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18 September 2020

602/636

Dear Mr Hoogervorst

**Re.: IASB Exposure Draft 2019/7 'General Presentation and Disclosures'**

The IDW appreciates the opportunity to comment on the IASB's Exposure Draft (ED/2019/7) 'General Presentation and Disclosures'.

We welcome the ED and its aims, as well as the direction of the proposals. Most of them could be expected to result in an improved presentation and disclosure of information in the financial statements, especially in the statement(s) of financial performance.

However, in regard to a few aspects, we recommend that the IASB reconsider the proposals, and provide more clarification or make improvements. This applies in particular to:

- 1) the proposed structure of the statement of profit or loss

Application of the new definitions will involve a lot of subjectivity and judgement (e.g. in determining 'main business activities', 'integral' and 'non-integral'), which may foster diversity and inconsistency in practice. Furthermore, we encourage the IASB to define the term 'cost of sales'.

- 2) the proposed disclosure of unusual income and expenses

In our opinion, the proposed definition of 'unusual income and expenses' does not appear appropriate for the intended purpose. In general, we have serious doubts as to whether the IASB will succeed in formulating clear and unambiguous definitions and requirements for the disclosure of

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'unusual income and expenses' that can be understood and applied consistently in practice.

- 3) the proposed requirements for disclosing management performance measures (MPMs).

Although we generally support the IASB's efforts to provide guidance on MPMs, the proposals appear immature in part. A clearer definition of MPMs is needed and the financial performance measures commonly used by many preparers should be included (e.g. return ratios such as return on capital employed and free cash flow).

Further, we would like to comment on the specific proposals as follows:

### **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.*

The IDW agrees with the proposal that all entities should present in the statement of profit or loss a subtotal for operating profit or loss.

### **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 understand the Board's reasons for defining operating profit or loss as a default category. Entities have different business activities, which makes it difficult to arrive at a finite definition, which will foster consistent application in practice.

Therefore, it will be easier to determine which income and expenses are classified in the investing or financing category.

According to paragraph 46 of ED IFRS X the operating category includes information about income and expenses from an entity's main business activities. The term 'main business activities' is a key term used throughout the ED, but unfortunately, a definition of this term is missing.

We think that a definition and an explanation of the Board's reasoning for using this term is necessary to both ensure consistent understanding and application in practice. In this context, we would like to point out the following problems and issues that have come to our attention and recommend the Board provide a clear definition of 'main business activities' and/or provide additional guidance:

- It is unclear how the term 'business activity' interacts with similar concepts in other IFRS, e.g. 'ordinary activities' in IFRS 15 or 'principal revenue-producing activities' in IAS 7.
- The same applies to the interaction with the requirements on operating segments under IFRS 8. We wonder whether decisions made by an entity's chief operating decision maker might be an indicator or starting point for the identification of the entity's main business activities.
- Further, we question how to determine the 'main business activity', especially when it comes to conglomerate groups.
- A uniform understanding is needed as to which income and expenses from financing and investing must be included in the operating category.

### **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?*

In general, we agree with the proposals.

Regarding our comments on the term 'main business activities' we refer to our answer to question 2.

#### **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?*

As already mentioned in our answer to question 2, the term 'main business activity' should be defined. This is particularly important as it is not clear whether financing is a main business activity e.g. for car manufacturers as opposed to telecommunications operators that finance purchases of handheld devices for their customers. Based on our understanding of 'main business activity', we would expect that entities providing only occasionally or on a case by case basis financing to their customers as defined by IFRS 15 (e.g. the above-mentioned telecommunications operators) would not fall in this category. Consequently, those entities would have to present all financing activities in the financing category. In contrast, according to paragraph 51 of ED IFRS X, for all other companies (e.g. the above-mentioned car manufacturers) it would be possible to classify all income and expenses from financing activities and all income and expenses from cash and cash equivalents in the operating category.

