EACB Comments

IASB's consultation on the Primary Financial Statements

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General comments

The members of the EACB gladly take the opportunity to comment on the IASB consultation about General Presentation and Disclosures (Primary Financial Statements).

Our members welcome the IASB's effort to introduce improvements to the way information is communicated in the financial statements, with a focus on financial performance They appreciate in principle the IASB proposal to introduce new subtotals and categories in the statement of profit or loss, however some members have specific concerns.

While some companies and users might greatly appreciate the new subtotals and categories in the statement of profit or loss as they think that it serves them in a better way when communicating financial results and/or understanding entity specific performance, some EACB members are more critical towards the new subtotals and categories and question whether the benefits outweigh the costs and efforts associated with the new requirements in all cases.

Furthermore, the EACB believes that adjustments are needed in particular concerning the parts about integral and non-integral associates and joint ventures, unusual income and expenses and Management Performance Measures. More specifically, the EACB is not supportive of the proposal that one the two methods (the nature of expense method or the function of expense method of analysis) - by nature or by function method - should be used to the exclusion of a mixed approach. Financial groups and financial conglomerates combine banking activities and insurance activities. While currently they present all operating expenses – both from insurance and banking activities – by nature, they may be required to present "costs directly attributable to insurance contracts" on a specified line using a by-function approach according to IFRS 17. Therefore, a mixed approach should be allowed and this will result in a better information provided to users.

Answers to specific questions

Q.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?

Q.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?

The function of the "Operating" category shall by description be to show the financial performance of the "main business activity". EACB understands that all income and expense not generated through "Investing" or "Financing" will be categorized into "Operating". Therefore, it is not necessary to give a detailed definition of "main business activity". EACB also concludes that whether or not an entity's activities belong to a "main business activity" is subject to judgement, as IASB also states in the ED at several points (e.g. in B27, or indirectly in B31, where a relation to IFRS 8 "Operating Segments" is made).

In order to use the accounting choices and special rules for several specialized entities (such as banks and insurance companies), the definition what a "main business activity" is, should be more precise, and users of this new IFRS should receive a guidance on what exactly IASB understands under the term "main business activity". Otherwise, there might be – in the case of highly diversified companies – some space for judgement of which rules to apply or not, which will increase the diversity in reporting practice especially for companies which are highly diversified rather big.

Moreover, summarizing every income and expense not generated by "Investing" or "Financing" may not be clear enough to review the operating performance of any given entity. For example, a company focussing on few activities will have different gain margins than a generalized company that has no specified "main business activity". Due to specialized business models, those companies are also exposed to higher risks concerning changes in markets or competitors. Therefore, these two companies should not be evaluated on summarized numbers. A separate disclosure of "main business activities" (sum of all identified activities) and "other operating activities" might help , because statement users might be able to see whether the company is specialized on some activities or if it is a generalized company.

Q.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?

The EACB welcomes the proposal to classify in the operating category of income and expenses from investments made in the course of the entity's main business activities, as from paragraph 48. In addition, the term "main business activity" should have been more detailed to avoid judgements in some cases.

Q.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?

The EACB fully supports the accounting option from paragraph 51 of the exposure draft as an important accounting choice for banks and believes that pursuing other routes would lead to reduced comparability.

Raising funds is a key feature of the business of credit institutions, with a view to providing financing to customers, and the interest result as well as the net commission income are important line items in the income statement of banks. For this reason, income and expenses from financing activities should be classified as operating.

In view of the above, a comparison of net income from the financing of customers and net expenses deriving from funding activities is desirable. An allocation of income and expenses from financing activities and from cash and cash equivalents to the provision of financing to customers and to other financing activities can be particularly onerous.

In particular, for banking institutions normally only a less significant portion of funding activities would relate to activities other than the provision of financing to customers. Thus, this option does not significantly reduce the comparability of bank financial statements.

A compulsory separation of income and expenses from financing activities and cash and cash equivalents that relate to the provision of finance to customers and income and expenses from financing activities and cash and cash equivalents, which do not relate to the provision of finance to customers, can be particularly onerous if compared to the resulting net financing expenses. As a result, the optional separation should be kept because there are organisations with multiple significant lines of business apart from the provision of finance to customers, e.g. organisations with captive finance companies, where separating the net financing expenses and income and expenses from cash and cash equivalents could prove beneficial.

Q.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?

Q.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? Do you find the interaction between different pieces of legislation?

Q.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?

The EACB does not support the disclosure of integral and non-integral associates and joint ventures.

