

LETTER OF COMMENT NO. 97

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Subject: Comment letter to the Preliminary Views on Financial Statements
Presentation Discussion Paper

Dear Sir David.

Sir David Tweedie

30 Cannon Street

Great Britain

London, EC4M 6XH

International Accounting Standards Board

Chairman

Thank you for the opportunity to provide comments on the Discussion Paper on Financial Statements Presentation. We welcome the discussion on improving the financial statements presentation framework. However our opinion is that many of the proposed changes do not fit to the specifics of the banking industry. Our concerns relate first of all to the direct method cash flow statement. Second, the principle of cohesive financial statements presentations is not very much relevant for the banks. Third, we would like to retain current option to present comprehensive income in two statements.

Banking business model is not cash oriented. Cash is not the central point of planning processes and accounting systems of the banks. Value creation processes and performance of the banks are not closely intertwined with the cash flows. One of the reasons for this is that transactions of core banking business – providing the loans and deposit taking are settled by using current accounts of the customers which are liabilities of the banks. For example interest income accrued on a loan is usually settled not by cash payment but by debiting the current accounts of the client.

Banking operations as a whole bring about cash deficits and surpluses which are vital for ensuring the liquidity of a bank. This is even more obvious during current time of financial crises. The issues of the liquidity management are in the responsibility of treasury departments and top management of the banks. However, direct method cash flow statement does not capture such liquidity aspect of cash operations. Disclosures in this area are within the scope of IFRS 7. Therefore not even the current financial crisis environment can be used as an argument for putting more emphasis on the cash flow statements of the banks.

Because cash flow statement is not relevant for analysing the performance and value of the banks we would like to see it optional for banking industry no matter whether it is prepared by direct or indirect method. We see no way that the direct cash flow statement can be substantiated on the cost / benefit principle. Therefore we cannot support any of the reconciliation schedules proposed in the discussion paper that use direct method cash flow statement.



The notion of cohesive portray of an entity is relevant especially for nonfinancial entities with an operating cycle. For the banks splitting of activities into operating, investing and financing is more difficult. Such splitting would be done mainly for the sake of fulfilling the reporting standards requirements. It can hardly bring more relevance into the information presented compared to current requirements. Ratios relevant for the banks are typically not based on splitting the financial statements into such activities. Many ratios analysed for the banks are regulation driven and do not use such splitting at all.

We welcome that structuring of the financial statements into operating, investing and financing activities should be based on management intention. However for entities in financial business area which do not have operating cycle the focus of management is not on splitting their activities in the way proposed by the discussion paper. We propose that exception not to structure the financial statements according to operating, investing and financing activities for such entities should be envisaged.

We are not supportive of industry specific standard which would apply to financial institutions. We think that the exceptions we propose for voluntary cash flow statement and for not providing the activity based structuring of the statements can be part of the financial statements presentation standard. Principle based formulations which would emphasise irrelevance of such requirements for entities whose business is not based on following such information might be used.

We do not agree with the proposal that only one statement of comprehensive income should be presented. In our opinion current option of presenting other operating income items in two statements should be retained. Merging all equity movements resulting from non-owner transactions into one statement would be more about promoting the form and not the substance principle. By form all such items meet the Framework definition of income and expenses. However the substance of items like cash flow hedge reserve, foreign translation differences, actuarial gains and losses from post-employment defined benefit plans is very different to normal income and expenses which present the true performance of the entity. In fact OCI items were established to distinguish them from normal income or expenses. Merging all comprehensive income items in one statement might lead to significant misinterpretations of the entity performance by the users.

Please, find our specific comments to the questions below. If any unclarities we stand ready to explain them.

Yours faithfully,

el Söchstl



# ANSWERS TO THE QUESTIONS RAISED IN THE DISCUSSION PAPER

#### Question 1

Would the objectives of financial statement presentation proposed 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.

Generally we agree with the objectives of financial statements as proposed. However we are concerned that the cohesiveness objective does not bring much improvement for the banks compared to the current presentation model. Our reasons are discussed in the opening part of the comment letter.

## Question 2

Would the separation of business activities from financing activities provide information that is more decision-useful than that provided in the financial statement formats used today (see paragraph 2.19)? Why or why not?

