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XX September 2020

Dear Hans,

IASB ED/2019/7 *General Presentation and Disclosures* – AASB comments

Commented [JB1]: Question to the Board:
Does the Board approve the comment letter as drafted below?

If not, what feedback does the Board propose to add, delete or amend?

Please note that staff have highlighted some areas requesting specific feedback from the Board below. Those areas are those that were subject to the most Board discussion at previous meetings.

The Australian Accounting Standards Board (AASB) is pleased to have the opportunity to provide comments on ED/2019/7 *General Presentation and Disclosures* issued in December 2019 (ED/2019/7).

In formulating these comments, the views of our Australian stakeholders were sought and considered. This included:

- consultation with the AASB's User Advisory Committee, comprising a range of primary users of financial statements;
- two webinars seeking feedback on the proposals, with participation from over 130 stakeholders. We would like to express particular thanks to Ann Tarca and Aida Vatrenjak for their participation in the webinars, which we consider was of significant mutual benefit to both the AASB and IASB;
- consultation with the AASB's Disclosure Initiative Project Advisory Panel, which comprises subject matter experts across a range of stakeholder groups;
- three formal comment letters; and
- other targeted consultation with key stakeholders, such as other regulators in Australia.

The AASB acknowledges the efforts of the International Accounting Standards Board (IASB) and broadly supports the direction of ED/2019/7 as the AASB believes the IASB has addressed the major concerns in the proposals. The AASB is particularly supportive of the revised structure of the statement of profit or loss, which we consider will provide enhanced comparability for users of financial statements.

However, as mentioned below in Appendix A, the AASB does have concern over some proposals, including:

- the proposal for entities to distinguish whether an associate or joint venture is integral or non-integral to the main business activities of the entity. We consider that this assessment is subject to significant judgement which may lead to both costs and inconsistencies in application. We also note that outreach with users has not identified that the distinction would add significant useful information to the financial statements. On that basis, we recommend the IASB removes the requirement and addresses only the presentation of those amounts in the statement of profit or loss;

- the proposed definition relating to unusual items of income and expenses may be improved by allowing entities to consider past events as an indicator of expectations about the future and by expanding its scope to include income and expense that would appear to only fall out of the proposed definition due to the potentially arbitrary cut-off; and
- the scope of the proposals for management performance measures appears to be overly restrictive, which may reduce the enhanced disclosure that the proposals would bring. We are also concerned that some of the components of the definition require clarification to ensure that they are easily understood by preparers and auditors.

If you have any questions regarding this letter, please contact myself or James Barden, Acting Senior Manager (jbarden@aasb.gov.au).

Yours sincerely,

[signature]

Dr. Keith Kendall
AASB Chair

APPENDIX A – Responses to questions raised in ED/2019/7

Question 1—operating profit or loss
Paragraph 60(a) of the Exposure Draft proposes that all entities present in the statement of profit or loss a subtotal for operating profit or loss. Paragraph BC53 of the Basis for Conclusions describes the Board's reasons for this proposal. Do you agree with the proposal? Why or why not? If not, what alternative approach would you suggest and why?

The AASB agrees with the IASB's proposal.

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?

The AASB agrees with the IASB's proposal.

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?

The AASB agrees with the IASB's proposal to include income and expenses arising from investments made in the course of an entity's main business activities in the operating category. We agree that it is useful for all income and expenses made in the course of an entity's main business activities to be reported in the operating category.

However, the AASB also received feedback from stakeholders that the distinction may be difficult to apply and lead to inconsistencies in practice. For example, some stakeholders raised uncertainty as to whether fair value gains or losses within the scope of IAS 41 *Agriculture* should be classified in the operating or investing category.

The AASB acknowledges that judgement is necessary in determining whether an investment is made within the course of an entity's main business activity and supports that approach to ensure a principles-based classification in the statement of profit or loss. However, we suggest the IASB strengthen the guidance relating to how an entity distinguishes whether an investment is made in the course of those main business activities.

A suggested approach is to review the way in which guidance is provided in paragraph B27. Paragraph B27 provides examples of the **types of entities** (emphasis added) that may invest in the course of their main business activities. The AASB considers this could provide more useful guidance by instead explaining how an entity assesses whether an investment is made within the course of the entity's main business activities.