However, precisely those companies whose main business activity is to provide financing to customers should be able to separate their financing activities to customers based on the legal entities within a group, segment reporting or in accordance with regulatory requirements. For this reason, from our point of view, such entities should present only income and expenses from financing activities, and from cash and cash equivalents, that relate to the provision of financing to customers in the operating category.

For those entities, who cannot separate their financing to customers from other financing activities – a phenomena, which, in our view, applies only to a few entities –, the Board should consider whether they should classify the corresponding income and expenses in the financing category. This would have the advantage of waiving the proposed accounting policy choice that allows certain entities to classify all income and expenses from financing activities and all income and expenses from cash and cash equivalents in the operating category without differentiation. This could enhance the relevance of the operating category as well as improving the consistency and comparability between entities, which is in the interest of analysts especially, but also all other financial statement users.

### **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?*

The IDW is not convinced about the proposed introduction of a separate investing category as proposed in the ED for the following reasons:

- First, it may create some additional implementation complexity, because the difference between 'investing' and 'operating' or the difference between 'investing' and 'financing' might, at times, require significant judgement, potentially resulting in diversity in practice and/or in arbitrary allocation.
- Further we note that the operating category is defined by the ED as a default category, i.e. all income and expenses should be included in the operating category that are not classified in 'investing', 'financing', 'integral associates and joint ventures', 'income tax' or 'discontinued operations'. Paragraph 48 of ED IFRS X states: *'An entity shall not classify in the investing category income and expenses specified in paragraphs 47(a)–47(b) generated in the course of its main business activities. Such income and expenses are instead classified in the operating category.'* Paragraph B33 further states: *'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.* Hence the investing category is defined by excluding some items that are classified as operating. This is a circular definition that will need to be resolved if the IASB is to maintain its intention to introduce an investing category.

- Another significant drawback of the proposed introduction of an investing category in ED IFRS X is that it differs from the definition of 'investing activities' in IAS 7, i.e. there is no cohesiveness between the statement of profit or loss and the statement of cash flows. In our view, this is potentially misleading. The term 'investing' is already used within IFRS and, from our point of view, it contradicts the basic idea of the statement of profit or loss, as it has so far generally been used in connection with cash inflows and cash outflows from the sale or disposal of assets, regardless of whether they are operating assets or not. If the IASB still insists on the introduction of a separate investment category, we recommend different terms and wording be used, as necessary, or ED IFRS X and IAS 7 be aligned in order to avoid confusion for preparers and users. Any differences between the meaning of 'investing activities' in the statement of profit or loss on the one hand and in the statement of cash flows on the other hand must be communicated clearly.
- Since only those returns from investments that are generated individually and largely independently of other resources held by an entity should be classified in the investing category, we assume that the amounts classified in this narrowly defined category will rarely be recurring and significant. The informative value might therefore be limited.

Against this background, we have considered whether it would not be sensible to dispense with the differentiation between the proposed investing and financing category. In our view, numerous delineation problems and ambiguities could be avoided if the two proposed categories were combined.

### **Question 6**

#### ***Profit or loss before financing and income tax and the financing category***

- 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.*
- 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 understand the IASB's ambitions to introduce the subtotal 'profit or loss before financing and income tax and the financing category', i.e. to present another new measure comparable between entities. However, as already mentioned in our answers to questions 2, 4 and 5, comparability is limited by several problems of delineation between both the financing and investing category and the financing and operating category. To avoid this and to achieve comparability between entities, we propose the distinction between 'investing' and 'financing' be dispensed with (we refer to our answer to question 5). As a result, the subtotal 'profit or loss before financing and income tax and the financing category' would be dropped. However, we believe that this is acceptable, since firstly, 'operating profit or loss' is by far the most important measure from the user's point of view, and secondly, preparers can always define a corresponding entity-specific management performance measure (MPM), if necessary, in accordance with the provisions of paragraphs 103 et seq. of ED IFRS X.

