

LETTER OF COMMENT NO. \ \ \ \ \ D

Memo



FirstRand Banking Group

Group Finance: Technical Accounting

To: International Accounting Standards Board

From: Technical Accounting

Date: April 2009

DISCUSSION PAPER ON PRELIMINARY VIEWS ON FINANCIAL STATEMENT PRESENTATION

We would like to thank the IASB and FASB for the opportunity to comment on their joint discussion paper on *Preliminary Views on Financial Statement Presentation*. FirstRand Bank also participated in discussions regarding the proposed amendments facilitated by The South African Institute of Chartered Accountants ("SAICA") and provided comments that were incorporated in their comment letter.

We support the comments as contained in the comment letter submitted by SAICA.

The purpose of our comment letter is to provide you with our general comments on the discussion paper and other matters that we strongly believe that the Boards' should reconsider in detail before incorporating the proposed amendments in an exposure draft or final standard.

1 General comments

We agree with the objectives of financial statement presentation as set out in the discussion paper, but do have concerns regarding the practical implementation of these objectives and certain other proposals in the discussion paper.

While we support the objectives of financial statement presentation we are concerned that the information required to incorporate these objectives will not be readily available and will require entities to implement new systems or upgrade current systems at great cost. We do not believe that these costs will be justified by a significant increase in the decision-usefulness of information presented in the financial statements.

Please refer to our response to Question 1 for the details of our concerns regarding the practical implementation of these objectives.

Furthermore, we are not convinced by the arguments presented in the discussion paper that the direct method of presenting operating cash flows will result in information that is more decision-useful than information provided by applying the indirect method, especially for a banking entity.

2 Responses to the specific questions

As mentioned in our introduction, we have only provided responses to the questions dealing with matters that we believe the Board should reconsider in detail. Please refer below for our responses to Questions 1, 5, 17 and 19 dealing with these specific matters.

Question 1

Would the objectives of financial statement presentation described in paragraphs 2.5–2.13 improve the usefulness of the information provided in an entity's financial statements and help users make better decisions in their capacity as capital providers? Why or why not? Should the boards consider any other objectives of financial statement presentation in addition to or instead of the objectives proposed in this discussion paper? If so, please describe and explain.

The principle of cohesiveness should be applied in the presentation of financial statements and will provide users with a better understanding of the impact of certain transactions/ management decisions on the financial statements as a whole.

The principle should be applied in such a manner that the relationship between items across the financial statements is clear. We are concerned about the implications of the guidance provided in this regard in paragraph 2.15 and do not believe that cohesiveness can only be achieved by aligning the line items, their descriptions and the order in which information is presented on each component of the financial statements. Although the discussion paper acknowledges that alignment of every line in each statement might not be feasible, it emphasises that the financial statements should be prepared to comply with the spirit of that goal. This emphasis can also be seen in the Boards' proposals regarding the presentation of operating cash flows. Please refer to our response to Question 19 for further comments regarding the presentation of the cash flow statement.

We would like to draw the Boards' attention to the fact that we believe that the disaggregation objective could lead to decreased comparability and consistency of financial statements, both between different entities and on a year-on-year basis within a specific entity.

The discussion paper states that assets and liabilities should be disaggregated in the financial statements into the operating, investing and financing categories based on management's approach (i.e. the way the assets and liabilities are used within the entity). Management's intention with or use of a specific asset or liability could change from one year to the next, and probably would change in response to changing economic and operational circumstances, leading to reclassifications between the various categories and resulting in decreased comparability in an entity's financial statements from one year to the next.

It would also not be practical for an entity to restate their annual financial statements and interim financial statements at each reporting period as management's intention changes. It is not clear whether the current requirement in IAS 1 regarding 3 periods in the statement of financial position where is reclassification is made, will remain. If it does, it would be especially impractical as there would in most instances be a reclassification every year.

We are also concerned that the disaggregation objective could lead to decreased comparability between entities if the level of disaggregation is not consistent. By not specifically defining the operating, investing and financing activities it could lead to inconsistent application by various entities within the same industry, leading to further decreases in comparability. Currently there is diversity in practice when applying the definitions of the operating, investing and financing activities as set out in IAS 7 Cash Flow Statements and we are concerned that this diversity will increase upon the adoption of the proposals in the discussion paper. Although we fully support the Boards' approach to implement standards that are principle based, rather than rules driven, we believe that in certain instances the board needs to provide more definitive guidance to achieve their objective of providing the users of financial statements with decision useful information.

The Boards should be cautious about the level of disaggregation required and should consider whether a balance could be achieved between providing the users of financial statements with sufficient information and overloading them. By requiring significant disaggregation on the face of the each financial statement, they could become too long and complex, making it more difficult for the users to understand what the basic result and position is. In our minds each component of the financial statements should provide users with a summary of the income and expenses, assets and liabilities. The notes to the financial statements should provide the users with the detailed information.

In addition, we are of the opinion that the level of disaggregation required in the reconciliation of cash flows to comprehensive income is to extensive. Obtaining the information required to complete this reconciliation would require significant input (time and costs) from the preparers of financial statements. The Boards should consider whether the cost of obtaining this information would justify the additional benefits/increased decision-usefulness of the information to users of financial statements.

Question 5

The proposed presentation model relies on a management approach to classification of assets and liabilities and the related changes in those items in the sections and categories in order to reflect the way an item is used within the entity or its reportable segment (see paragraphs 2.27, 2.34 and 2.39–2.41).

- (a) Would a management approach provide the most useful view of an entity to users of its financial statements?
- (b) Would the potential for reduced comparability of financial statements resulting from a management approach to classification outweigh the benefits of that approach? Why or why not?

