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October 31, 2020

Mr. Hans Hoogervorst
Chairman
International Accounting Standards Board
Columbus Building
7 Westferry Circus
Canary Wharf
London, UK E14 4HD

Re: General Presentation and Disclosures

Dear Mr. Hoogervorst:

CFA Institute appreciates the opportunity to comment on the Exposure Draft, *General Presentation and Disclosures* (the Exposure Draft or ED). CFA Institute[1] is providing comments consistent with our objective of promoting fair and transparent global capital markets and advocating for investor protections. An integral part of our efforts toward meeting those goals is ensuring that corporate financial reporting and disclosures – and the related audits – provided to investors and other end users are of high quality.

We appreciate that the Exposure Draft is intended to improve communication in financial reporting and bring discipline to primary financial statements presentation, especially to the statement of profit or loss. We are supportive of the Board's initiative and as an overall matter believe this is a step in the right direction. We respond to the items that the Board is seeking input on herein, but continue to take great interest in the Board's agenda setting process as we believe that there is more that can and should be accomplished in this area. Our views on these matters continue to be informed by the views set out in our publication, *A Comprehensive Business Reporting Model: Financial Reporting for Investors* ("CBRM"), which addressed both conceptual issues as well as revisions to financial statement display—that is, the business reporting model in its entirety. Our April 14, 2009 comment letter regarding the IASB and FASB joint *Discussion Paper: Preliminary Views on Financial Statement Presentation* provides our overarching perspectives relative to the financial statement presentation matters. Specific responses to the Exposure Draft questions are included in the **Appendix**. A tabular summary of our views is provided below and our key comments on the Exposure Draft follow the tabular summary.

[1] CFA Institute is a global, not-for-profit professional association of nearly 171,400 investment analysts, advisers, portfolio managers, and other investment professionals in 165 countries, of whom more than 164,000 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 154-member societies in 77 countries and territories.

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SUMMARY OF VIEWS ON KEY EXPOSURE DRAFT PROPOSALS		
BOARD PROPOSAL	**CFA VIEW**	**CFA RESPONSE**
STATEMENT OF PROFIT OR LOSS		
Present a more structured statement of profit or loss with new, defined subtotals on the face, including operating profit.	Support additional subtotals but concerned that using same captions as the statement of cash flows – but with different definitions – will add confusion.	Key Comments Responses to Q1 & Q2
Classify income and expense from investments from main business activities in the operating category.	Support	Response to Q3
Classify income and expense from financing activities in the operating category for entities that provide financing to customers as a main business activity in the operating category.	Not opposed	Response to Q4
New definition of investing activities for the statement of profit or loss.	Recommend definition be revised to align with statement of cash flows.	Key Comments Response to Q5
Present profit or loss before financing and income tax.	Support	Response to Q6
New definition of financing activities for statement of profit or loss.	Recommend definition be revised to align with statement of cash flows.	Key Comments Response to Q6
Present share of profit or loss of associates and joint ventures below operating profit.	Support	Response to Q7
Present share of profit or loss of integral and non-integral associates and joint ventures separately.	Support and recommend additional disclosures of tax effects so a “clean” tax number can be produced.	Response to Q7
New requirements regarding aggregation and disaggregation.	Support greater disaggregation. Recommend additional guidance regarding the term “shared characteristics” for determining aggregation.	Key Comments Response to Q8
Present an analysis of operating expenses either by nature or by function on the face.	Support and recommend supplementary required disclosure of analysis of expenses by function/nature in footnotes.	Key Comments Response to Q9
New definition and disclosure requirements for “unusual items.”	Support with additional clarification and disclosures recommended.	Key Comments Response to Q10
Remove non-GAAP measures from the face unless they comprise amounts recognised and measured applying IFRS standards and fit into the structure of the statement of profit or loss.	Support	Key Comments Response to Q11
Not use columns to present non-GAAP measures on the face.	Support	
Present foreign exchange differences in the same category as the income/expenses that gave rise to these differences.	Support	Response to Q14
NOTE DISCLOSURES		
Disclose information about unusual items.	Support and recommend disclosure of prior period amounts whether flagged as unusual or not; also recommend identification of unusual items of income as well as expense.	Response to Q10
Disclose Management Performance Measures (“MPMs”) as defined.	Support but consider renaming MPMs to avoid confusion with non-GAAP measures.	Key Comments Response to Q11
No proposed requirements regarding EBITDA.	Support	Response to Q12
CASH FLOW STATEMENT		
Classify interest and dividends according to the specific, proposed requirements.	Support	Key Comments Response to Q13
Use operating profit or loss as the starting point for the indirect method.	Support although CFA prefers the direct method	Key Comments Response to Q13
STATEMENT OF FINANCIAL CONDITION		
Present goodwill and integral and non-integral associates and joint ventures separately.	Support and further recommend that integral and non-integral be presented separately to conform to the presentation on the statement of profit and loss	Response to Q14

STATEMENT OF PROFIT OR LOSS SUBTOTALS

Additional statement of profit or loss subtotals will promote consistency

We support the greater use of subtotals such as *operating profit or loss*; *operating profit or loss and income and expenses from integral associates and joint ventures*; and *profit or loss before financing and income tax*. The lack of specific requirements in IAS 1 has led to diversity in the presentation and calculation of subtotals even among entities in the same industry, such that subtotals with the same label are often defined differently by different entities. This diversity makes it difficult for users of financial statements to understand the information provided and compare information across entities. We therefore support the requirement to present these subtotals as we believe it will promote greater consistency and comparability among entities.

