in order to ensure that the total operating expenses of the acquiree can be included in the group's disclosures of total operating expenses by nature. Given the tight reporting schedules, we question whether entities will be able to comply with the requirement to disclose an analysis of their total operating expenses using the nature of expense method.

Prohibition of a mixture of the nature of expense method and the function of expense method (paragraph B46)

We understand from proposed new paragraph B46 that entities should not use a mixture of the nature of expense method and the function of expense method except when required to do so by paragraph B47. Paragraph B47 requires entities to present in the statement of profit or loss the line items required by paragraph 65 regardless of the method of analysis of expenses used.

We have several concerns regarding these statements in paragraphs B46 and B47. Firstly, we regret that the IASB itself is weakening its proposed principle that entities shall not use a mixture of the nature of expense method and the function of expense method by articulating an exception to this principle in paragraph B47. Furthermore, no (principle-based) rationale for the exemption is provided. As a result, in practice, it may be difficult to explain why entities should not mix both methods, which could result in a lower acceptance of that principle.

Secondly, the link between paragraph B15 and paragraph B47 is unclear. Paragraph B47 – as an exception to the principle that entities shall not use a mixture of the nature of expense method and the function of expense method – requires entities to present in the statement of profit or loss the line items required by paragraph 65. Paragraph 65 includes a reference to further application guidance in paragraph B15 and B44. Paragraph B15, in turn, enumerates circumstances that would give rise to the separate presentation in the statement of financial performance or disclosure in the notes of items of income and expense (such as write-downs of inventories to net realisable value or of property, plant and equipment to recoverable

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amount, as well as reversals of such write-downs, restructurings of the activities of an entity, disposals of items of property, plant and equipment, etc.). It should be noted that the circumstances listed in paragraph B15 are expenses analysed by nature. We therefore question whether the IASB also aims to exclude the circumstances listed in paragraph B15 from the prohibition of a mixture of both methods, or whether the reference in paragraph B47 applies to the line items listed in paragraph 65 only.

Thirdly, according to paragraph BC110 of the Basis for Conclusions, users have raised concerns that useful information can be lost because entities choose which method to use and because, in practice, many entities use a mixture of both methods. Therefore, the IASB proposes to strengthen the requirements by requiring an entity to use '*the single method*' that would provide the most useful information to the users of the financial statements. We do not completely agree with that statement. Regarding the concerns raised by users, we think it would be necessary to analyse in detail which information is lost or obscured by a mixture of both methods. Based on the results of this analysis, we suggest the IASB to clarify which line items would (not) fit into the structure of the respective method.

On the other hand, in our opinion, it is not clear whether and to what extent the IASB is requiring a '*pure presentation*', i.e. whether the notion of '*the single method*' in paragraph BC111 means that any kind of 'mixed presentation' is prohibited. However, we do not completely agree with the view that any kind of mixed presentation will lead to a loss of information. Instead, we believe that additional line items – although they may not fit into the structure – may provide useful information to users of the financial statement.

For instance, some entities using the function of expense method currently present impairment losses and restructuring expenses as a separate line item in the statement of profit or loss or within the line item 'other operating expense'. On the one hand, this may be considered as not to be in line with the '*single method*' presentation. On the other hand, allocating impairment losses and restructuring expenses to functions would result in volatile line items across different reporting periods. To enhance comparability between different reporting periods and across entities, a presentation as a separate line item (or disclosure in the notes) would provide users with useful information. For that reason, some entities currently choose to present restructuring expenses and impairment losses within 'other operating expenses'. Allocating these expenses to functions would be a significant change for entities currently using the function of expense method. We believe that some expense items will be difficult to allocate to functions (e.g. impairment losses on goodwill). In our opinion, it is therefore more reasonable to present these expense items within in a separate line item 'other operating expenses' rather than allocating them to functions. Furthermore, allocating impairment losses to functional areas would result in corresponding explanations in the notes, which might be scrutinised by users and investors. However, we get the impression from the Illustrative Example that the IASB's intention might be to require entities to allocate expenses currently presented within the line item 'other operating expense' to functions (as the analysis of operating expenses by function in the statement of profit or loss in the Illustrative Example only includes a line item 'other income', but a line item 'other expenses' is lacking).

For the reasons above, we suggest the IASB investigate and clarify further:

- what useful information is lost – according to the concerns raised by users – because in practice many entities use a mixture of both methods,

- address the concerns raised by users more specific and clarify which line items would (not) fit into the structure of the nature of expense method (or the function of expense method respectively), and
- whether and to what extent a 'pure' presentation shall be required, i.e. whether any kind of 'mixed presentation' shall be prohibited.

Relationship between required line items and the proposed categories in the statement of profit or loss (paragraph B44)

We agree with the proposal in paragraph B44 and the reasons for the proposal provided in paragraph BC108 of the Basis for Conclusions. In our opinion, a faithful representation of each of the categories in the statement of profit or loss should be given a higher priority than the presentation of the line items (by nature).

