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Accounting Standards Committee of Germany

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Berlin, XX September 2020

Mr Hans Hoogervorst
Chairman of the
International Accounting Standards Board
Columbus Building
7 Westferry Circus / Canary Wharf
London E14 4HD

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

Appendix – Answers to the questions in the ED

Question 1

[TBD, Gegenstand der kommenden Sitzung]

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 objective of the ED is to increase the comparability by requiring entities to present new defined subtotals (such as the *operating profit or loss*), we would prefer a direct definition of the operating category.

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). However, we are concerned that defining the operating category as a default category might lead to an inconsistent classification in practice. As a result, the operating category might be 'blurred' with income and expenses from 'non-operating' activities, simply because these items do not meet the definition of the investing and financing category.

Nevertheless, in paragraph 46 of the ED the IASB is proposing 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).

Furthermore, we recommend the IASB to consider whether another category should be defined as the residual category (e.g. '*investing*', '*financing*' or even a fourth category '*other*'). In determining the default category, it should be considered which categorie can best be defined directly resulting in a clear and distinct description of the categories. The remaining category could then be defined as the default category.

Clarification needed regarding the notion of 'an entity's main business activities'

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

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. However, 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 particularly difficult for entities with multiple business activities and conglomerates to determine their main business activities.

Further, it is not clear whether income and expenses arising from those activities, that, applying paragraph B31 of the ED, are not part of an entity's main business activities, shall not be classified to the operating category. 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. On the one hand, it could be argued that including income and expenses from the advertising agency would 'blur' the operating profit or loss measure with non-customer-finance income and expenses. On the other hand, income and expenses from the advertising agency do neither meet the definition of the investing nor the financing category and, thus, they would to be presented by default in the operating category.

Further, we would like to highlight that the classification depends on the perspective adopted (e.g. financial statements of the group vs. separate financial statements of a subsidiary). This means, depending on the perspective adopted, that the classification of income and expenses to the categories needs to be carried out differently. As a result, it is possible that e.g. income and expenses on investment property would be classified to the operating category from the perspective of a subsidiary, but in the group's financial statements – due a different determination of the group's main business activities – these income and expenses might need to be presented within the investing category.

For reasons above, we recommend the IASB to:

- clarify the *notion of 'an entity's main business activities'*,
- develop further guidance to assist entities in determining their main business activities, especially when a business activity is not a separate operating segment, and
- clarify whether income and expenses arising from activities, that, applying paragraph B31 of the ED, are not part of an entity's main business activities, must not be classified to the operating category.

Lack of a principle-based guidance for classifying income and expenses to the operating category (paragraphs 46 and B33)

In our opinion, the principle for classifying income and expenses to the operating category is unclear. Although paragraph B33 is providing some guidance which items of income and expenses should be classified in the operating category, we are of the opinion that further principle-based guidance is needed.

According to paragraph B33 income and expenses from investments do not include income and expenses from *assets* used by an entity in the production of goods and delivery of services (such as income and expenses from property, plant and equipment, intangible assets and trade receivables). These income and expense items shall be presented in the operating category, instead. Thereby paragraph B33 appears to suggest that classifying income and expenses to the operating category should be based on whether the underlying asset or liability is an *'operating'* asset or an *'operating'* liability. A similar rationale is provided by the ED for the investing and the financing category: Income and expenses:

- from *financial assets* and *other investments* shall be classified to the investing category (ref. paragraph B32), and
- from financing activities shall be classified in the financing category. Income and expenses from financing activities include income and expenses on the following *liabilities*: debentures, loans, notes, bonds and mortgages, lease liabilities, and trade payables.

We have the impression that this is a reminder to the proposals of the former *Financial Statement Presentation* project, which proposed an application of the cohesiveness principle to the presentation across all the primary financial statements.

Kommentiert [IC1]: Möchte sich der IFRS-FA hierzu weiter positionieren?

We do not agree with the reasoning provided in paragraph B33 (i.e. that income and expenses from assets used by an entity in the production of goods and delivery of services shall be classified in the operating category). From a conceptual point of view, the classification of income and expenses to the operating category should rather be based on whether the income and expenses incurred in the course of an entity's main business activities (i.e. whether they incurred in order to contribute to the performance of the entity, i.e. to generate revenue).