Banks are not only in the position of financial statements preparers but also analyse financial statements of their customers. We see the potential that the proposal can bring improvements for the decision usefulness when analysing our non-financial customers.

However as reasoned in the opening part of the comment letter separation of business and financing activities is hardly relevant for financial institutions and for the ratios calculated for them. It can even aggravate the comparability of the statements as financial institutions may classify similar items differently based on management decision, for example bonds issued. (Please, see also our answer to the question 5.) We propose that exception for financial institutions is envisaged and such separation is not required.

## Question 3

Should equity be presented as a section separate from the financing section or should it be included as a category in the financing section (see paragraphs 2.19(b), 2.36 and 2.52–2.55)? Why or why not?

Equity should be presented separately. In our opinion equity does not meet the conditions for classification into financing category in paragraph 2.34 because it is not interchangeable source of funding the business activities. Equity is not only about equity instruments issued but also about reserves retained from the earnings which are not interchangeable source of funding. If some users consider equity to be part of financing activities they can easily add the amount into their rations calculated for financing activities.

## Question 4

In the proposed presentation model, an entity would present its discontinued operations in a separate section (see paragraphs 2.20, 2.37 and 2.71–2.73). Does this presentation provide decision-useful information? Instead of presenting this information in a separate section, should



an entity present information about its discontinued operations in the relevant categories (operating, investing, financing assets and financing liabilities)? Why or why not?

Discontinued operations should be presented separately and not be split into the relevant categories. Operating, investing and financing activities categories of the financial statement should only cover continuing operations.

#### 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?

As discussed in the opening part of the comment letter we are supportive of a management approach to classification for those entities whose business is structured into such activities. Reduced comparability can be the issue for the financial entities whose business does not strictly distinguish between such activities. For them such separation can bring artificial element resulting from the fact that irrelevant splitting may reduce comparability and overburden users with additional information.

Moreover we have to object to the requirement that the drivers for classification are solely the assets and liabilities from which the income and expenses and cash flows come from. This may not be possible for entities with off balance sheet activities like fee business. Therefore complementary criterion for classification of such income / expenses and cash flows has to be envisaged.

## Question 6

Paragraph 2.27 proposes that both assets and liabilities should be presented in the business section and in the financing section of the statement of financial position. Would this change in presentation coupled with the separation of business and financing activities in the statements of comprehensive income and cash flows make it easier for users to calculate some key financial ratios for an entity's business activities or its financing activities? Why or why not?

We agree that both assets and liabilities can belong both to the business and the financing section. Our opinion about separation of business and financing activities and calculating the financial ratios is given in the opening part of the discussion paper and in the answers to the questions 2 and 5.

# Question 7

Paragraphs 2.27, 2.76 and 2.77 discuss classification of assets and liabilities by entities that have more than one reportable segment for segment reporting purposes. Should those entities



classify assets and liabilities (and related changes) at the reportable segment level as proposed instead of at the entity level? Please explain.

Incorporating compulsory segment information on the face of financial statement would be burdensome both for preparers and users. All relevant information can be found in the segment reporting disclosures.

It should be up to the entity to decide whether, what segment information and with which detail they provide on the face of the financial statements. Such segment information would not be driven by IFRS 8 requirements. For example financial conglomerate with banking and insurance activities may decide to show segment information which it considers to be relevant also on the face of the statement of financial position and the statement of comprehensive income.

## Question 8

The proposed presentation model introduces sections and categories in the statements of financial position, comprehensive income and cash flows. As discussed in paragraph 1.21(c), the boards will need to consider making consequential amendments to existing segment disclosure requirements as a result of the proposed classification scheme. For example, the boards may need to clarify which assets should be disclosed by segment: only total assets as required today or assets for each section or category within a section. What, if any, changes in segment disclosures should the boards consider to make segment information more useful in light of the proposed presentation model? Please explain.

Segment reporting should be solely within the scope of IFRS 8. As written in the answer to the question 7 financial presentation standard should give opportunity to present the segment information on the face of financial statements on a voluntary basis. Such information would be outside the scope of IFRS 8 and would be provided in the detail that entity considers relevant for understanding its financial statements.

