



LETTER OF COMMENT NO. 34

1st April 2009

International Accounting Standard Board
30 Cannon Street
London
EC4M 6XH
United Kingdom

Ref: Comments to the Discussion Paper *Preliminary Views on Financial Statement Presentation*.

Dear Sir / Madam

On behalf of the III Working Group on IFRS impact and Central Balance-Sheet Data Offices databases (III WG hereinafter) of the European Committee of CBSO¹, I submit you a comment letter including an annex with the detailed answers to the Discussion Paper (DP) on Preliminary Views on Financial Statements Presentation. Both, this letter and its annex 1, provide the viewpoints and considerations derived of our main requirements as regular users of financial statements.

This document presents the valuation and main concerns of the III WG to the DP.

1. General need of this project

The III WG welcomes the efforts done by the drafters of the DP: this DP improves the present situation since external users currently face difficulties when they analyze financial statements. These statements are indeed very heterogeneous and a work of comparability between firms submitted to IFRS rules is very complicate. The harmonization objective of the DP has to be congratulated.

Nevertheless, a detailed examination of the Discussion Paper (DP) leads the III WG to express some reserves. The model proposed is mainly dedicated to match the needs of capital providers and of investors. It doesn't take into enough consideration other needs of external users such as statisticians.

¹ Annex 2 makes a brief presentation of the European Committee of Central Balance-Sheet Data Offices (ECCBSO). Please note that these opinions do not necessary reflect the viewpoint of the central banks/ institutions to which the members of the III WG belong.

The III WG doubts whether the changes proposed in the Discussion Paper are necessary at all. According to our understanding this project was started in order to tackle two major problems. Firstly, to solve the prevailing debate whether other comprehensive income (OCI) should be included in a “net profit” figure, and secondly, to counter the problem that information in IFRS financial statements is in practice highly aggregated as described in S1 of the Discussion Paper. However, both issues are not addressed properly in the proposals of the IASB. The separation of net profit and OCI is still maintained, the integration of OCI is now only realized mandatory in one single statement. Regarding the second issue, the Discussion Paper only proposes a rough classification guideline where aggregation on a high level will still be possible.

In contrast to solving these issues, the Discussion Paper suggests a rough classification being totally different to current practice. We see no need for this new classification. Moreover, it introduces problematic objectives underlying the presentation model combined with a questionable management approach. We reject these proposals completely as explained in our detailed answers in Annex 1 to questions 1, 2, 5, 9, 10, 13, 14 and 16 raised in the Discussion Paper. We also provide comments to the questions 6, 19, 23 and 26.

2. The proposed model of financial statements presentation is threatening the integrity of relevant information needed to statistic compilation

In general we consider the effort valuable in defining a common format for financial statements.

However, the presentation selected by the boards in the DP supposes a change with respect to the current situation, presenting the statements according to business and financing activities, affecting the comparability of the information across entities.

The proposed format in the DP means a presentation model that classifies assets, liabilities, income, expenses and flows first in categories and within each category in sections, also recommending to detail, if relevant, sections in concepts (type of assets or liabilities and in the case of comprehensive income concepts are defined first by function and then by nature). In contrast, the current statement of financial position and statement of comprehensive income by nature (the most used by companies) is primary defined by concept. Statisticians, as other users of financial statements, need the information in such a concept level.

The priority of the model proposed by IASB is the forecast of cash flows generation; the whole information model is biased to that aim. An example of this priority is in paragraph 3.42, where the DP establishes that “an entity should disaggregate by function income and expenses items within the operating, investing, financing assets and financing liabilities categories in the statement of comprehensive income to the extent that this will enhance the usefulness of the information in predicting the entity’s future cash flows”. In addition in paragraph

3.44 is said exactly the same about disaggregating items by nature that could be detailed within those functions only to the extent that they are useful for cash flows predictions. Therefore the proposal favors the information only necessary for investors.

This approach of presentation of financial statements defined in the Discussion Paper, pushing concepts by nature in a third or fourth level of detail, is threatening or even prevents the compilation of the current available information needed by statisticians and other external users. Statistics are based on availability of homogeneous data among companies and countries on a concepts approach (information by kind of assets and by nature of income/expenses). The structure of financial statements in the DP does not warrant that concepts are fully detailed (i.e. wages and salaries normally would be included in different line items in the statement of comprehensive incomes depending on its function. Insignificant amounts in a specific line will not be detailed what means that it will not be possible to find the total amount of employee expenses of the company in the face of the financial statements). It could be also possible the absolute lack of information in the statements of those concepts non significant within the line items where they should be included. In the event of a disclosure in notes of such amounts, the compilation of information becomes an arduous task.