One disadvantage of this approach consists in a potential proliferation of line items presented because the same required line item (e.g. impairment losses on financial instruments) could be required to be presented in more than one section. However, in our opinion, this disadvantage is mitigated in the light of the use of structured electronic reporting technologies and given the fact that IFRS 7 *Financial Instruments: Disclosures* requires detailed disclosures regarding items of income, expense, gains, or losses on financial instruments.

Therefore, we agree with the proposed requirement in paragraph B44 that an entity may need to present a required line item in different categories of the statement of profit or loss.

Requirement to present the cost of sales in the statement of profit or loss (paragraphs 65(a)(vii) and 71)

In our opinion, paragraph 65(a)(vii) is confusing as it requires an entity to present a separate line item '*cost of sales*' in the statement of profit or loss. But, according to paragraph 71, that requirement applies only to entities using the function of expense method. By contrast, all other line items listed in paragraph 65 are applicable to all entities, irrespective of whether the nature of expense method or the function of expense method is applied. As the IASB explains in paragraph BC115 of the Basis for Conclusions, this is even valid for expense items required to be presented in the statement of profit or loss that are expenses analysed by nature (e.g. impairment losses determined in accordance with IFRS 9).

Therefore, we suggest the IASB to clarify that an entity that applies the nature of expense method need neither present nor disclose its cost of sales. Furthermore, it might be helpful to explicitly include a requirement in the new IFRS Standard (e.g. in paragraph B44) that the minimum line items in the statement of profit or loss are required to be presented (if material) regardless of the method of analysis of expenses in the operating profit section. Currently, this is only reflected in paragraph BC116 of the Basis for Conclusions.

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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?

Proposed definition of 'unusual income and expenses' (paragraph 100)

We support the IASB's intention to highlight 'unusual' items of income and expenses and require entities to disclose 'unusual income and expenses' in the notes. We think that users of financial statements would benefit from greater transparency of information if clear guidelines regarding the presentation of 'unusual income and expenses' were available. However, as explained in more detail below, we think that the proposed definition of 'unusual income and expenses' is too restrictive and therefore do not agree with the proposed definition. We believe further that it is not possible to develop a definition that can be applied across entities and industries. Rather, the assessment whether income and expenses are 'unusual' can only be made on the basis on an entity-specific approach. Therefore, we recommend the IASB allowing entities to develop and apply consistently their own definition of 'unusual income and expenses'. Thus, the guidance in the new IFRS Standard should include general requirements for the fair presentation and disclosure of 'unusual income and expenses'.

We agree with the IASB's objective to provide more transparency about income and expenses that an entity considers to be unusual. Whilst we agree with that objective, in our view, the proposed definition of 'unusual income and expenses' has some conceptual weaknesses.

Under the current definition of 'unusual income and expenses', assessing whether an item is 'unusual' requires significant judgement and will be difficult to implement for entities. Due to the uncertainty of future events, it will be particularly difficult for entities to assess whether – looking forward – similar income and expenses will recur. However, it is easy to determine with hindsight whether an item of income or expense recurred in subsequent periods. Therefore, classifying an item as 'unusual' may be called into question by users of financial statements and entities may be required to explain why an 'unusual' item of income and has recurred in subsequent periods.

The complexity of the assessment whether similar income and expenses will not recur for several future annual reporting periods becomes particularly apparent in times of an economic

crisis (such as the current Covid-19 crisis): Due to high uncertainty in times of an economic crisis, entities are facing difficulties in forecasting their future fiscal results and thus, might not be able to predict whether income or expenses similar in type and amount will not arise in several future annual reporting periods. Uncertainties relate to the following:

- The beginning, end, and expected duration of a crisis are difficult to determine. For example, as of 31 December 2019, it was hardly possible for entities to forecast the effects of the Covid-19 pandemic. Currently, entities are confronted with the questions of how long the crisis will last and how it will impact their business. In this context, the extent to which the crisis affects several future reporting periods is also important for assessing whether income and expenses incurred due to the Covid-19 pandemic are 'unusual'.
- The expectation of what is to be considered as usual '*under normal circumstances*' has to be revised to a yet unknown 'new normal' course of business (post-crisis). Therefore, it will be difficult to separate the portion of 'unusual' income and expenses as the expectation of what would have been considered as 'usual' income and expenses is unknown (e.g. entities in some industries, e.g. online retailers, are currently generating 'unusual' revenue due to the Covid-19 pandemic).
- In defining 'unusual income and expenses' the IASB seems to have in mind individual, events or transactions (e.g. a fire at an entity's factory)that are clearly identifiable and whose effects on the statement of profit or loss can be easily isolated and quantified. However, an individual event (such as the Covid-19 pandemic) may have an impact on many transactions and business activities, making it difficult to determine what was caused by that singular event and how the 'normal' course of business would have been without that event (e.g. whether an insolvency is caused by the crisis or whether an entity was threatened with insolvency before).