# Question 9

Are the business section and the operating and investing categories within that section defined appropriately (see paragraphs 2.31–2.33 and 2.63–2.67)? Why or why not?

In our opinion the definitions are generally appropriate. However the criterion of interchangeability which is decisive for financing section categorisation might be clarified further.

#### Question 10

Are the financing section and the financing assets and financing liabilities categories within that section defined appropriately (see paragraphs 2.34 and 2.56–2.62)? Should the financing section be restricted to financial assets and financial liabilities as defined in IFRSs and US GAAP as proposed? Why or why not?

We agree with the proposal that only financial assets liabilities can be categorised in financing section. The financing section should also include related treasury assets (as defined in paragraph 2.60).



## Question 11

Paragraph 3.2 proposes that an entity should present a classified statement of financial position (short-term and long-term subcategories for assets and liabilities) except when a presentation of assets and liabilities in order of liquidity provides information that is more relevant.

- (a) What types of entities would you expect not to present a classified statement of financial position? Why?
- (b) Should there be more guidance for distinguishing which entities should present a statement of financial position in order of liquidity? If so, what additional guidance is needed?

We do not think that changes in this area are needed compared to current situation. Definition in IAS 1.51 which reads "except when presentation of assets and liabilities in order of liquidity provides information that is more relevant" is principle based and sufficient. We expect that financial institutions would use this form of presentation as currently the practice is.

#### Question 12

Paragraph 3.14 proposes that cash equivalents should be presented and classified in a manner similar to other short-term investments, not as part of cash. Do you agree? Why or why not?

We agree that cash equivalents are not presented as cash but are classified together with non-cash assets and liabilities.

#### Question 13

Paragraph 3.19 proposes that an entity should present its similar assets and liabilities that are measured on different bases on separate lines in the statement of financial position. Would this disaggregation provide information that is more decision-useful than a presentation that permits line items to include similar assets and liabilities measured on different bases? Why or why not?

Assets and liabilities can be measured on different basis and still have the same or very similar substance. Financial statements line items should be based on similar economic characteristics. Therefore the requirement to present similar assets and liabilities measured on a different basis on separate line items should not be applied strictly.

Example is a fixed rate loan received by the entity which is swapped into floating rate. To remove the accounting mismatch fair value option is used for the loan upon initial recognition. Such loan is economically the same like other loan liabilities. Fair value measurement was chosen only to avoid accounting mismatch which results form the fact that measurement principles are not perfect. To require separate presentation of such loan (within fair value option liabilities or more generally fair value through profit or loss financial liabilities) would promote their form over the substance.

Generally different measurement basis evidences that the assets or liabilities are different enough to be presented separately. However it is not necessarily true as we showed in the previous paragraph. Therefore if such principle is introduced in the standard we propose to formulate it less strictly like "Different measurement bases for assets and liabilities usually suggest that their nature or function differs and therefore they should be presented as separate line items. However there may be cases when different measurement bases are not substantiated." Example of the loan can be added.



However if entity presented assets and liabilities measured on a different bases in the same line items, disclosures about this fact and disaggregation of the line item carrying amount into each measurement category would be necessary.

## Question 14

Should an entity present comprehensive income and its components in a single statement of comprehensive income as proposed (see paragraphs 3.24–3.33)? Why or why not? If not, how should they be presented?

In the opening part of the comment letter we gave our opinion and reasons that we strongly support the option to present other comprehensive income in a separate statement. As regards this issue we do not see any reason to change the current status as set by IAS 1.

## Question 15

Paragraph 3.25 proposes that an entity should indicate the category to which items of other comprehensive income relate (except some foreign currency translation adjustments) (see paragraphs 3.37–3.41). Would that information be decision-useful? Why or why not?

We do not agree with categorisation of the other comprehensive income items. Such categorisation would not bring decision useful information for analyses because these items do not evidence real performance of the entity. They are part of the statement of comprehensive income more by their form than by their substance. We discuss this issue also in the opening part of the comment letter.

# Question 16

Paragraphs 3.42–3.48 propose that an entity should further disaggregate within each section and category in the statement of comprehensive income its revenues, expenses, gains and losses by their function, by their nature, or both if doing so will enhance the usefulness of the information in predicting the entity's future cash flows. Would this level of disaggregation provide information that is decision-useful to users in their capacity as capital providers? Why or why not?

