

BELGIAN ACCOUNTING STANDARDS BOARD



LETTER OF COMMENT NO. 221

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Our reference
C-068

Your reference

Date
20th may 2009

Dear Sir, Madam,

The Belgian Accounting Standards Board (BASB) would like to comment on the IASB/FASB Phase B Financial Statement Presentation Project. We notice that those *Preliminary Views on Financial Statement Presentation* could result in important changes with the currently used format for financial statements.

General comment

In Europe, the application of IFRS for consolidated financial accounts of traded companies is mandatory since the financial year starting on or after 1 January 2005. Since users have just digested the existing standards relating to what they require in terms of financial statement presentation, we are of the opinion that it is too soon to change the financial statement presentation in such a radically way. We also expect that the costs of compliance with the proposed requirements will exceed the benefits. This will also be the case especially for financial institutions and insurance companies.

Questions concerning objectives and principles of financial statement presentation

The cohesiveness and disaggregation objectives

We broadly support the proposed objectives as cohesiveness and disaggregation as long as it results in information that is useful and relevant for the users of the financial statements.

Although the cohesiveness principle is a good objective and will indeed enhance the coherence between the statement of the financial position, the statement of comprehensive income and the statement of cash flows, the BASB believes it is valuable as long as it provides additional useful, meaningful information.

As regards the disaggregation objective, we underline the fact that the notes already include a lot of useful information that need not necessarily to be presented on the face of the primary financial statements. Detailed information should, in our view, be given in many cases in the notes, not in separate lines in the primary financial statements. The fundamental qualitative characteristic of financial reporting is the relevance of the information given to the users. This relevance principle is at risk when applying the disaggregation objective to financial statements. Because the disaggregation objective will lead to excessive detail, the financial statements will become more difficult to read and too excessive details will distort the understandability and accessibility of the information. Users are used to a top-down approach in reading the information.

The liquidity and financial flexibility objective

The Discussion Paper explains that an entity should present information in its financial statements in a manner that helps users to assess the entity's ability to meet its financial commitments as they become due and to invest in business opportunities. The BASB disagrees with this objective since it results in practice to the deletion of the current/non current classification for assets and liabilities. The classification of the assets and liabilities should reflect how each of those assets and liabilities are used in the business.

Classification into business and financing and the sub-division of business into operating and investing

The BASB agrees that presenting separately business activities from financing activities will provide information that is more decision-useful than the information currently presented in the financial statements. However, we doubt this separation will be easily to make and are of the opinion that more guidance would be welcome. Especially for financial institutions, the distinction between activities that lead to value creation and those that show the way business activities are funded or financed will be difficult to make. As a consequence, we believe that the making of the distinction could become very arbitrary.

Presentation of equity as included in, or as a separate section from, the financing section

We agree that equity should be presented as a section separate from the financing section, since, amongst other agreements, the expected returns from owners are quite different from the expected returns from non-owners. However, this implies that the distinction is clearly made between equity and financial liabilities when it comes to financial instruments with characteristics of equity. In this respect, we believe that as long as equity is not defined positively but by default - if a financial instrument (or part of that instrument) does not meet the definition in IAS 32 of a financial asset or an financial liability, it is classified as an equity instrument – it will be hard to separate items that should be presented within the equity section from items that should be presented within the financing section.

Presentation of discontinued operations in a separate section

We support the proposal to show discontinued operations separately. The presentation of discontinued operations separately from the business and the financing activities provides decision-useful information.

Besides, IFRS 5 already requires presenting discontinued operations separately in the statement of comprehensive income just like disclosing the net cash flows attributable to the operating, investing and financing activities of discontinued operations. Thus the separate presentation proposed in the Discussion Paper would enable to achieve the cohesiveness objective. In this context, we would also recommend to review certain paragraphs of IFRS 5 to make sure no inconsistencies will appear after the revision of IAS 1.

