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Bern, 28 September 2020

Comment Letter on the Exposure Draft ED/2019/7 "General Presentation and Disclosures"

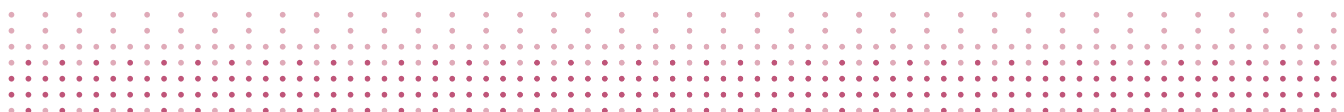
Dear Madam, Dear Sir

SwissHoldings, the Swiss Federation of Industrial and Services Groups in Switzerland, represents 59 Swiss groups, including most of the country's major industrial and commercial enterprises. We very much welcome the opportunity to provide comments to this Exposure Draft (ED).

We very much appreciate that the IASB addresses the topics that are included in the ED. In our view many of the right questions are being asked. It is welcome that *Operating Profit* will become a defined term, and that topics such as the presentation of results of Associated and Joint Ventures are addressed and some basic improvements to IAS 7 are made. It is also important that there is a wider discussion about matters such as income statement presentation and non-GAAP measures, and we support that the IASB brings forward proposals about these matters.

Nevertheless we have strong reservations about some of the proposals.

- In some cases the proposals are not articulated clearly and precisely enough and will lead to confusion and inconsistency in practice. It is for example still unclear to what extent income statement sub-totals and individual line items, which is an existing issue under IAS 1, are permitted or prohibited by the ED. Indeed some SwissHoldings member companies are concerned that they will need to implement new non-GAAP income metrics in the future as their current income statement presentation will no longer be permitted.
- The proposals would benefit greatly from expanded Implementation Guidance and Illustrative Examples. Many obvious and frequently occuring situations are not clearly addressed.
- The proposal to have *Operating Profit* as a residual that is in no way linked or reconcilable to the IFRS 8 Operating Segment disclosures is particularly unfortunate.
- Some of the proposals seem to us to add little additional value to readers.
    - The *Management Performance Measures* proposals create new metrics that duplicate the existing Alternative Performance Measures disclosures already required by regulators such as the SIX and ESMA.
    - The *by-nature* disclosures and *unusual income and expense* disclosures are also largely duplications of information already required by other standards or that is given in the Management Discussion and Analysis.



- The proposals to require a *by-nature* disclosure of income statement items and to allocate foreign exchange gains/losses across the income statement will be time consuming and costly to implement.
- The proposals do not include any reliefs for non-public companies and smaller Group companies that use stand-alone IFRS for their statutory reporting. Since many of the proposals are supposedly at the request of investors, they are presumably not relevant for example for 100% owned subsidiaries.

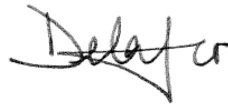
We therefore recommend that the IASB reconsider their proposals, taking into account the results of the Fieldwork and the Comment Letters; and reissue a revised Exposure Draft with significantly expanded Implementation Guidance and Illustrative Examples at a future date.

Our response has been prepared in conjunction with our member companies. Please contact us if you require additional information.

Yours sincerely

SwissHoldings

Federation of Industrial and Service Groups in Switzerland



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Member Executive Committee

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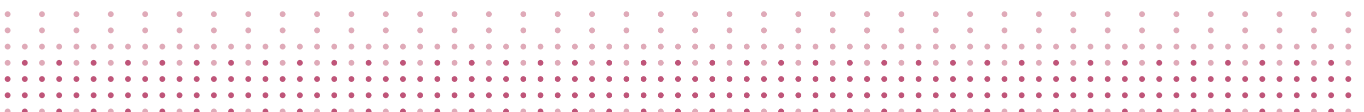

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APPENDIX

QUESTIONS FOR RESPONDENTS

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?

Answer to Question 1

We agree that *Operating Profit* should be a defined term.

This is not addressed by the current IAS 1, which no doubt accounts for a lot of the variability and inconsistency in practice. It is very welcome and, in our view, essential that this becomes a defined term.

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?

Answer to Question 2

We disagree with the proposal to have *Operating Profit* as a residual. It is regrettable that there is not a positive definition of what operating profit is. Moreover the approach in ED may well lead to *Operating Profit* becoming a dumping ground where every kind of cost that does not clearly meet the definitions of *Investing* or *Financing* ends up in *Operating*. It seems to us a better approach to have a clear conceptual definition of O*perating* and then having greatly expanded Implementation Guidance for commonly occurring issues.

With these proposals, the IASB would create *Operating Profit* per the ED, in addition to already having *Operating Segments* per IFRS 8 and *Operating Activities* per IAS 7. These three terms are in no way conceptually aligned, consistent or reconcilable with each other. This cannot help users of the financial statements.

