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June 5, 2020

DRAFT COMMENT LETTER

On behalf of the Austrian Financial Reporting and Auditing Committee (AFRAC), the privately organised standard-setting body for financial reporting and auditing standards in Austria, we appreciate the opportunity to comment on *Exposure Draft* ED/2019/7 *"General Presentation and Disclosures (Primary Financial Statements)".*

Principal authors of this comment letter were Max Eibensteiner, Leopold Fischl, Erich Kandler, Helmut Kerschbaumer, Gerhard Prachner, and Alfred Wagenhofer. In order to assure a balanced Austrian view, the professional background of these authors is diverse.

GENERAL REMARKS

Generally, we agree with the objective of the Exposure Draft and the proposed changes of the statement of profit or loss and other statements. The previous requirements for items and subtotals in the statement of profit or loss are not adequate for modern financial reporting and gave rise to a lack of comparability and the disclosure of management performance measures. The Exposure Draft strikes a balance between comparability (even some uniformity) and entity-specific needs.

We are in favor of the introduction of the three categories, particularly the operating category, although we note that the investing and financing categories are not aligned with similar categories in the statement of cash flows. While we support the distinction in integral and non-integral joint ventures and associates, we do not find it useful to require specific sub-categories of the operating category with clumsy names. We think the description of unusual income and expenses as being of limited predictive value is conceptually sound and helpful in practice. We generally agree with the importance of disclosures for management performance measures.

We also agree with the proposal in the Exposure Draft to replace IAS 1 by a new standard and to move parts of the current IAS 1 requirements to IAS 8 and to other standards.

Detailed comments on the questions and other comments can be found below.

SPECIFIC REMARKS

Question 1- Operating Profit or Loss

Paragraph 60(a) of the Exposure Draft proposes that all entities present in the statement of profit or loss a subtotal for operating profit or loss. Paragraph BC53 of the Basis for Conclusions describes the Board's reasons for this proposal.

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

We agree. The current requirements in IAS 1 regarding the format of the statement of profit or loss are insufficient. Entities currently use different, or no, subtotals, which reduces comparability.

Operating profit/loss is a measure used pervasively and in most business operations of the reporting entity. Moreover, it is well understood in the financial community and widely used by financial analysts. It should be defined in an IFRS in order to reduce diversity and enhance comparability between entities. The proposed operating category indeed leads to a more comparable performance measure but provides sufficient flexibility to accommodate the main business models.

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?

We generally agree. Investing and financing activities can be defined in a standard more clearly than the operating category, so it is useful to define operating as the residual (para. 46). Issues with the proposed categorization arise for banks and insurance companies and for conglomerates (see our comments to questions below).

The ED proposes to include the unwinding of the discounting of non-financing liabilities in the financing category (see para. BC42). Currently, there is a choice at least for IAS 19 provisions to include them in the operating or non-operating category. We support this proposal and suggest that the stated principle is also introduced in the rest of the standards where unwinding of discounting occurs.

Finally, see also our comments below on the split between integral and non-integral associates and joint ventures.

Question 3- The Operating Category: Income and Expenses from Investments Made in the Course of an Entity's Main Business Activities

Paragraph 48 of the Exposure Draft proposes that an entity classifies in the operating category income and expenses from investments made in the course of the entity's main business activities. Paragraphs BC58–BC61 of the Basis for Conclusions describe the Board's reasons for this proposal.

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

We agree with the proposal that the operating category includes income and expenses from the main business activity, and appreciate the description that resolves issues arising for banking and insurance activities (para. 52).

While the guidance in para. 48 helps, it does not resolve the issue of "main business activities" of an entity that has two approximately equal unrelated activities, say, a conglomerate group with manufacturing and banking activities. Either these entities can use a column format to present their different activities (with the concern that the comparison values might be cumbersome to present) or are forced to select one of their activities as their main business activity. We would expect more guidance in such a case.

Question 4- The Operating Category: An Entity that Provides Financing to Customers as a Main Business Activity

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

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

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

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

We question the proposed free presentation policy choice. We understand the intent of the IASB to avoid allocations ("may not be able to identify a non-arbitrary basis for allocating", see para. BC65, BC66) but we note that allocations are a common process in many measurements under IFRS standards. Even if they appear to be "arbitrary," they are subject to continuity and thus provide relevant information. Instead of offering a free choice, we suggest limiting the choice by referring to the management approach, that is, binding it to the policy used in the entity.

We also note that a firm that elects the full inclusion of financing in the operating category (para. 51(b)) shall (!) not present a subtotal of profit or loss before financing and income tax (para. BC69). This changes the now stricter format of the statement of profit or loss.