Other example to illustrate the difficulties in compiling information is the treatment of the foreign currency transaction which gains and losses would have to be disaggregated and included in the same category and section as the assets and liabilities that generate that gains or losses. Information about foreign currency could be missed on account of this disaggregation.

3. Problems of comparability based on subjective classification through the management approach

The classification in sections and categories is not precise enough and it derives in a subjective classification (management approach) depending on the entity's consideration of assets and liabilities as part of its operating, investing or financing activities.

- Comparability between companies at a concept level is not guaranteed due to the different consideration every entity gives to its assets or liabilities (the same concept can be used in a different manner).
- Temporal comparability is neither assured: the presentation of one item in the statements of different years could change if the entity's consideration of that item as operating, investing or financing change between years.
- Internal comparability: depending also of the management consideration the same concepts (i.e. shares in subsidiaries, buildings, etc) could be assigned to different line items due to the different use given as operation, investment or finance. Also due to the segmentation of the financial information the same concept could be in various sections and categories depending of the possible different consideration in every segment of activity.

4. 'Cherry picking' behavior

In the opinion of the III WG the proposal increases the 'cherry picking' behavior. The management approach can influence on presenting the information in a manner that is advisable for the entity.

5. Difficulty in bookkeeping

The III WG considers that the proposed model increases the degree of difficulty of bookkeeping and its subsequent process of preparation of annual accounts, turning the automation of that process into an arduous task for companies, that only could be solved with important changes in the way accounts are currently done, being necessary an even closer link between managers and accountants. Also the accounting software could need major revisions raising doubts regarding cost/benefit considerations. Therefore, considering this possible drawback, it should be advisable to pay attention to the opinion of bookkeeper and software providers.

Altogether, the III WG finally considers that the general approach of financial statement presentation oriented to users as capital providers could be improved taking into consideration other current and potential users. The results obtained by concentrating on capital providers leads to a biased approach in the DP, on which the III WG transmits to the IASB our total disagreement.

Annex 1 to this comment letter provides the detailed answers to some of the discussion questions stated by IASB.

Yours faithfully,

A handwritten signature in black ink, appearing to read "Manuel Ortega", is written over a horizontal line. The signature is stylized and cursive.

Manuel Ortega
Chairman of the III WG on IFRS impact and CBSO databases
Head of CBSO at Banco de España

ANNEX 1 – Answers to questions included in invitation to comment

On the objectives of financial presentation (question 1)

Cohesiveness objective

III WG does not support this objective. Although the terminology sounds promising, this objective would lead to distortions in the different statements contradicting the purpose of these statements. For pension obligations e.g., their classification into the business or into the financing section is already debatable. The treatment of changes of pension obligations within the income statement leads to further problems. Changes coming from current services costs could be clearly classified as operating while the interest costs on defined benefit obligations need to be considered as financing. This small example of an important element from the balance sheet already demonstrates that the cohesiveness principle leads to inaccurate results.

Disaggregation objective

III WG disagrees with the disaggregation objective as formulated in 2.7. The disaggregation of information in a manner that makes it useful in assessing the amount, timing and uncertainty of future cash flows is not of primary importance. Therefore, information should be first disaggregated **by its nature**, and only subsequently and only if necessary by further characteristics e.g. by the way it is measured.

Furthermore, III WG shares the concern that the current practice summarizes items that are different in nature. This is one of the biggest problems within the current IFRS/IAS rules. However, the presentation proposed in the Discussion Paper does not really help since it only suggests a rough classification guideline as can be seen in the table of 2.22. As already pronounced in earlier comment letters, III WG asks the board to introduce a general presentation format which could be adjusted in exceptional cases if that would provide better information.

Liquidity and financial flexibility objective

According to our understanding this objective is already fulfilled by the current presentation format with the exception that further disaggregation would provide significant improvements in analyzing the liquidity and financial flexibility of an entity.

On the new presentation model (question 2, 9, 10 and 14)

On the proposed separation between business and financing activities (question 2 and 10)

III WG does not support the proposed separation between business and financing as many items can be seen as serving both purposes. Accounts payable e.g. are a way of financing an entity's operations but at the same time essential for running

the operation of an entity. The same characteristics are true for cash. Thus, for some assets and in particular many liabilities a proper definition separating business and financing activities would not be possible. Therefore, III WG principally puts the need for this separation into question. The proposed separation would in most cases only be determined with a management bias whereas its benefits are questionable. On the other side, III WG thinks that the current form of the balance sheet (distinguishing assets against equity and liabilities) does provide the information needed.

