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Dear Sir or Madam

Exposure Draft ED/2019/7 General Presentation and Disclosures

We would like to make the following overall points on the Exposure Draft on *General Presentation and Disclosures*, which are explained in more detail in the attached responses to the questions raised in that document.

- We do not oppose the proposal to classify income and expenses from investments within the operating category where appropriate, but note that some judgement will be required to determine whether or not such investments are part of the core business or whether they arise largely independently of the business, and as such diversity in practice is likely to arise.

- As a result of the above, the investing and financing categories as proposed may not be as clear cut as might be thought. In particular, the financing category might not reflect the reporting entity's view of its management of debt and debt-related costs, which might be after the effect of certain short-term investments in managing a "net debt" position.

- The difference in approach to operating, investing and financing categories in the income statement and in the cash flow statement are likely to lead to some confusion in the minds of users of financial statements.

- We do not support the mandatory presentation of "finance-like" elements of operating charges, such as interest on provisions discounted to present value and the net interest on the net defined benefit obligation, within the financing category. In the absence of a clear conceptual rationale for the change, we believe the classification should be an accounting policy choice, as it is now.

- We do not support the classification of integral associates and joint-ventures within a new measure of operating profit, and would prefer that any analysis of associates and joint ventures between integral and non-integral should be confined to the notes to the financial statements.

- We are concerned that the proposals for aggregation and disaggregation seem to be ruling out the use of "other" as a description and believe that the proposals for explanations of aggregated immaterial items would lead to extensive and unhelpful narrative which will further clutter the notes to the financial statements.

- We are concerned that the proposals to revise the classification of expenses by nature or by function, and the new guidance for determining which presentation is most appropriate, could present problems for many reporting entities, and also believe that the current wording of the

proposals suggests a bias towards reporting expenses by nature, which will not be appropriate for all entities.

- We believe that the proposal to identify and disclose “unusual items” of income and expense requires further clarification and amendment to avoid the reporting of relatively immaterial items. In addition, the interaction between unusual items and management performance measures may have unintended consequences, such as increasing the complexity of reporting and reducing clarity for users of the accounts, and as such requires further thought.

- We are concerned by the proposals in the Exposure Draft regarding the definition of, and presentation of, Management Performance Measures, not least because of the interaction between the Board’s proposals and existing mandatory requirements for listed entities e.g. in Europe and the United Kingdom.

We hope that you find our comments useful and thank you for the opportunity to be able to comment on this matter.

Yours faithfully

John Irvine

Corporate Financial Controller

British American Tobacco plc

Encs/

Exposure draft ED/2019/07: General Presentation and Disclosures

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?

Response:
We have no objection to this proposal. The proposal is largely consistent with existing practice, even allowing for some diversity in practice. In addition, the proposal will be welcomed by those having to prepare accounting bases reconciliations for public documents, for example between U.S. GAAP and IFRS.

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?

Response:
We have no objection to this proposal. It should be noted, however, that in practice some reporting entities could interpret the classification of income and expenses slightly differently, and hence some diversity in practice is likely to remain even after the proposal is implemented.

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?

Response:
We do not oppose the requirement to classify income and expenses from investments within the operating category where they were made in the course of the entity's main business activities, i.e. as part of the entity's normal operations, as opposed to financing activities. This is consistent with the overall objective that operating profit reflects gains or losses that are neither financing-related nor investing-related as such.

It should be noted, however, that some judgement will be required to classify investments between those made in the course of the main business activities (to be included in the operating category) and

those made as part of the investing activities. As a result, it is unlikely that there will full comparability from one entity to another, and there may be some diversity in practice.

The definition in paragraph 47 of the Exposure Draft of the investing category is not entirely clear, and further guidance on this from the Board would be appreciated. The rationale set out in the basis of conclusions is also not as clear as it could be and begs the question of what is actually an investing activity.

In our view, the operating / investing distinction is potentially blurred and inconsistent with the approach established in the current version of IAS 7 *Statement of Cash Flows*. Arguably the current IAS 7 model provides guidance that ensures consistency across different business models, whereas the proposals in the Exposure Draft do not and are more likely to lead to diversity and incompatibility in practice.