We would like to add the following remarks regarding the current proposals for the financing category:

- The term 'financing activities' is (re)defined in Appendix A to ED IFRS X. Accordingly, it is not included in the list of 'terms that are defined in other Standards and used in this [draft] Standard with the same meaning' since the Board proposes to expand and clarify the definition of 'financing activities' from IAS 7. As this is confusing, we recommend aligning IAS 7 with ED IFRS X to ensure consistency between IFRS.
- We also note that paragraph 65(a)(ii) of ED IFRS X requires that 'income or expenses from financing activities' be presented as a line item in the statement of profit or loss. We would challenge whether this requirement contradicts the prohibition on offsetting income and expense pursuant to paragraph 32 of IAS 1 (resp. paragraph 29 of ED IFRS X).

### **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?*

In principle, we understand the IASB's considerations and proposals. However, we do have some concerns as to their relevance, usefulness, and practicability particularly, in terms of cost-benefit considerations.

First, we would like to recommend that the IASB clarify the objective of the distinction between 'integral' and 'non-integral' associates and joint ventures. In our view, whether an associate or a joint venture is 'integral to the main business activities of an entity' is highly discretionary when based on the few application guidelines provided in ED. Further, the definition of integral associates and joint ventures ties in with the term 'main business activities', which also needs to be defined or described in more detail (we refer to our answer to question 2).

It is unclear whether the terms integral/non-integral associates and joint ventures category should be interpreted in a broader or narrower sense. For example, we note that 'integral associates and joint ventures' are defined in the ED (IFRS 12, Appendix A) as follows: '*Associates and joint ventures accounted for using the equity method that are integral to the main business activities of an entity and hence do not generate a return individually and largely independently of the other assets of the entity*'. This definition could be linked to the definition of cash-generating units according to IAS 36 (i.e. '*smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets.*'). We question whether this is the IASB's intention and if so, whether it would be reasonable to conclude that integral associates and joint ventures are those that are part of a cash-generating unit (CGU) of the group.



If, by definition, integral associates and joint ventures can only exist when they are part of a CGU of the reporting entity, the scope of the proposed requirements is likely to be very limited. In our view, another starting point for determining 'integral associates or joint ventures' might also be their inclusion in the entity's segment reporting according to IFRS 8.

Irrespective of the final definition, the determination of integral or non-integral associates and joint ventures will require considerable judgement and the dividing line will be difficult for external users to understand. This will limit the informational benefit.

Against this background, we wonder whether the issue is of such relevance as to warrant a separate category and a subtotal in the statement of profit or loss. In our view, it would be conceivable to dispense with the proposed subtotal in general. All associates and joint ventures could be included in the operating category and, when material, a line item should be presented. In addition, the disclosure requirements under IFRS 12 could be extended.

However, if the IASB intends to maintain the distinction between integral and non-integral associates and joint ventures, as a minimum integral associates and joint ventures should be included in the operating category, because they form part of the main business activities of the entity. In this case, it would still be possible to omit the sub-total 'operating profit or loss and in-come and expenses from integral associates and joint ventures' and to present integral associates and joint ventures as a separate item in the operating category; but only if they are material.

Finally, we would like to add some remarks to the Board's proposals regarding the presentation of associates and joint ventures in the statement of profit or loss from an insurer's viewpoint. There are also concerns as insurers invest the premiums, they receive to pay out the benefits subsequently. This so-called reversed production process (i.e. receiving the consideration first and then performing subsequently) is typical for insurers. In requiring in IFRS 17 that insurers present both 'investment revenue' and 'insurance finance expense' together within the 'net finance result' the IASB has addressed this adequately. This accounting treatment depicts the linkage between an insurer's investment activity and the financing effect of issuing insurance contracts. Insurers usually also use the funds received from policyholders when investing in associates or joint ventures. These form part of an insurer's investment, regardless of whether they are integral or not. The returns generated by these investments are used to finance the unwinding of discount of technical provisions (i.e. insurance contract liabilities), and as far as participating contracts are concerned the cash flows for

the liabilities may be directly affected by the return on associates or joint ventures, again regardless whether they are integral or not. In order to better reflect the linkage and achievement of the objective of IFRS 17, we question whether it would be more appropriate to require the share of profit or loss of associates and joint ventures to be accounted for as part of the 'net finance result' and therefore, be presented – as separate items, if considered necessary – between credit impairment losses and insurance finance expenses, or alternatively, immediately after 'net financial result' similar to what is currently required after '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?*

The IDW agrees with the proposed description of the roles of the primary financial statements and the notes.