Question 5- The Investing Category

Paragraphs 47‑48 of the Exposure Draft propose that an entity classifies in the investing category income and expenses (including related incremental expenses) from assets that generate a return individually and largely independently of other resources held by the entity, unless they are investments made in the course of the entity's main business activities. Paragraphs BC48‑BC52 of the Basis for Conclusions describe the Board's reasons for the proposal.

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

We agree with the definition.

We are concerned with the proposal that the investing category includes only incremental expenses related to investment (para. 47(b)). This implies that profit or loss from investing is overstated relative to profit or loss from operating activities, which as a default includes all fixed expenses. Nevertheless, we do not see an easy solution that avoids complex allocations (see para. BC50).

A fundamental conceptual issue is that the investing category in the statement of profit or loss is defined more narrowly to cash flow from investing activities in IAS 7. Although both are primary statements and prominently report on investing, they are totally non-comparable. If these two concepts cannot be reconciled, it may be useful to consider different labels to avoid confusion among users.

Related to the comment above, it is not clear if the financing category corresponds to the financing activities in IAS 7. For example, how do income and expenses from cash or cash equivalents relate to investing and financing?

<u>Question 6- Profit or Loss Before Financing and Income Tax and the Financing Category</u>

(a) Paragraphs 60(c) and 64 of the Exposure Draft propose that all entities, except for some specified entities (see paragraph 64 of the Exposure Draft), present a profit or loss before financing and income tax subtotal in the statement of profit or loss.

(b) Paragraph 49 of the Exposure Draft proposes which income and expenses an entity classifies in the financing category.

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

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

We agree with requiring the presentation of a subtotal profit or loss before financing and income tax.

Moreover, as far as trade payables (para. B35 c)) are concerned, the Board may consider to be more precise in its wording. It is not clear, what exactly "negotiated on extended credit terms" should circumscribe? To which benchmark is "extended" referring to? Does it relate to common terms for a specific country, region or industry? We propose to include expenses related to trade liabilities for which discounting at initial recognition would be required (i.e. usually liabilities with a maturity at inception of more than one year).

As we mention before, we are not in favor of the policy choice in para. 51 and, consequentially, also not for the exception in para. 64.

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?

We agree that it is useful to distinguish between integral and non-integral associates and joint ventures in IFRS 12 because the reasons holding the shares are economically different. We also find information about them and the income and expenses from them relevant for users.

In terms of presentation, we do not agree with requiring a separate subtotal for income and expenses from integral associates and joint ventures. We understand that analysts often do exclude them when calculating ratios, they find the information even if it is in a separate line item within operating profit or loss. We find the label "operating profit or loss and income and expenses from integral associates and joint ventures" clumsy and hard to relate to. We also cannot think of a sensible abbreviation when referring to this subtotal. The clumsy labeling, though, looks very "academic" and suggests that integral associates and joint ventures are a separate category rather than part of operating profit or loss.

We agree that the reporting entity shall disclose why it considers specific JVs and associates as integral to enable users to judge which kind of services/products/know-how provided by the investee contributes significantly to the operating profit or loss.

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?

We generally agree.

However, the aggregation of dissimilar items can hardly be avoided without making financial statements hard to read. E.g. "other income", i.e. income generated in the course of an entity's daily business but that is not revenue with customers can include a broad variety of items, ranging from canteen income to insurance reimbursements. From a preparer's view, the question remains if these items need to be presented separately, considering the fact that especially in consolidated financial statements the diversity in this area might be substantial. The application of the guidance for aggregation and disaggregation requires much judgement in practice, so further guidance would be helpful.

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?

We generally agree. We believe eliminating a free choice between the nature or function of expense method improves comparability of the statement of profit or loss. We also find the guidance on the selection of the presentation method in para. B45 useful.

However, we doubt whether para. B45 (a) is a helpful indicator for choosing a presentation of operating cost by function or nature. Para. B45 requires entities to decide "which method of expense analysis provides the most useful information" and subpara. (a) is essentially requiring the same. We suggest eliminating (a) because (b) to (d) provide sufficient guidance.

We support the proposal to require disclosure of the costs by nature in the notes when cost by function is applied in the statement of financial performance. This is in line with para. B45(d) that it is the default category.

We are strongly against a possibility that an entity can use a mixed approach in the statement of profit or loss. We are not sure if such a possibility could arise following para. B46 and B47.

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?

We generally agree. We believe information on unusual income and expenses is important precisely because these items have limited predictive value. Therefore, we support the Board's proposed definition of "unusual" as "being of limited predictive value". The examples given in para. B67-B75 are helpful because they clearly indicate that the definition is meant to be very restrictive. Entities that want to provide additional information on other items that are not "unusual" are free to do so, although outside the single note required in para. 100.