Such guidance could provide both examples of what would and would not constitute investing in the course of the entity's main business activities.

For example, investments made in the course of the entity's main business may include:

- fair value gains and losses from investment property held by an entity whose main business activity is investing in real estate; and
- fair value gains and losses on agriculture held by an entity whose main business activity is to wholesale such agriculture.[1]

Although simple, we consider they assist in illustrating how the proposal would be applied, rather than only listing the types of entities where the occurrence may be common. Alternatively, examples of situations where an entity would not be investing in the course of its main business activities may also be useful to illustrate the principle, including:

- surplus assets not related to the entity's main business activities;
- an investment property held for rental returns by an entity whose only main business activity is, for example, making wine; and
- assets held for capital appreciation, such as gold, where the entity's main business activity is, for example, investing in real estate.

Other feedback has suggested that more guidance may be required on how an entity determines what its 'main business activities' are. The AASB notes that entities are currently required to disclose their 'principal activities' under IAS 1 paragraph 138, and that requirement has been largely carried forward into paragraph 99 of proposed IFRS X (with a change in terminology from 'principal activities' to 'main business activities'). On that basis, we acknowledge such an assessment is not necessarily a new requirement.

However, how entities define their 'main business activities' is now much more important given the proposed categorisation's reliance on that assessment. Therefore, we consider that additional guidance may be warranted.

The AASB acknowledges proposed paragraph B27 which states "If, applying IFRS 8 *Operating Segments*, an entity reports a segment that constitutes a single business activity, that may indicate that that business activity is a main business activity". We recommend the IASB provide additional guidance/indicators of main business activities similar and in addition to paragraph B27. However, we also recommend that the guidance should not be too prescriptive and be limited to examples or indicators to help identify main business activities. We think this is important so that entities still have some flexibility in defining what the main business activities are in their context, given the diverse range of entities reporting under IFRS Standards. The AASB is also aware that in some cases, entities will have a pool of assets which support both the main business activities and produce returns more generally for shareholders. Stakeholders questioned whether the proposals would require such pools of assets to be split between the operating and investing categories to reflect the main purpose of the individual assets. To the extent the IASB assess this as practical through its fieldwork, the AASB supports the requirements in the ED which appear to require an entity to categorise the returns on an asset-by-asset basis.

1 Assuming that such agriculture does not generate returns largely independently from other resources of the entity.

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?

The AASB agrees with the IASB's proposal.

Question 5—the investing category
Paragraphs 47–48 of the Exposure Draft propose that an entity classifies in the investing category income and expenses (including related incremental expenses) from assets that generate a return individually and largely independently of other resources held by the entity, unless they are investments made in the course of the entity's main business activities. Paragraphs BC48–BC52 of the Basis for Conclusions describe the Board's reasons for the proposal. Do you agree with the proposal? Why or why not? If not, what alternative approach would you suggest and why?

The AASB agrees with the IASB's proposal.

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?

The AASB agrees with the IASB's proposal.

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?

The AASB does not agree with the IASB's proposal to require entities to distinguish between whether associates and joint ventures are integral or non-integral. This is for several reasons that we outline below.

Instead, the AASB recommends that all associates and joint ventures accounted for using the equity method are presented in a single, separate category, below operating profit. This would revise the proposed subtotal for operating profit or loss and income and expenses from integral associates and joint ventures with a subtotal for operating profit or loss and income and expenses from associates and joint ventures (accounted for using the equity method). Our reasons for this proposal are outlined below.

Cost of preparing the information

Feedback received in the AASB's outreach, particularly from preparers of financial statements, indicates that the judgement involved in determining whether an associate or joint venture is integral or non-integral would involve costs for preparers. Some feedback also suggested that the definition and small amount of guidance as proposed may not lead to entities making such judgements consistently.

In respect of those comments, the AASB identifies the following practical challenges in determining whether an investment is integral or non-integral as proposed:

Commented [JB2]: Question to the Board:

Does the Board agree with the below-mentioned concerns with the proposed definition as drafted?