Defining operating profit as the default category is a pragmatic solution

Ideally, we believe that the Board should directly define the operating category, as well as the term "main business activities", given its centrality to the statement of profit or loss, but we appreciate the difficulty in doing so and as a result are not opposed to the Board's pragmatic approach of leaving operating profit or loss to be the default or a residual category. That said, we do have some suggestions on improving the definitions of financing and investing categories for the statement of profit or loss, to ensure that the operating category is as robust as the Board intends it to be, which are discussed later in this letter.

We have the same view regarding the Board's decision not to define Earnings Before Income Taxes, Depreciation and Amortization ("EBITDA"). Given the complexities of defining operating profit or loss, we understand that it is not feasible for the Board to define EBITDA. Accordingly, we are comfortable with the Board's approach of introducing the defined term of Management Performance Measures (MPMs) – though we might label them differently – which would encompass this metric.

MPMs will provide useful information to investors in a disciplined way

We also support the Board's proposal regarding MPMs. We understand the definition of an MPM to consist of various subtotals of income and expenses that are not currently mandated by IFRS. Thus, MPMs would allow management to provide alternative subtotals of income and expense in order to present their version of net income. As a result, MPMs will be a useful way for many entities to convey to users what management believes are the most relevant measures of an entity's financial performance.

Accordingly, we agree with the ED's proposal regarding MPMs and the proposal to require their reconciliation with an IFRS prescribed subtotal. We believe that this approach will provide users with the benefits of the management insights that these metrics provide, while mitigating some of their drawbacks, such as a lack of consistency, transparency, and auditability. Mandatory reconciliation to other subtotals will increase their transparency; and the inclusion of MPMs in a single footnote will make the information easier to access, improve navigation within the financial statements, and make the metrics subject to audit, thereby providing further reassurance to investors.

MPMs should be shown for all prior years presented

In addition to requiring a clear-cut justification and explanation of the methodology chosen to calculate MPMs, we believe that entities should be required to provide a rationale for any changes to MPMs, and that MPMs should be shown for all prior years presented in the financial statements using the company's current methodology for calculating MPMs. A transparent time-series would enhance the usefulness of MPMs to investors and support their efforts in assessing both an entity's performance over time as well as the stewardship of management.

Use of MPMs should be monitored to produce an improved definition of operating profit or loss

We suspect that over time, disclosure of MPMs will provide important insight into entity-specific definitions of operating profit, and we therefore encourage the Board to monitor these disclosures in order to eventually formulate a concrete definition of operating profit or loss that is more than just a default or residual category.

MPMs should be renamed to avoid confusion with APMs and non-GAAP measures

We understand MPMs to consist of various subtotals of income and expenses that are not currently mandated by IFRS. If a metric is determined to be an MPM, it must be reconciled to the most directly comparable total or subtotal specified by IFRS standards, and disclosures regarding their definition and relevance are required in the footnotes.

In contrast, alternative performance measures (APMs) provided by management comprise a wide variety of metrics such as ratios or alternative measures that do not necessarily have an anchor or relationship either to operating profit or loss or even, necessarily, to IFRS – for example, same-store sales, number of clicks for a website, or various ESG metrics. APMs, therefore, encompass a much wider range of metrics than MPMs.

MPMs as defined in the proposal also appear to be a narrow subset of what are known in the US as non-GAAP measures, which are loosely defined as a measure that excludes (or includes) amounts from the most directly comparable measure calculated in accordance with GAAP. MPMs, on the other hand, are limited to subtotals of income and expenses, each of which are derived from the statement of profit or loss that is prepared in accordance with IFRS. Other financial measures (such as adjusted revenue or return on capital employed) are not MPMs and would not be included in the proposed disclosure.

Given the intended narrow scope of MPMs, we recommend re-naming these measures to a more descriptive term such as Management's Alternative P&L Subtotals (MAPLS) or Alternative Earnings Measures (AEMs), to avoid their being confused by users of financial statements with the broader categories of APMs and non-GAAP measures. A more descriptive term should be used in order to readily convey to users of financial statements why these metrics consist only of subtotals of income and expense items, and why they do not include revenue-only measures such as adjusted revenues, or other metrics such as ROE. In addition, we believe the Board should provide greater clarity in the final standard regarding the purpose of MPMs, so that users clearly understand how they fit into the overall framework of financial metrics.

DISAGGREGATION

Greater disaggregation is useful to investors

We welcome the IASB's initiative to promote greater disaggregation in the statement of profit of loss, as we strongly believe that more granularity is needed in order to allow analysts and investors to understand the drivers of profitability and to forecast future profits and cash flows on this basis. Disaggregating items with dissimilar characteristics provides users of financial statements with relevant information and avoids obscuring material information. Discouraging preparers from aggregating many dissimilar items into the "Other" category will also prove helpful to users.

Additional guidance needed on "shared characteristics"

That said, we note that the guidance on both aggregation and disaggregation is based on the principle of "shared characteristics." We are concerned that this term may be too vague to serve as an appropriate guide in preparers' decisions about whether to aggregate or disaggregate information, thereby resulting in guidance that may be insufficient to mandate the level of disaggregation that would be meaningful to users. The current definition does not prioritize which characteristics are most important for determining aggregation: is it nature, role/function, or measurement? While we appreciate the fact that the Board would like to create a principles-based approach to determining aggregation, we believe that additional guidance is needed in order to ensure that there is some consistency within and across entities to aggregation and to make this a workable standard for preparers, auditors and users of financial statements.

