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Dear Sirs

Concerning PAAinE discussion paper: *The Performance Reporting debate*

We hereby send you our comment letter to the discussion paper *The Performance Reporting debate,* and at the same time we apologize for the delay.

In general we have considered the following issues to be essential to the performance reporting:

- One income statement (total income or comprehensive income) and no recycling
- The performance view should be from the perspective of the entity and not the shareholders
- A more precise defined income statement and at least a definition of subtotals in the income statement
- Comparability in the income statement is far more essential than flexibility
- A simple income statement without too many columns; further information should be specified in the notes

In the discussion paper you raise various questions which we will try to answer below.

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

It is necessary to have a line which succinctly summarises an entity's performance. In our opinion, it is important to focus on the aggregate increase in the entity's equity besides transactions with the shareholders. The line focused upon should therefore be the entity's comprehensive income. In future, no distinction should be made between items recognised in the income statement and items recognised in the comprehensive income.

In an entity's performance reporting (PR), it must, however, be accepted that various subtotals appear which, depending on the user's purpose of the PR, can be used as an expression of the entity' performance. In order to be able to compare the entities, the substance of such sub-totals should be defined.

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

Performance is to express the total performance in the entity, defined as changes in equity not originating from transactions with the shareholders. The fact that some types of income are not realised (eg revaluations) or are hedging or currency translation are not, in our opinion, decisive for whether there is performance. There has been a trend towards lacking focus on income and expenses recognised directly in equity, which is equally part of the entity's performance, but where the financial reporting rules formerly stipulated recognition directly in equity. But a foreign-exchange adjustment, for instance, on an investment in a subsidiary is, in our opinion, part of the entity's total performance and should be presented as such.

If the items are unrealised, it should be mandatory to disclose that in the notes.

Performance must therefore be defined, on the part of the entity, as the aggregate added value generated in the entity in the past year – besides transactions directly with the shareholders. The reason is that the primary stakeholders who are to use an entity's PR to assess the entity are typically not the management, but shareholders and other stakeholders assessing the entity as a whole.

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

Net income is an old notion which has gradually become meaningless. As stated above, we believe the entity's performance should be defined as the comprehensive income and not – as is the case today – using two totals: net income and comprehensive income. Net income should – as a notion or total – be replaced by comprehensive income.

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

The bottom line in a statement usually bears more weight simply by virtue of being at the bottom – and thus in particular focus. However, in recent years, the readers of financial statements have placed much focus on other sub-totals in the income statement: EBIT and EBITDA.

Whether the bottom line bears more weight or not is thus subjective and depending on the individual reader's approach to the financial statements and the entity's performance.

In the present model with two totals, focus has been directed more towards net income, and the users of financial statements have not focused equally on the use of comprehensive income. Either net income or other sub-totals in the income statement have been used to a wide extent by the users of financial statements and neither the public at large nor the entity has attracted attention to the comprehensive income reflecting the total added value in the entity.

In our opinion, the entity's performance should be expressed through the comprehensive income and there should therefore only be one income statement so that neither more nor less focus is placed on the total added value generated in the entity in the past year.

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

Since we believe there is only a need for one income statement, recycling is not needed as is the case today between the two statements of income. The total statement of income will, however, per definition include unrealised gains and losses which used to be recognised in the comprehensive income. There may therefore be a need for additional specification of the amounts recognised in the notes – including unrealised gains and losses. However, recycling will not be required as the recognised gains and losses already at the time they were unrealised were included in the income statement. We therefore do not recommend recycling between comprehensive income items.

6. Which of the following disaggregation criteria have both merit and are capable of being implemented? How would you define terms used in those criteria and what are the pros and cons of this disaggregation principle?

In our opinion, in prioritised groups the following criteria both have merit and are capable of being implemented:

1. *Classification by nature of expenses:* Such a classification provides the user of financial statements with an overview of how the entity's funds have been applied to generate added value. We find the classification should be made on the face of the income statement and not in the notes.
   Core or non-core: Classification makes sense in that an entity can have several operating activities some of which are core and some are non-core. In both cases, however, they are items included in the sub-totals EBIT and EBITDA. We believe classification can be made directly in the income statement or in the notes, depending on the entity's needs and the significance of the non-core activities.
   Operations versus financing versus other (investment): Today, such classification is used in Denmark to some extent, as the operating items are presented before the investing items (eg amortisation/depreciation, etc.) and the financing items are presented last. Such classification can therefore be used directly in the income statement. Also, the classification allows of a good correlation to the presentation of the cash flow statement.