We support most of the Board's proposed principles and general requirements on aggregation and disaggregation of information, as they are particularly helpful to preparers in distinguishing material from immaterial information to achieve appropriate presentation in the financial statements. However, we consider the proposal in paragraph 28 (i.e. '*an entity shall disclose information in the notes about the composition of aggregated items*', including an indication of the nature and amount of the largest item in an aggregation consisting of several unrelated immaterial amounts) as a violation of the basic principle stated in paragraph 29 of IAS 1 (i.e. '*An entity shall present separately items of a dissimilar nature or function unless they are immaterial.*'). In our view, such a disclosure would neither provide relevant financial information nor influence the decision of the primary users of the financial statements. We therefore urge the IASB to adopt the

above-mentioned basic principle of IAS 1 unchanged in ED IFRS X, since it is essential to avoid information overload in the financial statements.

Further, we would like to point out that, according to the proposals in paragraph 27 of ED IFRS X, the aggregation of immaterial items with other items is based on the assessment of whether they share 'similar characteristics'. We believe that the Board should clarify the meaning of 'shared similar characteristics' either by defining it or by including meaningful examples. The concept of shared characteristics is also used in paragraph 12 of IFRS 8 for analysing whether operating segments are to be aggregated. However, IFRS 8 provides more detailed guidance. We believe that more guidance would also be helpful in regard to the term 'shared similar characteristics' in the context of paragraph 27 of ED IFRS X.

Finally, we suggest the Board also include 'impairment' in the list of circumstances that would give rise to a separate presentation in the statement(s) of financial performance or in the notes provided in paragraph B15 of ED IFRS X.

### **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?*

In general, we agree that an entity shall present in the operating category of the statement of profit or loss an analysis of expenses using a classification based on either their nature (i.e. the nature of expense method) or their function within the entity (i.e. the function of expense method).

We support the Board's initiative to limit mixed presentation of operating expenses under both the nature of expense method and the function of expense method. We note that mixed presentation has developed over time, and this

would be a good opportunity to redefine the boundaries of what constitutes acceptable practice.

The IDW explicitly asks the Board to clarify whether it intends to further limit or even to prohibit the mixed presentation of operating expenses under both the nature of expense method and the function of expense method. In this context, paragraph B46 needs more clarification.

Further, if the IASB intends a strict separation of the two methods of presenting operating expenses in the statement of profit or loss, it should clarify how to deal with paragraph B15 of ED IFRS X. This paragraph is identical to paragraph 98 of IAS 1 and requires a separate presentation of items of income and expense in the statement(s) of financial performance or in the notes (e.g. restructuring or reversals of any provisions for the costs of restructuring, litigation settlements, write-downs of inventory or items of property, plant and equipment) under specific circumstances. If a mixed presentation is to be strictly prohibited in future, to the Board must clarify that when the function of expense method is used, these items have to be allocated on the basis of their function and, generally, may not be presented separately in the statement(s) of financial performance.

Additionally, paragraph B47 of ED IFRS X requires entities to present the line items listed in paragraph 65 irrespective of the method used for analysing operating expenses in the statement of profit or loss. In our view, this could also lead to a mix of methods, as some line items correspond to the nature of expense method, whereas others correspond to the function of expense method (see e.g. paragraph 65(b) of ED IFRS X).