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The term 'main business activities' is used across the ED, but does not seem to be anywhere defined or explained. Neither is it clear, or even discussed, how these 'main business activities' are linked to the 'business activities' per IFRS 8 pp5 (a). Can it be that there are 'business activities' in the IFRS 8 operating segments that are not "main" business activities per the ED? If so, then where should the income and expenses of these "non-main" businesses appear in the new income statement per the ED. And if not, then surely the word "main" in the ED is then redundant. It is noteworthy that the ED contains no consequential amendments to IFRS 8, for example IFRS 8 pp28 would still require a reconciliation to the 'profit before tax' and not to the new *Operating Profit*. The ED and IFRS 8 seem to operate in parallel but never seem to meet.

In order to positively define *Operating Profit* the following could be suggested:

- Preparers should define what their 'business activities' are in their financial statements.
- Some of these 'business activities' may earn revenues and be in scope as *Operating Segments* per IFRS 8. There may also be other 'business activities' such as are mentioned in IFRS 8 pp 6.
- The *Operating Profit* is the sum of the results of these 'business activities'.
- In addition there are
    - 'Investing activities', where excess funds are invested to generate returns. These maybe individual investments, non-integral associates and JVs, and might also include subsidiaries.
    - 'Financing activities', being the cost of servicing debt.
    - Note here that 'Investing activities' and 'Financing activities' are not precisely the same as those defined in the ED.

Something like this would obviously need a lot more work, but this would surely be worthwhile. Since we took something like a decade to work on operating leases, it would not be unreasonable to invest some time and thought into getting a robust solution for operating profit.

Finally, we would draw the IASB's attention to an entirely predictable practical consequence of the proposals in the ED as written: *Operating Profit* as a residual will progressively become a dumping ground for any items of income or expense that cannot be demonstrably shown as either *investing* or *financing* (as defined in the ED).

- We can assure the IASB that this already happens with the IAS 7 cash flow, where many auditors apply a checklist approach to IAS 7 pp16 and pp17 – the burden of proof resting on the preparer to demonstrate that items that, in substance, are clearly of an investing or financing nature can fit to these checklists. Failure to do results in these cash flows being dumped into the *Cash Flows from Operating Activities*.

- Already under the ED some foreign exchange gains/losses and maybe some other items will end up in *Operating Profit* that are not currently part of it. There will be checklist style reviews of pp47-52 of the ED during the implementation, and resulting changes to operating profit that will be inconsistent and difficult to explain to internal and external readers.
- At the same time the management view, shown by IFRS 8, remains unchanged. Internal management may increasingly not relate to the IFRS *Operating Profit* in the income statement, regarding it as merely a compliance number. External Management Discussion and Analysis would increasingly focus on the APMs, with cross reference to the IFRS 8 segment results.

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?

Answer to Question 3

Again, we note that the term 'main business activities' does not seem to be defined.

The spirit of the text would seem to be that banks and financial institutions, and also insurance companies, should include in the *Operating* section items such as interest income and gains/losses from management of financial assets. This would seem a sensible idea, but the wording of the ED requires the reader to read-between-the-lines to understand the requirements. We would suggest that the final standard should explicitly say this.

We see a risk that companies other than banks, etc. would have to make an item-by-item review about which investing income/expenses come from 'main business activities' and which do not.

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?

Answer to Question 4

Our member companies are not generally involved in providing financing to customers as a main business activity.

We understand the issues outlined in the BC that leads the IASB to provide an option. We again note that there seems no cross-reference to the management's internal view per IFRS 8. This may be an area to explore, as for example, if the gains/losses from providing finance to customers are somehow allocated in the internal management reporting to the *Operating Segments*, then this would suggest that they can and should be included in *Operating Profit*. Conversely, if they are not allocated internally, this would suggest that they should not be allocated to the *Operating* category in the external financial reporting. Therefore, rather than having a free choice, the option selected should be informed based on the internal management view, which would align with the availability of data and the cost-benefit trade-off involved in the allocation.

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?

Answer to Question 5

We understand what the intention is, but the wording and concept do not seem the best to achieve this intention. The idea of investments that generate returns "individually and largely independently of other resources" seems too wide and at the same time too vague. For example, most associated companies would seem to fit into this category and probably many joint ventures too. Some subsidiaries may even match this description, as may some properties.

As far as we understand the intention, all companies run their "main business activities", whatever they might be. While doing this, at various points there may surplus assets or resources that the company will invest either long-term or short-term to generate a return. We assume that this is what is meant here, in short "asset management". Additionally, the company will maintain sufficient cash/working capital to operate, but presumably this will be part of *Financing*, per pp49(a) of the ED. If this is indeed the intention, then the wording of the definitions and requirements in the ED need to be reworked.

It is unclear from pp47 (b) and BC50 what incremental expenses are meant here. Some examples would be helpful. For example, does this include the wages, salaries and other variable costs of running an asset management team within the Group Treasury department that do nothing else? And does that assessment change if these activities are outsourced to a third party? We note that there is no equivalent "incremental expenses" clause in the *Financing* section in pp 49-52.

Question 6 - Profit or loss before financing and income tax and the financing category

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?