<u>Question 4—the operating category: an entity that provides financing to customers as a main business activity</u>

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?

Response:
We are supportive of the requirement that customer financing where it forms part of an entity's main business activities should be classified within operating expenses.

<u>Question 5—the investing category</u>

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?

Response:
We do not oppose the proposal that returns from investments which do not form part of the main business activities should be classified within investing activities. It should be noted, however, that some judgement will be required to classify investment returns between those made in the course of the main business activities (to be included in the operating category) and those made as part of the investing activities. As a result, it is unlikely that there will be full comparability from one entity to another, and there may be some diversity in practice.

As noted above in our response to Question 3, in our view, the operating / investing distinction is potentially blurred and inconsistent with the approach established in the current version of IAS 7. Arguably the current IAS 7 model provides guidance that ensures consistency across different business models, whereas the proposals in the Exposure Draft do not and are more likely to lead to diversity and incompatibility in practice.

In our view, the use of similar terms with different definitions in two separate primary statements is likely to confuse users of the accounts who have a right to expect a consistent approach within the financial statements. The rationale in the Basis of Conclusions (paragraph BC51) for having a difference between IAS 7 and the Exposure Draft on categorisation is not fully convincing. It should be noted that reporting entities often use an alternative management measure to compensate for capital expenditure (capex) on plant, property and expenditure being shown as an investing activity in the cash flow statement but depreciation on the same as an operating activity, for example by categorising capex as part of cash flows from operations in a management (non-statutory) cash flow statement.

Rather than continue with an inconsistency between the replacement for IAS 1 and the existing IAS 7 (even after the proposed minor adjustments in the Exposure Draft), perhaps this is an opportunity to add a more extensive revision of IAS 7 to the project scope.

We would welcome additional guidance from the Board on the definitions of operating, investing and financing activities. It would be useful to help define by way of illustration and example which investing-like activities would be more likely to form part of the main business activities than not. Examples from outside of the financial services sector would be considered particularly useful.

It should be considered that the separating of income from investments into the investing category, while income on cash and cash equivalents is shown within the financing category, is not consistent with how many entities manage their debt and financial assets as “net debt”. Many entities would have a Treasury policy of managing cash in territories with short-term or longer-term restrictions on remittance by placing cash on deposit in financial instruments designed to protect the economic value of the funds and provide a return in excess of local inflation or currency depreciation. Nevertheless, in the view of management, these deposits are held as part of the management of net debt and are often regarded as being economically no different from cash and cash equivalents, even if they do not meet the definition as set out in IAS 7. Under the proposals in the Exposure Draft, the returns on cash are offset against the expense of debt, but the returns from investments managed as part of net debt are not. Additionally, it is not entirely clear whether these returns would be shown within the operating category or the investing activity.

The Exposure Draft places the results of associates and joint ventures in the investing category. In replacing IAS 1 *Presentation of Financial Statements*, an opportunity exists to reconsider how the results of associates and joint ventures are reported within the income statement. IAS 1 and the Exposure Draft both require that the entity’s share of the profit or loss of associates and joint ventures (a post-tax value) is shown prior to profit and loss before tax (and hence prior to the tax charge), whereas it would be more logical to show the results of associates on a post-tax basis after the entity’s tax charge.

Alternatively, the share of associates and joint ventures results could be incorporated to key subtotals (on a pre-tax basis) within the income statement. This was the approach taken by the UK Accounting Standards Board (ASB) in developing SSAP 1 (superseded by FRS 9 and later by FRS 102) whereby the share of associates’ operating profit was included in operating profit, the share of financing costs in finance costs and the share of tax in taxation.

While a revision of equity accounting into "gross equity accounting" as suggested above might be considered beyond the scope envisioned by the Exposure Draft, which is touched on in BC88, nevertheless the replacement of IAS 1 is clearly the time to consider such a change. If this would require a revision to other existing Standards, then this should be done at the same time.

Our comments on the concept of integral associates introduced by the Exposure Draft are noted below as a response to Question 7.