2. *Classification by function:* This type of classification does not allow of the same degree of comparability in the income statement. The reason is that the same items are not part of the various functions in different entities. Thus, the comparability probably provided by a classification by nature is not possible to the same degree. It must therefore be required – if a classification by function is applied – that a complete classification by nature is presented in the notes.
   Recurring or non-recurring: Such a breakdown may create value – eg in connection with presentation of special items in the income statement – however, we believe it should only be a breakdown which is included in the entity's normal operations and, thus, a note specification. It should not be a breakdown made directly in the income statement.
   Realised or unrealised: For a number of users of financial it may be of great significance how much of the entity's income that is realised and how much remains unrealised. Such

a breakdown should also be presented in the notes as it could otherwise call for recycling in the income statement between the various lines.

If a breakdown by recurring or non-recurring activities / core or non-core activities is to be applied, it would, however, require unambiguous definitions of the elements of the fields of activity concerned. For instance – when is income core and when is an expense non-core?

In our opinion, the other notions do not offer additional merit to the income statement.

7. Are the current IFRS provisions in relating to the netting of items of income and expenses appropriate? What are the specific areas where the current requirement allow information essential for analyses to be concealed or, alternatively, do not permit netting where it would result in more useful information?

If netting is permitted, it should be performed on a systematic basis in order not to raise any doubt about when netting can or should be made. In practice, special items (IAS 1.87) are today netted and presented net in the income statement in Denmark, even if they are altogether different income and expense items. It should be made a minimum requirement that any netted items are specified in the notes. However, we believe in general that the access to netting should be specified in more detail than is the case today in the existing rules.

8. What is the underlying nature of the adjustments made by entities when reporting non-GAAP measures in their communications with the markets? What are the adjustments seeking to achieve? Should any of these non-GAAP measures be incorporated into the IFRS financial reporting model?

The reasons why entities present non-GAAP figures in, eg, stock market announcements, is a wish to decompose the net profit or loss for the year and explain why the year's performance has been as it has or why it has not met expectations. The non-GAAP statements usually list a number of issues which management consider extraordinary or non-recurring and therefore should be explained in more detail. The non-GAAP figures are usually very subjective and depend very much on the decomposition basis. The statements may also be unilateral where a number of 'extraordinary expenses' are netted from the EBIT and it thus appears that the entity's expectations have – except for such items – been met.

In addition, share analysts require in a number of incidents additional specifications from the entities, which are also presented in stock exchange announcements, such as quarterly income statements or other key figures. Such additional disclosures can vary depending on the entity and should therefore, in our opinion, not be part of the performance reporting.

Since the purpose of non-GAAP statements is usually decomposition or explanation – of a subjective nature for the individual entity – we believe they should not be part of the income statement, but could be presented in the notes or in a stock exchange announcement. However, it should be made a requirement that if such figures are presented in the notes, the reason for the presentation should be given.

9. In determining the optimum degree of standardization of the reporting formats, what is the right balance between comparability and flexibility? In other words is the general level of standardization in the current IAS 1 appropriate or should more precise formats be prescribed?

We believe flexibility is a notion which can only be of relevance from the entity's perspective – it is the entity that has a need to be able to present an income statement as they wish (flexibility). Therefore, flexibility focuses on the entity's needs – not at the needs of the users of financial statements.

In our opinion, there should be an unambiguous set of rules for what the individual sub-totals in the income statement contain – as it should be pre-defined what the substance of a given accounting item is. That would create comparability among entities, eg, operating within the same line of business. Under the current IAS 1, one may see that the only comparable income statement items in to, otherwise comparable, entities working in the same line of business are net revenue and net profit/loss for the year. In our opinion, this is not adequate for users of financial statements and allows of limited possibility of using the annual reports across borders. Also, the present rules meet the entities' flexibility requirements more than they meet the users' need for comparable disclosures.

In conclusion, comparability is more important than flexibility.

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If you would like further clarification of the points raised in this letter, we shall be happy to discuss these with you.

Yours sincerely

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Standards Committee

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