- Given the limited guidance, it could be particularly judgemental and difficult when trying to distinguish whether returns occur separately from the other assets of the entity. For example, an associate or joint venture may generate a return by mere association with a recognised brand name of the reporting entity, despite not necessarily sharing or using that brand name. In that case, it may be particularly challenging to determine whether that return occurs individually and largely independently of the brand name;
- proposed paragraph 20D provides guidance that entities should assess whether a 'significant interdependency' exists between the investment and the entity. It is unclear how the concepts of 'generating returns individually and largely independently of other assets' in the definition of

integral, and 'significant interdependency' in the guidance in paragraph 20D interact. For instance, it is unclear whether an asset must be recognisable for a significant interdependency to also exist. An example of this might be where the associate and the reporting entity share a brand name (which is noted as a possible significant interdependency in paragraph 20D), but that brand name is internally generated, and hence not recognisable. In that case, would the associate meet the definition of integral?

- further, it is unclear how the definitions of significant influence (for associates) and joint control (for joint ventures) interact with the proposed definition and guidance. In particular, applying paragraph 20D of the proposed amendments to IFRS 12, it could become difficult to conclude that a significant interdependency between an entity and an associate or joint venture does not exist where the parent has significant influence over the investment's financial and operating policies, or jointly controls the entity. However, the management of the entity (which is the source of the interdependency) would not be a recognisable asset and therefore, the associate or joint venture may still produce returns individually and largely independently of the other assets of the entity. Again, it is unclear how the concepts of 'generates returns individually and largely independently of other assets' and 'significant interdependency' are intended to interact, and in some cases it appears that they may conflict;
- BC78-BC79 to ED/2019/7 note the IASB's expectation that most joint ventures would be integral to the business. With that in mind, we question whether it would be more cost-efficient for the IASB to include a rebuttable presumption that joint ventures would be integral?
- if the definition is too broad or lacks guidance, entities may be able to easily reclassify the associate or joint venture when they are performing well or underperforming to reach the desired presentation in the statement of profit or loss; and
- lastly, an associate or joint venture may represent a significant element of a business's financial performance, but may do so individually and largely independently of other assets of the entity (for example, a venture into a new type of business activity, or a similar business activity but using assets entirely independent of the reporting entity). In that case, the associate or joint venture would be classified as non-integral, despite its financial significance to the group. The AASB notes that the definition refers to the investment being integral to the main business activities; however, we question whether that would be well understood by users without an understanding of the technical requirements of the proposals.

<u>Feedback from users</u>

Users indicated to the AASB that distinguishing between integral and non-integral associates and joint ventures:

- appears to be arbitrary; and
- would not provide additional information on associates or joint ventures that is particularly useful.

Users reiterated their preference to keep associates and joint ventures accounted for using the equity method separate from the operating category so as not to mix pre and post-tax items in the operating category.

Some users also noted that their information needs relating to associates and joint ventures could be satisfied through increased disclosures, particularly with regard to the financial position of associates and joint ventures. The AASB notes that IFRS 12 *Disclosure of Interests in Other Entities* already requires significant disclosure of the nature of an entity's interest in other entities.

AASB's proposed approach

Commented [JB3]: **Question to the Board:** Does the Board agree with the proposed approach as drafted?

It appears that the cost of distinguishing associates and joint ventures between whether they are integral or non-integral would outweigh the benefits of providing such information. On that basis, the AASB disagrees with the IASB's proposal, and instead suggests that the IASB require entities to present a separate category and subtotal for associates and joint ventures accounted for using the equity method directly below the operating category. We consider that this would:

- reduce costs for preparers;
- allow preparers to give prominence to the results of associates and joint ventures outside of the investing category; and
- provide information to users on the results of associates or joint ventures accounted for using the equity method, but not mix this information with the pre-tax items in the operating category.

To address other feedback from users on disclosures related to associates and joint ventures, we recommend the IASB gives further consideration to the need for enhancing the requirements of IFRS 12 during its forthcoming post-implementation review of IFRS 10 *Consolidated Financial Statements*, IFRS 11 *Joint Arrangements* and IFRS 12.

Other comments

Some prepares were also reluctant to undertake an assessment of whether associates and joint ventures are integral and instead suggested consideration of requiring proportionate consolidation for joint ventures that might be considered 'integral' instead of equity accounting. The AASB notes that this would involve a fundamental revision of the accounting requirements for associates and joint ventures. The AASB recommends that the IASB consider such feedback further as part of its research project on the Equity Method.