<u>Question 6—profit or loss before financing and income tax and the financing category</u>

> *(a) Paragraphs 60(c) and 64 of the Exposure Draft propose that all entities, except for some specified entities (see paragraph 64 of the Exposure Draft), present a profit or loss before financing and income tax subtotal in the statement of profit or loss.*
>
> *(b) Paragraph 49 of the Exposure Draft proposes which income and expenses an entity classifies in the financing category.*

Paragraphs BC33–BC45 of the Basis for Conclusions describe the Board's reasons for the proposals. Do you agree with the proposals? Why or why not? If not, what alternative approach would you suggest and why?

Response:
Regarding part (a), we would not object to a requirement to disclose "profit or loss before financing and income tax" as a subtotal on the face of the Profit and Loss account.

The proposal as to which income and expenses are classified within the financing category (part (b)) is more problematic.

As noted above in our response to Question 5, it should be considered that the separating of income from investments into the investing category with income on cash and cash equivalents shown within the financing category is not consistent with how many entities manage their debt and financial assets as "net debt" where, in the view of management, deposits classified as investments are held as part of the management of net debt and are regarded as being economically no different from cash and cash equivalents, even if they do not meet the definition as set out in IAS 7. Under the proposals in the Exposure Draft, the returns on cash are offset against the expense of debt, but the returns from investments managed as part of net debt are not.

It is not sufficiently clear what the financing category is supposed to represent under the proposals contained in the Exposure Draft. For many entities, net finance costs (as currently required under IAS 1) is indeed the reporting of the finance costs less finance income of the business as it relates to the activity of raising and managing net debt and recognising the costs of doing so as interest. The offset of income on cash and cash equivalents would of course form part of this. For these entities, interest arising from the discounting of provisions, or the net interest on the net defined benefit liability, is more likely to be classified as an operating expense as both are more closely related to the normal operations of the entity than to the financing and capital management of the entity.

Under the proposals in the Exposure Draft, however, the financing section would consist of several different elements:

- income from cash and cash equivalents, on the effective interest basis;
- income and expenses on finance liabilities (debt), on the effective interest basis;
- income and expenses on other items such as liabilities for provisions (e.g. litigation liabilities and decommissioning provisions), and from post-employment benefits, where these arise from the passage of time, with provisions accounting and retirement benefits accounting utilising different methodologies and assumptions to calculate present value.

The concept of financing is supposedly based on the principles in IAS 7, but in the Exposure Draft it becomes something else, including interest on provisions and retirement benefits. While there is diversity in practice, with some entities regarding these items as financing in nature, this is not the only view, as it can be argued that retirement benefits liabilities and provisions are only stated at present value simply because the relevant standards tell us to, whereas the interest cost associated with borrowings is a real charge and part of the cost of debt / capital management.

The fact that U.S. GAAP has recently chosen to present interest on provisions and retirement benefits within financing costs is not in itself a definitive reason for doing so, although it may help with gaap reconciliations for investors in different jurisdictions.

The Basis of Conclusions states that the finance elements of retirement benefit costs are commonly considered to be finance-like but does not explain by whom or why. While some analysts and rating agencies treat retirement benefit liabilities as a form of debt (an approach often mirrored in debt covenants) and consequently make adjustments to earnings to take out the so-called financing element (leaving just the service charge), this does not mean that we should follow this approach to exclude "net interest on the net liability" from operating profit in the primary statements. Even if the proposals in the Exposure Draft were adopted, analysts and rating agencies would still have to make adjustments to reportable profit to comply with their credit rating models.

The interest component of retirement benefit charges is neither reflecting the time value of money over multiple periods (it reflects only one reporting period's assumptions at a time) nor true interest i.e. on an effective interest basis, so it is something quite different and does not really belong in financing lumped in with interest on debt.

While no-one is entirely happy with how retirement benefit accounting works, the current model is at least reasonably understandable, workable and comparable across reporting entities, even if there is diversity in presentation of the "financing" component. This diversity in practice could just as easily be fixed by requiring the "financing" element to be included within operating profit for all reporting entities.