In this context, we recommend the Board reword paragraphs 42 and 66 of ED IFRS X to clarify that additional line items are allowed, as long as the preparers do not mix the methods of presenting operating expenses (i.e. using either the nature of expense method or the function of expense method).

Further, we would like to draw particular attention to the fact that, in accordance with paragraphs 65(b)(ii) and B47 of the ED, impairment losses under IFRS 9 must always be presented as a separate line item in the statement of profit or loss (i.e. regardless of which method of analysing operating expenses is used), whereas impairments of property, plant and equipment may not be presented as a separate line item when the function of expense method is applied. We suggest the IASB establish consistent requirements in this regard.

Finally, we would like to point out that a strict separation between the nature of expense method and the function of expense method might be challenging in terms of not resulting in the presentation of relevant and useful information for some entities. This applies e.g. for financial conglomerates. In order for the banking activities of financial conglomerates to be comparable with the activities

of standalone banks and for their insurance activities to be comparable with those of standalone insurers, it may be useful to allow financial conglomerates to classify of operating expenses resulting from their banking activities according to the nature of those activities and for those resulting from their insurance activities according to their function. Information as to the nature of expenses relating to the insurance activities should then be provided in the notes.

Also the requirement of paragraph 72 of ED IFRS X, i.e. an entity that presents an analysis of its operating expenses by using the function of expense method in the statement of profit or loss must present additionally an analysis using the nature of expense method in the notes, ultimately leads to doubled efforts for the entity, since it has, in fact, to apply both methods simultaneously. This requirement will result in significant additional costs for preparers as they often will not have adequate IT systems in place to readily provide a by-nature analysis of operating expenses as the ED requires.

### **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?*

In principle, we agree with the IASB that the disclosure of unusual income and expenses can enhance the informative value of financial information and the ability to forecast entities' financial performance. Therefore, we welcome the Board's efforts to define 'unusual income and expenses', as it would also improve transparency and comparability across reporting entities.

However, such a definition (as well as the complementary guidelines) needs to be robust and less susceptible to abuse. The IDW has considerable doubts that the Board will succeed in formulating such clear and unambiguous definitions and requirements that can be understood and applied consistently by all entities.

As part of the 'Improvements to International Accounting Standards' (issued in 2003), the IASB deliberately decided to delete the concept of extraordinary items from IAS 8 and to explicitly prohibit the presentation of income and expense items as 'extraordinary items' in the statement(s) of financial performance and in the notes (we refer to paragraph 87 of IAS 1). In our opinion, the reasoning at that time remains valid today. Similarly, the presentation of unusual income and expenses would, similar to the presentation of extraordinary items at that time, require arbitrary segregation of the effects of related external events on an entity's profit or loss for the period. Items that are treated as 'extraordinary' or 'unusual' result from normal business risks to which an entity is exposed. In the opinion of the Board at that time, they do not justify separate presentation in the financial performance statement(s) as such items are ultimately only a subset of the income and expense items that may warrant disclosure to assist users in predicting the future performance of an entity. Paragraph 86 of IAS 1 requires disclosure of the nature and amount of material items of income and expense, where appropriate (we refer to paragraphs BC63 et seq. of IAS 1). We believe that these statements are still correct.

Regarding the IASB's current proposals, we have the following additional remarks:

- Firstly, in our view, the definition of 'unusual income and expenses' is unclear. There is a need for greater clarity and guidance on the interpretation of the terms 'several' in relation to future annual reporting periods, 'reasonably expected' and 'type' in relation to the term 'nature that is used in other IFRS. Without clarification, entities will apply the definition differently, which will reduce comparability.

In this context, we recommend the example in paragraph B69 of ED IFRS X be made more precise. We understand that certain litigation costs are to be classified as 'unusual' given that the litigation costs of the period are higher than reasonably expected. However, we are not sure whether the entity shall classify all litigation costs related to the particular action in the period as 'unusual' or whether it is the excess of total litigation costs compared to reasonably expected litigation costs that shall be classified as 'unusual'.