Further, we think that the proposed definition of 'unusual income and expenses' is very narrow in terms of whether '*it is reasonable to expect that income or expenses that are similar in type and amount will not arise for several future annual reporting periods*' (ref. paragraph 100). In our view, the reference to whether similar income or expenses '*will not arise for several future annual reporting periods*' may result in income or expenses that have limited predictive value being not identified as 'unusual'. For example, gains and losses from the disposal of assets that arise regularly will not be covered by the proposed definition. However, signalling that 'economic substance' was divested provides useful information to investors. To provide an indication of recurring earnings, in practice, gains and losses from the disposal of assets are commonly adjusted, for example by insurers and investment property entities. As a result, the proposed definition might result in a loss of useful information and users of financial statements will only receive an incomplete picture of what is to be considered as 'unusual' or 'non-recurring'.

Another issue concerns the fact, that the assessment of whether income and expenses are considered as 'unusual' can change over time. For example, if an entity expects to dispose large amounts of assets over the next three years, income and expenses from the sale of these assets will not meet the definition of 'unusual' until no similar income and expenses are expected to incur in future reporting periods, i.e. only income and expenses that incurred in the last reporting period, i.e. the third year, are captured by the definition of 'unusual'. As a result, income and expenses resulting from similar circumstances are classified inconsistently.

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In addition, the proposed definition of 'unusual income and expenses' has practical limits for some industries. For example, for insurance entities, due to the specific circumstances of their business model it will be difficult to determine whether an insured event meets the definition of 'unusual'. According to paragraph BC133 of the Basis for Conclusions an earthquake in a non-earthquake prone zone is deemed to be a transaction or event that may give rise to income or expenses that are unusual in nature. However, as the IASB explains in paragraph BC134 of the Basis for Conclusions, if the earthquake gives rise to expenses that are expected to arise for a number of years, these expenses are not covered by the definition of 'unusual'. For insurance entities, determining whether expenses arising from an earthquake (as an insured event) are 'unusual' is even more complex, as their business model consists in the insurance of such events. Therefore, for insurance entities, only a small number of instances will likely meet the definition of 'unusual' income and expenses.

Similar difficulties may arise for entities in a start-up or expansion phase that are in the process of developing their business. For these entities it might be difficult to determine whether revenues from a large contract with a new customer is to be considered as 'unusual' if these entities are on a growth path and similar transactions might occur in the future.

Another issue that the IASB should consider relates to the question whether unusual income and expenses are not expected – by type *and* amount (or: either by type or amount) – to recur in the future. On the one hand, the proposed definition of unusual income and expenses in paragraph 100 is referring to '*by type and amount*'. On the other hand, the IASB explains in paragraph B69 that: '*Income and expenses that are not unusual by type may be unusual by amount*'. However, considering the guidance provided, we wonder whether, in fact, both conditions (i.e. by type *and* amount) need to be met to classify an item as unusual. We, therefore, suggest the IASB clarifying whether both conditions (i.e. both, by type *and* amount) need to be met to classify an item as unusual.

Determining whether income and expenses are 'unusual' is highly dependent on an entity's specific facts and circumstances. Accordingly, the identification of whether an item is 'unusual' will inevitably remain judgmental to a certain degree. Thus, we understand why the IASB is seeking to set limits to what extent an item is not deemed unusual. However, the proposed new IFRS Standard is introducing a couple of examples of items that might be considered as 'unusual' depending on an entity's specific facts and circumstances, for example, an impairment loss resulting from a fire at an entity's factory (paragraph B68), litigation expenses incurred higher than reasonably expected (paragraph B69), restructuring expenses (paragraph B71), the effect of a tax reform (Illustrative Example) and a drop in the market price of inventories (Illustrative Example). Given this broad range of events and transaction, that may give rise to 'unusual income and expenses', we question whether the IASB's objective of setting limits and reducing entities' leeway regarding the classification of expenses as unusual (ref. paragraph BC123 of the Basis for Conclusions) will be achieved.

For the reasons above, we do not believe that the IASB's objective – to provide users with useful information about income and expenses which may not persist – can be achieved. The proposed definition is too restrictive as it does not cover many income and expense items with low predictive value that are currently, in practice, labelled as 'unusual items'. As a result, users of financial statements will only receive an incomplete picture of what is to be considered as 'unusual'.

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Given the large variety of possible events and transactions that may give rise to unusual income and expenses, we do not believe that a definition of unusual income and expenses can be developed that can be applied across entities and industries. Rather, the assessment whether income and expenses are 'unusual' can only be made on the basis on an entity-specific approach. We therefore recommend the IASB not to define unusual income and expenses. Instead, entities should be required to develop and apply their own accounting policy regarding the definition of unusual income and expenses.

To help entities assess which items of income and expenses analysts typically would exclude when assessing the persistence or sustainability of an entity's financial performance, we suggest the IASB to investigate further which items of 'unusual' or 'infrequent' income and expenses provide useful information to users. Feedback of investors and other users of financial statements about what they consider to be 'unusual' could be used by the IASB to provide entities with additional guidance regarding the identification of unusual income and expenses.