Answer to Question 6

a) This seems clear to us, and we have no additional comments.

b) The main requirement we hear from users is to have a clear interest expense, whereby they can look at the cost of financing the company, with reference to its net debt. It is unhelpful that interest costs or financing costs would include non-cash accounting items such as unwinding of discounts on provisions from the operating business.

Contrary to what is stated in BC43, our experience is that most users do not regard the unwinding of discounts on IAS 37 provisions as a financing topic. Most such large and long-term provisions arise from matters such as legal and environmental cases. These are entirely operational by nature and not treated either by the company or external users as a financing activity. We would draw the IASB's attention to the following:

- This can lead to distortion of the operating results, whereby a company may incur an operating obligation but be required to report part of this a financing cost.

- It seems inconsistent in the ED that foreign exchange gains and losses from provisions of operating nature would now need to be allocated to the *Operating* section of the income statement, while the accounting unwind of the discount is allocated to the *Financing* section. Indeed maybe preparers will need to somehow bifurcate such foreign exchange gains and losses to allocate the gains/losses attributable to the discount unwind into the *Financing* section.

Having a designated place for reporting the net interest costs from IAS 19 Defined Benefit plans is a sensible idea. These can reasonably be considered as a *Financing* item, and in many cases the financing of defined benefit pension plans are managed centrally by a Group Treasury function (in contrast to operating provisions).

As noted in the answer to question 5, the "incremental expenses" noted in pp47(b) are not addressed where these arise in a financing context.

We consider that interest (and penalties) on income taxes should be presented as part of the *Income Tax*es category, not as part of the *Financing* category. These additional amounts due to tax authorities are the consequence of the entity's tax filing decisions (including its approach to uncertain tax positions) and should be presented as such. The interest rates applied by the tax authorities may include some punitive element and are not necessarily reflective of the company's financing costs.

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?

Answer to Question 7

The ED is right to address this topic as the current IAS 1 leads to a variety of practice.

Companies will always have a clear business reason for acquiring associated companies and/or joint ventures. These are, by nature, complicated arrangements typically with complex legal and governance issues; they do not happen by accident and the company surely has a rationale for the transaction. We see the distinction the ED tries to bring, between those transactions that are directly or indirectly related to the company's 'main business activities' and those transactions that are in substance an investment of surplus funds made to generate an independent financial return.

We believe the wording in the ED is not successful in making a clear split between the two categories. For example, most associates and JVs will generate an individual return and will operate at an arms-length to the investing company, typically with independent management structures. In reality we would assume most associates and JVs are linked (either currently or potentially) to the 'main business activities', but the ED would result in most being classified as *non-integral*.

While it can be argued that some (indeed most) associates and JVs are linked to the main business activities, we welcome the proposal to segregate them from *operating profit* on the face of the income statement and to provide sub-totals. For internal and external users, operating profit is a Key Performance Indicator, and for practical reasons including post-tax equity method results from associates and JVs adds unwanted volatility and unpredictability to *operating profit*.

Some of our members consider that the distinction is not meaningful for all entities, and it would be better to classify all associates and JVs in the *investing* category, and leave the *integral/non-integral* distinction to a management performance measure.

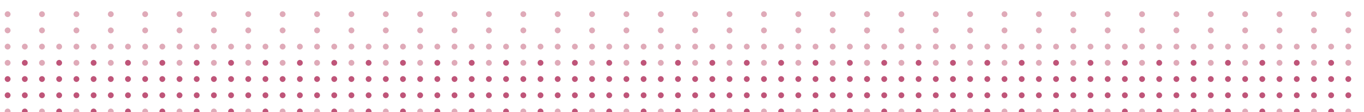
Furthermore, we do not see any real need to segregate *non-integral* associates and JVs from other investing income and expenses on the face of the income statement, unless material. This could be done in the footnotes to avoid clutter on the face of the income statement.

We would draw the IASB's attention to pp20D of the proposed amendments to IFRS 12. In our view, there is a high likelihood that this will end up being used as a checklist. We see a risk that some associates and JVs which are operational in nature would end up being treated as *non-integral*, or vice-versa, based on this list. The examples listed in pp20D seem to us rather narrow and only cater for a certain sub-group of operating associates and JVs. A more principle-based approach would be preferred, with clear Implementation Guidance and Illustrative Examples.

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?

Answer to Question 8

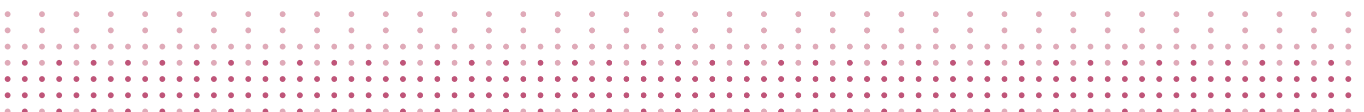
a) This seems clear to us, and we have no additional comments.

b) We welcome the introduction of principles of aggregation and disaggregation. Nevertheless, the ED should recognise that there will always be a certain number of items that do not fit into the defined categories. This is why most, if not all, companies have a multitude of "other" accounts in their own internal chart of accounts. This is not wrong, and the point is to ensure that the content of these headings are appropriately described and, when these "other" amounts are sufficiently material, that a breakdown or analysis is given.

