To the members of the International Accounting Standards Board

Submitted electronically

Subject: Eumedion's response to IASB's 'Exposure Draft ED/2019/7 General Presentation and Disclosures' (the 'ED')

Ref: B20.17

The Hague, 30 September 2020

Dear members of the IASB,

Eumedion appreciates the opportunity to respond to your request for views on the ED. Eumedion is the dedicated representative of the interests of 50 institutional investors, all committed to a long term investment horizon. Eumedion aims to promote good corporate governance and sustainability in the companies our participants invest in. We regard accounting standards as a critical part of a global financial infrastructure, especially since investors are dependent on the quality of accounting standards for allocating their own and entrusted capital. Together our participants invest over € 6 trillion of capital in equity and corporate non-equity instruments.

We consider the proposals generally to be very favourable for investors and we are confident that the final proposals will indeed genuinely contribute to better communication between reporting entities and investors.

The other main messages we would like to highlight to the Board are:

- We suggest to define ‘Operating Profit Before Depreciation, Amortisation and specific Impairments’ as a non-mandatory subtotal, instead of ‘Operating Profit Before Depreciation and Amortisation’;
- We suggest to refrain from defining the subtotal ‘integral associates and joint ventures’ and ‘non-integral associates and joint ventures’;
- We highlight the significant loss of comparability if companies report by function or a mixed presentation and suggest the latter two formats to be included in the notes only;
- We applaud the Board’s attention to disclosures on Non-Controlling Interests and suggest requiring the disclosure of ‘proportionate shares’ of certain line-items, in line with our earlier published position paper.

Please find below our detailed responses to the questions in the ED.

If the IASB or the Staff would like to discuss our views in further detail, please do not hesitate to contact us. Our contact person is Martijn Bos (martijn.bos@eumedion.nl, +31 70 2040 304).

Yours sincerely,

Rients Abma

Executive Director
Eumedion

Zuid Hollandlaan 7
2596 AL THE HAGUE
THE NETHERLANDS

Draft response to individual questions of the Exposure Draft

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?

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?

We agree with question 1 and 2. Eumedion welcomes an IFRS defined operating profit or loss subtotal for all entities as it facilitates investors in better understanding what operating profit comprises of, and equally important, helps understand what elements are excluded from operating profit.

The proposed 'residual' approach is easy to understand for investors as it is clear that only items that meet specific criteria are excluded from operating profit. The resulting subtotals form a sound basis for better understanding how related management performance measures ('MPMs') differ from operating profit. The proposed definition facilitates both more basic comparability analyses, but it will also facilitate in-depth fundamental analysis as a reconciliation of the differences between MPMs and IFRS subtotals allow investors to make their own judgments. The definition of the operating profit subtotal will make fundamental analysis of reporting entities more insightful and less cumbersome for investors.

We would like to see the names of the proposed subtotals that include 'profit or loss' are shortened by eliminating 'or loss' from their respective names.

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?

We agree with the Board's proposal and the Board's view in the basis for conclusions.

In reference to EFRAG's Draft Comment Letter, we believe that the IASB should continue to focus on financial information that is relevant to investors and that provides a faithful representation, rather than focus on avoiding differences with existing regulatory frameworks. While liaising with constituents like regulators might help to ensure that IFRS Standards result in useful information, other frameworks might have different objectives and, therefore, should not predominate the IASB's decisions.

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?

We see room for improving the proposals for certain entities. In line with the proposal, if an entity has no meaningful cash & cash equivalents ('CCE') related to the provision of financing to customers, all results relating to CCE should be taken in the financing category. Reversely, if the CCE of an entity is foremost directly related to the provision of financing to customers, it makes sense to allow entities to have the option as described in the proposal. However, if the entity is not a financial institution ('non-

financials'), investors judge the balances of CCE hardly ever as 'operating assets'. Examples of 'operating cash' are cash in escrow accounts and the relatively small amounts of cash balances that retail companies hold overnight. We consider this observation in line with the Board's basis for conclusions BC40(a,b&c). The proposed standard implicitly expects non-financials to make rather arbitrary and diverging judgments in distinguishing between CCE related to the provision of financing to customers and CCE unrelated thereto. We therefore suggest that the final standard instead introduces a rebuttable presumption that assumes that CCE is not part of the operating category, unless it is evident that it is. Only if it is evident that the CCE is foremost related to the provision of financing to customers, the entity should be allowed to include all related results in the operating category. We expect this modification to make it easier to apply the resulting standard in practice and cause less divergence in application.