For that reason, we also do not agree with the proposal of classifying interest revenue from trade receivables to the operating category. In our opinion, generating interest revenue from trade payables is not an entity's primary business purpose (except for entities that provide financing to customers as a main business activity). Rather, as explained in paragraph BC229 and BC244 of IFRS 15: '*A contract that has a financing component includes, conceptually, two transactions – one for the sale and one for the financing. […] As a result […], a contract with a* *customer that has a significant financing component would be separated into a revenue component (for the notional cash sales price) and a loan component (for the effect of the deferred or advance payment terms).'* Therefore, we suggest that interest revenue on trade receivables should be presented in the same category as interest (and similar) income from financial asset, i.e. in the investing category.

Further, 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 all income and expenses on these items would have to be presented within the operating category. We therefore recommend the IASB to reconsider the proposed principle for classifying income and expenses to the operating category and to apply that principle consistently to income and expenses to both, trade payables and trade receivables.

Kommentiert [IC2]: Möchte der IFRS-FA einen anderen Ausweis in Bezug auf Zinsaufwendungen aus Verbindlichkeiten aus Lieferungen und Leistungen (mit verlängertem Zahlungsziel) anregen? Oder soll nur (wie vorgeschlagen) eine Empfehlung an den IASB dahingehend geäußert werden, ein in sich schlüssiges und überzeugendes Prinzip für die Kategorie Operating vorzulegen?

Within this context, we think that further clarification is also needed as to whether income and expenses from an asset (or a liability) shall unilaterally be classified each 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 an asset (or a 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 sales are carried out via 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', corresponding requirements regarding changes in classification to the categories of the statement of profit or loss are lacking.

Proposed description of the categories – 'operating', 'investing' and 'financing' (paragraphs 45)

The proposed descriptions for the categories in the statement of profit and loss (i.e. '*operating*', '*investing*' and '*financing*') are inconsistent within the IFRS 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. Further, we note that – except for the classification of interest and dividend cash flows – the IASB is not seeking to further align classifications across the primary financial statements (ref. BC30 of the Basis for Conclusions).

However, using the same terms with a different meaning might create confusion and reduce understandability of the information provided in the primary financial statements. Therefore, we suggest the IASB to:

- either use different terms when describing the new categories of the statement of profit or loss, when it is reasonable that differences in the classification between the statement of cash flows and the statement of profit or loss should be retained, or
- align the categories of the statement of profit or loss with the corresponding sections of the statement of cash flows.

We regret that the IASB is proposing only targeted improvements to the statement of cash flows. As explained in more detail in our answer to question 13, we suggest the IASB to undertake a comprehensive review of IAS 7 in the light of the proposals on the new structure and content of the statement of cash flows.

To enhance understandability, we further recommend the IASB to include a definition of the new categories in Appendix A of the new IFRS Standard. Currently, such definitions are missing.

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 affected entities enough time to make any necessary updates to their systems and resolve any operational challenges, we recommend

Kommentiert [IC3]: Hinweis an den IFRS-FA:
Der IASB hat in seiner Abschätzung der Kosten den Implementierungsaufwand für die Vorschläge zur FX-Umrechnung nicht explizit gewürdigt. In der *Basis for Conclusions* wird lediglich in Tz. BC285(b) darauf verwiesen, dass der Implementierungsaufwand für solche Unternehmen höher ausfallen kann, die über eine zentralisierte Treasury-Funktion verfügen. In solchen Fällen sei mit zusätzlichen Kosten der Implementierung aus der erforderlichen Zuordnung der FX-Effekte auf die Kategorien zu rechnen.

the IASB to extend the transition period to 36 months (please refer to our answer to question 14).

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 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 foreign exchange differences resulting when income and expenses from the items that gave rise to the foreign exchange differences are classified in more than one category.

Kommentiert [IC4]: Beispiel benennen?

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 in 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), e.g. if a classification in the category affected by the risk an entity manages would involve grossing up gains and losses or for derivatives 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.

Kommentiert [IC5]: Hinweis an den IFRS-FA:
Antwort abzustimmen mit der grundsätzlichen Position in Bezug auf die Kategorie „*Investing*".

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 loss will be presented within a single category. Regarding a hybrid contract containing a host that is a liability, the embedded derivative would need 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).

Kommentiert [IC6]: Möchte der IFRS-FA eine Alternative oder eine Empfehlung anregen?

Question 3-6

[TBD, Gegenstand der kommenden Sitzung]

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'. ~~As, e.g.~~For example, associates and joint ventures in a start-up phase and R&D co-operations, are setting up a new business, and thus, ~~they~~ 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 ~~the same~~ 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 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 ~~and, hence, do not meet the definition of income and expenses from investments~~.

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 ~~investors~~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*.
- 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.

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).