We note the discussion in BC26-27 about thresholds and templates. In general we think the ED is light on Implementation Guidance and Illustrative Examples, and this is another area where more guidance would be helpful.

- Having mandatory thresholds is problematic (although it is done in IFRS 8, for example). Nevertheless this could be an area to further explore. For example within the total provisions there will typically be a few recurring categories, such as restructuring and legal, and there will almost always be an "Other Provisions" category. Now if "Other Provisions" represents 50% of the total provisions balance then that would seem to require further breakdown/explanation, whereas if it only represents 20% then a sentence or two describing what is in there may be sufficient, and if under 10% maybe nothing is required. Some practice guidance without mandatory thresholds may well be helpful.

- We would agree that mandatory templates are also not a good idea, for reasons explained in BC27. However this does not mean that the final standard cannot provide Illustrative Examples of best practice (or even good practice). In our experience these "other items" typically arise in a few main areas:
    - Other operating / income expense;
    - Other financial income /expense (basically non-operating items excluding interest and financing costs);
    - Receivables/Prepayments and Payables/Accruals balance sheet items (long- and short-term) – typically split between "trade" and "other";
    - Other assets/liabilities balance sheet items (long- and short-term, financial and non-financial); and
    - Provisions.



The wording of the first sentence of pp25 can be read as requiring that a *by-nature* split is required (with *by-nature* as discussed in pp68 and elsewhere) of balance sheet and income statement items even if the company is using a *by-function* disclosure. We believe this is not the IASB's intention, and would recommend replacing the word "nature" in pp25 and elsewhere when it does not refer to the *by-nature* topic.

The wording of the second sentence of pp27 is also unfortunate. This can be read as implying that the word "other" should not be used, and that an alternative label should be found. From discussions with the IASB we understand this is not their intention, and therefore we recommend to make clear that what is needed is a breakdown of large aggregates of dissimilar items, regardless of what label is used.

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?

Answer to Question 9

We believe that these proposals need a significant amount of further work, including a reconsideration of what exactly the proposals are trying to achieve. Many of the existing defects in IAS 1 are not addressed, for example on the use of sub-totals and separate line items. As elsewhere, we think that more Implementation Guidance and Illustrative Examples are essential. Specifically:

<u>Sub-totals in the P&L</u>

IAS 1 pp85 allows this, but nevertheless there is a certain variability in practice. Depending on the view of the preparers, and the view of the local regulators and auditors, this has been a strong contributing factor to the proliferation of non-GAAP income statement measures. Unfortunately, the ED is silent on this and we (and others) have interpreted this as being even more restrictive. One consequence is that some SwissHoldings member companies believe they will need to implement new non-GAAP income metrics in the future, as their current income statement presentation will no longer be permitted.

- We believe the final standard should clarify whether sub-totals within *operating profit* are permitted or not. This particularly relates to sub-totals such as 'business profit' (or similar) which are sometimes used as a sub-total before line items such as restructuring costs.
- It should also clarify whether a sub-total for 'gross profit' when using the *by-function* method is compulsory, allowed optionally or prohibited.
- The final standard should include more Implementation Guidance and Illustrative Examples of commonly occurring issues such as restructuring, major litigation, acquisition related costs, gains and losses on disposal of businesses, and impairment of goodwill.

We further believe that pp62 of the ED should be expanded from "no integral associates and joint ventures" to "no material integral associates and joint ventures", and that similarly pp60(b) should not be required if integral associates and joint ventures are immaterial.

Specific line items in the P&L and the so-called "mixing of methods"

IAS 1 pp85 requires the presentation of additional line items when this is relevant to an understanding of performance, but nevertheless there is a certain variability in practice. As with the sub-totals topic, this has led to the growth of non-GAAP income statements metrics. IAS 1 pp98 provides useful guidance, however this is used as a restrictive checklist in by some auditors/regulators. Therefore a company that shows 'impairment of goodwill' as a separate line item on the face of its P&L may well be challenged, especially if using the *by-function* presentation. Because of this many companies then make these kind of disclosures outside of the financial statements in non-GAAP measures.

Unfortunately, the ED doubles-down on the existing issues in IAS 1. The ED seems to take a view that the purity of having a clean *by-function* or *by-nature* presentation (as required by B47) is more important than having a clearly understandable and useful income statement – although as we explain below, the ED includes various exceptions that do not seem to have any conceptual rationale.

For example, if we read the ED and listen to the IASB board members and staff, we understand that 'impairment of goodwill' is prohibited from being shown as a separate line item in an income statement prepared using the *by-function* method – it seems that the IASB believes that is more helpful to readers that it is buried in 'General Expenses' or similar. At the same time, pp82(d) of the ED makes it compulsory to show goodwill on the face of the balance sheet and pp3.115 of the IASB's Discussion Paper on Business Combinations—Disclosures, Goodwill and Impairment even proposes "requiring companies to present on their balance sheets the amount of total equity excluding goodwill". Regardless of the rights and wrongs of goodwill accounting, what is undoubtedly true is that readers want to understand these amounts clearly across the Primary Financial Statements – it is simply dysfunctional to ban goodwill impairment from being a line item in the income statement, while making it obligatory to include goodwill in the balance sheet and as a disclosure outside of equity.

