



The Corporate Reporting Users' Forum



LETTER OF COMMENT NO. 110B

Ms Denise Gomez,
Project Manager,
International Accounting Standards Board,
30 Cannon St, London. EC4M 6XH

Cc Mr Kim Petrona, Senior Project Manager, Financial Standards Board

Dear Sirs/Madam,

Financial Statement Presentation Discussion Paper
ACRUF Response and Comment

Over many years now the presentation of company financial performance via the statutory accounts presentation, has become progressively more complex. The view of many of our constituents is that financial performance analysis has become increasingly difficult given the ever more opaque nature of financial performance presentation. In that context we welcome the Board's focus on this critical issue for corporate reporting users and the Board's desire to improve both the quality, logic and comparability of accounting disclosures.

We have reviewed fully the Board's Financial Statement Presentation (FSP) discussion paper, and while there are many proposals that we believe have merit, we find that in our view there remains a number of key issues that are either not addressed or indeed add rather than reduce the complexity of the presentation of company financial performance.

The discussion paper suggests radical change in the way in which financial statements are presented. The ACRUF is not convinced that such wholesale change in the presentation of financial data is necessarily warranted. While the proposals do offer the prospect of more information we are not able to conclude that the format in the FSP discussion paper does not indeed create further complexity. Furthermore, ACRUF believes that a number of fundamental issues that have increased complexity in FSP, and that have been raised with the Board by various constituents, are not in fact addressed in this discussion paper.

The radical nature of the proposals in our view is likely to be strongly resisted by preparers. We are therefore concerned that the final outcome of this proposal would be a compromised set of standards; compromised in that in order to gain the necessary support much of that proposed would be negotiated away.

We have set out in the following, the concerns that ACRUF has with the general underlying principles embodied by the discussion paper, as well as citing issues that we have with some of the specific proposals set out in the discussion paper.

We the ACRUF would also like to emphasise that while we have made a independent submission to the Board's, we support and concur with vast majority of the issues and comments that our International CRUF colleagues will raise in their submission with the exception of their concerns and comments regarding the presentation of cashflow via the direct method. While not attached to our submission the ACRUF also supports the comprehensive and detailed comments presented in the Appendices attached to the International CRUF submission.



We echo the sentiments expressed by our International CRUF colleagues. We support the Boards in their efforts to bring about improvements in financial statement presentation. We too however would urge the Boards to look to a more pragmatic and targeted approach to this issue, one that delivers perhaps more limited but certainly more targeted and tangible results, within a reasonably short timeframe.

Issues with the General Principles of the Financial Statement presentation

In our view users of financial statement analysis look to the Profit & Loss statement to present the measure of the residual of operating income in excess of operating costs in the period i.e. the net profit/net income. This "excess" can then ultimately be looked to by users to assess the level of returns generated on the company's economic resources that are currently employed.

As the Board itself acknowledged in its exposure draft of "An improved Conceptual Framework for Financial Reporting" May 2008 –

"Present and potential capital providers are the most prominent users of an entity's financial reports. They have the most critical and immediate need for the information in financial reports. They are interested in assessing an entity's ability to generate future net cashflows, which significantly affects the entity's ability to distribute cash to them in the form of dividends or other types of distributions to owner, or interest and repayment of borrowers."

Over the last decade however, the clarity of the financial reporting as presented in the P&L statement has diminished. The critical role of P&L statement as a means of communicating the operational performance instead has been blurred/muddied with progressively more balance sheet adjustments. The P&L no longer clearly differentiates between the financial effects operating decisions and of changes in balance sheet values. Even more particularly these changes in balance sheet values are not differentiated between fair value adjustments which could just as easily be unwound in the following period, and those changes which do relate to the operational performance of the business.

The FSP discussion paper in effect seems to acknowledge this critical issue for users via the suggestion of a categorisation of "operating", "investing" and "financing". While the ACRUF would applaud this recognition we remain concerned that the approach offered in the FSP discussion paper may indeed complicate, rather than simplify the key issue of being able to assess "operating performance". We are therefore not convinced that this proposal will assist users with this issue

Comprehensive Income is not a satisfactory substitute for Net Profit/Net Income

Users are vitally interested in the concept of operating performance of the business and we would still want to see net profit/net income promoted as the key "bottom line" operating performance "Comprehensive Income" is not as set out in the FSP discussion paper as a substitute and it is not in our view useful to users in their quest to measure the operational performance of a company.