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 '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, the proposed new paragraph 38A of IAS 7 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-integral 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, 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.

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 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 new proposed 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.

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.

For the reasons above, we do not believe that the proposals ~~, in practice,~~ 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~~will lead to changes in the presentation method selected in the statement of profit or loss~~. 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 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 ~~– after considering the indicators in paragraph B45 –~~ 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. ~~We~~ T~~t~~herefore, 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 ~~line~~ items under the nature of expense method might be low. Considering the Illustrative Example (Part I, Note 1), we question whether ~~the line items~~disclosures regarding the '*reversal of inventory write downs*', '*impairment of property, plant and equipment*'', '*impairment losses on trade receivables*', '*gains (losses) on derivatives*', and ~~especially~~ '*other miscellaneous expenses*' provide information that is more relevant for forecasts than a presentation by function.

~~Further,~~ It should be stressed that ~~under current proposals, the IASB is not requiring a set of minimum line items specifically required under the nature of expense method. Proposed new paragraph 69 rather enumerates typical line items of the nature of expense method, '*such as information about expenses related to materials (raw materials, employees (employee benefits), equipment (depreciation) or intangible assets (amortisation)*'. However, this information is already required to be disclosed under~~ 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~~for entities classifying expenses by function~~. 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. We therefore encourage the IASB to investigate further, which information about operating expenses by nature is needed by users of financial statements.

~~In addition,~~ 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~~ We have received feedback from ~~our constituents~~ 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 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 ~~und~~ 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 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 under the current proposals 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 ~~choose to present these expense items~~ 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. 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,
- ~~specifically~~ 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 ~~BC108 of the Basis for Conclusions~~)

We agree with the proposal in paragraph B44 and the reasons for the proposal provided in paragraph BC108 of the Basis for Conclusions. ~~The IASB explains in paragraphs B44 and BC108 of the Basis for Conclusions that I~~in our opinion, a ~~order to achieve 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 ~~entities shall be required to disaggregate~~ a required line item~~, for example impairment losses on financial instruments, and present it~~ in different categories of the statement of profit or loss.

~~We do not completely agree with that statement. Whilst we agree with the principle that the categories shall be presented faithfully, we do not agree with the conclusion that required line items shall be presented separately in each section of the statement of profit or loss, as this means that the same required line item (e.g. impairment losses on financial instruments) would appear in more than one section. Firstly, in our view, this approach would result in a proliferation of line items which could obscure information and reduce the understandability of the statement of profit or loss. Secondly, in applying this approach the information about the total amount of e.g. impairment losses on financial instruments is lost, as it is separated into different categories of the statement of profit or loss. Thirdly, applying this approach might also result in a presentation that depict an incomplete picture of the line items by function. This means that the line items to be presented under the function of expense method (i.e. 'cost of sales', 'selling expenses', general and administration expenses', etc.) would in general exclude amounts related to the requirements of IFRS 9 that need to be presented separately in accordance with paragraph 65(b).~~

~~We therefore encourage the IASB to investigate whether the line items required according to the proposed new paragraph 65(b) shall continue to be presented separately on the face 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)

~~The IASB proposes in paragraphs 65(a)(vii) to require an entity to present in the statement of profit or loss a separate line item '*cost of sales*'. Proposed new paragraph 71 states that '*an entity applying the function of expense method shall present its cost of sales separately from other expenses*'.~~

~~However, in~~In our opinion, paragraph~~s~~ 65(a)(vii) is confusing as it requires an entity to present a separate ~~(minimum)~~ line item *'cost of sales'* in the statement of profit or loss. But, according to paragraph 71, ~~, but~~ that requirement applies only to entities ~~that apply~~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 ~~line~~ 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). ~~The IASB further explains in paragraph BC116 of the Basis for Conclusions that '*to ensure that these line items continue to be presented prominently, the Board proposes to require entities to present them separately in the statement of profit or loss whichever method of analysis of operating expenses is used.*'~~

Therefore, w~~W~~e suggest the IASB to clarify that an entity that applies the nature of expense method need neither present nor disclose its cost of sales. ~~This means that paragraph 71 should be read as an exception to the principle that all line items listed in paragraph 65 are applicable to all entities regardless of the method of analysis of expenses in the operating profit section.~~

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.

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 provide a definition of 'unusual 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 comparability and transparency of information ~~among entities~~ if clear guidelines ~~if more standardisation were available~~ regarding the definition and presentation of 'unusual income and expenses' were available~~items~~. In practice, entities currently apply different ~~The current lack of IFRS guidance – and the explicit prohibition of labelling items as 'extraordinary' – results in a variety of different~~ approaches for reporting unusual or infrequently occurring transactions or events in IFRS financial statements.