In turn, as discussed by the IASB in paragraph BC123(b), the guidance in the new IFRS Standard should include general requirements for the fair presentation and disclosure of 'unusual income and expenses', including:

- requiring entities to disclose their accounting policy as to how the entity's management defines an item to be 'unusual',
- emphasizing that a neutral and unbiased approach should be applied in identifying unusual or infrequent items (i.e. an entity shall not unilaterally identify expenses/losses to be 'unusual' and exclude unusual income/gains from its definition of 'unusual'),
- requiring entities to classify and present unusual income and expenses consistently over time, and
- requiring entities to disclose information about 'unusual income and expenses' (as proposed by the IASB in paragraph 101), including an explanation why an item was classified as 'unusual' in the reporting period.

In our opinion, this approach would allow entities flexibility in identifying items as unusual according to their business and industry and investors would be provided with relevant information about what an entity considers as its 'sustainable earnings'.

Presentation of unusual income and expenses within the defined categories in the statement of profit or loss (paragraph BC56 of the Basis for Conclusions)

We support the IASB's proposal that unusual income and expenses should be attributed to the categories in the statement of profit or loss. This means that the operating category (or any other category) includes unusual income and expenses. We agree with the reasoning provided in paragraph BC56 of the Basis for Conclusions that '*a low predictive value*' is not a characteristic that differentiates whether income or expenses are operating (or any other category).

In our view, a presentation of unusual income and expenses within the categories would result in a faithful representation of the categories. Therefore, we agree with the proposal.

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Information to be disclosed about unusual income and expenses (paragraph 101)

In general, we are in favour of the IASB's objective of providing users with information about 'unusual income and expenses'. Therefore, we agree with the proposal of requiring entities to disclose unusual (or similarly described) income and expenses and to report management performance measures that have been adjusted to reflect the effect of unusual income and expenses.

However, as explained above, we do not agree with the proposed definition of 'unusual income and expenses'. Instead, we recommend the IASB to develop general requirements for the disclosure and faithful representation of such items. As we believe that it is not possible to develop a definition that can be applied across entities and industries, we recommend the IASB that entities should develop and apply their own accounting policy regarding the definition of 'unusual income and expenses'. Consequently, entities should be required to disclose their accounting policy adopted regarding the (entity-specific) definition of 'unusual income and expenses' (i.e. how the entity has determined that an item of income or expense is considered to be 'unusual' or 'non-recurring'). Therefore, we recommend the IASB to include in the new IFRS Standard a requirement to disclose the accounting policy adopted regarding as to what the entity's management considers to be an 'unusual income and expenses'.

Further, if the IASB adopts a 'management approach' (i.e. allowing entities to apply their own entity-specific definition of 'unusual'), we recommend to include in the new IFRS Standard principles and requirements for the fair presentation and disclosure of 'unusual income and expenses', such as:

- information about 'unusual income and expenses' should be neutral (as discussed by paragraph BC130 of the Basis for Conclusions), and
- income and expenses should be classified consistently as 'unusual' over time.

Regarding the proposed disclosure requirements in the proposed new paragraph 101, we agree with the proposal to require a narrative description of the transactions or other events that gave rise to each item of unusual income and expense and why income and expenses that are similar in type and amount will not arise for several future annual reporting periods. In our opinion, these disclosures would provide users with relevant information and currently, in practice, there is room for improvements regarding the explanations provided by management as to why an item is 'unusual'.

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Question 11 – management performance measures

(a) Paragraph 103 of the Exposure Draft proposes a definition of 'management performance measures'.
(b) Paragraph 106 of the Exposure Draft proposes requiring an entity to disclose in a single note information about its management performance measures.
(c) Paragraphs 106(a)–106(d) of the Exposure Draft propose what information an entity would be required to disclose about its management performance measures.

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

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

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

Proposed definition of 'management performance measures' (paragraph 103)

We think that users of financial statements would benefit from greater transparency by requiring entities providing insights into how management views the entity's performance and how the entity is managed. Furthermore, current disclosure requirements throughout IFRS Standards do not provide entities flexibility to 'tell their story' in IFRS financial statements. Thus, requiring disclosures for management performance measures has the potential to better link information presented in IFRS financial statements to information presented outside financial statements (such as the management commentary).

However, in our opinion, there are some conceptual weaknesses regarding the proposed definition of 'management performance measures':

- According to paragraph BC153 of the Basis for Conclusions, the IASB has decided to limit the scope of the project on improvements to the reporting of financial performance and the related notes. Therefore, the proposed definition of 'management performance measures' is limited to subtotals of income and expenses. Other financial measures (including measures related to the statement of financial position or cash flows) are not management performance measures. This exemption is particularly relevant for measures such as 'free cash flow' or 'net debt' which are commonly reported by corporate entities in the non-financial sector.
- Furthermore, proposed paragraph B80(a) states that individual items or subtotals of only income or expenses are not management performance measures. This exemption is particularly relevant for 'adjusted revenue' measures which is one of the most commonly reported performance measure for entities in the non-financial sector.
- In the insurance industry, cost-to-income ratios are typically reported by insurers as one of their most significant financial key performance indicators. Again, these measures would not be covered by the proposed definition of 'management performance measures' as financial ratios are excluded by paragraph B80(c).