We expect the remainder of this proposal will have the most meaningful impact on reporting for entities with a 'mixed' business model like certain industrial companies that also have lessor activities and possibly non-financials that provide longer term supply chain financing to their customers. Even though the option to include all financing in the operating category is unlikely to be an attractive option for entities, it is also results in the least informative categorisation for investors. We therefore suggest that the final standard uses stronger language and require entities to make an effort to identify a reasonable basis for judging which income and expenses from financing activities do relate to the provision of financing to customers. Only if such financing arrangements are meaningful and no reasonable basis can be found, the reporting entity should be expected to include all such income and expenses in the operating category.

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?

We agree. Many investors wish to model future margin development, in particular EBITDA margin and operating income margin development. The proposals facilitate this analysis by excluding income from non-operating investments and associates from operating profit as these income and expenses are not directly related to revenues, operating assets, and operating liabilities. We also support the

Board’s proposal to classify income and expenses from cash & cash equivalents in the financing category.

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?

We agree with the Board’s proposal and the Board’s view in the basis for conclusions. We reiterate our support for the Board’s proposal to classify income and expenses from cash & cash equivalents in the financing category. We refer to the explanation in our response to question 4.

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?

We disagree. We do not expect investors to actively monitor a distinction between integral and non-integral associates and joint ventures. Putting such distinction in the Standards may unduly trigger reporting entities to look for a rather arbitrary basis for making such distinction. What message does the company send to the unit's employees if the associate they work for does only meets the criteria for non-integral? A recent outreach event highlighted that the criteria would be too strict for a major oil company and would result in a distinction that they consider as not meaningful. Eumedion proposes an alternative approach: IFRS should refrain from any reference to integral or non-integral joint ventures and associates. Those reporting entities that wish to make this distinction could still report such a subtotal as an MPM.

We do appreciate that the Board in this particular element of the proposals acknowledges an important characteristic that an IFRS defined operating profit subtotal should exclude the results of associates and joint ventures.

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?

We agree with the proposals. We expect requirements on aggregation and disaggregation to significantly enhance the usefulness of many financial statements for investors, in particular the requirements that govern 'other' items.

We wonder whether it is more appropriate to add the word 'consolidated' to paragraph 20(a): 'obtaining a <u>consolidated</u> overview of the entity's assets, liabilities, equity, income, expenses and cash flows;'. By adding 'consolidated' it effectively excludes any reference to statutory financial statements that may be included in the financial statements.

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?

We agree. Generally, investors find a presentation of the statement of profit & loss by nature most useful. By nature benefits from less judgmental allocations of costs (to functions) and help make the resulting presentation more consistent over years and allows for better comparison with peers. Comparability is a very important aspect of financial reporting. We also expect the proposed aggregation and disaggregation requirements to work more favourably for presentation by nature and rather unpredictable for presentation by function. One could argue that a presentation by function is more likely to result in aggregations of very dissimilar items into a single line item, which seems quite at cross with what the Board is trying to accomplish. We support the board's requirement that a presentation by nature should always be available in the financial statements.

An alternative for this proposal is to always require presentation by nature in the primary financial statements, while allowing entities to include a presentation by function or even mixed in the notes if they wish. The key benefit of this approach is that the notes of the financial statements will then refer to the presentation by nature as well. Substantial information is lost for investors if the notes refer only to presentation by function.

We are pleased with the Board's stance on not allowing a mixed model in the primary financial statements as it gives rise to even more uncertainties on how the entity calibrated the mixed model for its particular situation and how consistency over time is safeguarded. If the Board would still want to explore presentation by function or mixed in the primary statements, we suggest the Board to explore what guidance could limit the damage to comparability, for example by requiring a separate and consistent presentation of certain line-items, such as depreciation.

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?

We agree. A substantial number of investors are keen to make their own assessment of what often is described as 'normalised' performance. Disclosures on items that are unusual can help them making this assessment. We do expect reporting entities to struggle with assessing which income and expenses meet the criteria of 'limited predictive value', i.e. 'when it is reasonable to expect that income or expenses that are similar in type and amount will not arise for several future annual reporting periods'. We therefore do expect some diversity in application of this proposal. The current proposals require the identification of 'all' unusual items, which could result in excessive costs for reporting entities. A limitation in the scope to significant items only seems reasonable. We would support a standard that also requires a balanced approach towards identifying both unusual expenses and notably unusual income as well. Companies may be more eager to identify unusual expenses than unusual income, whereas for investors both are equally important. The final standard could therefore benefit from including a reference to reciprocity in the criteria for unusual income and unusual expenses.