Question 8—roles of the primary financial statements and the notes, aggregation and disaggregation
(a) Paragraphs 20–21 of the Exposure Draft set out the proposed description of the roles of the primary financial statements and the notes. (b) Paragraphs 25–28 and B5–B15 of the Exposure Draft set out proposals for principles and general requirements on the aggregation and disaggregation of information. Paragraphs BC19–BC27 of the Basis for Conclusions describe the Board's reasons for these proposals. Do you agree with the proposals? Why or why not? If not, what alternative approach would you suggest and why?

The AASB agrees with the IASB defining the roles of the primary financial statements and the notes.

The AASB also generally agrees with the proposed principles and general requirements on the aggregation and disaggregation of information. However, we recommend the IASB link materiality more closely with the aggregation and disaggregation principles. Whilst paragraph B9 of proposed IFRS X clarifies that it is the concept of materiality that drives aggregation and disaggregation in the notes, we recommend that materiality, particularly the qualitative assessment of it for the purpose of presentation and disclosure, is incorporated more clearly as a key component of aggregation and disaggregation in the body of proposed IFRS X.

The AASB also received feedback noting a current lack of clear guidance in IAS 1 on the presentation of certain items in the statement of financial performance, for example where to present a day one gain or loss, the unwinding of a discount or a gain/loss on derecognition of certain types of financial instruments under IFRS 9. The participant also noted the challenges of classifying the interest on a lease liability. We consider that the proposals will be useful in assisting entities in determining the most appropriate aggregation category for such items. However, we understand that the additional guidance required for the items noted above goes beyond the scope of the current project.

The AASB also questions whether it is necessary to require a disaggregation of the 'other' category, so far as that category is only an aggregation of individually immaterial items. If the aggregation and disaggregation principles incorporate the concept of materiality (both quantitatively and qualitatively), then by definition an 'other' category should not require further disaggregation or explanation of its content. The requirement as proposed could also be quite onerous for preparers to undertake and could result in a significant amount of immaterial information disclosed in the notes.

If the IASB does retain the proposed requirements for the 'other' category, then the AASB recommends the IASB illustrates such a requirement, noting that the illustrative examples as proposed include a line item labelled with 'other'.

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?

The AASB supports the IASB's proposals to require an entity to analyse its operating expenses using the nature of expense method or the function of expense method, whichever is more appropriate. This is primarily on the basis that the proposal would bring greater comparability to the financial statements, particularly where comparing entities with similar business activities.

Users place importance on consistency in analysing an entity's operating expenses either by nature or by function. While some users were indifferent to the method used, others also supported the IASB's proposal to require re-analysis by nature in the notes where a functional analysis is undertaken on the face of the statement of profit or loss.

We note that during outreach, some preparers argued that the proposals may be costly to implement. However, the AASB did not identify any new arguments in that outreach that the IASB had not already considered in its Basis for Conclusions.

However, we are concerned that paragraph B47 of proposed IFRS X inappropriately requires the presentation of the required line items listed in paragraph 65. This requirement may result in a mixed analysis in a situation when an entity analyses the operating expenses by function but is required to include some minimum line items (e.g., impairment loss), which fits into the analyses by nature. The AASB considers that it is inconsistent with the requirement to use a single method.

Commented [JB4]: Question to the Board: Do you agree with the drafting of the feedback regarding the required minimum line items causing a mixed analysis of operating expenses by default?

The AASB also notes that the required line items appear to have been carried over from IAS 1 without a reconsideration of whether they are appropriate in the context of the revised IFRS X. The AASB recommends the IASB re-consider the appropriateness of the required line items as a whole, particularly given those required line items have accumulated over a series of time through new and revised standards, and therefore not necessarily with the same motivations for their inclusion. We consider this project provides an opportunity to review the required line items as a package. As an example, why are impairment losses related to financial assets (which are a required line item) deserving of more prominence than impairment losses related to non-financial assets (which are not a required line item)?

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?

The AASB generally supports the IASB's proposal to require disclosure of unusual items of income and expenses. We agree that such disclosure has the potential to provide useful information to estimate future cash flows. However, the AASB has some concerns regarding the determination and the definition of the items.