Disclosure of unusual items enhances disaggregation

We also support the proposed guidance regarding unusual items. Requiring entities to separately disclose unusual items in a single footnote enhances the principle of disaggregation, as it will provide further insight into the additional proposed required subtotals and will enable both entities and investors to isolate items that are viewed as having limited predictive value.

We also agree with the IASB's proposed definition of unusual items as those items with "limited predictive value" from the perspective of investors, because it can encompass a variety of attributes, including the size, frequency and nature of an expense.

We support the Board's proposal to require disclosure in the footnotes rather than inclusion on the face of the statement of profit or loss, as we believe that inclusion in the statement of profit or loss risks obscuring some of the subtotals. Disclosure in a single note will also enable investors to easily track such items over time, and thereby draw their own conclusions as to whether items truly are unusual in nature. Disclosure will also likely serve as a useful link to many MPMs, given the likelihood that many MPMs will strip out unusual items.

Expense analysis by both nature and function is consistent with greater disaggregation

We support the Board's proposal that an entity that presents an analysis of expenses classified in the operating category using the *function of expense* method shall also disclose in a single note an analysis of its total operating expenses using the *nature of expense* method. As we discuss in more detail in the **Appendix**, we would prefer that the Board require entities to present expenses using

both methods, with one (the approach that the entity finds most useful) on the face of the income statement, and the other disclosed in the notes.

We believe that our approach is consistent with the Board's overall goal of greater disaggregation, as the dual presentation model enables investors to analyze an entity's performance in multiple ways. The two sets of information – expenses by nature and by function – are considered highly complementary by many users and necessary to develop a full understanding of an entity's key profit drivers and industry trends. In addition, by requiring both analyses, comparability of financial statements will be enhanced, as users will be able to compare the financial results of entities no matter which analysis an entity chooses to present on the face of the statement of profit or loss.

COHESIVENESS

Using the same captions for the statement of profit or loss and statement of cash flows but with different definitions will confuse users

We support the introduction of the investing and financing categories to the statement of profit or loss. On its surface, it would appear to advance the CFA's goal of "cohesiveness" among the primary financial statements. As discussed in our CBRM, a foundational principle of the basic financial statements is cohesiveness of balances within and among the basic financial statements. Cohesiveness improves the usefulness of financial statements by allowing investors to see the flow of transactions across the statement of financial condition, statement of profit or loss, and statement of cash flows. Increased cohesiveness is likely to lead to the need for fewer disclosures because there is a clear linkage of information between all primary financial statements and as a result, the underlying relationships between balances that produce the financial results will be more obvious to investors. Cohesiveness, therefore, increases transparency and understandability for users.

The Board has stated that it developed its proposals for the categories in the statement of profit or loss without trying to align classifications across the primary financial statements. Consequently, income and expenses classified in the operating, investing and financing categories in the statement of profit or loss do not necessarily correspond with the cash flows from operating, investing and financing activities in the statement of cash flows.

We are concerned that this approach, i.e., applying the current cash flow categories (operating, investing, financing) to the statement of profit or loss, *but with definitions that are different from those used in the statement of cash flows, is inherently flawed*. Rather than enhancing the cohesiveness of the basic financial statements, the disconnect between categories used in these two primary statements as to what is operating, financing and investing will likely lead to greater confusion among investors, and result in the need for additional disclosures and discussion to explain how the categories reconcile between the two statements.

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Example of lack of alignment

For example, we compiled the following table to understand how various items would be classified by non-financial entities in the statement of cash flows and the statement of profit or loss under the proposed guidance:

ITEM	CURRENT CLASSIFICATION CASH FLOW STATEMENT (IAS 7)	PROPOSED CLASSIFICATION CASH FLOW STATEMENT (NON-FINANCIAL ENTITIES) (ED Summary p. 12)	PROPOSED CLASSIFICATION STATEMENT OF PROFIT/ LOSS (NON-FINANCIAL ENTITIES)
Interest paid	Operating or financing	**Financing**	**Financing** Specifically: Interest charge on trade payables negotiated on extended credit terms (¶B35(c)) and similar items
Interest received	Operating or investing	**Investing**	**Financing** Specifically: interest revenue from cash and cash equivalents where the entity does not provide financing to customers as a main business activity (¶B34(a))
Dividends received	Operating or investing	**Investing**	**Investing** Specifically: dividends from equity investments (¶B32 (a)(v))
Dividends paid	Operating or financing	**Financing**	N/A

From the above, we see that interest received would be classified as an *investing* activity in the statement of cash flows, while interest income from cash and cash equivalents would be categorized in the *financing* category in the statement of profit or loss. As discussed further in the **Appendix** in our response to Question 5, we believe that the temporary investment of excess cash is traditionally considered by users to be an investing activity. Accordingly, we believe it is preferable for interest income from cash and cash equivalents to be classified in the investing category on both statements, so as to promote cohesiveness among the financial statements and avoid confusion on the part of users.

