



EFRAG  
35 Square de Meeûs  
(5<sup>th</sup> floor)  
1000 Bruxelles

23 February 2010

**BUSINESSEUROPE's response to the PAAinE Discussion Paper *Performance Reporting: a European Discussion Paper***

Dear Sir/Madam,

BUSINESSEUROPE welcomes the PAAinE Discussion Paper *Performance Reporting: a European Discussion Paper*. As it explains (for example in paragraph 3.16), the 2008 IASB/FASB Discussion Paper ("DP") on Financial Statement Presentation did not address performance reporting, in particular which items should be included and which should be excluded from a financial measure of performance.

Whilst many preparers and users may be relieved that the DP does not therefore revisit the definition of net income, there should be no complacency because in other projects, notably on pensions and financial instruments, the Boards may make decisions between OCI and net income without a conceptual basis. There may also be future changes in recognition and measurement requirements for certain assets and liabilities.

It is therefore very important that this issue is addressed urgently, and the PAAinE paper only goes so far. We agree with PAAinE's conclusion (as a result of PwC studies referenced in paragraph 3.31) that users "are apparently not using comprehensive income as a proxy for management performance".

We are providing some general comments in the appendix to this letter followed by responses to the specific questions posed in the paper.

Yours sincerely,

Jérôme P. Chauvin  
Director  
Legal Affairs Department  
Internal Market Department



## **APPENDIX**

### **General comments**

In the first paragraph of the paper (1.1), there is the statement that “the primary objective of all accounting standards and all standard-setting effort is to maximise the usefulness of the performance reporting aspects of the financial statements”. BUSINESSEUROPE would give priority to the income statement and the need for performance reporting.

However, whilst BUSINESSEUROPE therefore agrees with the PAAinE statement, and the consequential implications that the paper sets out, probably the most critical issue underlying the debate on Financial Statement Presentation is that the IASB/FASB have a different view. The Exposure Draft of Chapter 1 of the Conceptual Framework proposes that “The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to present and potential equity investors, lenders, and other creditors in making decisions in their capacity as capital providers.”

Compared with the objective set out by PAAinE, the ED does not have the same focus on performance and this leads the IASB/FASB, for example, to downgrade the primacy of the income statement, and to consider that it should be simply the difference between two balance sheets (excluding transactions with equity owners).

There is one other issue we would like to raise at the outset of this response. This is not a criticism of the PAAinE paper, but there is perhaps some confusion as to the meaning of the word “disaggregation” simply because PAAinE use it in a different way from the DP. The PAAinE paper refers to various levels of disaggregation, for example “primary” disaggregation may be a means of distinguishing between net income and OCI. Whereas the DP only discusses disaggregation in the context of items already within net income or within OCI, and also uses the term categorisation to divide up the income statement between operating, investing and financing.

There may be a specific cause of confusion within the PAAinE paper itself because of the different levels of disaggregation. In parts of the paper it is not always clear whether the discussion is about the boundaries of net income or of disaggregating information within net income (and key lines/sub-totals within net income). This is mentioned in paragraph 5.55. We feel these are two very different aspects and should be dealt with separately.

BUSINESSEUROPE believes there is a need for a measure of reporting performance and providing a conceptual definition of net income. We feel that an income statement based on balance sheet movements is not considered useful, particularly when the balance sheet includes items measured at amounts that are not an indicator of expected future cash flows. Whilst we agree with paragraph 1.2 of the PAAinE paper that a primary performance reporting objective has implications for recognition and measurement, there are situations where the recognition and measurement may be appropriate for the balance sheet but not for reporting performance.





The BUSINESSEUROPE approach would be to strip out the movements in the balance sheet that obscure the presentation of performance. Certain changes in assets and liabilities reflect scenarios that cannot materialise because they are contrary to the entity's strategy, while others reflect changes that might eventually materialise but in the very long term. Net income should for example only include movements in fair value to the extent that those fair values represent amounts with a high expectation of cash realisation. Examples of movements to be excluded from net income for all entities would therefore be exchange differences on translation from functional currency to presentation currency, and actuarial gains and losses where the corridor approach is not applied for pensions.

### **Questions**

*Question 1: Do you think there is anything else in the development of existing standards (apart from that discussed in chapter 2) that should be taken into account when considering the way forward for performance reporting?*

BUSINESSEUROPE agrees that the key issues are set out in chapter 1. The development of the use of fair value in financial reporting has a significant impact on how to approach performance reporting. Fair value measurement, even where it may be appropriate for balance sheet reporting, may not necessarily be useful in performance reporting.

*Question 2: Do you agree with the observation in this chapter that, at the level at which standards are written, there is no generally agreed notion of what represents 'performance' and that in fact performance is a complex, multi-faceted issue that cannot be encompassed in one or a few numbers? If you do not, please explain your reasoning.*

BUSINESSEUROPE agrees with the observations in general. However we consider that, as explained in the introduction to this response, the opportunity has been missed to take this issue further in this paper. Whilst performance in terms of financial reporting cannot be a single number, we agree with PAAinE (chapter 4) that net income is the starting point for communication between preparers and users. A conceptual definition is needed.