We concur with our International CRUF colleagues that the FSP discussion paper continues to promote the merits of "Comprehensive Income" over Net Profit /Net Income. We would also reiterate the comments presented by the International CRUF, that users in this jurisdiction also struggle with -

1. The P&L does not encourage a clear differentiation between core operating activities and those which are not central to the main operating activities of the enterprise.
2. The term "other" in both the P&L and the cashflow can be used to cover a multitude of sins.
3. Mergers and acquisitions have a significant impact on the financial statements of companies and make analysing the subsequent operating performance of the business extremely difficult (particularly when such events occur frequently).
4. The way in which businesses hedge their exposure to economic risks such as interest rates and forex is very difficult to assess using published accounts and it is under the mark to market approach difficult to separate the effect these hedges will ultimately have on future operating performance of the business as opposed to those that will not.
5. Understanding the link between tax payments presented in cashflow statement (in our jurisdiction seen via a direct method cashflow statement) and the tax expense presented in the P&L is often impossible.

The FSP discussion paper misses a number of opportunities

The FSP discussion paper does appear to assist with some aspects of several of these problems (particularly by the proposed use of reconciliations). It also does acknowledge user demand for more information about items with very different economic characteristics to facilitate better forecasting.

It does nothing however to tackle the M&A impacts on financial account presentation, how businesses show the effects of hedging, or tax. We acknowledge that all these issues are difficult but unless we have a go at grappling with them they will never be resolved (or at least clearly understood as beyond the capacity of the current framework and therefore off the agenda). The DP provided an ideal opportunity to do just that.

The balance sheet focus is misguided

The FSP discussion paper proposes quite a radical change to the presentation of the balance sheet. While this proposal would better align the classification of the balance sheet with the P&L by grouping items around their financial purpose, the current balance sheet reporting structure is not something that is seen by most users as a key issue. So again like the International CRUF, we see the FSP discussion paper's suggestion regarding the balance sheet format as interesting and while this may offer some improvement, it seems that this change would not necessarily be seen by users as addressing a pressing balance sheet issue.



Users would indeed suggest that financial statement presentation should be more driven by the focus of users on the “performance” of the business via either the P&L or cashflow. We acknowledge the importance of the “stock” measures presented through balance sheet.

The view of Australian users however is that the “flow” statements are the key means both to describing these activities and measuring their financial performance, with the changes in the value presented through the balance sheet a reflection of these operating performances. Not in fact the other way around.

The emphasis that Australian financial analysts place on the cashflow statement indeed suggests that company’s management and their auditors would provide significantly enhanced value to users if more effort was spent on verifying, reconciling and providing supporting notes to cash flow statements. The values presented in the cashflow statement are viewed as less subjective as opposed to trying to revalue assets and liabilities the values of which are perceived by users as more subjective and likely to see significant change in the following reporting period.

It would seem that the FSP discussion paper continues to reflect the emphasis of the IASB on balance sheet and balance sheet values, versus the emphasis of users generally (as represented by all CRUF groups) on P&L and cashflow statements. We would encourage the IASB to take stock of these differences in focus.

The Cashflow statement direct method proposal

The proposal of the FSP discussion paper proposes requiring a direct cashflow format is not unsurprisingly, strongly supported by the ACRUF. As one of the only jurisdictions where the direct method has been the standard, (although the indirect method was recently made available as an option under AASB), ACUF strongly supports the direct method cashflow presentation.

Indeed as the P&L statement has seen the inclusion of balance sheet adjustments, users in Australia have turned to the direct method presentation of cashflows as a means of reconciling the P&L with balance sheet in particular being able to isolate the effects of mark to market.

We acknowledge that the Australian direct cashflow statement presentation simply calculate the direct operating cashflows indirectly and then simply present them as a direct cashflow is our view a “moot” point. This is still information that is presented by the entity and is provided under an audited process and therefore is valuable and an independent source of flow information to users beyond the P&L.

We have no information on the relative costs associated with the preparation of the *direct vs. indirect cashflow statements*. It does not however appear that there is any evidence to suggest that Australian companies have faced in the past or at present, a cost in absolute or relative terms that is either prohibitive or uncompetitive. Furthermore, there are many internationally based companies that appear to have been able to provide the direct method cashflow statements for their Australian subsidiaries without any major issues or additional relative costs.



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Concluding remarks

We applaud the Boards for their preparedness to look beyond the existing financial statement presentation convention in the search of better serving the needs of both preparers and users. The FSP discussion paper suggests that the Boards do not understand the view of users that financial statements in their current form are not meeting many of their financial informational needs. The ACRUF concurs and applauds the Board's desire to improve performance reporting as one of the key forms of communications between managements and the users.

We believe however, that the emphasis that the FSP discussion paper appears to place upon the balance sheet and the reporting of changes in balance sheet values through the P&L statement is a key philosophical difference with the users the ACRUF represents. We are also concerned that the radical proposals made in the FSP discussion paper indeed go beyond the willingness of preparers and the needs of users. The ACRUF would be supportive of changes where there is already substantive agreement among users and preparers about the shortcomings in current financial statement presentation convention.

ACRUF is strongly supportive of both Boards in their desire to improve financial statement presentation. Like our International CRUF colleagues however, ACRUF believes that a more pragmatic and targeted approach will more quickly deliver users with tangible results and therefore we would support the Boards in their refocused attempt to deliver this.

Kind Regards,

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