More broadly, we believe the IASB should adopt a definition of investing activities which is the same for both the statement of profit or loss and the statement of cash flows. Doing so would enhance the cohesiveness of the basic financial statements and increase transparency and understandability for users as there would be a clear linkage of information between the primary financial statements.

Proposed definition of investing: Unclear and inconsistent with common understanding of term

However, we do not advocate adopting the definition of investing activities that is currently proposed for the statement of profit or loss, as we believe the proposed definition is unclear and may not encompass activities that are traditionally considered investing activities as they are understood currently from the statement of cash flows.

In general, we find that "investing activities" is broadly understood by investors to be cash flows generated on an interim basis from funds while management determines a longer-term use for its funds that is consistent with its main business activities. We illustrate this point in our response to Question 5, showing how interest income on cash equivalents, traditionally considered an investment activity, would be excluded from the proposed investing category; and income/expenses on derivatives not used for risk management, an activity traditionally considered to be a financing activity, would be included in the proposed investing category.

To sum up, we encourage the Board to revisit its proposals where the categorization of activities is not aligned between the statement of cash flows and the statement of profit or loss. We believe that proceeding with the approach that is currently proposed by the Board will unfortunately not improve financial statement reporting but will actually cause greater confusion on the part of users, and will require additional disclosure, reconciliation, and explanation on the part of preparers.

STATEMENT OF CASH FLOWS

A consistent starting point and elimination of choices will improve the statement of cash flows

We agree that operating profit or loss should be the starting point for the indirect method of cash flows, as requiring a consistent starting point will enhance comparability among entities. We also agree with removing the choices for classifying interest and dividend cash flows in the statement of cash flows, as we believe this will also enhance comparability among entities, without a reduction in information content.

The direct method for the statement of cash flows will reduce the reliance on MPMs and APMs

With the above said, as we discussed in our CBRM and our April 14, 2009 letter regarding the IASB and FASB's joint *Discussion Paper: Preliminary Views on Financial Statement Presentation*, we continue to believe that companies should be required to prepare their statement of cash flows under the direct method. Cash flows are a fundamental component of valuing businesses, and the direct method provides investors offers insights into the quality of revenues and earnings, and the characteristics of the cash conversion cycle, which are not available from an indirect method of reporting cash flow from operating activities.

Simply put, cash is the ultimate performance measure, and the direct cash flow method makes an entity's cash flows more transparent. This transparency will obviate the need for crude proxies such as EBITDA and other MPMs, to which the Board is bringing greater rigor but will always suffer from being entity-specific and therefore will lack comparability. Therefore, including direct method statements of cash flows will enhance substantially the usefulness of financial reporting and reduce the reliance on alternative, entity-specific metrics.

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It is time to leverage advances in technology to the preparation of the statement of cash flows

Financial statement preparers often cite the anticipated implementation and transition costs associated with systems modification as a reason for opposing the direct method. However, we note that technology has improved considerably since these issues have been debated. In addition, we note that many of these costs would be one-time rather than recurring. There is also a need to consider the incremental cost of preparing a direct method statement of cash flows versus the current inadequacies of the indirect method. The indirect method requires estimates of adjustments for the effects of non-operating transactions, business acquisitions and dispositions and foreign currency rate fluctuations, and these are cumbersome. Accordingly, we strongly encourage the Board to revisit the cost-benefit assessments associated with mandating use of the direct method as we believe the benefits of the direct method far outweigh the costs of converting to this method.

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We appreciate the opportunity to comment on the Exposure Document.

Sincerely,

/s/ Sandra J. Peters

Sandra J. Peters, CPA, CFA
Senior Head, Global Financial Reporting Policy Advocacy
CFA Institute

Appendix

SPECIFIC QUESTIONS

Q1 – OPERATING PROFIT OR LOSS

Paragraph 60(a) of the ED 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 Conclusion (BC) 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?

Q2 – THE OPERATING CATEGORY

Paragraph 46 of the ED proposes that all entities classify in the operating category all income and expenses not classified in the other categories, such as investing category or the financing category. Paragraphs BC54-BC57 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?

Due to the interrelated nature of these issues, we are responding to these questions together.

Mandatory Subtotals Add Consistency – We agree with the Board's proposal to require all entities to present a subtotal for operating profit or loss in the statement of profit or loss. This is obviously a key metric for most entities, and many analysts and investors do not realise that the "operating profit" or "EBIT" (earnings before interest and taxes) figures reported by many entities are not IFRS-defined metrics and are subject to wide discretion by management with respect to the inclusion and exclusion of income and expense items. We therefore welcome the IASB's proposal to add consistency to the operating profit or loss subtotal and to enhance its comparability over time and between business entities. A clear, consistent subtotal that is subject to audit is very welcome.

Residual Definition is Pragmatic – We also appreciate the difficulties of defining "operating" in the context of many different industries and therefore do not object to the IASB's pragmatic approach that any item pertaining to an entity's continuing operations that does not meet the criteria to be considered as a nonoperating item, such as a financing, investment or taxation item, must, by definition, be an operating item.

MPMs Will Add Insight to Definition of Operating Profit – As companies implement the requirements of the final standard, we would expect that some industry practices and conventions will arise that will lead to greater consistency in the definition of operating profit or loss over time. In addition, we expect the definition of operating profit will further be enhanced by the management performance measures (MPMs) that entities choose to present. We, therefore, encourage the Board to perform a post-implementation review of these aspects of the final standard with the express goal of eventually refining the definition of operating profit or loss and providing additional implementation guidance to ensure greater uniformity in the application of this subtotal. We strongly believe that increased consistency in the application of this subtotal will greatly enhance the usefulness of the statement of profit or loss for investors.