Nonetheless, the exact meaning of the definition of "unusual" could create room for discretion and non-comparability in practice. Discretion and non-comparability were reasons why former requirements to disclose extraordinary items were abandoned. Relating to this prior experience, we suggest that entities should not present unusual items on the face of the financial statements by specifically referring to 'unusual line items' and 'unusual subtotals' within the subtotals required by the ED. If the definition of "unusual" differs between entities, such line items and subtotals would be non-comparable.

The indicators proposed by the Board are well-defined, balancing the reporting entity's ability for judgement with the necessity of setting clear boundaries for what can be considered as unusual in terms of nature and/or number of items. We suggest to be more prescriptive about the outlook horizon of "several future annual reporting periods". Using the entity's planning horizon as commonly used in impairment testing could be a reasonable benchmark.

The guidance is not entirely clear for unusual incomes and expenses that are linked, but fall in two different accounting periods. In some insurance cases, significant time can lie between the recognition of the expense (e.g., the damage caused by a fire incident) and the insurance reimbursement. It might be worth considering such situations in B73, making clear that both should be (at least from our perspective) unusual in the period they affect the profit and loss accounts (given the fact that a fire is an unusual incident by itself which in some industries is not).

<u>Question 11- Management Performance Measures</u>

(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?

We generally agree with the definition of management performance measures and the proposed disclosure requirements. They are in line with requirements by supervisory institutions, such as the ESMA guidelines.

We suggest clarifying that the requirements relate to management performance measures that are based on subtotals or other items in the statement of profit or loss, and not necessarily to other performance measures that entities use, in particular, non-financial measures.

We also find it useful to explicitly state which measures are not management performance measures in para. 104. However, because EBITDA is widely used, we suggest including EBITDA in the list in para. 104, provided the EBITDA used by an entity is directly reconcilable from the items in the statement of profit or loss.

We believe that the requirements in para. 106 (c) and (d) can be very costly for entities because they can mean drilling down to each entity within the group.

We would also find it useful to discuss the relation between management performance measures and segment earnings under IFRS 8 and suggest to require an explanation of the relation in the notes. And we suggest requiring that the management performance measures that are reported are actually used internally by management, by applying the management approach. This should also limit the number of management performance measures reported as such.

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?

We disagree. EBITDA is a widely used performance measure and be even included in the list of measures that are not MPMs in para. 104 (see also our comments to Question 11). There is diversity in the calculation in practice, hence, a standardization is particularly relevant.

We propose a calculation of EBITDA readily based on subtotals and other items in the statement of profit or loss. If an entity uses a different calculation it should not name this measure as EBITDA.

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?

We agree with both proposals.

However, as we noted earlier, we are not happy with the differing definition of investing activities in the statement of profit or loss and in the statement of cash flows. We think the conceptual difference will lead to confusion in practice. A distinct labelling or a reconciliation would be helpful.

<u>Question 14- Other Comments</u>

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?

We have the following comments.

1. Labelling of subtotals

The proposal introduces several new subtotals with sometimes clumsy names. We suggest clarification whether entities can use other names as long as it is clear what they mean (as, for example, when using "balance sheet" for statement of financial position, para. 10)?

We are concerned how entities and users will abbreviate the new long names. Some common abbreviations, like EBIT or EBITDA, are not used, but new names are introduced. We suggest the IASB takes the opportunity to also propose unique abbreviations for the new subtotals.

Then, the following subtotals are:

   Profit before financing and income tax
± Income and expenses from financing activities
= Profit before tax

Why is it not "profit before income tax" or the first subtotal "profit before financing and tax"?

Para. 74 proposes new, more descriptive titles for the two subtotals in the statement of OCI, but they are clumsy and are not used throughout the ED including supporting materials.

Para. 74 states "Income and expenses to be included in profit or loss in the future when specific conditions are met". In subsequent text and the examples in the IE other names are used. For example, the ED defines "reclassification adjustments" (Appendix A), which is apparently the same as "to be included in profit or loss in the future …". On the other hand, the table at the end of the proposed Standard includes a general replacement of "reclassification" with some other text (or its variation?). "Reclassification" is also used in other contexts. We suggest to use clear labels for the various concepts.

Then, the example of the statement of OCI in IE, page 7, uses "Income and expenses that may be included in profit or loss in the future". What does "may" mean?

2. Regulatory items

Several entities, particularly in specific industries, are subject to regulatory requirements that are based on subtotals or items in the statement of profit or loss. It should be explicitly stated that it is permitted to report such regulatory measures in the notes.

3. Renumbering

We suggest to renumber the paragraphs in IAS 8 (revised) with consecutive numbers instead of adding capital letters to the existing numbers because of the many changes that are proposed.

4. Translations

The ED introduces some new terms, such as “unusual”. We urge the IASB to check if there arise translation issues in some languages.