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We do not agree with the IASB's decision that these measures should not be considered as management performance measures. Depending on how an entity is managed and industry practice, these measures are commonly reported in practice and disclosing such measures provide useful information to users. Excluding these measures would result in an incomplete picture of how management views the entity's financial performance and how the business is managed.

In addition, paragraphs 104 and B78 propose to exempt some performance measures (e.g. 'gross profit' and similar subtotals) from the definition of management performance measures. As the IASB explains in paragraph BC170 of the Basis for Conclusions, these subtotals are exempted from the disclosure requirements as they are – though not specified by IFRS Standards – '*commonly used in the financial statements and are well understood by users of financial statements*.' Whilst we agree with the statement that these subtotals are well understood in practice, such an approach of casuistic exceptions may raise questions to also exempt other performance measures that also might be well-known or widely used within an industry. We, therefore, do not support the proposal to exempt these measures by providing a list of specified measures; we would rather suggest developing a principle-based approach.

However, we do not suggest the IASB to extend the definition of management performance measures. Rather, we encourage the IASB to investigate how the proposed guidelines and disclosures requirements interrelate with similar disclosure requirements about performance measures, published by regulators. For example, with respect to our constituency, entities are required to present information about:

- alternative performance measures (APMs) as defined by the ESMA Guidelines on Alternative Performance Measures (when disclosing APMs in management reports, ad-hoc disclosures and prospectuses),
- their most significant financial key performance indicators that are also used for the internal management of the group (GAS 20 *Group Management Report*), and
- measures required to be presented in accordance with European or national legislation, this is particularly relevant for banks and insurance companies.

It should be noted that the scope of these guidelines does not coincide with the scope of the IASB's proposals regarding management performance measures. This would not be problematic if the scope of the IASB's proposals regarding management performance measures were to include those performance measures that are not already covered by other guidelines (such as the ESMA APM Guidelines). However, this is not the case. Rather, the IASB's proposals are overlapping with the ESMA APM Guidelines, with the scope of the IASB's proposals being much narrower. For example, the ESMA APM Guidelines include measures related to the statement of financial position or cash flows. This means, that entities ultimately may end up in disclosing information about:

- management performance measures (as defined by the proposed new paragraph 103) in the notes
- APMs in accordance with the ESMA APM Guideline in the management report, if not already reported in the notes (subject to the IASB's disclosure requirements), and
- performance measures eventually required by other regulators in the management report.

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Furthermore, the scope of the IASB's proposals is very broad in terms of 'public communication'. Paragraph B79 states: '*Only subtotals that management uses in public communications outside financial statements, for example, in management commentary, press releases or in investor presentations, meet the definition of management performance measures.*' This requires entities to investigate all possible communications.

Information to be disclosed about management performance measures (paragraph 106)

As explained before, we think that users of financial statements would benefit from greater transparency arising from disclosures about management performance measures.

Within our jurisdiction, the relevant guidelines with respect to the disclosure of performance measures are well-known to entities and entities already have a sound experience with respect to providing such disclosures (which are similar to the disclosure requirements proposed by the IASB). As disclosures about management performance measures are mandatorily to be presented within the management report, these disclosures are subject to the audit of the financial report and to enforcement procedures by the national competent authority. However, in our experience, some deficiencies persist in practice regarding explanations for the use of performance measures (including an explanation of material reconciling items).

Nevertheless, the disclosure of the effect on tax and non-controlling interests of each reconciling item (paragraph 106(c)) would be a change for entities in our jurisdiction. Regarding these disclosures, we question whether users are explicitly requesting information about the earnings adjustments attributable to the parent and the tax effect of those adjustments that can be used to calculate a related earnings per share figure (ref. paragraph BC177 of the Basis for Conclusions). However, from the viewpoint of the preparers of financial statements, the cost for obtaining and auditing the disclosures of the effect on tax and non-controlling interests (including the processes and internal controls that need to be implemented to generate the information required) need to be considered as well.

Location of information to be disclosed about management performance measures

We support the proposal that information about management performance measures shall be within IFRS financial statements as this means that disclosures about management performance measures will be subject to the audit of the IFRS financial statements. In our opinion, incorporating disclosures about management performance measures in the IFRS financial statements would improve the discipline with which these disclosures are prepared and, thus, would result in providing users with more transparent information and a reasonable assurance about the adjustments and amounts used in determining management performance measures.