For many reporting entities, this so-called financing element is as much a component of the IAS 19 employee benefit cost as the service cost, and hence is shown as part of operating costs. In addition, it should be noted that the calculation of the service cost - which is agreed to be an operating cost - presupposes an assumption for the discount rate. The separation between "operating" and "financing" elements for costs recognised under IAS 19 is not so clear cut as might first be thought.

In the absence of a conceptual reason as to why the cost of providing post-employment benefits should be separated between operating and financing elements in the income statement, it would seem better to leave things as they are, allowing management to determine which approach best serves the users of the accounts.

Similar points could also be made on interest on provisions. In the absence of a conceptual rationale for separating the initial charge and changes in the estimate of the provision as operating charges

from changes in the present value of the provision due to the passage of time, the requirement to do so in the Exposure Draft does seem somewhat arbitrary, even if some reporters already do so.

For other reporters, the costs reflected in a provision, both the initial charge and the unwind of the discount, have historically been taken to the same place in the income statement treating both the initial charge to operating profit and the discounting element as an additional operating charge over time as part of operating profit or loss, ensuring that the full amount of the charge for which the provision has been set up is reflected in the same place in the income statement i.e. operating profit, rather than shown in two places as an initial discounted charge in operating profit with the unwind of discount shown in financing.

For both post-employment benefits and provisions, there is no evidence that diversity in practice is causing serious problems to users of the accounts as in both cases the amounts which are deemed to be “finance-like” are quantified in the notes to the accounts (where material) and the reporting entity’s accounting policies explain the treatment as an operating cost or a financing cost in the income statement.

While removing diversity in practice is a laudable goal for financial reporting, if there is no conceptual rationale for choosing one method rather than another, and there is no real benefit to financial reporting in forcing all reporters to use one method rather than the other, it must be questioned as to whether such a change is really necessary.

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?

Response:
In paragraph BC8, the Board notes some diversity in practice regarding the presentation of the share of profit or loss of associates and joint ventures accounted for using the equity method as a separate line item, with some reporting entities including associates within a measure of operating profit rather than reporting the post-tax share of associates as a single line placed immediately before profit before taxation (as shown in the examples in the Illustrative Guidance of IAS 1).

We understand that the proposal in the Exposure Draft to exclude results from associates and joint ventures from operating profit / loss is designed to improve the comparability of operating profit/loss across entities. We further understand that the additional proposal to introduce a new subtotal incorporating both operating profit and results of certain equity-accounted entities, labelled "integral associates and joint ventures", is being introduced to accommodate business activities of certain associates which are not largely independent from income and expenses classified by the reporting entity in the operating category as such income and expenses, but which would otherwise not meet the new definition of investing activities (paragraphs BC80 and BC81). Correspondingly, only the results of associates where these are investment-like will be reported within the investing category.

The Board have noted that the activities of associates and joint ventures can be closely related to the activities of the reporting entity. However, there may well be certain investments in associates that a reporting entity has made which are relatively insignificant to the business but would still meet the definition of an integral associate, whereas other associates which are more significant to the investee in terms of earnings per share would not count as an integral associate. The current wording of the Exposure Draft takes no account of materiality. For the avoidance of doubt, an explicit reference to materiality should be made to avoid an "all in – all out" approach. Where both integral and non-integral results are immaterial, then the disaggregation between the two categories clearly becomes irrelevant. Where only non-integral results are material, no further disclosures should be required.

The treatment of associates as a *single* line item within profit and loss is of long standing, with UK and other European listed entities having reported on this basis since the adoption of IFRS in 2005. While a single line item of post-tax results reported before the parent entity's profit before taxation has never really been entirely satisfactory, reporting the share of after-tax results of certain associates and joint ventures within a secondary measure of operating profit is less so as the amounts are even more incomparable.