Various line items are allowed to be shown, indeed required to be shown if material, as set out pp65(b) and (c). But these are only as specified by IFRS 9 and IFRS 17, respectively, and not based on any conceptual or practical need. One can ask why it is helpful to readers to extract 'impairment losses from trade receivables' from 'Selling, General and Administration expenses' on the face of the income statement, while at the same time being prohibited from extracting other items, such as 'impairment of property, plant and equipment' and 'impairment of intangible assets'. The reason is of course that IFRS 9 makes such disclosure requirements, while the older IAS 36 does not. There is no conceptual rationale for this. We recommend therefore that in the next stage of this process the IASB make a comprehensive view of all other standards and remove any reference in these standards to compulsory primary financial statement presentation, and instead collects all of these requirements in one place in the new standard – and that there is a consistent concept around which items should be disclosed and not that the ones disclosed are those that come from more recently issued standards.

We note there are no requirements to give specific line items, beyond 'cost of sales', which is required by pp71 of the ED. The ED does not make clear why 'cost of sales' is specifically required, or why this is not required for companies using the *by-nature* method as a supplementary disclosure. IAS 38 pp126-127 requires disclosure of 'research and development' costs, but no attempt is made to link the ED to this. Given the high interest in the amounts companies invest into research and development, we would recommend this be a required line item and that the amount should be that specified in IAS 38, with additional Implementation Guidance added.

Finally, we would like to address the issue of 'restructuring costs'. It is not clear whether restructuring is viewed as a *by-nature* or as a *by-function*. While some seem to consider that 'restructuring' is a nature of expense, we do not agree with this view. This should be clarified by the IASB, since this will determine under which presentation it can be shown.

In our view, a restructuring programme triggers many expenses of different natures: termination and other employee benefits, impairment of assets and accelerated depreciation, gains and losses on disposal of assets, provisions for litigation and environmental issues. In an analysis of expenses *by-nature*, these costs have to be presented under the respective headings for each nature. On the other hand, restructuring expenses are related to different activities (changing the scope or nature of a business operation) than the activities undertaken to run a factory or operate a warehouse. Therefore, in a presentation of costs *by-function*, it would be correct to show 'restructuring costs' separately from cost of sales or distribution expenses.

If the Board agrees with our view, then the example in B15(b) should be amended to read "<u>provisions for termination benefits arising from</u> restructurings of the activities of an entity and reversals of any provisions for <u>these termination benefits</u>" (since the other items are *by-nature*), and it should be clarified that the items in B15 can only be presented in an analysis *by-nature*. Furthermore, the Illustrative Example of the statement of profit or loss should include 'restructuring expenses' as an example of a function, in order to remove the current ambiguity.

On the other hand, if the Board considers that restructuring is a nature of expense, then it should present a line for this in the Illustrative Example of Note 1 – Analysis of operating expenses *by-nature*. We would then be interested to know how the impairment of property, plant and equipment should be split between the line for that nature and the line for the "restructuring nature".

Requirement to provide by-nature split when using by-function method

For those companies that use the *by-function* split, providing this information will require a considerable implementation effort that will be both expensive and time-consuming. This is because the information needed to produce this presentation is usually not available in the existing financial reporting systems.

Moreover, we consider these proposals will add very little value to external users, and contrary to the statements in the ED, we have experienced no demand from users to provide this information.

Much of the required disclosure already exists elsewhere in the financial statements and in more detail. Specifically:

- The footnotes for
    - Property, plant and equipment;
    - Goodwill;
    - Intangible assets; and
    - Leasing

  all already include considerable detail, including movement tables and breakdowns by asset-type.
- The footnote for Employee Benefits gives a breakdown of this amount.
- The footnote for Segment Reporting gives additional segment breakdowns of some of this information, such as depreciation, amortisation and impairments.
- The Management Discussion and Analysis gives breakdowns, segment splits and narrative disclosure of income statement line items.

All of the above is readily available, and the proposals in the ED lead to a copy/paste duplication of already published financial information. The remaining elements typically cannot be derived from the company's internal reporting systems. Here we can note:

- The proposed additional disclosures around inventory movements and raw materials purchases/consumption have very limited value.
    - Firstly for companies that have different operating segments with different gross margins, presenting consolidated amounts is not meaningful.