Q3 – THE OPERATING CATEGORY: INCOME AND EXPENSES FROM INVESTMENTS MADE IN THE COURSE OF AN ENTITY'S MAIN BUSINESS ACTIVITIES

Paragraph 48 of the ED 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.
Paragraph BC58-BC61 of the BC 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?

We agree that income from investments should be classified in the operating category if the investments relate to those made in the course of an entity's main business activities.

However, as discussed further below in our response to Question 5, we are concerned that it may be difficult to define which investments belong in the operating category, due to the imprecision of the proposed definition of "investing activities".

Q4 – THE OPERATING CATEGORY: AN ENTITY THAT PROVIDES FINANCING TO CUSTOMERS AS A MAIN BUSINESS ACTIVITY

Paragraph 51 of the ED 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***

Paragraph BC62-BC69 of the BC 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?

In general, we are not supportive of standards that provide accounting policy choices to issuers as we believe this diminishes comparability for users. However, we recognize that providing financing to customers is a main business activity for some entities. In this regard, we believe that the segment information provided, or improved segment disclosures, would be of use to investors in assessing the results and profitability of these activities. Accordingly, we are not opposed to the proposed approach.

<u>Q5 – THE INVESTING CATEGORY</u>
Paragraph 47-48 of the ED proposes 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.
Paragraph BC48-BC52 of the BC 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?

<u>New Categories Promote Greater Disaggregation</u> – We agree that investment income and expenses should be separated from operating income and expenses arising from an entity's main business activities. We also agree with the IASB's logic to include the results from non-integral associates and joint ventures in the investment category as, by definition, these investments are made outside an entity's main business activities, and doing so would enhance the disaggregation of the financial statements.

<u>Lack of Alignment with Statement of Cash Flows</u> – Notwithstanding our support of the proposal to separate investing activities from operating activities, we are concerned with the proposed definition of "investing activities" for purposes of categorization in the statement of profit or loss. As the Board notes in its Basis for Conclusions (BC30), the Board developed proposals for the categories in the statement of profit or loss without trying to align classifications across the primary financial statements. The result is that in certain instances the classification of an item is different in the statement of profit or loss and the statement of cash flows. For example, interest received on cash equivalents would be classified as *investing* cash flows on the statement of cash flows, but would be classified as *financing activities* on the income statement. As noted previously, investors will struggle to understand the reasons for this difference in classification between the two financial statements, and recommend that the Board aim for full alignment across the financial statements.[2]

<u>Proposed Definition Unclear</u> – In addition to these inconsistencies, we find that the proposed definition for investing activities for the statement of profit or loss to be unclear. We struggle to apply the proposed definition (income and 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), because, in our view, *all* returns by definition are generated by using an entity's resources. Thus, it is difficult to work out which returns are considered to be generated "individually" or "independently," given the inherent interrelationships that exist between capital deployed by an entity and returns generated thereon.

[2] In this regard, we also note IAS 7 paragraph 6 initially defines "Investing activities" as "the acquisition and disposal of long-term assets and other investments ***not included in cash equivalents*** <u>and the receipt of some interest and dividends as described in paragraphs 34A–34D</u>." (emphasis added). The new guidance proposed paragraph 34A(b) then states that interest income from cash equivalents ***is included*** in investing activities. We find this guidance with respect to the classification of cash equivalents confusing, as first it seems that items related to cash equivalents *are not* included in investing activities, and then it is stated that interest on cash equivalents *is* included in investing activities, and we therefore recommend that at a minimum the Board should provide a more coherent definition for Investing activities for the Statement of Cash Flows. It appears there have been so many modifications that the definition is now not meaningful. A new clearer definition is needed.

To illustrate this point, we cite the following examples in the ED, as well as the conclusions we would have reached regarding classification by applying the general definition of investing activities proposed, and in the absence of the specific guidance provided in the ED:

Item	Proposed Classification in Statement of Profit or Loss	Proposed Classification in Statement of Cash Flows	CFA View
Interest income from cash equivalents	Financing (¶49)	Investing (IAS 7 ¶34(a)(b))	Investing
Income/expenses from derivatives not used for risk management	Investing (¶59)	Investing? (IAS 7 ¶16 (g)(h)	Financing

Inconsistency with Plain Meaning of " Investing" – We find that "investing activities" is broadly understood by users to consist of cash flows generated from returns made on an interim basis while management determines a longer-term use for its funds that is consistent with its main business activities. For example, regarding the cash equivalent example above, these activities are typically considered either operating or investing activities by analysts; whereas in the derivative example above, they are not typically considered to be investments. Therefore, the proposed statement of profit or loss definition of investing activities seems to produce, in each case, the opposite conclusion from that which an investor would presumably reach.

Additionally, regarding derivatives not used for risk management purposes, IFRS 9 defines a derivative in part as an instrument that *has no significant initial net investment* – so that to classify them as investing activities seems to be fundamentally at odds with their basic definition.

Enhancing Cohesiveness – To avoid creating more confusion in this area, we recommend that the Board propose a new definition for investing activities which is more consistent with the plain meaning of investing and which is the same for both the statement of profit or loss and the statement of cash flows. By using the same definition of investing activities for both statements, the Board would enhance the cohesiveness of the basic financial statements and increase transparency and understandability for users, as there would be a clear linkage of information between the primary financial statements.