However, we do not agree with the proposed removal of the contents of paragraph 97 of IAS 1. In our view, 'unusual items' and 'material items' are two different concepts. Although the latter might not have predicative value, separate disclosure could still be important to provide relevant information to investors. Therefore, we believe that all entities should be required to disclose both material items and unusual items.

Question 11—management performance measures

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

Paragraphs BC145–BC180 of the Basis for Conclusions describe the Board's reasons for the proposals and discuss approaches that were considered but rejected by the Board.

Do you agree that information about management performance measures as defined by the Board should be included in the financial statements? Why or why not?

Do you agree with the proposed disclosure requirements for management performance measures? Why or why not? If not, what alternative disclosures would you suggest and why?

We agree with the disclosure requirements for MPMs. Despite the current widespread lack of proper definitions, reconciliations, and audit of MPMs, they can influence investor perceptions and market prices as much as an IFRS defined subtotal can. Therefore, all metrics that meet the definition of an MPM should benefit from a proper definition, reconciliation (if applicable) and audit. The Board's proposals help safeguard this by the requirement to disclose of all MPMs in a single note to the financial statements. In this way, the IASB may influence the quality of reporting outside financial statements while staying within its boundaries of setting requirements for the financial statements.

We in principle agree with the proposed definition of MPMs. The proposals limit the definition of MPMs to those metrics that communicate a management's view to investors (together with other criteria). However, we are not sure how this works out for mandatory disclosure requirements that may contain management views, such as SolvencyII disclosures, reporting entities that apart from IFRS also file their 10Ks under US GAAP, or possibly energy companies in their regulatory filings. Such filings are often monitored by investors and it could be excessively burdensome for management to force them to include all of these metrics in the proposed single note to the IFRS financial statements. Unintended consequences may need to be addressed. A possible solution might be to add a fourth criterion that excludes those metrics that contain management views whose publication is mandatory under a framework other than IFRS that the reporting entity is striving to comply with.

In line with EFRAG (as set out in its Draft Comment Letter), we consider another aspect of the proposed definition of MPMs as too narrow, as it restricts MPMs to subtotals of income and expenses. It is unclear to us why other common non-IFRS measures such as adjusted revenue, and key ratios are excluded from the proposed definition.

Eumedion also supports EFRAG's call on the IASB to clarify the interaction between the proposed MPM requirements and the existing operating segment disclosures under IFRS 8 Operating segments. There is significant room for improvement in IFRS 8 and requiring (reconciliations to) certain IFRS defined subtotals from all primary financial statements seems like a natural next step.

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?

We agree. EBITDA currently is for valid reasons one of the most used metrics in financial analysis; not only in more straightforward financial comparisons, but also in the more intricate analyses of forecasting future cash flows where the depreciation and amortisation charges are modelled separately based on assumptions for capital expenditures resulting from the future asset intensity of a company. Not defining EBITDA is indeed consistent with the Board's decision not to define EBIT, but operating profit instead. By adding operating profit before depreciation & amortisation to the list of subtotals that are not MPMs, we would expect entities that report EBITDA-like metrics to always provide a reconciliation to operating profit before depreciation & amortisation. We wonder if BC172 needs rephrasing as it suggests that 'Consequently, EBITDA measures <u>may</u> meet the definition of management performance measures'. We wonder how a reported EBITDA number could not qualify as an MPM. Even in a case where the calculation of EBITDA is identical to operating profit before depreciation & amortisation, EBITDA still is not defined by the Board. BC172 may therefore need to be rephrased to 'Consequently, measures described as EBITDA meet the definition of management performance measures'.

We would like to highlight an important shortcoming in the proposed definition of operating profit before depreciation & amortisation. Even though there is a wide variety in practice how companies define EBIT, there is widespread consensus among investors and reporting entities on how EBIT should in principle differ from EBITDA: 'DA' should not only add back Depreciation & Amortisation expenses, but also impairment charges of fixed and intangible assets need to be excluded; i.e. all impairments that relate to capital expenditures in tangible and intangible assets and impairments of acquisition related intangibles. Not all types of impairments are excluded, impairments related to the valuation of inventory, and financial assets are included EBITDA. In our experience reporting entities by and large already do so for decades; analyst estimates of EBITDA exclude these specific impairments; credit rating agencies and data aggregators like Bloomberg, Factset and CapitalIQ who are quite responsive to investor's data needs, do so as well. S&P Global's Corporate Methodology - Ratios And Adjustments reads: *"Asset impairments/write-downs: We exclude impairment costs or reversals on tangible and intangible noncurrent assets from our definition of EBITDA because they are akin to depreciation or amortization costs in that they represent a company's income statement recognition of earlier capital expenditures. However, we include impairment costs on current assets, such as inventory and trade receivables because the charges for inventory represent a company's recognition in the income statement of money that it has already spent, and those for trade receivables represent the reduction of revenue and income previously recognized but that the*