We support the principle based disaggregation proposal in the discussion paper. This can help the users of the financial statements to have better picture about the entity and better data for their analyses. However for the banks this requirement is not so relevant because they do not use disaggregation by function as also confirmed by the paragraph 3.52.

#### 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 support the proposal that current requirements for allocating and presenting income taxes are retained.

#### Question 18

Paragraph 3.63 proposes that an entity should present foreign currency transaction gains and losses, including the components of any net gain or loss arising on remeasurement into its functional currency, in the same section and category as the assets and liabilities that gave rise to the gains or losses.

- (a) Would this provide decision-useful information to users in their capacity as capital providers? Please explain why or why not and discuss any alternative methods of presenting this information.
- (b) What costs should the boards consider related to presenting the components of net foreign currency transaction gains or losses for presentation in different sections and categories?

Presentation of foreign currency transaction gains and losses within separate section would be overly burdensome for the banks. Till now there have been no requirements to track the foreign exchange differences on individual assets or liabilities level. Banks often use system of position accounts by which they calculate foreign transaction gains / losses on an aggregate level because they also manage FX risk on such level. Such requirement would bring about major system changes that cannot be substantiated on the cost/benefits principle.

This issue can be solved for the banks by accepting our argument discussed above that financial statements of institutions without operating cycle - typically financial institutions - should not be structured into operating, investing and financing category. If such argument is not accepted by standard setters we ask for exception that at least foreign exchange differences should not be categorised this way. From our point of view requirement for the categorisation of foreign exchange differences means that we have to meet the burdensome specific requirement on the field of irrelevant general requirements.

#### 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?

As we discuss and reason in the opening part of the comment letter cash flow statement is irrelevant for analysing the banking business. We ask that the requirement to present cash flow statement is optional for the banks no matter by what method it is prepared. Direct cash flow method statement would be extremely burdensome to prepare by the banks because they do not gather information about individual transactions on cash basis.



## Question 20

What costs should the boards consider related to using a direct method to present operating cash flows (see paragraphs 3.81–3.83)? Please distinguish between one-off or one-time implementation costs and ongoing application costs. How might those costs be reduced without reducing the benefits of presenting operating cash receipts and payments?

It is not even possible to estimate the costs as accounting and other data source systems are not cash flow oriented. Implementation costs of fundamental changes can hardly be estimated unless professional study is made.

## Question 21

On the basis of the discussion in paragraphs 3,88–3.95, should the effects of basket transactions be allocated to the related sections and categories in the statement of comprehensive income and the statement of cash flows to achieve cohesiveness? If not, in which section or category should those effects be presented?

We support the proposal that basked transactions are not allocated into categories but are presented in the category that reflects the activity that was predominant source of those effects.

# Question 22

Should an entity that presents assets and liabilities in order of liquidity in its statement of financial position disclose information about the maturities of its short-term contractual assets and liabilities in the notes to financial statements as proposed in paragraph 4.7? Should all entities present this information? Why or why not?

For entities which present assets and liabilities in order of liquidity in their statements of financial position relevant information can be brought by disclosures of remaining contractual maturities of their short-term assets and liabilities as proposed in the discussion paper. In our opinion such requirements should be harmonised with the requirements about liquidity risk of IFRS 7. Disclosures of contractual maturities should be given under the liquidity risk disclosures heading when they relate to financial instruments. For banks practically all assets and liabilities with contractual maturity are financial assets and liabilities. IFRS 7 requires disclosures of remaining maturities only for financial liabilities. The discussion paper would require disclosures for both assets and liabilities. Such requirements are overlapping. At least the new financial presentation standard should have reference to IFRS 7 and state that such disclosures are not required to the extend they are provided in accordance to IFRS 7 under liquidity disclosures requirement. IFRS 7 should similarly say that remaining contractual maturity analysis can be partly (for short-term financial liabilities) fulfilled by providing the disclosures about remaining contractual maturities of both short-term assets and liabilities as required by the financial presentation standard.