Q6 – PROFIT OR LOSS BEFORE FINANCING AND INCOME TAX AND THE FINANCING CATEGORY

(a) Paragraph 60(c) and 64 of the ED proposes that all entities, except for some specified entities (see paragraph 64 of the ED), present a profit or loss before financing and income tax subtotal in the statement of profit or loss.

(b) Paragraph 49 of the ED proposes which income and expenses an entity classifies in the financing category.

Paragraph BC 33-BC45 of the BC describe the Board's reasons for the proposals.
Do you agree with the proposals? Why or why not? If not, what alternative approach would you suggest and why?

We agree that a subtotal that encompasses all income and expenses from continuing operations with the exception of income and expenses from financing activities and taxation represents, for non-financial entities, a meaningful metric that may be particularly useful when comparing companies with similar operations and profit streams that are financed differently and/or subject to different tax jurisdictions and rates.

Interest on Cash as Financing Activity – However, as discussed earlier, we are concerned that income from cash and cash equivalents would be categorized in the financing category in the statement of profit or loss, whereas it would be categorized as an investing activity in the statement of cash flows. It will be difficult for even the most sophisticated investors to understand why the same item is classified differently on the statement of profit or loss and the statement of cash flows. We disagree with the Board's assertion that users of an entity's financial statements treat excess cash and temporary investments of excess cash as part of the entity's financing; rather, we believe that such activities are traditionally considered by users to be an investing activity. Accordingly, we believe it is preferable for income from cash and cash equivalents to be classified in the investing category on both statements, so as to promote cohesiveness among the financial statements and avoid confusion on the part of users.

Mix of Pre- and Post-Tax Financing Activities – Finally, while we support the disclosure of a pre-tax profit figure, we are concerned about the risk of mixing taxed and untaxed income, given that the proposed "pre-tax" subtotal would include income or losses from associates and joint ventures on a post-tax basis. Please refer to our response to Question 7 for our suggestions with respect to the presentation of income and losses from associates and joint ventures on both a pre- and post-tax basis, as well as the clear separation of taxed from non-taxed income in the statement of profit or loss at all times.

<u>Q7 – INTEGRAL AND NON-INTEGRAL ASSOCIATES AND JOINT VENTURES</u>

- ***(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 ED proposes to require that an entity presents 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) Paragraph 53, 75(a) and 82(g)-82(h) of the ED, 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-B89 and BC205-213 of the BC 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?

<u>Agree with New Subtotal; Recommend Policy Disclosure</u> – We agree with the Board's approach and reasoning in this area and believe it will prove useful to investors as it will provide clarity and transparency as to how associates and joints ventures are being managed, entities' dependence on such investments, and better visibility around capital allocation to such investments.

To further enhance this distinction, we suggest that the Board mandate an accounting policy disclosure in explaining how an entity differentiates between "integral" and "non-integral" and when and what could trigger a reclassification in future periods.

<u>Mix of Pre- and Post-Tax Activities</u> – In addition, we believe that profit before and after tax needs to be clearly separated. We are concerned that by including earnings from integral associates and joint ventures in operating income, a company's consolidated pre-tax profit or loss would mix its pre-tax consolidated operating profit with post-tax equity consolidated results from integral associates and joint ventures. This can obscure information regarding an entity's effective tax rate and underlying profitability.

While we appreciate that many joint ventures may be structured as separate legal entities and that an issuer may therefore be only legally entitled to the investee's after-tax profits, we note that investors are often interested in assessing the earnings power associated with an entity's activities irrespective of legal structures that may have been chosen for various operational, legal and practical reasons. The absence of a "clean" pre-tax number tends to impair an investor's ability to accurately determine an entity's true gross and operating margins. Similarly, an entity's effective tax rate, which is used for many types of investor analysis, is also distorted by mixing pre-tax and after-tax profits. Given that the tax expense line item can present one of the largest items of expenditure in an entity's consolidated statement of profit or loss, mixing pre- and post-tax numbers can lead to an inaccurate view of an entity's earnings power.

Accordingly, we would prefer that entities provide information on the profitability of all associates and joint ventures on both a pre- and after- tax basis where such information is available.

Alignment with Statement of Financial Condition – Finally, we recommend that to further promote the cohesiveness of the primary financial statements, the Board should require separate presentation of integral and non-integral associates and joint ventures on the statement of financial condition. Doing so will enable investors to clearly link the earnings of these investments with the size of the investment, and provide greater insight into the profitability of these investments.

Q8 – ROLE OF THE PRIMARY FINANCIAL STATEMENTS AND THE NOTES, AGGREGATION AND DISAGGREGATION

(a) Paragraph 20-21 of the ED set out the proposed description of the roles of the primary financial statements and the notes.

(b) Paragraph 25-28 and B5-B15 of the ED set out proposals for principles and general requirements on the aggregation and disaggregation of information.

Paragraph BC19-BC27 of the BC 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?

We welcome the IASB's initiative to promote greater disaggregation in the statement of profit of loss, as we strongly believe that more granularity is needed in order to allow analysts and investors to understand the drivers of profitability and to forecast future profits and cash flows on this basis.