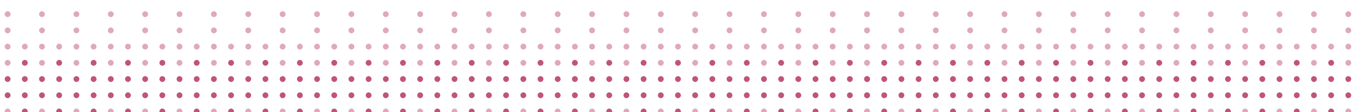
  - Secondly, in our experience, users that are modelling cost of sales / gross profit all do so by starting with the sales numbers and then applying a gross profit margin. In order to do this they will be interested in direct materials, labour and overheads, but providing them with a single amount for personnel costs, depreciation of property, plant and equipment, etc. without any split of how much of these relate to manufacturing and how much relate to other areas (such as sales/marketing, research/development and administration) is essentially useless.
  - A much more helpful approach would be to provide some granularity on the cost of sales number required by pp71 of the ED.
- Companies are left with a residual amount of expenses, which mathematically consist of functional lines, such as 'research and development' and 'selling, general and administration', excluding personnel costs and depreciation, etc. These line items are typically discussed in the Management Discussion and Analysis, but the readers interest will usually be to get more information on each functional line, for example by getting a split of "research" and "development" or some split along the lines of IAS 39 pp66. However, providing entity wide totals as required by the ED is of little value.

<u>Lack of requirement to provide by-function split when using by-nature method</u>

We note that there is no symmetric proposal to require additional analysis *by-function* when the *by-nature* method is used in the income statement. According to BC 114 there is no demand for this. We find that surprising, and for example we would expect that many users of financial statements would not accept being given totals for personnel expenses, depreciation of property, plant and equipment, etc. and at the same being given no breakdown of these and no information about how these relate to 'Cost of Sales'/'Gross Profit' or 'Research & Development' expenses, for example.

We again note IAS 38 pp126-127, which would seem to require companies using the *by-nature* presentation to calculate and disclose research and development costs, and indeed IAS 38 pp66 requires certain attributions to be carried out. It is not completely clear whether research and development costs as envisaged by IAS 38 are considered a *by-function* or *by-nature* line item, although their inclusion in the Illustrative Example of the statement of profit or loss implies they are a function, and the costs in IAS 38 pp66 represent the relevant natures of expenses.

Since the IASB presumably believes that the existing disclosure regime is adequate for companies using the *by-nature* method, we would recommend that the same thinking is required companies using the *by-function* method. Where specific areas need to be addressed, then there should be a targeted disclosure.



SwissHoldings

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?

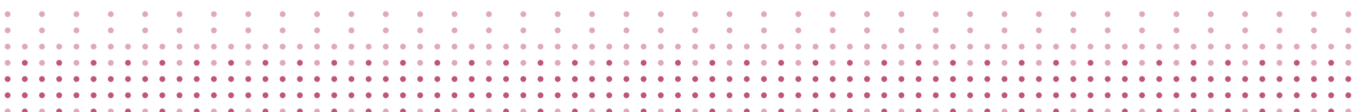
Answer to Question 10

We do not doubt there is demand from many readers for this kind of information. The question for us is how best to provide it and where that information should be provided. There is indeed a certain merit to collecting all of this information in one place, or at least improving the internal cross-referencing to make it easier to find. In our view this is rather a matter of consistency of interpreting the existing standards, improving implementation guidance and better sharing best practice.

It seems to us that adding a further new concept of *Unusual Items*, in addition to the new MPMs and the existing APMs, will further complicate financial reporting and confuse readers. Some *Unusual Items* will be adjusted in the MPMs/APMs and some will not. Similarly the MPMs/APMs will include some adjustment items that are not deemed *Unusual* according to the narrow definition of the ED.

Moreover the correct application of IAS 1 pp17(c), IAS 34 pp15 and various guidelines that exist for Management Discussion and Analysis ought to address many of these issues.

We do not believe that it is the task of preparers of financial statements to prejudge on behalf of readers which items are of limited predictive value and which ones are not. Often we do not know ourselves. We rather see that the financial statements should explain the current year's results and highlight there any significant items for the readers' full understanding (per IAS 1 pp17, IAS 34 pp16A (c) and elsewhere). Any forward-looking discussion about which items of current income/expense will carry on into future periods or indeed which new items of income/expense will arise in our view should take place in the Management Discussion and Analysis, and at the various public presentations made by the Company's management and investor relations team.



For example in the Illustrative Examples on page 12, the example talks about the abolition of a property tax in Country A being considered an *Unusual Item*. If material, no doubt readers would want to take this into account in future estimates of the company's earnings. However, a reader would similarly and equally want to take into account if a new property tax was enacted that that would result in additional future costs and cash outflows; but the proposal does nothing to address this second point. A reader might be rather upset in case the company informed them about one and not the other.

The answer is surely to establish some framework and guidelines to better explain the development of revenues and costs, and the place for this forward-looking discussion would seem to be in the Management Discussion and Analysis and in management and investor presentations.

In general, we found the requirements restrictive and would expect that there would relatively few such *Unusual Items* disclosed. The wording of the standard rather puts the onus on the preparer to demonstrate that a specific item is *Unusual* and the default position is that everything is part of the usual operating business. Companies may well be reluctant to disclose borderline items that might reoccur for fear of being accused of over-using *Unusual Items* (which BC 122 seems to imply is happening). The principle of if-in-doubt-then-disclose seems to work in reverse here.