The EACB believes that the underlying definitions of integral and non-integral are not sufficiently differentiating the relevant two categories. This leads to uncertainty in the preparation of financial statements. Data for the separate disclosure of integral and non-integral associates and joint ventures is not readily available and for entities that provide financing to customers as a main activity the cost of the disclosure may not be compensated by the benefit to users of financial statements. For example, in some financial institutions, financial statements associates and joint ventures are not significant. In this case the breakdown would lead to excess line items in the income statement. The additional benefit compared to the disclosure of associates and joint ventures accounted for at equity as required by IAS 1.82 (c) is to be questioned. EACB recognises that in some companies – especially in those working with numerous international subsidiaries – this may be a vital part to distinguish operational income from investment income. As for financial institutions, there are few examples of international companies that regionally do not incorporate subsidiaries and instead install joint ventures or associates to fulfil their business.

Financial institutions also seldomly have a line of production that depends on single service providers (they invested in). Therefore, from the point of view of a financial institution, EACB rejects the idea to create new accounting processes of categorization and monitoring for Associates and Joint Ventures that stand in no proportion to the results to be expected. On the contrary, we understand that statement users might really better understand entities endeavouring in the industrial sector if these associates and joint ventures are segregated into "integral" and "non-integral". Therefore, if IASB might not want to drop the idea of integral and non-integral associates and joint ventures,EACB would suggest to add for certain industries / business models a bail-out-rule to avoid the efforts of categorization, maybe connected to materiality boundaries (e.g. if the portion of at equity-accounted Associates and Joint Ventures in comparison to an entities balance sheet total or profit or loss total is less than 1/5).

If IASB does not consider this a practicable solution, EACB suggests to implement a simplified method. As IASB stated in the Basis for Conclusions of the ED (BC78) as well as in the amended IFRS 12.20D, integral associates and joint ventures share certain characteristics, which indicate the importance for the entity. As examples the amended IFRS 12.20D lists "integrated lines of business", "supplier/customer-relations that would be difficult to replace without significant business disruption" or "sharing a name or brand"., EACB would suspect that any of these examples would urge an entity to increase its "power" (in terms of IFRS 10) to a level where it at least has the ability to avoid negative developments for itself. We therefore believe that, in most cases, entities would tend to at least increase their investment up to the level of Joint Ventures. In these cases, a segregation of joint ventures as "integral" and associates as "non-integral" would give a good indication between operational and non-operational income without the necessary processes of categorization and monitoring.

In some EACB member's opinion joint ventures are almost always categorized as "integral" due to political reasons. This is the case because categorizing a joint venture as "non-integral" would bring up a lot of questions from analysts and especially investors. A company labelling a joint venture as "non-integral" might be forced to explain and justify its commitment with and (financial) involvement in this specific joint venture as there might be doubts from investors regarding the profitability and overall strategic usefulness of such entity. In severe cases this could potentially trigger pressure from investors and analysts to sell a "non integral" joint venture. Hence, some EACB members believe that a company will almost never label a joint venture as "non-integral" in order to avoid the political discussion and the consequences that it might have on a company's strategic set up. We believe that this point also backs the EACB's proposal for a segregation of joint ventures as "integral" and associates as "non-integral" without the necessary and burdensome process of categorizing and monitoring each associate or joint venture individually.

Furthermore, some EACB members share the opinion that the definitions of integral and non-integral in its existing form can potentially lead to undesired effects when applying those definitions into practice and hence provide investors and analysts with misleading information. According to the current definition integral entities do not generate a return individually and largely independently of other company assets. Contrary to that, non-integral entities generate a return individually and largely independently of other company assets. However, there might be cases in practice where an entity generates a return individually and largely independently of other company assets but would still be seen as "integral" to the core business of the company. This could e.g. be the case when a hypothetical Bank A enters into a joint venture with a hypothetical Bank B in order to develop a new plattform for the sale of certain financial products. According to the definition, if Bank A does not use its own existing company infrastructure (e.g. software, workforce, skills and knowledge, customer database) to develop the platform and sell the new products to customers but instead uses a third party or even Bank B, it would classify the joint venture as "non-integral" and below operating income even though the plattform definitely qualified as core business of a Bank (selling financial products to customers). On the contrary, for the same plattform and financial product if Bank A uses its own infrastructure it would classify the same joint venture as "integral" and above operating income. This being said, depending solely on the legal holding structure of the arrangement the same issue could be shown either above or below operating income in the income statement. <u>Therefore in some EACB members opinion it is questionable whether the current definition provides the desired benefits and really helps to distinguish between core business (=operating income) and non-core business of a company.</u>

Q.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? opinion, to what extent would a requirement on companies to apply a common standard for non-financial information resolve the problems identified?