As noted in our response to Question 5, the share of associates and joint ventures results could be incorporated to key subtotals (on a pre-tax basis) within the income statement. The was the approach taken by the UK Accounting Standards Board in developing SSAP 1 whereby the share of associates' operating profit was included in operating profit, the share of financing costs in finance costs and the share of tax in taxation. While a revision of equity accounting into "gross equity accounting" as suggested above might be considered beyond the scope envisioned by the Exposure Draft, nevertheless the replacement of IAS 1 is clearly the time to consider such a change. This could be applied to the results of all associates and joint ventures, or only for integral associates and joint ventures. In effect, the presentation would be more consistent with the presentation and accounting for joint operations.

For reporting entities operating in certain sectors such as extractive industries or the pharmaceutical business, where partnerships with joint ventures and associates are more common than not, it could be argued that the proposal in the Exposure Draft for an additional operating profit line including the results of certain associates and joint ventures would be useful for comparability across these particular sectors. However, this objective could be better served for these reporting entities by targeted additional disclosures in the notes to the accounts rather than a change to the primary statements affecting all reporting entities.

The definition of integral associates within the proposed amendments to IFRS 12 is quite clear in terms of what it is trying to achieve particularly in terms of highlighting significant interdependency between a reporting entity and its associate or joint venture. To go this route, we would agree with the amendments to IFRS 12 to define "integral associates" in some way, but would rather amend IFRS 12 to require disclosure of integral and non-integral results of associates and joint-ventures, where

material, and, if material, the disclosure of an additional operating profit measure within the notes to the accounts to include integral associates and joint ventures rather than add clutter and confusion to the income statement in showing associates in two places. Existing disclosure requirements such as those in IAS 24 *Related Party Disclosures* would ensure that the significance of transactions between the parent and the associate are not lost.

Another point to consider is the disparity between the treatment in the profit and loss account and the treatment in the cash flow statement. In the cash flow statement we treat all dividends from associates as investing activities, whereas in the profit and loss account the Exposure Draft proposes that we will treat the results of the associates as either part of an investing activity if they are non-integral and as part of operating results if they are integral.

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?

Response:

The basis of conclusions in particular makes the point that use of the term "other" has been raised as a concern by users of the accounts (in feedback on the agenda consultation) with reporting entities leaving large amounts in "other" without further analysis. While we agree that it is appropriate to aggregate immaterial items, we believe that the proposals in the Exposure Draft go too far in effectively prohibiting the use of the term 'other'. It should be noted that a significant volume of explanatory text would be required to be added to the financial statements with little or no value, thereby running counter to the requirement to be clear and concise.

We believe that reporting entities should be able to aggregate immaterial items and the use of a generic title, such as "other", might be the only appropriate way of doing so. It is impractical to suggest otherwise. Having so aggregated, the proposals in the Exposure Draft would then require associated narrative for these immaterial items which would be more extensive than that for material line items and so unduly focus users of the financial statements on these immaterial items.

While we understand and appreciate that IFRS in general does not utilise quantitative thresholds, we would suggest that an alternative would be to incorporate quantitative and qualitative guidance for determining the level of analysis required, such as is applied in IFRS 8 *Segmental Reporting*.

We are not averse to the presentation of goodwill separately on the face on the Balance Sheet, however we consider that the concept of materiality should be available to reporting entities so as not to unnecessarily expand the statement of financial position for insignificant balances. In addition, we would propose that goodwill, when it is separately presented, appear first, followed by other intangible assets.

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?

Response:
IAS 1 requires management to choose between presenting expenses by function or expenses by nature on the face of the income statement; if you present by function you also supply by nature in the notes. IAS 1 requires entities to choose between by function or by nature on the basis of what information was more relevant and reliable for users of the accounts.

The Exposure Draft goes beyond this by requiring a reporting entity to use the single method that would provide the most useful information to the users of its financial statements, considering the entity's particular circumstances with paragraph B45 providing guidelines for making this determination including: the most useful information about key drivers in profitability; which method most closely represents the way the business is managed and how management reports internally; and industry practice.

Whilst we do understand the desire to improve comparability, we are not sure that the current proposal is effective in that effort, and further, there is a clear bias in the Proposals to require detailed reporting by nature of expense which will not reflect how many entities organise their reporting.
While we appreciate that certain users of financial statements may wish to see the presentation of the income statement by nature as well as by function, we do not believe that this will drive improved comparability or transparency.