For example, most large companies would probably consider all restructurings as a not *Unusual Item*, whereas many readers will still want to see this cost being quantified and highlighted – and then they can decide for themselves how to treat them in their analysis. Note here that subsidiaries in the same Group, might find that a restructuring that is not *Unusual* for the global organisation is *Unusual* in the context of the subsidiary's stand-alone IFRS financial statements. The ED is silent about how to handle such situations.

It is not specified in the ED whether it is necessary to repeat disclosures made elsewhere in the financial statements. For example, an impairment of goodwill might be considered as *Unusual*, but the 'goodwill' footnote will already include the (not inconsiderable) disclosure requirements of IAS 36. Is it necessary that these are repeated in the new *Unusual Items* footnote, or should there be a condensed disclosure and cross-reference or a simple cross-reference? Clear guidance should be given here.

We believe that this whole text should be amended to make it clear that only <u>large and</u> unusual items, meaning material items, need to be disclosed. The text as written implies all such items are required, including if necessary a cross-reference to the relevant paragraphs on materiality. IAS 34 pp16A (c) for example talks about items that are "unusual because of their nature, size or incidence", and this seems to us a much better definition.

We note that pp106 (c-d) require information about income tax and non-controlling interest impacts from MPMs, while there is no equivalent requirement for *Unusual Items*. Conversely, the Illustrative Example table on page 13 does show the tax and NCI impacts from the *Unusual items*. This example seem predicated on the assumption that every *Unusual item* will be excluded from the MPM which is obviously not true. We recommend that the IASB clarifies the precise requirement here.

We do not understand why in pp101(d) it is deemed necessary that companies using the *by-function* income statement presentation need to make *by-nature* disclosures, but the opposite is not required. We would imagine that in case of an *Unusual Item*, such as a material impairment of property, plant and equipment, that readers of a *by-nature* income statement would be interested to know whether this at a manufacturing, commercial, research or administrative site.

The comment in BC 122 that "The Board observed that many entities disclose unusual or similarly described expenses (and a few disclose unusual income)" is in our view not appropriate for serious proposals. The implication being companies that disclose unusual items do so selectively in order to somehow mislead readers. While abuses undoubtedly happen, in the vast majority of cases companies are disclosing material unusual items to help readers (optionally and beyond the requirements of existing IFRS) and in response to readers' requests. Responsible companies are well-incentivised to disclose material items of unusual income, as failure to do so will result in readers having an unrealistic benchmark for future periods. such remarks as in BC 122 will be taken as a discouragement to disclose *Unusual Items*.

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?

Answer to Question 11

We agree with the statements and concerns noted in BC 145-147. The question is how should these concerns be addressed and what is the best way forward.

We note that the term "Alternative Performance Measures" has already been defined by various regulators, including ESMA and the SIX Exchange Regulation, is already in operation and preparers and users are familiar with this. The ED proposals now bring in *Management Performance Measures* as well as *Unusual income and expenses*. In our view there would then be too many concepts which ultimately will simply confuse readers. We believe that by far the best approach for the IASB would be to agree a joint project with regulators, such as ESMA and the SIX Exchange Regulation. For example, a much simpler and more understandable approach would be:

- having the already existing ESMA/SIX Alternative Performance Measures disclosures being subject to some kind of auditors' report (as is often done for statutory Executive Remuneration disclosures); and
- requiring the amounts used to be reconciled to the IFRS disclosures, such as is required by IAS 33 pp73 for non-GAAP EPS disclosures.

The definition of *Management Performance Measures* (hereafter MPMs) in the ED is in our view narrow and only covers a subset of Alternative Performance Measures (hereafter APMs) as defined by ESMA and others. Specifically measures such as "Net Debt" and "Free Cash Flow" require no disclosure or reconciliation in the ED. Similarly, there is no requirement to explain how "Constant Currency" and similar growth rates are calculated.

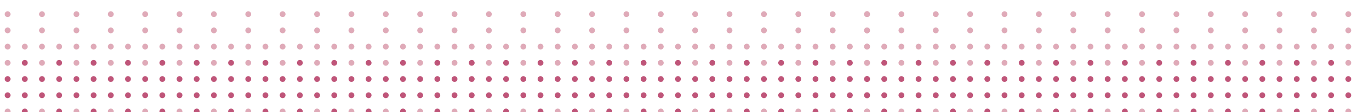
Moreover the ED does not address some of the core reasons for the growth in APMs, which include the rigid wording and interpretation of IAS 1 and the disconnect between IAS 7 and the way that most businesses manage their cash. Indeed, our understanding from some comments from IASB board members and staff is that the use of additional sub-totals and separate line items in the income statement will become even more restrictive than previously, especially for companies using the *by-function* presentation; and this has led at least one preparer in the SwissHoldings group to conclude that they will need to establish APMs in the future.

The proposed disclosures for MPMs are therefore a duplication for those companies that already disclose APMs, and an unnecessary burden and distraction for those that do not.