Paragraph B70 of proposed IFRS X states that income or expenses are classified as unusual based on expectations about the future rather than past occurrences. The AASB agrees that items of income and expense should be classified on the basis of expectations of the future. However, we consider the IASB should also permit entities to consider the past to assess the reasonableness of the entity's expectations of the future. In other words, the AASB recommends that an indicator of whether an item of income or expense is likely to recur should be whether the entity's assumptions about the future are consistent with past events. However, we stress that where the circumstances or conditions are not consistent with similar past events, expectations of the future should take precedence. This would be important to ensure that the entity does not classify an item as unusual because it did not occur over the several previous reporting periods, despite the entity expecting the expense is to recur within the next several reporting periods. Whilst we acknowledge it is not perfectly comparable in purpose or operation, this could be similar in principle to IAS 36 *Impairment of Assets* paragraph 34, which requires management to assess the reasonableness of its assumptions in future cash flow projections with reference to actual past events. The AASB considers this would provide a more objective basis for both preparers and auditors to make the requisite judgements in assessing whether an event is likely to recur. The AASB acknowledges that proposed paragraph B70 seems to imply this would be possible, given references to the entity identifying 'a developing pattern' in the case of an event that has previously occurred. However, as noted, the AASB recommends that consideration of the past is made one of the more prominent indicators.

Commented [JB5]: Question to the Board: Do Board members agree with the recommendation to include the past as an indicator of whether an item is expected to recur, as drafted?

The AASB also has a concern regarding items of income or expense that occur over multiple reporting periods but may still be unusual in substance. For example, a restructuring program that occurs over a 12-month period, but crosses over the reporting period, would not meet the proposed definition in the first reporting period of occurrence (to the extent the related expenses are expected to recur in similar in type and amount). However, the expenses would be disclosed as unusual in the second reporting period where the restructuring occurs, which we are concerned may call into question why the expense was not highlighted in the previous reporting period when it was occurring. This may also be further exacerbated by applying paragraph B74 of proposed IFRS X, which requires that comparative information is only presented for unusual items of income and expense to the extent that the item was also unusual in the comparative reporting period. In the example provided above, it appears no comparative information would be provided in the second year when the unusual item is disclosed.

The AASB acknowledges and agrees that the requirement should provide information for users to assess future cash flows; however, we question whether a timeframe based on the reporting date achieves this object or would be too short-term in focus. We also question whether it is useful to only have disclosure in the final year of an unusual multi-year item.

However, the AASB also recognises the strong feedback from users (including users in Australia) to limit the scope of the proposed definition, so as not to allow inappropriate use of the ability to describe items of income and expense as unusual. With that in mind, the practical difficulties in defining unusual items of income and expense are acknowledged. However, the AASB recommends the IASB consider whether the definition could be expanded to include those short-term items of income or expense that may recur in the next reporting period, but are also appropriately expected not to recur thereafter. Users also noted the importance of clear disclosure of management's judgements and expectations relating to items classified as unusual.

The AASB recommends that the income tax effect and the effect on non-controlling interests is disclosed for each item of unusual items of income and expense. Users noted that this information is important for reasons similar to those the IASB has noted in paragraph BC134 in relation to management performance measures.

Some stakeholders requested clarification of what the IASB means by 'several reporting periods'; however, the AASB agrees with the IASB's reasons set out in BC129-BC136 for choosing the term. We consider that defining a specific period of time could be arbitrary, and lead to a focus more on rules than principles.

Some stakeholders also raised questions during outreach as to whether unusually low revenue would require disclosure. The AASB acknowledges that proposed IFRS X clearly refers to items of income and expense being unusual in type or amount, which would lead to a lower amount than future expectations meeting the definition of unusual. However, we recommend the IASB consider whether a specific example or clarification in the application guidance might be useful for the avoidance of doubt amongst preparers and auditors.

Question 11—management performance measures
(a) Paragraph 103 of the Exposure Draft proposes a definition of 'management performance measures'. (b) Paragraph 106 of the Exposure Draft proposes requiring an entity to disclose in a single note information about its management performance measures. (c) Paragraphs 106(a)–106(d) of the Exposure Draft propose what information an entity would be required to disclose about its management performance measures. Paragraphs BC145–BC180 of the Basis for Conclusions describe the Board's reasons for the proposals and discuss approaches that were considered but rejected by the Board. Do you agree that information about management performance measures as defined by the Board should be included in the financial statements? Why or why not? Do you agree with the proposed disclosure requirements for management performance measures? Why or why not? If not, what alternative disclosures would you suggest and why?