For example, an entity typically incurs litigation costs of EUR 5 million per period. However, in current period the entity incurs EUR 10 million as result



of a particular action (one litigation case). However, other litigation costs for the period only amounted to EUR 3 million. Therefore, we question whether the unusual amount is EUR 10 million (i.e. costs related to the particular action) or EUR 8 million (i.e. total litigation costs compared to reasonably expected litigation costs = EUR 13 million ./. EUR 5 million).

- Further, we have some concerns about the statement in paragraph BC136 of the ED, i.e. *'The proposed definition requires entities to consider whether similar income or expense will recur in the future. It does not require entities to consider whether a similar income or expense has occurred in the past.'* In our view, it seems counterintuitive to ignore the past when determining whether income and expenses are 'unusual'. For such an entity-specific assessment, all relevant and available information ought to be considered, i.e. information regarding both the future and the past.
- If the IASB retains its proposal to require presenting 'unusual income and expenses', we believe that implementation will be challenging in practice, because entities will be required to make significant discretionary decisions. Therefore, in developing a final definition, we recommend that the IASB consider whether the current corona pandemic would result in the inclusion of 'unusual income and expenses' in the financial statements. This would be a true endurance test.
- We support the IASB's proposal to present 'unusual income and expenses' in a single note and not as separate items in the statement(s) of financial performance.
- We note that the current wording of paragraph 101 of the ED requires entities to disclose in a single note *all* unusual receipts and expenditures. This may lead to the disclosure of immaterial information subsequently. We therefore recommend that paragraph 101 of the ED be reworded to ensure that the disclosures required are in accordance with the principle of materiality.
- Finally, we recommend the IASB extend the guidance in paragraph B75 of the ED to include explanations as to the relationship between the disclosure of 'unusual income and expenses' and the use of management performance measures (MPMs). In our opinion, it should be made clear that consistency is not required between the disclosures on unusual income and expenses (as required by the ED) and the MPMs (based on management's view) as this could undermine the desired objectivity and standardisation of the disclosures of 'unusual income and expenses'.



### **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?*

The IDW acknowledges that non-IFRS measures such as management performance measures (MPMs) are often used in practice to provide users with useful insight into management's view of the entity's performance and its management of the business. We also appreciate that additional guidance could result in them be used in a more transparent and consistent manner.

Despite our support for the IASB's efforts to improve the relevance and informative value of financial statements, we have several concerns as to the proposals regarding MPMs, as they are insufficiently clear and need more elaboration. For example:

- In our view, the definition of MPMs needs to be clarified. The identification of MPMs appears to be highly discretionary. In particular, the concept of 'public communication' seems too broad to ensure the completeness of preparers' disclosures. We are concerned that the costs (including related audit costs) incurred in analysing all public communication may outweigh the benefits of the approach.

- It is unclear how preparers shall proceed in the case of entities publishing several MPMs. Clarification would be helpful as to whether all MPMs must be disclosed in the financial statements.
- Further, we question whether an entity may, after the publication of financial statements, report on an MPM that was not previously defined as such in the financial statements.
- The ED defines MPMs very narrowly and is overly restrictive (we refer e.g. to paragraphs 104 and B80 of ED IFRS X). In practice, many preparers use other financial measures in their communication with investors. From a conceptual point of view, we wonder why only subtotals of income and expense and no other frequently used indicators would be permitted as MPMs (e.g. return on capital employed, free cash flow). The interaction between the proposals on MPMs and what is currently defined and required by IFRS 8 for operating segments should be explained more in detail. At present there is, for example, no comparable restriction on 'faithful presentation' on the presentation of performance measures in the context of segment reporting (we refer to paragraph 105(a) of ED IFRSX).
- We note that the requirements in items c) and d) of paragraph 106 of ED IFRS X could involve high costs for preparers, which might outweigh the benefits. In particular, an entity should not be required to determine additional information for the purposes of IFRS disclosure which management itself has not used for decision-making.
- Finally, it would be useful if the Board were to include some of the explanations pertaining to the definition and the proposed restrictions of MPMs not only in the Basis for Conclusions, but also in the main-body or application guidance of the new standard.