Moreover, as mentioned before, useful information could be lost with the proposed financial statement presentation model. The separation of business activities from financing liabilities is not precise enough and it depends on the entity's consideration of assets and liabilities. Therefore, it would provide a subjective manner of presenting financial statements. For statistic tasks the comparability across entities would not be guaranteed due to the lack of homogeneity between entities and the temporal and internal homogeneity, as expressed before.

On the term "investing" assets and liabilities (question 9)

The term "investing" for the second category in the business section is misleading. From 2.33 this category is defined as assets and liabilities within the business section but outside of operating, being unrelated to the central purpose for which the entity is in business. Thus it is in no way comparable to the common understanding of "investing" or "investments". III WG strongly suggests that the term "investing" should be dropped and the category should be named as "remaining" or "other".

On a single statement of comprehensive income (question 14)

III WG would like to express a disappointment that no definition of what is net income and what is other comprehensive income is discussed in the proposal of the IASB or whether the current split still needs to be maintained. That should have been the main focus of the project; III WG would have at least expected a discussion by the Board of the pros and cons of different definitions. III WG thinks that the question whether net income and other comprehensive income should be presented in one single statement is only a minor problem of the overall issue.

On the proposed cash flow statement

III WG does not agree that cash flows from operations and cash flows from investing activities (based on the current definition in IAS 7) will be merged together in the proposed cash flow statement. About the inappropriateness of the term "investing" as used in the Discussion Paper see our remark to question 9.

On the management approach (question 5)

The III WG rejects completely that classification should be based on a *management approach*. It leads to the *incomparability of financial statements*.

For example, the DP establishes an entity should further disaggregate its income and expense items by their nature within those functions to the extent that this will enhance the usefulness of the information in predicting the entity's future cash flows. Therefore the proposal favors the information only necessary for investors, disregarding value given by a concept approach (information by kind of assets and by nature of income/cost) since it is only required if it improves the cash flows prediction.

This approach biases the information and do not permit the achievement of complete information necessary for other external users, as statisticians.

Whether the new format makes it easier to calculate ratios (question 6)

III WG doubts that the new presentation of the core financial statements makes it easier to calculate certain key ratios. There are many ratios currently used to analyze financial statements (which often have several adaptations in the way of calculation). In addition, there is also a constant evolution in the definition of new ratios. Consequently, there will always be the need to adjust the figures presented in financial statements in order to come to the intended calculation.

Moreover, as institutions that analyze financial statements, III WG does not perceive that the current structure of financial statements creates big problems in calculating ratios. The problem is rather that companies show their financial statements in an aggregated form. But this problem would not be solved through the proposed presentation layout as the Discussion Paper only suggests a new rough classification guideline. Precisely, the new statement presentation will favor complexity and heterogeneity in the preparation of financial ratios and indicators, making more difficult their interpretation by financial analysts.

Presenting assets and liabilities depending on the way they are measured (question 13)

Assets and liabilities should be first disaggregated by its nature. If assets and liabilities are of the same nature and are measured differently, the measurement base could be used for further disaggregation. See in addition the answer to the *disaggregation principle* of question 1.

Disaggregating information by function and by nature in the income statement (question 16)

In 3.42 and 3.44 of the Discussion Paper it is proposed to disaggregate income and expense items firstly by function, and to disaggregate subsequently by their nature within those functions to the extent that the usefulness of the information is enhanced. III WG rejects this proposal for several reasons:

- The proposal introduces further discretion to the management to present important items like employee benefits expense.
- Furthermore, the total figures of items by nature are needed and not only a part of it.
- Finally, the proposal would lead to a quite complex income statement with subsequent problems in the analysis.

Although III WG is not in favor of options, it thinks that an entity should be further allowed to use both alternatives of the income statement as both presentation models have a long and accepted tradition. Apart from this III WG perceive a presentation by nature being more useful than the one by function.

On the direct method of presenting cash flows (question 19)

The direct method of presenting cash flows would provide in general a better understanding of the origins of cash. However, the direct method is not really helpful if it only contains a limited number of items like cash receipts and payments (maybe together with interest and taxes paid), as can be seen from some examples of the direct method used in Europe. In addition, if there are high costs incurred by an entity to present cash flows using the direct method (e.g. in the case that a group has many subsidiaries to consolidate), cost-benefit considerations might not justify the requirement of the direct method.