The management approach to the classification of assets and liabilities

First of all, to avoid any confusion, we would suggest to change the terminology “management approach” since it already refers to IFRS 8 on operating segments. Operating segments will show amounts that are reported to the chief operating decision maker for the purposes of allocating resources to the segment and assessing its performance. Thus, segment information can be disclosed based on non-GAAP measures. In our view, primary financial statements should present only IFRS figures.

We do not think that the application of the management approach will reduce the comparability of financial statements since the notes foresee in a precisely description of the basis of classification and that this classification should be consistent from one period to another.

The question whether a company should classify the assets and liabilities at the reportable segment level or at the entity level depends on the nature of the assets and liabilities involved. The classification of assets and liabilities concerning post-employment benefits (pensions) at the reportable segment level does not seem us appropriate.

Definition of the business section and the operating and investing categories

Although we agree with the distinction between the operating and investing categories, the BASB thinks that, if it is the intention to make a distinction between core and non-core business, a more precisely definition is needed, perhaps by using the terminology recurrent/non-recurrent.

Implications of the objectives and principles for each financial statement

A classified statement of financial position

First of all, we disagree with the short-term and long-term subcategories for assets and liabilities. We prefer to maintain the current distinction between current and non-current assets and liabilities, because in our view, the length of the operating cycle is far more relevant than the distinction based on the contractual maturity or the expected date of realization or settlement.

Presentation and classification of cash equivalents

The BASB wants to emphasize that the presentation and classification of equivalents in a manner similar to other short-term investments will mean that the notion of cash equivalents, as it is currently defined in IAS 7, would disappear.

Similar assets and liabilities that are measured on different bases, should be presented on separate lines in the statement of financial position

The current version of IAS 1 already stipulates that the use of different measurement bases for different classes of assets suggests that their nature or function differs and therefore, that an entity should present them as separate line items.

A single statement of comprehensive income

IAS 1 requires an entity to present all items of income and expense recognized in a period either in a single statement of comprehensive income, or in two separate statements: an income statement (displaying profit or loss) and a statement of comprehensive income (displays items of other comprehensive income). The Discussion Paper proposes that the option to present two separate statements should be deleted. Entities should present one single statement of comprehensive income.

We strongly disagree with the deletion of the income statement. The income statement must be presented separately from the statement "other comprehensive income", which includes the movements resulting from non-owner changes in equity.

Indication of the category to which items of other comprehensive income relate

We are of the opinion that information about the indication of the category, to which foreign currency translation adjustments relate, is not decision-useful. For the other comprehensive income items, the indication of the category does not seem us difficult to do, but will, again, in our view, not provide relevant information.

Disaggregation by function and/or by nature

The current version of IAS 1 gives the choice to an entity to present an analysis of expenses recognized in profit or loss using a classification based on their nature or their function within the business processes, whichever provides information that is reliable and more relevant. The Discussion Paper is not neutral as regards disaggregating income and expense items and seems to favour the disaggregation by function, while requiring additional disaggregation by nature.

We also disagree with the required disaggregation in the primary financial statements. Too much disaggregation will result in too many lines in the primary financial statements and reduces the understandability and accessibility of the information. Additional disaggregated information should be disclosed in the notes.

Allocation of income taxes

We disagree with any further allocation of tax expenses/benefits to the business and financing section (or to categories within those sections).

Presentation of foreign currency transaction gains and losses

The Discussion Paper proposes that foreign currency transaction gains and losses, that are included in net income, are presented in the statement of comprehensive income in the same section and category as the assets and liabilities that gave rise to the gains and losses.

If the foreign currency transaction gains and losses arise on the remeasurement of transactions denominated in a foreign currency, we agree that presenting such foreign currency gains and losses in the same section and category as the assets and liabilities that gave rise to the gains and losses, would result in decision-useful information. On the contrary, the presentation of the aggregated amount resulting from all foreign currency transactions in the financial income does not provide much useful information.

In reference to the cohesiveness objective, it seems the BASB relevant, for instance, to present foreign currency transaction gains and losses resulting from the remeasurement of commercial receivables denominated in a foreign currency and classified within the operating section in the statement of financial position, within the operating section of the statement of comprehensive income.