Definition of "Shared Characteristics" – However, we are concerned that the IASB's proposal is based on the term "shared characteristics," which may be too vague to serve as an appropriate guide in preparers' decisions about whether to aggregate or disaggregate information, thereby resulting in guidance that may be insufficient to mandate the level of disaggregation that would be meaningful to users.

We note that the term "shared characteristics" is defined in the Conceptual Framework as follows (CF.7.7):

> *Classification is the sorting of assets, liabilities, equity, income or expenses on the basis of shared characteristics for presentation and disclosure purposes. Such characteristics include—but are not limited to—the nature of the item, its role (or function) within the business activities conducted by the entity, and how it is measured.*

First, we note that this definition has not been brought forward to the ED, and that the Conceptual Framework is not authoritative in nature, so that, at a minimum, the definition of "shared characteristics" should be incorporated into the final standard.

Secondly, and more fundamentally, we are concerned that this definition does not prioritize which characteristics are most important for determining aggregation: is it nature, role/function, or measurement? Depending on which characteristics an entity determines is most relevant, the ultimate presentation in the statement of profit or loss could be vastly different. While we appreciate the fact that the Board would like to create a principles-based approach to determining aggregation, we believe that some additional guidance, in the form of illustrative examples or a

discussion of how to prioritize key characteristics in determining aggregation, is needed in order to make this a workable standard in practice.

Q9 – ANALYSIS OF OPERATING EXPENSES

Paragraph 68 and B45 of the ED 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 ED proposes requiring an entity that provides an analysis using the nature of expense method in the notes.
Paragraph BC109-BC114 of the BC 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?

Dual Analysis – As noted in the body of our letter, while we support the Board's proposal that an entity that presents an analysis of expenses classified in the operating category using the function of expense method shall also disclose in a single note an analysis of its total operating expenses using the nature of expense method, we also believe the reverse should be required. That is, an entity that presents its primary analysis of expenses using the nature of expense method should also disclose an analysis of each item by function. The two sets of information are highly complementary and both are often needed in order for an analyst to develop a full understanding of an entity's key profit drivers and industry trends.

Materiality – In addition, we continue to advocate for required disclosure of the materiality judgments exercised by preparers in the preparation of the financial statements. Research demonstrates that, in general, users have a lower materiality threshold than preparers and auditors have. Given the lack of consensus in materiality thresholds between auditors, preparers, and users, such disclosure would provide greater transparency to users and enable them to more readily assess the information presented in the financial statements.

Appendix

Q10 – UNUSUAL INCOME AND EXPENSES

(a) Paragraph 100 of the ED introduces a definition of 'unusual income and expenses'.

(b) Paragraph 101 of the ED proposes to require all entities to disclose unusual income and expenses in a single note.

(c) Paragraphs B67-B75 of the ED proposes application guidance to help an entity to identify its unusual income and expenses.

(d) Paragraphs 101(a)-101(d) of the ED proposes what information should be disclosed relating to unusual income and expenses.

Paragraph B122-BC144 of the BC 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?

Agree with Definition & Disclosure – We agree with the IASB's proposed definition of unusual items as being those with "limited predictive value" from the perspective of investors, because it can encompass a variety of attributes, including the size, frequency and nature of an expense. We also welcome the IASB's proposal to disclose all unusual items in a single note to the financial statements, as disclosure on the face of the statement of profit or loss would likely risk obscuring some of the subtotals. Disclosure in a single note will also enable investors to easily track such items over time, and thereby draw their own conclusions as to whether items truly are unusual in nature; and will also enable investors to compare these items used in arriving at MPMs, given that there is likely to be some overlap in these two categories.

Quantifying Unusual Items & Disclosing Prior Periods – In addition, where items are classified as unusual, we would like to see the amounts disclosed not just for the current period, but also for prior periods, where applicable, irrespective of whether the item was considered to be unusual in that period. Also, we believe that clarification is needed regarding what an amount an entity should classify and disclose as unusual when an item is considered unusual due to its amount. For example, assume a company normally incurs litigation expenses of €5 million, and in the current period it incurs total litigation costs of €16 million, due to a settlement of €10 million for a particular action that is not expected to recur in several years. The company could interpret the unusual amount as either:

- €10 million, representing the one-time settlement
- €16 million, representing total ligation costs of 16 million; or
- €11 million, representing the portion in excess of the usual run rate of 5 million.

We believe the company should classify the €10 million as unusual in this example, and suggest that the Board include additional guidance or an illustrative example to clarify this point.

Symmetry of Application to Revenues & Expenses – Finally, we would like to see a principle of symmetry applied to the classification of income and expenses as "unusual" based on their type and/or amount and welcome the IASB's proposals in this regard. At present, many companies routinely remove significant litigation expenses, restructuring charges and asset impairments in the calculation of "underlying", "core", or "adjusted profits" irrespective of the frequency with which they recur, while including any and all gains from asset disposals in the "clean" profit figure, even in years when the resulting gains are exceptionally large and distort the entity's profit figure.

Q11 – MANAGEMENT PERFORMANCE MEASURES

- ***(a) Paragraph 103 of the ED proposes a definition of 'management performance measures'.***
- ***(b) Paragraph 106 of the ED proposes requiring an entity to disclose in a single note information about its management performance measures.***
- ***(c) Paragraph 106(a)-106(d) of the ED propose what information an entity would be required to disclose about its management performance measures.***

Paragraph BC145-BC180 of the BC describes the Board's reasons for the proposal 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?