Reporting entities that currently report on a functional basis do so because this is how they run their business and monitor performance internally. These entities will have to maintain two income statements – by function for internal reporting and performance monitoring, and by nature for external reporting. Where the analysis of expenses by nature is prepared solely to meet an external disclosure requirement, the ability of management to answer questions about those expenses or trends is likely to be limited.

Furthermore, there are a number of companies that currently use a hybrid of the nature and function presentations as they believe this provides a useful presentation for readers. These companies may find the move to presentation either by function or by nature could reduce the usefulness of their income statement presentation to users.

We would like to propose an alternative which might meet the perceived needs of users without significantly increasing the burden on preparers. We would propose that rather than a secondary classification of all expenses, a more practical approach for those companies that present expenses by function would be to continue to present as additional information the specific financial statement line items by nature required by IAS 1 (i.e. depreciation; amortisation; and employee costs included in the statement of profit or loss) but then to provide an analysis of each of these items showing the split between functional line items. This information is more likely to be available from existing reporting processes in most cases and could therefore be reported without excessive additional cost.

<u>Question 10—unusual income and expenses</u>

> *(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?

Response:
The Exposure Draft includes a proposal for a new requirement to identify unusual income and expenses - income and expenses, of similar types and amounts, not expected to reoccur in the next few periods - with mandatory disclosure in a separate note to the accounts. These items are highlighted because they have limited predictive value – they are genuine "one-offs". As such, this appears to be similar to the concept of "extraordinary items" that U.S. GAAP and IFRS dispensed with a few years ago. U.S. GAAP concedes that unusual items are essentially extraordinary items that are disclosed in the notes to the accounts rather than on the face of the income statement.

Whilst we do understand the basis for the proposal, we disagree with how the proposal is currently drafted and propose that further clarifications and/or amendments be made.

Firstly, the current drafting of unusual items implies that the threshold for the identification and recording of such items is low – potentially requiring entities to carry out an exercise to search for items that meet the definition, going beyond how management monitor the performance of the business – and is therefore open to significant divergence in practice. We recommend that it is made clear that to meet the definition of an unusual item, the item must be material to a user's understanding of the performance of the business.

Whether individual items of income or expense are unusual by type or by amount involves significant levels of judgement. Such items would include one offs, such as a loss on a fire, as well as more regular items which are unusually large (e.g. a large litigation loss in the context of on-going litigation expenses i.e. a larger than expected expense). Determining unusual items by amount would involve determining a reasonable range of base values expected to occur in the next several future periods. However, the suggestion in paragraph B70 that two fires in close succession could indicate a pattern of factory fires which would not count as unusual items suggests an unlikely scenario which in real life would be considerable headaches for management and their insurers!

Secondly, we would request further clarification to be given regarding the interaction between unusual items and the proposed management performance measures detailed in the exposure draft. Such clarification should focus on whether all unusual items by definition should fall within the management performance measures / MPMs (based on the principle of unusual items going beyond the level at which management monitor the performance of the business), or whether there could be

divergence with some items being classified as unusual but not as an MPM (or indeed some items classified as a MPM but not as unusual). For example, paragraph B71 notes that restructuring costs occurring from period to period (either a programme over several periods or as a result of regular acquisitions) might not be unusual; but in many cases such restructuring costs would be shown as an MPM.

Paragraph B75 notes that the Exposure Draft's definition of unusual may not coincide with the definition MPMs, with MPMs including "some or all" of the unusual items. Is it possible they might not include any of the unusual items? This remains unclear without field testing.

There is already much in the way of existing guidance on management performance measures APMs (e.g. ESMA and FRC on Additional Performance Measures / APMs) and the IASB should be aware that their requirements in the Exposure Draft may not be wholly in sync with existing regulatory guidance.

Paragraph B75 notes that all unusual income and expenses must be included in a single note in accordance with paragraph 101 and this can be included in an MPMs note or separate from an MPMs note. While putting in this detail into a single note might aid transparency and understandability in some cases, it may lead to unintended clutter, particularly where a separate note is presented for APMs which may not be the same as unusual income and expenses.