## Question 23

Paragraph 4.19 proposes that an entity should present a schedule in the notes to financial statements that reconciles cash flows to comprehensive income and disaggregates comprehensive income into four components:



(a) cash received or paid other than in transactions with owners, (b) accruals other than remeasurements, (c) remeasurements that are recurring fair value changes or valuation adjustments, and (d) remeasurements that are not recurring fair value changes or valuation adjustments.

(a) Would the proposed reconciliation schedule increase users' understanding of the amount, timing and uncertainty of an entity's future cash flows? Why or why not? Please include a discussion of the costs and benefits of providing the reconciliation schedule.

(b) Should changes in assets and liabilities be disaggregated into the components described in paragraph 4.19? Please explain your rationale for any component you would either add or omit. (c) Is the guidance provided in paragraphs 4.31, 4.41 and 4.44–4.46 clear and sufficient to prepare the reconciliation schedule? If not, please explain how the guidance should be modified.

We cannot agree with any reconciliation schedule that reconciles any statements to the direct method cash flow statement. Our conclusions why direct method cash flow statement is completely irrelevant are given in the opening part of the comment letter.

#### Question 24

Should the boards address further disaggregation of changes in fair value in a future project (see paragraphs 4.42 and 4.43)? Why or why not?

We think that existing IFRS requirements give good possibility for the entities to present the fair value changes from economic point of view. Further disaggregation of changes in fair value should not be addressed by the boards.

## Question 25

Should the boards consider other alternative reconciliation formats for disaggregating information in the financial statements, such as the statement of financial position reconciliation and the statement of comprehensive income matrix described in Appendix B, paragraphs B10–B22? For example, should entities that primarily manage assets and liabilities rather than cash flows (for example, entities in the financial services industries) be required to use the statement of financial position reconciliation format rather than the proposed format that reconciles cash flows to comprehensive income? Why or why not?

We refuse any reconciliation schedule that contains direct method cash flow statement. Proposal given in the question which says that for financial services industry statement of financial position reconciliation schedule (which is the most complicated) might be used evidences deep misunderstanding of banking business.

However as we want to contribute to the discussion we admit that the statement of comprehensive income matrix might be relevant. The reason is that it disaggregates the items of comprehensive income without links to other statements. Information provided by this schedule might be used for assessing the subjectivity and persistence of income and expenses. To provide such information columns as proposed (a) cash flows (b) accruals, allocations and other, (c) recurring remeasurements (d) non-recurring remeasurements are properly defined except for the clarifications needed for the column (a) which we discuss in the next paragraph. This is from theoretical point of view.



To implement such schedule into <u>practical</u> life many more issues would have to be addressed. First, cash flows are not the only means how transactions are settled in the banking business. In the opening part of the comment letter we mention that large part of transaction is settled using current accounts of customers which are liabilities of the banks. This is how the transactions are settled (realised) and are not accrued any more. Therefore the cash flow column (a) would have to be redefined. Second, tracking the realised (settled) part of income and expenses can be difficult because currently such information is not required by IFRS. Such requirement would result in accounting system changes and should be addressed within the feasibility testing. Issues for example arise in the area of realised foreign exchange gains / losses. It is also very difficult to say when interest income from impaired financial assets is realised. After addressing such issues the conclusion may be that the schedule is not practicable to prepare.

## Question 26

The FASB's preliminary view is that a memo column in the reconciliation schedule could provide a way for management to draw users' attention to unusual or infrequent events or transactions that are often presented as special items in earnings reports (see paragraphs 4.48–4.52). As noted in paragraph 4.53, the IASB is not supportive of including information in the reconciliation schedule about unusual or infrequent events or transactions.

- (a) Would this information be decision-useful to users in their capacity as capital providers? Why or why not?
- (b) APB Opinion No. 30 Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions, contains definitions of unusual and infrequent (repeated in paragraph 4.51). Are those definitions too restrictive? If so, what type of restrictions, if any, should be placed on information presented in this column?
- (c) Should an entity have the option of presenting the information in narrative format only?

We do not think that any changes are necessary in this area compared to current situation when no items can be labelled as extraordinary. The same is true for unusual of infrequent events or transactions. IFRS already provide the possibility to give narrative description of such information and this should be retained.