company will not fully collect. Our definition of EBIT generally includes impairment charges or reversals, except we may adjust for very large and irregular impairments or impairment reversals of non-current assets." [1] The EFRAG User Panel unanimously concurred with this approach and considered these impairments as accelerated forms of depreciation and amortisation.[2]

We wonder if table A.13 of in the 'Basis for conclusions' document as provided by the Board could be misinterpreted by stakeholders. It states that out of 100 companies, only 21 exclude impairments and amortisation of intangible assets, and only 15 companies exclude impairments of property, plant and equipment. This could give the impression that only a small number of reporting entities exclude these charges from EBITDA. However the table does not reveal how many companies include these charges in EBITDA. As explained before, we are not aware of any company actively doing this. It could well be that the other 79 companies had no impairments and amortisation of intangible assets in the investigated reporting year, or that these companies were just not clear on how their EBITDA was defined. In other words, the table could equally imply that 100% of the companies investigated exclude the mentioned impairments.

We would understand the Board to be rather hesitant to introduce a definition under the name of operating profit before depreciation & amortisation that in fact excludes more elements than its name suggests. But the current definition is just not what investors need for in their financial analysis. Including these impairments would severely hamper the widespread acceptance of this new IFRS definition as it will be regarded as 'distorted by impairments', unlike the current assumed definition of EBITDA that is not distorted by impairments.

Under the current proposals, a reconciliation of a reporting entity's adjusted operating profit before depreciation & amortisation will wrongly guide investors' attention to the biggest differences, which are likely to be caused by the, for the purpose of this type of metrics, not so interesting impairments.

On the whole, the current definition of operating profit before depreciation and amortisation is an improvement over having not such a definition; however there is much more merit in an IFRS definition that mirrors the well proven practices of both investors and reporting entities. Eumedion therefore suggests that the Board chooses a name that does reflect the exclusion of these specific impairments and adjust the definition accordingly: for example 'Operating Profit Before Depreciation, Amortisation and specific Impairments'.

Question 13—statement of cash flows

[1] https://www.maalot.co.il/Publications/MT20190402140633.PDF, page 5

[2] Excluding these impairments from EBITDA should not be interpreted as that investors do not care about reporting on and holding management accountable for disappointing acquisitions and investments, and their resulting impairments.

(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?

We agree with the concept of a uniform starting point for the cash flow statement for all reporting entities. We have no outspoken preference as we acknowledge the advantages of a shorter cash flow statement. However, we also see merit in starting with net profit or loss as such presentation more intuitively answers the question 'The net result is 'x', how come the net increase in cash is different from this net result?' A cash flow statement that starts with net profit or loss may also entice reporting entities to port the generally higher granularity of the profit & loss statement to the cash flow statement.

We also support the proposal to remove the classification choices with regard to interest and dividend cash flows for most entities.

Furthermore, in line with EFRAG (as set out in its Draft Comment Letter), we are concerned about the classification inconsistencies between the statement of profit or loss and the statement of cash flows. These inconsistencies might impair the understandability for users of financial statements, especially considering the identical names of the different categories. We see no immediate solution for this problem, but there seems merit in exploring how the consistency can be improved. Therefore, we agree with EFRAG's suggestion to start a separate project on IAS 7 to comprehensively review the challenges that arise in practice and explore how consistency can be improved.

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?

We applaud the proposals attention for additional disclosures on Non-Controlling Interest ('NCI'). Eumedion published a position paper on NCI that explains in detail how NCIs gravely affect the

insightfulness of financial statements and how the disclosure of ‘the entity’s proportionate share’ in certain line items could alleviate this.[3]

[3] https://www.eumedion.nl/clientdata/215/media/clientimages/position_paper_full_consolidation_of_partly_owned_subsidiaries_requires_additional_disclosure.pdf?v=191119160654