We believe that the combination of the proposals on unusual items and management performance measures is likely to increase the complexity of reporting and reduce comparability across businesses, leading to a reduction in clarity for users of accounts.

Paragraph B73 notes that where income and expenses have been identified as unusual, related income and expenses are not also classified as unusual unless they are themselves unusual. In the example given in paragraph B73, a sale giving rise to unusual revenue, the sale is identified as unusual, but not the associated selling costs including inventory cost. So, the sale is unusual, not the profit on the sale. This is not what users are expecting to see – both the sale and the net profit are useful information. Paragraphs BC143 and BC144 note that the Board considered this and decided that it would be too costly and could lead to an inconsistent application of the principles (defeating the objective). We would argue the opposite.

No specific period is noted for the future periods: the board wanted something more than just short term (i.e. next year); to consider every future period is impractical. To specify a period would be arbitrary, but clearly it will involve judgement for the preparer and could reduce comparability. Given the concept of unusual income and expenses is a little arbitrary, perhaps a rule would not be out of place.

The same types of unusual income and expenses might have arisen in the past - it is the effect on the future that is important. Unfortunately, while this may help with the predictive quality of information, it leads to a lack of clarity and comparability with previous periods, unlike management performance measures which are applied consistently year after year. For the avoidance of doubt, perhaps the proposals should be clear that unusual items are identified for the current reporting period only, and that comparatives are not required. As a forwards-looking measure, comparatives for "unusual items" would be meaningless.

The Board has concluded that unusual income and expense could result from transactions or other events that are unusual in nature, but under the proposed definitions, this is not always the case. An unusual event, such as an earthquake or virus pandemic, can give rise to increased costs which are expected to arise for a number of years, but are not unusual expenses as such.

And finally, we would request deeper consideration of the specific definitions which currently appear to create inconsistent treatment – for example:

- items of accrued income and expense that are recognised as unusual, but which are subsequently reversed in future periods if unused do not necessarily meet the recognition criteria to be classified as unusual on reversal;
- a genuinely one-off transformation or restructuring project that spans more than one financial reporting period and therefore will continue next year but not for multiple years in the future;
- consideration of the consistency between the IFRS and the US GAAP definition of 'unusual', since comparability issues could arise in the event of the definitions diverging.

<u>Question 11—management performance measures</u>

(a) Paragraph 103 of the Exposure Draft proposes a definition of 'management performance measures'.

(b) Paragraph 106 of the Exposure Draft proposes requiring an entity to disclose in a single note information about its management performance measures.

(c) Paragraphs 106(a)–106(d) of the Exposure Draft propose what information an entity would be required to disclose about its management performance measures.

Paragraphs BC145–BC180 of the Basis for Conclusions describe the Board's reasons for the proposals and discuss approaches that were considered but rejected by the Board. Do you agree that information about management performance measures as defined by the Board should be included in the financial statements? Why or why not? Do you agree with the proposed disclosure requirements for management performance measures? Why or why not? If not, what alternative disclosures would you suggest and why?

Response:

Many reporting entities disclose financial information outside the financial statements by providing management-defined performance measures in communications with users of financial statements. Users consider that information provided by such measures can be useful because it provides insight into how management views the entity's financial performance, how a business is managed, and the sustainability of an entity's financial performance.

Certain users of financial statements expressed concerns about the quality of disclosures provided about these measures, however, and in some cases the disclosures lack transparency in how the management-defined performance measures are calculated, lack clarity regarding why these measures provide management's view of the entity's performance, create difficulties for users trying to reconcile the measures to the related measures specified by IFRS Standards, and are reported inconsistently from period to period.

The Board has concluded that management performance measures can complement measures specified by IFRS Standards, providing users of financial statements with useful insight into management's view of performance and its management of the business. The Board is of the view that including these measures in the financial statements would make them subject to the same requirements regardless of the entity's jurisdiction and would improve the discipline with which they are prepared and improve their transparency.