The EACB believes that it is uncertain to what extent diversified groups that have different lines of business can or have to disclose a disaggregation of their income and expenses within the operating profit or loss in order to present their different business models adequately. This can be an important issue for certain EACB members because their group companies are operating in the insurance business as well as in the investment fund business. Moreover, this is an important issue for conglomerate member institutions because their group companies are operating in different industries, e.g. having an insurance business subsidiary as well as an investment fund business subsidiary.

Q.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?

Such analysis of operating expenses is useful especially for companies that produce goods and offer services to their customers. Banks, other financial institutions and insurance companies will not give useful information to users of their statements by providing such analysis. EACB is therefore concerned that the former IAS 1's paragraph, stating that every industry should consider the industry standard when assessing which method should be used, did not make it into the released ED. We therefore are afraid that there will be a wide spread in practice, which a) does not provide the reader with better information and b) is not useful in regard to the industry itself. We therefore would appreciate if IASB could consider implementing a bail-out-rule for those entities that have no physical (or in case of intangible products like software: manufactured) product/s as business objective/s.

In paragraph B46 of the exposure draft it is forbidden that entities use a mixture of the nature of expense method and the function of expense method except when required to do so by paragraph B47.

The EACB is not supportive of the proposal that one of the two methods - by nature or by function method - should be used to the exclusion of a mixed approach. Financial groups and financial conglomerates combine banking activities and insurance activities. While currently they present all operating expenses – both from insurance and banking activities – by nature, they may be required to present "costs directly attributable to insurance contracts" on a specified line using a by-function approach according to IFRS 17. Therefore, a mixed approach should be allowed and this will result in a better information provided to users

Moreover, a categorization by function can provide information on the way the line item is controlled by management. A mix of methods can prevent information overload by providing an aggregation of similar items from the view of the business model. The line item administrative costs in a bank income statement, for example, can be regarded as a fixed costs block that mainly comprises a mix of fixed asset expenses and personnel expenses. A split would result in at least three line items of fixed costs. This would be in addition to the existing interest, fee, credit provision line items as well as the new subtotals and line items required by the exposure draft.

EACB opposes the strict prohibition of a mixture of the nature of expense method and the function of expense method and asks the Board to consider exemptions in those cases where such a mix could prevent information overload by providing an aggregation of similar items from the view of the business model.

Q.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?

EACB suggests that the "unusual" should be replaced by the more descriptive wording "non-recurring" because this corresponds to the definition of these income and expense items in the exposure draft. This definition should clarify what is the necessary frequency of occurrence in order to be clasified as unusual. As a result, EACB supports a rewording and a clearing up of the uncertainty surrounding this topic.

In any case, the determination and disclosure of unusual income and expenses requires expenditures and entails uncertainty. Since the classification is based on future conditions the issue of the documentation and audit of unusual items arises. The reporting of unusual income and expenses within one note would require a central coordination. This can be extremely costly for cooperative banks as many of them pursue a decentralised controlling approach.

In practice, most reporting entities, already give explanations on any item (balance sheet and P&L) of unusual size / amount, if material. To report those numbers in one single note would be possible (the data is available), but would require central coordination and will hardly be done by information technology, therefore inducing manual efforts (and enlarging the risk of errors and mistakes). This would be especially costly for member institutions that pursue a decentralised controlling approach. In addition, the ED suggests that besides unusual items in terms of effect size / amount, an entity should also report unusual items concerning the nature of the item. Considering the aggregation level needed to maintain an understandable p&l statement, there will be a considerable amount of items that will eventually produce "unusual" effects in terms of nature, although these unusual items might be immaterial to the entity overall and in itself.

EACB believes that the effort needed to produce this single note is disproportionate to the gains of statements' readers, as every reader might have different views on which income or expenses he wishes to eliminate or not. For example, some financial institutions have effects arising from the sale of investments such as equity instruments or real estate properties. Sometimes these effects arise from planned activities, sometimes they are triggered by external events. For example, the sale of an investment a financial institution held in the course of its main business activities, maybe for private equity endeavours, should be viewed differently from the sale induced by a squeeze out a Bank could not bias. Both might be unusual in terms of amount, as the bank will not necessarily have comparable effects in the next years. But one of these two resulted from a planned activity, the other one not. Without further guidance on this matter, there will also be a wide spread in practice as well as a vast space for judgement on an individual basis, which will counter the comparability effect IASB wanted to generate.

As a summary, we believe that the requirement of a single note of unusual income and expenses should not be part of the upcoming IFRS. If IASB might still wish to implement this requirement, EACB strongly advices to clarify the regulations and definitions on this matter.