Whilst we agree with the IASB's objective, we think that the proposed definition of income 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*' (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 narrow scope 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'.

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 when improving the guidance proposed 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, ~~e.g. in paragraphs B71 and BC133 of the Basis for Conclusions, in which the IASB is providing examples for income and expenses that are not deemed unusual 'by type',~~ we wonder whether, in fact, both conditions (i.e. by type *and* amount) need to be met to classify an income or expense 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 income or expense 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 agree~~we are concerned whether the IASB’s objective – to provide users with useful information about income and expenses which may not persist – can be achieved~~with the proposed definition of unusual income and expenses~~. On the one hand, we understand that the IASB is seeking to set limits and reduce entities’ discretion regarding the classification of expenses as unusual. On the other hand~~In our opinion~~, the proposed definition is too narrow 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’. ~~Hence, we believe that under the proposed definition the IASB’s objective – of enabling users to identify income and expenses which may not persist – will not be achieved.~~

Nevertheless, we support the IASB’s intention to provide more transparency about income and expenses that an entity considers to be unusual. Therefore, we encourage the IASB to investigate further which information about ‘unusual’ or ‘infrequent’ income and expenses provides useful information to users and hence should be covered by a definition of unusual income and expenses.

Kommentiert [IC7]: Frage an die IFRS-FA:
Wie möchte sich der IFRS-FA insgesamt zur Definition von ‚ungewöhnlichen Erträgen und Aufwendungen‘ positionieren? Möchte der IFRS-FA Empfehlungen an den IASB zur Überarbeitung der Definition aussprechen?

Im Ergebnis aus der 84. Sitzung des IFRS-FA war festzuhalten, dass der Vorschlag einer Definition sowie die Vorgabe von Angabepflichten begrüßt wird. Gleichwohl weise die vorgeschlagene Definition Schwächen auf, da sie zu eng gefasst ist. Andererseits sei eine möglichst eng gefasst Definition wünschenswert, um für den Adressaten nützliche Informationen zur "ungewöhnlichen Erträgen und Aufwendungen“ bereitzustellen.

Proposed definition of ‘unusual income and expenses’ in the light of the current Covid-19 crisis

We are concerned whether, in times of an economic crisis such as the current Covid-19 crisis, the proposed definition of ‘unusual income and expenses’ can achieve the desired objective of providing useful information about income and expenses which may not persist. 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 provide a forecast. Consequently, as the definition of ‘unusual’ is based on an expectation about the future, entities might not be able to forecast their future ‘usual’ income and expenses, and thus, will not be able to predict whether or not it is reasonable to expect that income or expenses similar in type and amount will arise in any of several future annual reporting periods.

Further, considering the current Covid-19 crisis, we question whether the outcome under the proposed definition provides useful information to users:

- A shortfall in revenue, which is probably the main effect under the current Covid-19 crisis, is not covered by the proposed definition of ‘unusual’, as the definition focuses on recognized income and expenses. Thus, the definition of 'unusual income and expenses' represents only a limited view on the impact of the crisis on the entity's financial performance.

- Further, we question whether the proposed definition is practicable. For example, the determination of idle cost requires that a normal capacity of the production facilities (even in times of a crisis) can be determined in order to separate the portion of 'unusual' idle cost. Again, entities will likely face difficulties in determining the production expected to be achieved on average over a number of periods '*under normal circumstances*'. As the Covid-19 pandemic currently demonstrates, the expectation of what can be expected to be achieved '*under normal circumstances*' needs to be revised to a yet unknown 'new normal' (post crisis).
- In addition, 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) which have effects on the statement of financial performance that can be isolated and quantified easily. However, an individual event (such as the Covid-19 pandemic) may have an impact on many transactions and business lines, so that it is hardly possible to determine what was caused by the singular event and how the 'normal' course of business would have been without that event.

For the reasons above, we question whether the proposed definition provides a robust differentiation between of 'usual' and 'unusual' income and expenses in times of an economic crisis. However, in our view, a proposed definition and related disclosures requirements should provide robust results under 'normal circumstances' as well as in times of an economic crisis. ~~Therefore, we do not agree with the proposed definition of 'unusual income and expenses'.~~

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.

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 allowing entities to disclose unusual (or similarly described) income and expenses and to report 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'.