We understand the basis for the proposal; however, we do not support the blanket requirement to include reconciling and explanatory information around management performance measures (MPMs) within the financial statements in all cases. We also believe that the narrow definition of MPMs, excluding alternative asset, liquidity and cash flow measures, will potentially create confusion for users, where entities utilise MPMs that fall outside of the narrow definition in the exposure draft.

Many large IFRS reporters are already subject to reporting requirements in relation to Additional Performance Measures (APMs) such as those issued by ESMA, the SEC or similar regulatory organisations. The definitions of APMs or MPMs to which these requirements apply are broadly consistent and we do not understand the rationale for the Board choosing a significantly narrower definition of MPMs to be included within the financial statements.

Management performance measures are the subject of a great deal of regulation as well as interpretation in different territories around the world it would seem advisable that the IASB should not regulate on management performance measures as such given that their guidance may well conflict with guidance issued by regulators in each territory

We would propose that if MPMs are presented within the financial statements, the relevant explanations and reconciliations should be included in the notes. However, if MPMs could be included in the document that contains audited financial statements but not in the primary statements or notes themselves, then the explanations and reconciliations should be included in the document, but not necessarily within the audited financial statements, as is required under U.S. reporting requirements. If considered necessary, the reconciliations could be made subject to audit wherever they are presented in the document. The rationale of including MPMs within the audited financial statements simply to ensure the MPMs are audited is not a good one.

Including Management Performance Measures within the financial statements so that they are covered by the requirements of IFRS and so that potentially misleading information is not provided outside the financial statements (as is suggested in paragraph BC159) does not take account of the regulatory environments (or multiple regulatory environments) that the reporting entity's accounts and additional information are subject to, and does not take account of audit regimes requiring additional information out with the financial statements to be consistent with and not contradictory to the information in the financial statements.

Also defining Management Performance Measures as being used in public communications outside financial statements does not take account of Management Performance Measures often appearing within financial statements (e.g. in a definition of segmental results).

It could be argued that placing the Management Performance Measures within a single note gives undue prominence to the management measures when compared with IFRS measures.

Further, with regard to the proposed requirement to incorporate the income tax effect of each item disclosed in a reconciliation between the most comparable IFRS measure and the management performance measure we have two concerns.

- firstly, we question the merit where the measure is by definition a pre-tax measure (e.g. adjusted profit from operations), and consider that this would in fact create confusion; and
- secondly, we would seek clarification that where the impact of an 'adjustment' is presented across multiple lines in the income statement that only the total tax impact is required (as is often disclosed in reconciliations of adjusted earnings per share) as opposed to the tax impact of every element of the adjustment.

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?

Response:
We have no view on the omission of EBITDA. It is relatively easy to calculate, and all the components are easily found in the disclosures. However, it seems a little odd *not* to include it given it is so widely used.

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?

Response:
We understand the basis for the proposal and are supportive of the requirement for operating profit or loss to be the starting point for the indirect method of reporting cash flows from operating activities. Requiring operating profit loss to be the starting point for the indirect method of reporting cash flows from operating activities does not in itself have any real issues except for the points noted above where we are changing the definition of what is in operating profit. Taking operating profit as a starting point is a pragmatic and practical measure used by many reporting entities already

However, it should be noted that the titles used in the statement of cash flows and the income statement are now proposed to be the same but relate to different items. Although we do not think this should be an issue, it may be something for the IASB to consider aligning should concerns be raised through IFRIC.

The amendments with the new paragraphs in IAS 7 would appear to be removing disparity and differences of treatment from the original standard and consolidating them along the lines used by many reporting entities already specifically to show dividends paid as a financing activity and interest paid as a financing activity (subject to business model), including interest capitalised, and interest received and dividends received as investing activities. For many reporting entities, this change in definition may require the reclassification of dividends and interest received from associates as a financing activity.

Paragraph 38a of the Exposure Draft notes that dividends from associates will be shown as an investing activity and this is applied to both integral and non-integral associates whereas in the income

statement integral associates are shown as part of operating results. This will result in inconsistent presentation in the two statements.

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?

Response:
No, we have no further comments.