The only possible advantage for external users might be in having the disclosures subject to audit. If this was felt to be of value, it could be simply solved by making the existing APM disclosures subject to a separate auditors' report. However we can assure the IASB that the regulators do take the existing guidelines, such as those published by ESMA and the SIX Exchange Regulation, very seriously and that any company filing financial statements would be very well advised to pay particular attention to these guidelines. Also external auditors already pay careful attention to APMs even though they are not subject to their audit opinion, and these often are a topic at Audit Committees and Remuneration Committees. Therefore, the idea that the current APMs are somehow "unpoliced" is erroneous.

We therefore recommend:

1) That the IASB abandon the idea of MPMs entirely and work with the regulators to make targeted improvements to the existing APM framework and to develop practice guidance in the same way as been done for Management Commentary.



2) That the IASB address the inflexibility and lack of clarity in the current IAS 1 and IAS 7, and also in the ED, that are leading to inconsistent practice and that are directly contributing to the growth of non-GAAP measures generally.

If the IASB is determined to go ahead with these proposals, we have the following additional comments on the ED as written.

It is unclear whether subsidiaries are required to have MPM disclosures in their stand-alone IFRS financial statements when the parent company uses these MPMs in public communications but the subsidiary does not. Currently some APMs are prepared only at a corporate level, others are embedded in the company's financial reporting systems and are used for internal management purposes: as such they may exist for divisional/segment units and for individual subsidiaries. The ED is unclear on this, and pp103 could be interpreted in several ways. We recommend the wording is tightened up to clarify whether this requirement is only for those group companies that are themselves using the MPMs in their own public communications or whether it applies other companies in the same group. We presume this is not required for subsidiaries and we do recommend that this be clarified in any final standard.

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?

Answer to Question 12

In our view the IASB has missed the opportunity to lead consistency in practice by defining terms such as "EBITDA", or indeed terms such as "Net Debt", "Free Cash Flow" and other widely used terms.

As noted in BC 172, EBITDA is not appropriate to all industries. Nevertheless, it is extremely common. We accept that there are differences in practice, but then there is all the more need for a body like the IASB to show leadership to improve the consistency, as for example was done in for Revenues in IFRS 15.

We would recommend that there should be a definition for EBITDA; and that where EBITDA is used by companies (which would be their choice about whether to do so or not), then this definition should be used. Any alternative EBITDA should be described as "adjusted EBITDA" (or similar) and should be reconciled to the IASB-defined EBITDA – in a similar way that IAS 33 requires APM-per-share metrics to reconcile to the IAS 33 EPS.

SwissHoldings

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?

Answer to Question 13

a) This seems a reasonable approach and will improve consistency between companies.

b) This a welcome step that will eliminate one weakness in the current IAS 7.

The proposals in pp33A and pp34A seem to us the most appropriate classification and eliminate an unnecessary area of inconsistency that is allowed by the current IAS 7 pp33-34.

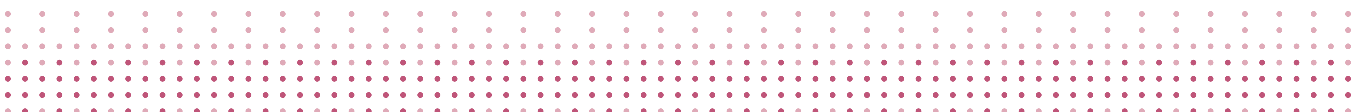
The requirements in pp34B-D also make sense to us, the intention being that there is a consistency between the income statement presentation and the cash flow statement presentation. The previous comments made in this letter to the lack of definition of 'main business activity' and the *investing* category apply here as well.

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?

Answer to Question 14

In general and across all proposals, we would ask the IASB to provide relief for small and medium size enterprises, private companies and entities such wholly-owned subsidiaries that use IFRS in their statutory filings. If we read the BC we find that many proposals are supposedly at the request of investors, and therefore presumably not relevant for example for 100% owned subsidiaries.



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We have the following additional remarks to Analysis of Effects

- BC 237
  - Pp57. Unusual Income and Expenses. As outlined above, we would expect that the proposals lead to less disclosure about *Unusual Items* due to the restrictive wording in the ED.
  - Pp57. Analysis of Operating Expenses by nature or function. We would expect that this applies to "all .." entities and not "many .."
- BC 242
  - We would confirm that (b) would be costly to implement. The large multinational members of SwissHoldings estimate that this would take around two years to design and implement. Implementation at smaller companies may require less work, but these companies also have less resources to implement such changes.
  - The classification of foreign exchange gains and losses, required by pp56-59, would be costly to implement for those companies that do not already do it. Implementation would require amendments to complex and bespoke treasury systems and processes (including the capturing of forecasted transactions) and not just the underlying general ledger accounting systems.
  - The items identified above would also take a long-time to implement, and would prevent early-implementation and delay implementation to the latest possible date.
  - In general the most expensive and time-consuming proposals are not necessarily the most critical in the ED. We would invite the IASB to consider whether implementing these is worth a general delay in implementation.