The IASB is increasingly requiring the preparers of financial statements to classify transactions based on management's approach/view. As alluded to in our response to Question 1, we believe that the management approach could potentially impact the comparability of financial statements between different entities and on a year-on-year basis within a specific entity.

We also note that some of the recent amendments and proposed amendments to IFRS 7 *Financial Instruments: Disclosures* require the disclosure of the amortised cost and fair value of the different classes of financial instruments. The reasons given for the amendments is that users commented on the difficulty of comparing the treatment of financial instruments between different entities. These comments indicate that users of financial statements want information that is comparable between entities. It also indicates that current direction of the IFRS 7 amendments is different from the direction of this discussion paper.

In addition, it seems as if the Boards' response to this is additional disclosure to effectively provide information for all scenarios i.e. for IFRS 7 an entity would have to disclose fair value and amortised cost. This creates a significant amount of additional work for the preparers of financial statements. In addition this approach of requiring entities to disclose additional information, regardless of their classification election, undermines the principle of providing entities with a choice regarding the classification of financial instruments into the categories as set out in IAS 39 Financial Instruments: Recognition and Measurement and the classification of other assets and liabilities based on the management approach.

We would like to caution the IASB that if they continue to focus on the management approach for the preparation and presentation of financial statements, they should be aware of the fact that they are compromising the qualitative characteristic of comparability. The Boards' should consider achieving a balance between presenting information because it is relevant to the users of financial statements and potentially decreasing the comparability.

In the currently effective Framework for the Preparation and Presentation of Financial Statements ("the Framework") relevance and comparability are both qualitative characteristics of financial statements. We note that the exposure draft of An improved Conceptual Framework for Financial Reporting the Boards' are proposing to split the qualitative characteristics of financial statements into fundamental qualitative characteristics and enhancing characteristics. The exposure draft proposes that relevance is a fundamental characteristic, while comparability will only be an enhancing characteristic. We believe that this represents a change in the fundamental principles underlying to financial statement presentation.

The Boards' should be aware that changing comparability to an enhancing characteristic and the increased use of the management approach could impact the comparability of financial statements of different entities. Taking into account that the Boards' are aware of the potential impact of the management approach on the presentation of financial statements, it would not be appropriate to subsequently issue amendments to various Standards requiring additional disclosure in order to ensure that information presented is comparable.

Question 17

Paragraph 3.55 proposes that an entity should allocate and present income taxes within the statement of comprehensive income in accordance with existing requirements (see paragraphs 3.56–3.62). To which sections and categories, if any, should an entity allocate income taxes in order to provide information that is decision-useful to users? Please explain.

We agree with the proposals that the existing treatment regarding the allocation and presentation of income taxes should be retained (i.e. relating to items recognised directly in equity, relating to items recognised in other comprehensive income, discontinued operations and the remaining balance to profit or loss).

If income taxes were to be allocated to the other sections and categories (operating, investing and financing), we believe that in practice it would result in entities apportioning the amount to the various categories. This would not present decision useful information.

As a matter related to the above mentioned, we would like to request the Boards' to provide guidance on whether the amount of tax presented in the statement of comprehensive income, should include all the various taxes (direct and indirect tax) incurred by an entity. There is currently no clear guidance in IFRSs regarding the presentation of indirect tax and as a result we believe that there is currently diversity in practice.

Indirect taxes include value added tax, sales tax, goods and services tax and stamp duties levied in addition to the normal income tax in IAS 12. Although these taxes do not meet the definition of income tax (which is calculated based on taxable profits), we do not believe it is correct to include these indirect taxes above the operating profit line in the statement of comprehensive income. By including these indirect taxes above the operating profit line, it gives the users of financial statements the impression that these indirect taxes are controllable by management as other operating expenses, which it is not.

Certain entities include these indirect taxes above the operating profit line, while other entities present these separately on the face of the statement of comprehensive income. This diversity in practice results in deceased comparability between the financial statements of different entities.

Question 19

Paragraph 3.75 proposes that an entity should use a direct method of presenting cash flows in the statement of cash flows.

- a) Would a direct method of presenting operating cash flows provide information that is decision-useful?
- b) Is a direct method more consistent with the proposed cohesiveness and disaggregation objectives (see paragraphs 3.75–3.80) than an indirect method? Why or why not?
- c) Would the information currently provided using an indirect method to present operating cash flows be provided in the proposed reconciliation schedule (see paragraphs 4.19 and 4.45)? Why or why not?

We do not support the Boards' proposal to prepare the cash flow statement using the direct method of presentation. As mentioned in the discussion paper, a significant number of entities currently use the indirect method to present their operating cash flows. The reason for this is that the information required for the direct presentation method is not readily available. When considering if information is decision-useful, the Framework states that a balance should be achieved between the additional benefits of the information and the costs to obtain the

information. We do not believe that the increase in the decision-usefulness of the information will justify the significant costs that will be required to present operating cash flows on the direct method.

Although we concede that the direct method might provide decision-useful information to the users of financial statements in certain industries, we do not believe that it would increase the decision-usefulnes of financial information in the banking industry. Our opinion is that the move to require the prepares of financial statements to present their cash flows using the direct method can only be justified where there is a clear need for the direct method of presentation as communicated by a large group of users. Our understanding is that currently the majority of users and preparers of financial statements prefer the indirect method for the presentation of operating cash flows.

The direct method is consistent with the overall goal of the cohesiveness and disaggregation objectives. We believe that the boards' decision to require that the cash flow statement be presented using the direct method is as a result of them trying to implement the principles of cohesiveness and disaggregation by aligning the line items, their descriptions and the order in which information is presented. As mentioned earlier, we do not believe that this is the best approach to achieving cohesiveness.