One suggestion that the IASB might want to consider when improving the guidance proposed relates to the question whether entities should be allowed to make references to other documents when complying with the proposed disclosures requirements. As explained above, as far as our constituency is concerned, entities are required by GAS 20 *Group Management Report* and by the ESMA APM Guidelines to disclose information about their performance measures (including a reconciliation) in their group management report, which is also subject to the audit of the financial statements. To avoid fragmentation of information, it would be

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helpful if entities were allowed to provide the disclosures required by proposed new paragraphs 106(a)-106(d) by cross-reference from the IFRS financial statement to some other statement, such as a management commentary (as permitted, for example, by IFRS 7.B6).

Further, we question whether entities are prohibited from presenting – on a voluntary basis – information about performance measures that are excluded from the IASB's scope of management performance measures. In our opinion, it is unclear whether entities can choose to voluntarily present information about measures such as 'ROCE', 'adjusted revenue', 'free cash flow', etc. in the same single note that it uses to disclose information about its management performance measures and, if so, whether entities would need to comply with the disclosure requirements set out by paragraphs 106(a)–106(d).

Question 12 – EBITDA
Paragraphs BC172–BC173 of the Basis for Conclusions explain why the Board has not proposed requirements relating to EBITDA. Do you agree? Why or why not? If not, what alternative approach would you suggest and why?

The IASB's decision not to propose requirements relating to EBITDA (paragraph BC172 of the Basis for Conclusions)

We do not agree with the IASB's decision not to define '*earnings before interest, tax, depreciation and amortisation*' (EBITDA). We prefer the opposite, i.e. providing a definition of EBITDA, to increase comparability across entities.

As the IASB explains in paragraph BC172 of the Basis for Conclusions, in practice, a large variety of EBITDA measures is used, and the calculation of these measures is diverse in practice. As a result, there is no consensus about what EBITDA represents.

However, for the same reasoning, the IASB is proposing a definition of the subtotals '*operating profit or loss*' and '*profit or loss before financing and income tax*': As the IASB explains in paragraph BC46 of the Basis for Conclusions, '*EBIT and similar subtotals are not comparable between entities because of the diverse ways in which entities classify items between finance income and expenses and other income and expenses. […] The proposed subtotal of profit or loss before financing and income tax would be comparable between entities.*' Therefore, in our opinion, the reasoning provided in paragraph BC172 of the Basis for Conclusions is not convincing. Providing a definition of EBITDA would enhance comparability between entities and might eliminate the current diversity in how measures labelled 'EBITDA' are calculated in financial statements.

Therefore, we do not agree with the IASB's decision not to define EBITDA. We acknowledge that providing a definition of EBITDA may give rise to complex questions regarding the classification of income and expense items effecting that the proposed definition might face

objections in practice. Nonetheless, we encourage the IASB to develop a direct definition of EBITDA, to increase comparability of that measure across entities.

Exemption of the measure 'operating profit or loss before depreciation and amortization' from the disclosure requirements for management performance measures (paragraph BC173 of the Basis for Conclusions)

As explained above, we do not agree with the IASB's decision not to define '*earnings before interest, tax, depreciation and amortisation*' (EBITDA).

Nonetheless, we understand that the IASB is proposing – as a pragmatic compromise – to exempt the measure '*operating profit or loss before depreciation and amortization*' from the disclosures for management performance measures. However, in our view, this approach lacks a principle-based substantiation. As explained before, we prefer a direct definition of EBITDA effecting that – if defined by the IASB – the *'operating profit or loss before depreciation and amortization'* subtotal would become a subtotal 'specified by IFRS Standards'.

Question 13 – statement of cash flows

(a) The proposed amendment to paragraph 18(b) of IAS 7 would require operating profit or loss to be the starting point for the indirect method of reporting cash flows from operating activities.
(b) The proposed new paragraphs 33A and 34A–34D of IAS 7 would specify the classification of interest and dividend cash flows.

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

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

Starting point for the indirect method (proposed amendment to paragraph 18(b) of IAS 7)

We agree with the proposal and the reasoning provided in paragraphs BC186-188 of the Basis for Conclusions. The operating profit or loss subtotal as a starting point has the advantage that fewer reconciling items have to be adjusted when determining cash flows from operating activities.

However, as explained in our overarching remarks to questions 2-6, we would like to emphasize that we believe that the IASB should further align the presentation in the statement of cash flows with the statement of profit or loss. Currently the IASB proposes to use the same terms with different meanings when describing the categories in the new structure of the statement of profit or loss which might create confusion and reduces understandability.

Therefore, we recommend the IASB to extend the scope of the *Primary Financial Statements* project and to undertake a targeted review of IAS 7 in the light of the proposals on the new

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structure and content of the statement pf profit or loss. When reviewing the proposals, the IASB should consider the following matters:

- the proposals on the separate presentation of the new categories in the statement of profit or loss,
- the description and the content of proposed new categories (i.e. an alignment of the content of new categories '*operating*', '*investing*' and '*financing*',
- the proposed presentation requirements for entities that provide finance to customers are their main business activity or invest in the course of their main business activities
- the proposed new presentation requirements for specific items (e.g. the classification of fair value gains and losses on derivatives and hedging instruments), and
- current presentation requirements of IAS 7 (e.g. the presentation of income taxes differs between the statement of cash flows and the statement of profit or loss).