We doubt that the proposed guidelines will reduce the extent to which performance measures are adjusted, nor that the use of alternative performance measures will be reduced by the proposed guidelines. As explained above, the IASB has already enumerated a couple of examples of unusual income and expenses (e.g. impairment losses, restructuring expenses, etc.). Therefore, we are concerned that the IASB is weakening its new product (i.e. the proposed new subtotals and the proposed new structure in the statement of profit or loss) through the proposals on 'unusual income and expenses'.

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'.

[…]

Kommentiert [IC8]: Hat der IFRS-FA weitere Anmerkungen zu den vorgeschlagenen Angabepflichten zu „ungewöhnlichen Erträgen und Aufwendungen"?

- Ort der Angabe (*in a single note*)
- Art der Angaben:
  - Betrag jedes Postens
  - den Posten in der Ergebnisrechnung, in dem die ungewöhnlichen Erträge und Aufwendungen jeweils enthalten sind
  - eine Aufgliederung der ungewöhnlichen Aufwendungen nach dem Gesamtkostenverfahren, sofern das Unternehmen das Umsatzkostenverfahren anwendet

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).

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 <u>not</u> 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.

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.

In addition, this may raise the question on whether the IASB should require the disclosure of performance measures that are presented outside the financial statements; the disclosure of which is already required by regulators.

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 this disclosure, 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).

[…]

Kommentiert [IC9]: Hat der IFRS-FA weitere Anmerkungen zu:
- den Angabepflichten in Tz. 106 des ED
- den Grundsätzen der Darstellung von MPMs
- zum Illustrative Example oder
- zu den vorgeschlagenen Änderungen an IAS 33 / IAS 34 im Zusammenhang mit MPMs?

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 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 regret that the IASB has not decided to define '*earnings before interest, tax, depreciation and amortisation*' (EBITDA). We would have preferred the opposite, i.e. providing a definition of EBITDA, to increase comparability across entities.

Nonetheless, we understand the IASB's reasoning for not undertaking an attempt to define EBITDA. We agree with the IASB's statement that, in practice, a large variety of EBITDA measures is used, and that the calculation of these measures is diverse in practice. As a result, there is no consensus about what EBITDA represents. Providing a definition of EBITDA would give rise to complex questions regarding the classification of income and expense items effecting that the proposed definition might face objections in practice.

However, for the same reasoning as provided in paragraph BC172 of the Basis for Conclusions, the IASB is proposing a definition of the subtotals '*operating profit or loss*' and '*operating profit 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 regret that the IASB has decided not to provide a definition of EBITDA.

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)

Given the difficulties the IASB is expecting when considering proposing a definition of EBITDA, we understand and agree with the approach to add '*operating profit before depreciation and amortisation*' to the list of measures that are not considered to be management performance measures.

Nonetheless, as explained above, we would have preferred a proposal of a definition of EBITDA. Thus, in our view, the proposed approach of exempting the measure '*operating profit or loss before depreciation and amortization*' from the disclosures for management performance measures is to be regarded as a pragmatic compromise. Furthermore, this approach lacks a principle-based substantiation.

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 reasons for the proposal, as described in paragraphs BC186-188 of the Basis for Conclusions. This starting point has the advantage that fewer reconciling items have to be adjusted when determining cash flows from operating activities.

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, paragraph 51 provides an entity that provides financing to customers as a main business activity with 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. 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 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 answer to question XX).

Further improvements to the statement of cash flows

We appreciate that the IASB is seeking to improve consistency of the statement of cash flows with the new content and structure of the statement of profit or loss. However, we regret that the IASB is proposing only limited amendments to the statement of cash flows and is missing the opportunity to address further deficiencies of IAS 7. For example, 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.

The IASB explains in paragraphs BC30 and BC194 of the Basis for Conclusions that – except for the classification of interest and dividend cash flows – it is not seeking to further align classifications across the primary financial statements. We regret this decision, as it may be claimed that the IASB itself weakens its own proposal because the new defined principle (cohesiveness objective) is only applied selectively to some cash flows.

We therefore suggest the IASB to initiate a separate project on IAS 7 *Statement of Cash Flows* with the objective of having a comprehensive review of IAS 7 in the light of the proposals on the new content and structure of the statement of profit or loss.

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?

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

We agree with the proposal and the reasons for the proposal, as described in paragraph BC119 of the Basis for Conclusions. In our opinion, the characteristics of goodwill are sufficiently different from those of 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.

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

We agree with the proposals. However, 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 believe that relabelling 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),
- 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 affected 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, we suggest the IASB to extend the transition period by 12 months to 36 months.

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.