In view of the proposals presented in the ED, we believe it makes sense to consider developing the concept of MPMs based on the management approach already anchored in IFRS, and thus in line with IFRS 8. Instead of focusing on all measures an entity has used in its public communications, we believe that the entity should only communicate those measures – either in a single note or alternatively, in the management commentary – that are used for internal management and monitoring purposes. In our view, only such measures are relevant and meaningful and thus helpful to users.

### **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 concur with the Board that – although earnings before interest, tax, depreciation and amortisation (EBITDA) is one of the most commonly used measures in practice – there is no consensus in practice about what EBITDA represents nor how it is calculated. Therefore, we understand the challenge of providing a clear and robust definition. However, we believe this is precisely what practice (and especially users) expect from the IASB in the context of this project.

In our view, the term 'EBITDA' should either be defined or be subject to the requirements of MPMs based on the varied definitions that we have seen in practice. For example, an entity might describe a measure as 'EBITDA' but exclude share-based payment expenses and business combination transaction costs from that measure. We believe that an entity may include a subtotal that is within operating profit, but that excludes depreciation and amortisation. However, once an entity uses the term 'EBITDA', we believe that this should be covered by the requirements of MPMs (unless the Board decides to define this measure).

Further, we also have a question of detail. Assuming an entity has used the entity-specific defined performance measure 'EBITDA', which is now in line with the subtotal 'operating profit or loss before depreciation and amortisation' as specified in ED IFRS X for long time in its public communications, we wonder whether the entity can continue to use the term 'EBITDA' and if so, whether the entity must provide disclosures on MPMs or, as the 'EBITDA' is in line with the subtotal 'operating profit or loss before depreciation and amortisation', this would not constitute a MPM pursuant to paragraph 104(c) such that the disclosure requirements for MPMs are not applicable. We suggest the IASB clarify this issue.

### **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 the Board's proposal to use 'operating profit or loss' as the starting point for the indirect method for reporting cash flows from operating activities. This could improve comparability and, to some extent, standardise the adjustments made to the 'operating profit or loss' in the operating cash flow category. As a result, the statement of cash flows and the statement of profit or loss will be better aligned, enabling users to understand how the operating profit or loss is converted to operating cash flows.

Further, we agree with the proposal to remove the current element of choice for classifying interest and dividend cash flows in the statement of cash flows.

However, as mentioned in our answer to question 5, one significant drawback of the ED's current proposals is that the terms 'investing category' and 'financing category' are labels that are consistently used in both the statement of profit or loss and in the statement of cash flows, despite their being inconsistent in terms of their respective definitions and composition. For conceptual reasons, we strongly recommend the Board either start a new project or enhance the current project to solve this problem and ensure consistency in IFRS.

#### **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?*

We note that there is significant diversity in practice regarding the item 'cost of sales' presented in a statement of profit or loss based on the function of expense method. In the absence of a definition of 'cost of sales', entities will continue to exercise discretion in deciding what to include in 'cost of sales'. Therefore, we encourage the IASB to define 'cost of sales'.

Under the proposed paragraphs 58 and B43 of the ED IFRS X, it is not clear whether, in the case of derivatives that are used to manage risks but are not designated as hedging instruments, an entity can present the effect in the same line item (e.g. 'cost of sales') or in the same category (other operating income/expenses). We suggest that paragraph B43 of IFRS X clarify that an entity should apply the presentation requirements of IAS 1 (i.e. paragraphs 68 - 72 of the ED IFRS X) when considering which line item should present the economic hedge results. Otherwise this proposal runs the risk of entities being able to obtain the benefits of hedge accounting presentation, without applying hedge accounting.

We would be pleased to answer any questions that you may have or discuss any aspect of this letter.

Yours sincerely

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