The AASB supports the disclosure of management performance measures in the financial statements to permit preparers to provide information to users on a transparent basis. We note in particular that users have indicated the proposed disclosure would be helpful and welcomed.

We are also aware of evidence which suggests that it has become increasingly common for Australian entities to report measures of financial performance that do not reflect the requirements of the Accounting Standards.[2] Additionally, other evidence suggests that 'non-GAAP' earnings numbers are more predictable and more closely correlated with share price movements than their GAAP counterpart. However, that research also suggests such numbers are less likely to reflect bad economic news on a timely basis (ie they are less conservative).[3]

In Australia, listed entities are required to provide an operating and financial review in accordance with the guidance set out by the corporate regulator, the Australian Securities and Investments Commission (ASIC).[4] That guidance notes that non-IFRS financial information may be useful or necessary in the Operating and Financial Review for shareholders and other users of financial reports. Where such non-IFRS measures are used in the Operating and Financial Review (or other another document separate to the financial report, such as market announcements), a separate ASIC regulatory guide requires certain disclosure to ensure those measures are not misleading, including a reconciliation to IFRS measures.[5] The disclosures/reconciliations do not form part of the financial statements and hence are not subject to audit.

Despite support for the disclosure of MPMs, the AASB does have some concerns regarding the proposals as drafted in ED/2019/7 as follows. These generally relate to the restrictive nature of the proposals, as well as the practicality of some proposals with respect to the audit.

2 Coulton, J., Ribeiro, A., Shan, Y., Taylor, S., 'The Rise and Rise of Non-GAAP Disclosure', Chartered Accountants Australia and New Zealand, 2016
3 Ribeiro, A., Shan, Y., Taylor, S., 'Non-GAAP Earnings and the Earnings Quality Trade-off', ABACUS, vol 55, no 1, 2019
4 See ASIC Regulatory Guide 247 *Effective disclosure in an operating and financial review*
5 See ASIC Regulatory Guide 230 *Disclosing non-IFRS financial information*

Restrictive nature of the definition

Commented [JB6]: Question to the Board:
Do Board members agree with the recommendations to make the definition of MPMs less restrictive, as drafted?

Overall, we consider the definition of MPMs is overly restrictive. There is a risk that many non-GAAP measures reported by management publicly would not be subject to the enhanced disclosure and transparency requirements of ED/2019/7. Such disclosure is expected to be useful to users of financial statements, and accordingly it is recommended that the definition is widened to include more performance measures than proposed, as well as other measures that could be reconciled to IFRS financial information. We discuss some specific restrictions below.

Faithful representation

The AASB acknowledges and share concerns that disclosing performance measures that do not faithfully represent what they purport to represent could provide incomplete or misleading information that users rely upon.

However, there is also concern that requiring management performance measures to meet a 'faithful representation' criterion before being subject to the proposed enhanced disclosure requirements may reduce the inclusion of useful information in the financial statements. We have also received feedback that this may be particularly costly from both a preparation and audit perspective, due to the significant judgement involved in determining (and opining) on whether a measure provides a faithful representation. This is particularly so given ED/2019/7 does not provide further guidance on when a management performance measure would, or would not, provide a faithful representation.

In addition to the cost constraints noted above, the AASB recommends this requirement is removed from the proposals on the following basis:

- IFRS 8 Operating Segments does not impose similar restrictions on the disclosure of segment information that reflects the views of management. It is not clear why the IASB has proposed something different in ED/2019/7;
- the related disclosures and reconciliations would provide information for users on what the measures represent. This would include an explanation of the how the measures are calculated, how they provide useful information about the entity's performance and a reconciliation to the most directly comparable IFRS subtotal or total. Given the IASB is unable to prevent the use of measures publicly, it would appear that including this information would be more beneficial than having measures reported publicly without robust disclosure. Users would then be able to make their own judgement as to whether the measure is appropriate and/or provides a faithful representation; and
- the presentation of management performance measures within the financial statements as subtotals would still be prohibited from having more prominence than subtotals and totals required by IFRS standards, reducing the potential for misleading users (as per paragraph 43(d) of proposed IFRS X).