Agree with Definition and Requirements; Recommend Prior Period Disclosure – As noted in the body of our letter, we support the proposed definition and disclosure requirements for MPMs. We believe that as defined, MPMs will provide insight into how management views earnings for an entity, and we recommend that the IASB use this data to further refine its definition of operating profit or loss going forward.

We believe that the proposed disclosure and reconciliation to an IFRS prescribed subtotal will increase the transparency and understandability of these measures, and their inclusion in the footnote disclosure will enhance reliability as they will now be subject to the audit process.

We recommend that when used MPMs should be shown for all prior years presented in the financial statements using the company's current methodology for calculating MPMs as this will allow investors to gauge an entity's performance over time, using management's own metrics.

Avoid Confusion with APMs and Non-GAAP Measures – Given the narrow scope of MPMs, we recommend re-naming these measures to a more descriptive term such as Alternative P&L Subtotals (APLS) or Alternative Management Earnings (AMEs), to avoid their being confused with the broader categories of APMs and non-GAAP measures. This more descriptive term would readily explain to users of financial statements why these metrics consist only of subtotals of income and expense items, and would not include revenue-only measures such as adjusted revenues, or other metrics such as ROE. In addition, we believe the Board should provide greater clarity regarding the purpose of MPMs, so that users clearly understand how they fit into the overall framework of financial metrics.

Q12 – EBITDA

Paragraphs BC172-BC173 of the BC 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?

As the Board notes, although EBITDA is one of the most commonly used measures in communications with users of financial statements, users have no consensus about what EBITDA represents, other than it being a useful starting point for various analyses. Its calculation varies widely in practice.

Given that the Board has decided not to define operating profit or loss directly, but instead has opted to define it as the default or residual category, we believe it is consistent that the Board has declined to define EBITDA. Simply put, if operating profit or loss has not been defined, how can EBITDA be defined? In light of this approach, we agree that it makes most sense for EBITDA to be categorized as a type of MPM that must be disclosed and reconciled. Again, we believe that as preparers present EBITDA and other MPMs over time, a consensus may begin to emerge in the definition of this metric and measures of operating profit for various industries that the Board may wish to consider in the future as part of a post-implementation assessment of the final standard and a reconsideration or refinement of the definition of "operating profit or loss".

Q13 – STATEMENT OF CASH FLOWS

(a) The proposed amendment to paragraph 18(b) of IAS 7 would require operating profit or loss to be starting point for the indirect method of reporting cash flows from operating activities.

(b) The proposed new paragraphs 33A of the BC 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?

Agree with Operating Profit (Loss) as Starting Point – We agree that operating profit or loss should be the starting point for the indirect method of cash flows, as requiring a consistent starting point will enhance comparability among entities. In addition, we agree that starting with operating profit or loss is superior to other alternatives, because by using operating profit or loss, an entity needs to present fewer adjustments to the starting point, which simplifies the presentation of the operating cash flows category.

Eliminating Classification Choices – We also agree with removing the choices for classifying interest and dividend cash flows in the statement of cash flows, as again, we believe this will enhance comparability among entities, without a reduction in information content.

A Better Statement of Cash Flow Takes Pressure off of EBITDA and MPMs – However, more fundamentally, and as discussed in more detail in our CBRM, we continue to believe that **companies should be required to prepare their statement of cash flows under the direct method.**

As further described in our April 14, 2009 letter regarding the IASB and FASB joint *Discussion Paper: Preliminary Views on Financial Statement Presentation*, the analytical value to investors of reporting cash flows from operating activities using the direct method is straightforward: It offers insights into the quality of revenues and earnings, and the characteristics of the cash conversion cycle, which are not available from an indirect method of reporting cash flow from operating activities. In general, this method of cash flow preparation better equips investors with the information necessary to appraise a company's liquidity, assess its earnings quality, and make more realistic cash flow forecasts. The direct method approach allows an investor to develop questions and an understanding about how the amount, timing and uncertainty of cash flows differ from revenue and expense elements in the statement of comprehensive income. Simply put, cash is the ultimate performance measure.

In the absence of a direct method approach to predict future operating cash flows, investors often resort to the use of crude, alternative proxies for cash flow, such as EBITDA. Therefore, including a direct method statement of cash flows will reduce the use of MPMs such as EBITDA.

Historically, preparers have cited technology costs as a chief concern with adopting the direct method. However, we note that since these issues have been debated, technology has changed considerably. Accordingly, we urge the Board to revisit this important issue, and reassess the cost-benefit analysis of the direct method, either as a part of this project or in a future project.

Q14 – OTHER COMMENTS

Do you have any other comments on the proposals in the ED, including the analysis of the effects (paragraphs BC232-BC312) of the BC, including Appendix) and Illustrative Examples accompanying the ED?

- *Statement of Financial Condition Classifications* – We are supportive of the ED's proposal to require an entity to present goodwill separately from intangible assets in its statement of financial position. We agree that the characteristics of goodwill are sufficiently different from those of intangible assets to warrant separate presentation.

- *Foreign Currency* – We support the proposed requirement to classify foreign exchange differences in the same category of the statement of profit or loss as the income and expenses from the items that gave rise to the foreign exchange differences. We believe that this approach is more useful to investors as it enables them to see the impact of foreign exchange gains on individual line items more clearly.