Classification of interest and dividend cash flows (proposed new paragraphs 33A and 34A–34D of IAS 7)

We agree with the proposals, for both, entities from the financial and non-financial sector. In our opinion, the proposals will result in a more consistent classification of interest and dividend cash flows.

Applying the IASB's proposals, entities from the non-financial sector would be required to classify interest and dividends received as investing cash flows and interest paid as financing cash flows. In our jurisdiction, this would be a change for most of the entities that currently classify interest cash flows predominantly as cash flows from operating activities.

An issue the IASB might want to consider when improving the guidance proposed, relates to the presentation of interest and dividend cash flows for entities that have more than one business activity (e.g. a manufacturer that also provides financing to customers). According to the proposed new paragraph 34B of IAS 7, an entity that provides 'financing to customers' as a main business activity or that 'invests in the course of its main business activities in assets that generate a return largely independently of other resources held by the entity' is required to classify dividends received and interest paid and received '*in a single category*' of the statement for cash flows. However, it is unclear, e.g. for a manufacturer that also provides financing to customers, whether paragraphs 34B-34D of IAS 7:

- apply only to interest received and paid in the course of its 'customer-financing' business activity, or
- apply to both, interest received and paid from the 'manufacturing' as well as the 'customer-financing' business activity.

We acknowledge that, for the statement of profit or loss, an entity that provides financing to customers as a main business activity has an accounting policy choice: As it may be difficult to allocate expenses from financing activities to the main activities, these entities are allowed to present all income and expenses from financing activities and all income and expenses from cash and cash equivalents in the operating category (paragraph 51). However, with respect to the statement of cash flows, requirements addressing the presentation of interest and dividends for entities with more than one business activity are lacking. Therefore, we suggest the IASB clarify whether entities with more than one business activity should allocate interest

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and dividend cash flows to their main activities which may result in a presentation of interest and dividend cash flows in more than one category in the statement of cash flows. For example, a manufacturer that also provides financing to customers will be required to present interest received from its 'manufacturing' business activity as investing cash flows; while interest received from its 'customer-financing' business activity will be presented as operating cash flows.

Also, as explained before, we are concerned that entities will face difficulties in determining whether the conditions for the specific presentation requirements of '*an entity that provides financing to customers as a main business activity or in the course of its invests main business activities invests in assets*' are met (please refer to our answers to question 3 and 4).

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

Classification of foreign exchange differences (paragraphs 56 and B39)

We agree with the principle that foreign exchange differences should be classified in the same category of the statement of profit or loss as the income and expenses from the items that gave rise to the foreign exchange differences. IFRS Standards currently do not include requirements regarding the classification of foreign exchange differences. Classifying exchange differences in the same category of the statement of profit or loss as the income and expenses from the items that gave rise to them would contributes to a faithful representation of the categories. Therefore, we agree with the proposals.

It should be noted that some entities would be required to change their presentation of foreign exchange differences. Currently, some entities already allocate foreign exchange differences according to their source and include exchange differences arising from operating activities in their operating profit or loss measure, while other entities instead include all foreign exchange differences in finance cost (i.e. they do not classify exchange differences in the same category that gave rise to them). These entities will need to change their internal processes and adapt their accounting systems to classify foreign exchange differences into the proposed categories in the statement of profit or loss. We have received feedback from our constituents that classifying foreign exchange differences to the categories of the statement of profit or loss is complex and costly to implement. To allow entities enough time to make any necessary updates to their accounting systems and resolve any operational challenges, we recommend the IASB to extend the transition period by a further year.

We note that – unlike the classification of fair value gains and losses on derivatives and hedging instruments – the IASB is not proposing any default category for the classification of foreign exchange differences for those instances where more than one category is affected by the foreign currency translation of an item. We wonder whether the IASB's intention was that

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income and expenses from an asset or a liability can only affect one category in the statement of profit or loss. Therefore, we suggest the IASB to clarify the presentation of foreign exchange differences when income and expenses from the items that gave rise to the foreign exchange differences are classified in more than one category.

Classification of fair value gains and losses on derivatives and hedging instruments (paragraphs 57-59 and B40-B42)

We agree with the proposal that fair value gains and losses on derivatives and hedging instruments should be classified in the category affected by the risk the entity manages. IFRS Standards currently do not require a classification of fair value gains and losses on derivatives and hedging instruments according to the category affected by the risk the entity manages. Therefore, some entities would need to change their presentation.