*Question 3: Do you agree that key lines are still useful, though only because of their value as a basis for communication to the market and as a starting point for analysis and comparison? If you do not, please explain your reasoning.*

BUSINESSEUROPE agrees with this conclusion. A benefit of the proposal in the DP to have separate categories is that every entity will present an operating profit; this is also a key starting point for communication - and, for example, can become the required first line in the cash flow statement.

*Question 4: Do you agree that, in order to fulfil this function, it is important that there are clear principles that underpin what is included and excluded from the key line(s) (in order to make their content understandable) and those principles need to be such that the content of a key line is standardised to a fair degree (in order to ensure the necessary comparability).*





Where key lines are aggregations (net income, operating profit), it is important that they are derived in accordance with the entity's business model. This might still be considered as standardisation. However if standardisation means that they are defined in IFRS according to detailed rules, then internal and external reporting can be driven apart resulting in costs and hindering communication with users both inside and outside the entity. While the discussion paper does not address cash flows, IFRS7 does provide a good example of the consequences to reporting when IFRS requires a departure from approaches widely used by entities.

*Question 5: This chapter discusses the need for standard setters to balance the competing demands of comparability and flexibility, in order to give users fairly consistent starting points for analysis, while allowing management to present income and expenses in a manner that reflects the particular circumstances of the entity. Has the range of approaches to flexibility and comparability given in the chapter been appropriately described? What do you believe would offer the best approach in practice?*

We assume by a range of approaches this means Options A-D. They may have been appropriately described but in itself this does not seem to advance the discussion. Our approach would be to apply the categorisation proposed in the DP, with further disaggregation by function or nature, and also extend this business model approach to the determination of net income itself.

*Question 6: This chapter finds no evidence that it is important for the "bottom line" of statement(s) of income and expense to be a key line. Do you agree that it is not important for the "bottom line" of statement(s) of income and expense to be a key line? If you do not, please explain your reasoning.*

We are surprised with the lack of evidence, and it may be that the survey group was not representative. Theoretically it should not matter whether the bottom line is a key line. However, this has been the practice historically and we do not believe that it is helpful to capital markets to make an unnecessary and potentially confusing change to what preparers and users are currently comfortable with.

*Question 7: In chapter 4, the paper observes that there is no evidence that it is important for the "bottom line" of statement(s) of income and expense to be a key line. Assuming that is correct, do you agree that it follows that the number of performance statements provided is not particularly important either. And thus that the one or two performance statements debate is a non-issue; the real issues relate to the key lines. Do you agree with this analysis and conclusion? If you do not, please explain your reasoning.*

The conclusion reached in this chapter is that there are several key lines, some of which are higher up the income statement. This does not mean that it is not important for the bottom line to be a key line. As indicated in our response to question 9, the issue of recycling remains important.

*Question 8: Do you agree that recycling is mainly an issue if a realised/unrealized split is the main disaggregation criterion for the statement(s) of income and expense, that therefore recycling is really a secondary issue and that the main issue is which disaggregation model should be used? If you do not, please explain your reasoning.*



As stated earlier, we believe it is confusing that the term disaggregation is used differently between this paper and the DP. However, taking the PAAinE definition, we have difficulty in trying to compare the alternative disaggregation models presented in the paper. In our view the key point is to distinguish between net income and OCI; the other models appear to be mixture of alternative ways to decide on this cut-off or to disaggregate the components of net income.

Recycling can provide insight into the cash (realisation) consequences of transactions.

*Question 9: Would the issue of recycling on its own affect your decision as to the best approach to disaggregation? Please explain your reasoning.*

As explained above, we believe that the first “disaggregation” (as defined by PAAinE) issue is to distinguish between net income and OCI. The issue of recycling is therefore important in terms of making this cut-off.

*Question 10: Do you have any comments on the basic models of disaggregation presented in this chapter? Are there any other broad types of model that would have been worth exploring?*

We repeat that there appears to be some confusion in the paper. In chapter 5 two different aspects appear to be merged, namely (a) distinguishing between the measure of performance and all other items, and (b) disaggregating line items within that measure of performance. This is discussed towards the end of chapter 5 (paragraph 5.55) but it would clearer to explain this earlier and to deal with the two aspects separately.

There is a need for a conceptual approach to distinguishing between net income and OCI based on an entity’s business model. Within the resulting definition of net income, we would accept the categorisation proposed in the DP between operating, investing and financing, and some further disaggregation (for example by function). We do not consider that there is merit in considering models purely based on realised/unrealised, core/non-core or recurring/non-recurring. The paper demonstrates the difficulty in defining the cut-off points.

*Question 11: Is the discussion of the advantages and disadvantages of each disaggregation model fair and complete? If not, how could it be improved?*

We repeat the point about there being potential for confusion. When presenting the advantages and disadvantages of each, it is not clear whether these approaches are being used to determine a measure of performance or to analyse net income under its existing definition in IFRS.

*Question 12: Which of the models of disaggregation—or combinations of models—do you favour and why do you believe it meets the needs of users better than the alternatives?*

We believe that there should be a conceptual definition of net income based on reporting financial performance.