The insertion leasing contracts at the date of acquisition would be a strong improvement strengthening consistency of the financial statements.

On the reconciliation schedule (question 23)

Although this schedule seems to present interesting information, III WG doubts that it will stand a thorough cost-benefit consideration.

On unusual and infrequent events (question 26)

(a) III WG supports the reasoning that unusual and infrequent events should be presented separately (at least in a memo item, but indicating to which elements in the income and cash flow statement it mainly refers). III WG considers this information as decision-useful.

(b) The definitions of *unusual* and *infrequent* should be elaborated by the board.

(c) The introduction of an option to present the information only in narrative format is not sufficient.

ANNEX 2 – PRESENTATION OF THE EUROPEAN COMMITTEE OF CENTRAL BALANCE SHEET DATA OFFICES (ECCBSO)

The European Committee of Central Balance Sheet Data Offices was set up in November 1987 on the initiative of several European central banks and the European Commission. Its aim is to contribute to improving the analysis of information on non-financial corporations, to exchange information and to undertake joint work. The members of the committee are the central balance sheet data offices of the central banks of Germany, Austria, Belgium, France, Greece, Ireland, Italy (the Centrale dei Bilanci is a company majority owned by the Banca d'Italia), Poland, Portugal, United Kingdom, Romania, Sweden and Spain, and similar units from the statistics offices of Finland, Denmark, Luxemburg, Netherlands and Sweden. All this central balance sheet data offices belongs to different departments (statistics, operation, research, others) in the central bank, what affects the general aim of the Committee, broadening its targets. As regards Ireland and the United Kingdom, these countries' participation is merely as listeners, since in practice they do not have a central balance sheet office. The European Commission also participates through its Directorates General for Economic and Financial Affairs and for Internal Market and Financial Services. The European Central Bank also participates in the ECCBSO meetings as well as in some of its Working Groups, been an active member of some of them. The chairmanship is on a rotating basis and is for a term of three years. The Bank of Belgium will hold the chair until November 2010.

Committee working groups

First Working Group (risk assessment). In 1999 this group worked in coordination with the related services of the European Central Bank to define a working guide for the homogenisation of the risk analysis tasks carried out by central banks in respect of the corporations whose liabilities are taken as collateral in monetary policy operations; it is continuing this task monitoring the improvements on the system of analysis on use in each central bank for this purpose. The aim of the group when it was set up in 1987 was to draw up a White Paper on corporate analysis in Europe. It drafted reports on the analysis of stocks and flows conducted in the various central balance sheet data offices.

Second Working Group (BACH). The group is entrusted with maintaining the BACH database of the European Commission and with improving comparability among the countries that report to this database. The database also includes data from Japan and the United States. The information in the database uses the basic structure defined in the IV Directive for the balance sheet and profit and loss account, in cascade format. It has encountered problems relating to the lack of consistency between the different databases and national charts of accounts that are its basis. The working group has extensive experience (it began working in 1987) in problems arising from the lack of comparability between the various sources and it has minimised these shortcomings. The group is responsible for the

upkeep of the BACH user guide, which highlights the causes for the lack of comparability between national data sources in the greatest detail.

Third working group (IFRS impact and CBSO databases). This group explores and monitors the effects of the EU's new financial reporting strategy [to adopt international accounting standards or international financial reporting standards (IAS/IFRS)] on the European central balance sheet data offices' databases and questionnaires. In addition, the group has studied the similarities and differences between the questionnaires that are the basis for the information available at each central balance sheet office. In all cases the source of the data is a standardised form, whether that which is compiled in the country for the filing of annual accounts (the case of Belgium and of Spain through one of its databases), whether the forms used to file corporate income tax (the case of France, through one of its databases) or whether specific standard forms (e.g. Germany, Austria, Spain, France, Italy and Portugal). The working group has developed a common standard format, compliance with the IFRS, using for that purpose the XBRL-IASB based taxonomy, finally creating some real cases of European Consolidated accounts and integrating all them in a common dataset, called ERICA.

Study Group. The group analyses financing conditions in Europe for non-financial corporations of the countries participating in the group (Austria, Belgium, France, Germany, Italy and Spain).

Group on European sectoral references. The group has developed a database of statistical ratio distributions for several European countries (Austria, Belgium, France, Germany, Italy, Netherland, Portugal and Spain), which is available to the financial institutions of the European Union and to the respective general government sectors.

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