However, we have some concerns regarding the proposal that fair value gains and losses on derivatives and hedging instruments shall be classified in the investing category (as a default category), if a classification in the category affected by the risk the entity manages would involve grossing up gains and losses and for derivatives are not used for risk management. This could result in entities being required to present an investing category simply due to their hedging and risk management activities which will be difficult to explain to users of financial statements. We also believe that it is unlikely that entities use derivatives for purposes other than risk management. Therefore, we recommend the IASB to redeliberate whether another category should be designated as the default category, i.e. the operating or financing category that are typically related to risk management.

Further, we are concerned that the proposals would result in an inconsistent presentation regarding embedded derivatives: While a derivative embedded within a hybrid contract containing a financial asset host is not accounted for separately (paragraph 4.3.2 of IFRS 9), a derivative embedded within a hybrid contract containing a financial liability host needs to be separated if specific conditions are met (paragraph 4.3.3 of IFRS 9). As a result, a hybrid contract containing a host that is an asset will regularly be measured in its entirety at fair value though profit or loss and fair value gains or losses will be presented within a single category. Regarding a hybrid contract containing a host that is a liability, the embedded derivative needs to be separated and accounted for as a derivative. Consequently, fair value gains and losses from that derivative would be classified by default in the investing category (as the derivative is not used for risk management), while income and expenses from the host contract may be presented in another category (e.g. in the financing category for example when the host contract is a loan).

Whilst the IASB is proposing new presentation requirements for the classification of fair value gains and losses on derivatives and hedging instruments in the statement of profit or loss (paragraphs 57-59), corresponding proposals for the statement of cash flows are lacking. As explained in our overarching remarks preceding questions 2-6, we therefore recommend the IASB to reflect its proposed presentation requirements on the presentation of fair value gains and losses in the statement of cash flows.

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Presentation of goodwill as a separate line item in the statement of financial position (paragraph 82(d))

We agree with the proposal and the reasoning provided in paragraph BC119 of the Basis for Conclusions. In our opinion, the characteristics of goodwill are sufficiently different from those of other intangible assets. In addition, the current IFRS taxonomy already contains an element for a separate presentation of goodwill. Therefore, we support the proposal to require entities to present goodwill as a separate line item in the statement of financial position.

However, we note that in its Discussion Paper DP/2020/1 *Business Combinations – Disclosures, Goodwill and Impairment* the IASB considers requiring entities to present in their statement of financial position the amount of total equity excluding goodwill. Whilst we agree with the proposal in paragraph 82(d) of the ED, we do not agree with the proposal in the DP/2020/1 to present a separate line item '*total equity excluding goodwill*'.

Renaming the categories of other comprehensive income (paragraphs 74 and BC117 of the Basis for Conclusions)

As the IASB is solely changing the description of the two categories, we do not believe that renaming the categories will achieve the desired objective. This means, that we do not think that relabelling the categories of other comprehensive income will increase the understandability of amounts included in other comprehensive income.

Further, as explained in our comment letter to the Discussion Paper DP/2013/1 *A Review of the Conceptual Framework for Financial Reporting*, we regret that the IASB has not addressed further questions regarding other comprehensive income. These questions include, for example, the distinction between profit or loss and other comprehensive income and under which circumstances income and expense previously recognised in other comprehensive income should be recognised subsequently in profit or loss (i.e. recycled).

Effective date and transition (paragraphs 117-119)

We agree with the proposal that the proposed new IFRS Standard and the proposed amendments to other IFRS Standards shall be applied retrospectively in accordance with IAS 8. As the IASB is proposing changes to the structure of the statement of profit or loss, a restatement of comparatives is necessary to provide users with information that is comparable and comprehensible.

We also agree with the proposal that the new presentation requirements should be applied to the condensed interim financial statements in the first year an entity applies the new IFRS Standard (paragraphs 118, BC184 and BC225 of the Basis for Conclusions).

However, we do not agree with the statement that '*a restatement of comparatives should be relatively straightforward*' (ref. BC184 of the Basis for Conclusions). Depending on their current presentation practice, entities might need to adapt their accounting systems and processes in order to comply with the new requirements. This is particularly relevant regarding the following proposals:

- classification of foreign exchange differences (paragraph 56),

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- analysis of total operating expenses by nature when the primary analysis of expenses is by function (paragraph 72).

As these proposals relate to transactions with large volumes that are processed automatically, entities will need to adapt their accounting systems to comply with the new presentation and disclosure requirements.

Since these changes are not narrow, we are concerned whether the proposed transition period of 18-24 months (from the date of the publication) allows entities enough time to adapt their accounting systems and collect the information needed to restate comparatives. In fact, due to retrospective application of the new IFRS Standard, entities affected would need to change their systems until the beginning of the comparative period. Thus, in fact, these entities would have a transition period of 6-12 months instead of 18-24 months. Therefore, should the IASB retain these proposals, we would suggest the IASB to extend the transition period by a further year.

With respect to insurance entities, we have received feedback from our constituents that explain that the effective date (or a permitted earlier application) of the new IFRS Standard should be aligned to the effective date of IFRS 17/IFRS 9.

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