If foreign currency transaction gains and losses arise on the remeasurement of foreign currency financial statements into the entity's functional currency when the functional currency is different from the local currency that is used by the entity, the classification in the appropriate sections or categories in the statement of comprehensive income may be difficult. The allocation would probably be arbitrary and thus would not provide decision-useful information. We would suggest presenting this amount in the operating category of the statement of comprehensive income.

Translation gains and losses resulting from translating an entity's functional currency financial statements into the reporting currency, which are included in other comprehensive income, should in our view not be allocated in the same section and category as the assets and liabilities that gave rise to the gains and losses.

The direct method of presenting operating cash flows

We strongly disagree with the proposal consisting in eliminating from IAS 7 the possibility of using the indirect method for the presentation of cash flows in the statement of cash flows. Most of the preparers are using this method, because it is the easiest and less administrative burdensome way to draw up a cash flow statement. The information related to cash transactions necessary to draw up a direct model of the cash flow statement is not always currently available. We think the recurrent costs will outweigh the benefits if any.

We are also not convinced that the direct method is more consistent with the proposed cohesiveness and disaggregation objectives than the indirect method. We would prefer trying to make the indirect method more consistent with the proposed cohesiveness and disaggregation objectives and would like to encourage the IASB to think about proposals in this respect.

Effects of basket transactions

Basket transactions, such as business combinations, are infrequent transactions that require a specific presentation to make sure that the users of financial statements identify their impact right away.

Accordingly the effects of basket transactions should not be allocated to the related sections and categories in the statement of comprehensive income and in the statement of cash flows but should be presented in a single line item in the statement of comprehensive income and in the statement of cash flows.

The assets and liabilities acquired in a basket transaction can be classified in the appropriate sections and categories in the statement of financial position.

What concerns the effects of basket transactions, considering the three different proposals made by the IASB in case the effects of basket transactions were not to be allocated, the BASB would prefer alternative B, namely the presentation in a separate section.

Notes to financial statements

Information about the maturities of its short-term contractual assets and liabilities

The BASB disagrees with this proposal since an entity presents assets and liabilities in order of liquidity in its statement of financial position when this information is more relevant than a classification into short-term and long-term subcategories of the operating, investing and financing liabilities categories. Allowing two different presentations on the face of the statement of financial position does not seem us appropriate.

Reconciliation schedule

As mentioned before, the BASB strongly disagrees with the proposal consisting in eliminating the indirect method of presenting the operating cash flows. Since the reconciliation schedule reconciles cash flows as they are presented using the direct method to comprehensive income, we do not support this proposal.

A reconciliation schedule will and can never replace the quantitative and qualitative information already included in the notes. In the proposal, it is not demonstrated that this reconciliation schedule would provide new information compared with what is already disclosed in the notes in application of the existing IFRSs. The additional cost for preparers to establish such a schedule seems huge.

Other alternative reconciliation formats

The alternative reconciliation formats presented in the Discussion Paper for disaggregating information in the financial statements are

- a statement of financial position reconciliation; and
- a statement of comprehensive income matrix.

Since non on both alternative reconciliation formats seem us satisfactory, the BASB is against the idea of requiring any reconciliation schedule to be presented in the notes. This information will not enhance the quality of the information already required in the notes.

A memo column to draw the users' attention to unusual or infrequent events or transactions

Since we note that the effects of unusual or infrequent events or transactions are already presented separately from the recurring performance, often by using the line "other income and expense" within the profit or loss, we do not see the added value of a memo column.

The separate presentation of those effects has to be isolated to improve the predictability of future cash flows. This proposal emphasizes the users' need of isolating non-recurring items. Without this information, it would be for instance impossible to determine the amount of normative EBITDA. Therefore we ask the IASB to make another proposal on how such information should be presented in the primary financial statements.

We hope that you will find our comments helpful. If you wish to discuss any of the points we have raised, please do not hesitate to contact the Belgian Accounting Standards Board.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Jan Verhoeve', with a stylized flourish at the end.

Jan Verhoeve
Chairman