Q.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 EACB opposes the wide scope of the origin of management performance measures. Moreover, certain Cooperative Banks also have serious reservations concerning the single note for management performance measures.

The IASB intends to make a rule for performance measures that are not originally reported in the annual financial statements. For the time being, there is no limitation of the origin of “public communication outside financial statements” from which the performance measures are to be gathered. This is a problem because accounting rules are not to be applied to the other communication of the company but have to be applied to the performance measures that are mentioned in the financial statements. This rule could lead to an accumulation of Non-GAAP subtotals of income and expenses. As a result , it would be costly to gather all publicly communicated performance measures, to examine them, to document them, to monitor them, and to reconciliate them, especially since income tax and the effect on non-controlling interests have to be disclosed. Moreover, it is difficult to ensure the comprehensiveness of the performance measures.

For many cooperative banks, this can be particularly onerous because they follow a decentralised controlling approach. The reporting of management performance measures within one note would require a central coordination. Moreover, this could affect alternative performance measures as defined by the ESMA guidelines and possibly also prescribed regulatory performance measures. This could double the reporting requirements.

Furthermore, performance measures that are not subject to IFRS obtain a particular note in the financial statements and are thus emphasised.

Moreover, this could affect alternative performance measures as defined by the ESMA guidelines and possibly also prescribed regulatory performance measures.If separate reporting cannot be avoided, then at least there should be reconciliations between IASB and ESMA, which is working on a similar topic (“Alternative Performance Measures”), to avoid two different sets of regulations. This would induce extra work and might even confuse statement readers, as two sets of performance measures with possibly marginal differences may be found in one document. Also, we would like to emphasise that some performance measures might be useful only for a small part of statement readers. This might be the case for performance measures that were made public for investors in an entity’s subordinated liabilities, for example. Some of those numbers therefore could confuse statement readers that have not invested in these subordinated liabilities.

Furthermore according to B83 of the ED an entity can disclose part of its MPMs in the note for segment information if it discloses in that note all of the information required by § Para 106 of the ED for all of its MPMs or provides a separate note that includes all of the information required for MPMs.

Certain member institutions fear that this requirement potentially leads to duplicate reporting of MPMs in those cases where entities continue to report part of their MPMs in the note for segment information according to IFRS 8 but refuse to report all the required information for MPMs in that segment note. Certain member institutions do report a set of selected MPMs in the IFRS 8 note but would rather choose to not expand this note by adding all the new information required by Para §106 of the ED. In those cases a separate MPM note - partially including duplicate information - needs to be provided. Certain member institutions question whether duplicate reporting of MPMs really helps to improve how information is communicated in the financial statements. EACB proposes that the IASB provides further explanation of how MPMs interact with performance measures already presented under IFRS 8 and considers the option of cross references for performance measures presented in the note for segment information.

According to the ED, for each MPM an entity must disclose a reconciliation to the most directly comparable subtotal/total referred to in Para §104 of the ED including the income tax effect and effect on NCIs and how the income tax effect was determined. Not all of the member institutions will have the information available with regard to the individual tax effect and NCIs for each individual performance measure. Hence, in those cases the calculation of those effects can be very complex, costly and burdensome. Certain member institutions suspect that the reason for stating individual tax effects and NCIs in the reconciliation is that those effects might be used by analysts to calculate adjusted EPS measures but from their point of view it is questionable whether the expected benefits will outweigh the related costs and efforts. It should also be kept in mind that many member institutions are not required to calculate and report EPS measures. Regarding the reconciliation certain member institutions invite the Board to reconsider how to handle disclosure of confidential or highly sensitive information. In some cases performance measures are adjusted by specific restructuring or tax effects that should not be disclosed in a reconciliation to the public and peer companies for competitive reasons.

EACB asks the IASB to take a stand on the above-mentioned questions and concerns regarding performance measures.

Q.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?

Q.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?

Q.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?

Other issues: Relation to other standards that affect the statement of profit and loss and other comprehensive income

IFRS 9 affects the structure of the statement of profit and loss and other comprehensive income for banks in particular. There are more standards that affect the structure of the statement of profit and loss and other comprehensive income, i.e. IFRS 5, IFRS 15, IFRS 16, and IFRS 17. In the exposure draft there are no instructions regarding the reconciliation of the requirements from these standards and the requirements in the exposure draft concerning the statement of profit and loss and other comprehensive income.

EACB invites the IASB to clarify the relation of the new structure of the statement of profit and loss and other comprehensive income to other standards that affect the statement of profit and loss and other comprehensive income.