Complementing totals or subtotals specified by IFRS Standards

It is not clear what the criterion in paragraph 103(b) that management performance measures "complement totals or subtotals specified by IFRS Standards" is intended to mean. For example, it is not clear if the IASB is simply suggesting that the measure must be reconcilable to an IFRS-defined total or subtotal, or something else. Without clarification, there could be significant judgement (potentially leading to additional cost) involved in assessing this criterion.

Subtotals of income and expenses

Subtotals of income and expenses are only a subset of the non-GAAP measures that entities might report. Other non-GAAP measures are also reported that incorporate measures from the statement of financial position or elsewhere, for example (but not limited to) return on assets or equity, current ratio or debt-equity ratio. However, where such measures use inputs that are adjusted from amounts recognised in accordance with IFRS Standards, whether that be in the statement of financial position or statement of cash flows, the AASB considers users would benefit from the same disclosure as subtotals of income and expenses.

The AASB acknowledges the IASB's objective to focus on financial performance. However, we consider that not including other measures linked to amounts recognised in accordance with and reconcilable to IFRS standards, the IASB would miss an opportunity to enhance transparency. We emphasise this point noting that the IASB has no active indication of undertaking a project focussing on financial position or cash flow.

Public communications

Feedback has suggested that it is not clear how far the IASB intends 'public communications' to span. For example, whether this is intended to include information made available via social media, other statutory or voluntary reports (such as a sustainability report), or only in connection with the release of the financial statements. This could also become a practical challenge for auditors if they are required to understand and review all of the various ways that an entity could communicate publicly.

The AASB recommends the IASB clarify the scope of public communications accordingly.

<u>Additional disclosure</u>

The AASB also recommends the IASB consider additional disclosure related to management performance measures and their linkage to unusual items of income and expenses – that is if and how unusual items of income and expenses are incorporated into management performance measures. We also consider that require disclosure of if and how management uses the performance measures internally may provide additional useful information on how management views the performance of the business.

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?

The AASB agrees with the IASB not defining EBITDA. Given its current diversity, we agree that it would be extremely challenging for the IASB to reach a generally agreed definition.

The AASB also notes and supports permitting the use of an 'operating profit or loss before depreciation and amortisation' subtotal without requiring the disclosure for management performance measures. However, for clarity and avoidance of doubt, we recommend that the IASB clarify that such a subtotal must be defined according to the IFRS-specified operating profit subtotal, and depreciation and amortisation as recognised in accordance with IFRS standards.

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?

The AASB generally agrees with the IASB's proposals for the statement of cash flows.

However, some stakeholders shared concern that users would not understand the varying definitions of operating, investing and financing between the statement of financial performance and the statement of cash flows. The AASB recommends the IASB consider aligning the definitions more closely, or to the extent that is impracticable for this project, to consider alternate titles in one of the statements.

The AASB also notes feedback from a user of financial statements that disagreed with the proposal for interest paid, interest received and dividends received. That member considered those items should be included in operating cash flows in an attempt to make the operating category in the cash flow statement the equivalent of net profit after tax.

However, other users were comfortable with the IASB's proposals.

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?

The AASB notes the IASB's intention to keep the scope of this project to focus on the statement of financial performance. However, feedback from stakeholders have suggested that some other topic areas or project are of importance for the IASB to consider, which we have listed below for consideration in the IASB forthcoming agenda consultation

Going concern

The AASB is aware of a range of improvements that are justified to the current requirements relating to going concern. In Australia, going concern assessments and disclosures have been spotlighted during a Parliamentary enquiry into the regulation of auditing in Australia (relevant to the audit quality debate), and the COVID-19 pandemic has further exacerbated challenges and feedback from stakeholders on the matter. In particular, we consider the IASB should undertake a project to consider:

- the adequacy of disclosure requirements relevant to management's assessment of the going concern assumption, particularly the interaction with the requirements of auditing standards; and
- the lack of guidance on what basis of preparation to use when the entity is no longer a going concern.

Other comprehensive income

The AASB has received feedback that the IASB should undertake a fundamental review of the requirements for when items should be classified in other comprehensive income, and the role of the statement itself.