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Allianz Comment Letter on Preliminary Views on Financial Statement Presentation

FINANCIAL STATEMENT PRESENTATION

Ladies and Gentlemen,

We are pleased to comment on the IASB/FASB Discussion Paper Preliminary views on Financial Statement Presentation (DP). The proposals for the financial statement presentation are of fundamental importance for the performance reporting of a company. We appreciate the efforts the boards have taken including the exercise of field testing. We would like to note, that we have participated in the field tests of the project. With the field test we experienced a better insight into the practical implementation issues of the proposals in the DP. Please find below our general observations and more specific comments on your questions.

General comments

The reasons for issuing the DP on Financial Statement Presentation are stated by the boards to improve the usefulness of the information provided in the financial statements and to help users make better decisions in their capacity as capital providers. The DP states three objectives underlying the boards' proposed presentation model: (1) to portray a cohesive financial picture of an entity's activities, (2) to disaggregate information so that it is useful in assessing an entity's future cash flows and (3) to present information about liquidity and financial flexibility.

While we conceptually agree with the principles proposed in the Discussion Paper, as field test participants we observed a number of practical implementation issues that, we are convinced, would not improve current financial reporting and would not meet user needs. In fact, the proposed presentation principles would actually contradict the proposed management approach to financial reporting. We will further expand on our concerns below:

Chairman of the Supervisory Board: Dr. Henning Schulte-Noelle
Board of Management: Michael Diekmann, Chairman
Or: Paul Achleitner, Oliver Bäte, Clement B. Booth, Enrico Cucchiari, Dr. Joachim Faber,
Dr. Helmut Perle, Dr. Gerhard Rupprecht, Jean-Philippe Thiery, Dr. Werner Zedelius
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- The principles of cohesiveness and disaggregation would dilute the information presented in the financial statements as too much detail would be required to be presented on the face of the financial statements as opposed to in the notes. The principles would lead to very lengthy financial statements. This would actually impair the clarity and readability of the information for users. Furthermore for many line items the principle of cohesiveness is not appropriate and an "alignment" is not possible.
- The preparation of a direct cash flow statement for insurers is not feasible and would be too complex to prepare under the current data generation process which is intertwined with intermediaries (brokers, agents, reinsurers). A direct cash flow statement would require significant process changes in the way the insurance business is operated with intermediaries and would require significant and costly changes to IT systems. We therefore have deep reservations about this proposal. Furthermore, analysts have expressed very different needs for information about cash, which we report in our MCEV disclosures. Furthermore, we would reject an approximation of the direct cash flow statement in terms of a so-called "direct-indirect method", which we attempted to construct as field participant. The cash flows would only be a proxy which would not be legitimate or useful information for financial statement purposes, nor qualify for audit or SOX requirements. In addition, given that only very few companies currently apply a direct cash flow statement, we recommend that the Boards keep the current indirect method for preparing a cash flow statement. In particular as the Boards do not provide in the Discussion Paper any explanation as to why the direct cash flow statement would provide more useful information in comparison to the indirect method.
- Based on our experience as field test participant, we do not support a reconciliation schedule between the direct cash flow statement and the statement of comprehensive income as it would require companies to disclose a vast amount of data over several pages, much of which is not relevant and likely to confuse the reader. Instead, we suggest more emphasis should be placed on existing roll-forward analysis of selected balance sheet items as required by existing standards.
- We disagree with the proposed requirement of a single statement of comprehensive income. We are concerned that with the combined presentation of net income and other comprehensive income (OCI) in a single statement, the presentation of performance will focus on comprehensive income, instead of net income. The variability of OCI however, which is particularly large for financial institutions, which could be particularly observed during the financial crisis over the past months, does not actually reflect the performance of a company and would therefore be misleading for users.
- We fully support the proposed management approach for financial reporting in the DP. However, we would like to note, that the proposed management approach is actually different from the management approach implemented in IFRS 8. Furthermore, we observed a number of examples where the DP actually deviates from a management approach, for example the principle of cohesiveness would, strictly applied, constrain a clear presentation of economic performance, for example the reconciliation schedule would rather obscure relevant financial performance.
- Allianz Group is of the opinion that the proposals have not adequately addressed the impact on and the performance reporting of financial institutions. For insurance companies as well as for banks the investing is an integral part of the operating business. At the same time, we appreciate that with the proposed management approach the Boards bridge the needs of presenting different business models for different industries. This DP does however not address the open key issues for performance reporting of insurers, when IFRS 4 Phase II will be in place. These open issues in particular around the presentation of income, premiums and margins remain to be resolved in the further development of Phase II. Supporting the management approach we

are also of the opinion that best practice should be developed by the industry itself to achieve more comparability.

When commenting on prior proposals by the IASB for reporting performance, Allianz stressed that it would be more appropriate to complete measurement issues first, before deciding on presentation issues. We still believe that this comment is very valid, even though the original proposals have changed in the DP. In fact, it appears that it would be more appropriate to complete fundamental accounting projects such as Fair Value Measurement and Revenue Recognition first and to change related accounting standards, before changing the presentation of the income statement, including OCI and to introduce a reconciliation between the direct cash flows statement and the statement of comprehensive income, disaggregating accruals and remeasurements.

Any required changes from current financial reporting should first demonstrate that they will better meet the users' needs. We are convinced that the proposals in the DP will not improve current reporting. Whilst we do not believe that the proposals would lead to better and more decision useful information, we are certain that they would require significant effort and cost to implement.

Please find below our more specific comments on your questions:

Chapter 2: Objectives and principles of financial statement presentation

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.

Conceptually, we agree with the objectives of financial statement presentation proposed in the DP. However, implementing them in the field test exercise evidenced a number of practical difficulties.

Principle of cohesiveness

In particular the boards proposal (paragraph 2.16) that ideally financial statements should be cohesive at the line item level is not feasible, as often items cannot be aligned between financial statements. In our view, each financial statement has a purpose in itself and this should not be distorted by giving undue emphasis on the principle of cohesiveness. Therefore we believe that the principle of cohesiveness should be applied within a management approach in presenting business and financing transaction. In the field testing we experienced that in particular a cohesive alignment of financial statements is not feasible for

- Cash items or income/expense without a related item in the statement of financial position (for example premiums)
- Items in the statement of financial position that relate to a number of different line items in the statement of comprehensive income (for example AfS investments relate to dividend or interest income, impairment, realized gains/losses, OCI)

We are particularly concerned that the application of the principle of cohesiveness will lead to very detailed and lengthy financial statements, which would include information currently presented in the notes to be presented on the face of the financial statements and would, in our view, impair the clarity and readability of the financial statements.

We agree that the definition of operating, investing and financing transactions should be consistently applied across the financial statements. And we also agree that amounts relating to income taxes, discontinued operations and equity should be separately presented. However, we note that the proposed general format for financial statement presentation in the DP is more appropriate for a manufacturing company and is not specific for financial institutions. Insurers typically manage their assets and liabilities, insurance liabilities are backed by investments. For the field test we included investment items (including acquisitions of associates and real estate) as part of operating business, the investment section was insignificant for presentational purposes.

Principle of disaggregation

Similarly, we note that the principle of disaggregation is useful for the presentation of financial statements. We are however concerned, that if applied extensively, the number of line items on the face of the financial statements, and the requirement to add subtotals, will lead to very lengthy financial statements, which would lack clarity for the user. In this regards, we would like to note that analysts have expressed consistently the view that they have only limited time to read the financial statements for making their analysis. The presentation of information in the financial statements should therefore help user to get a clear and fast overview of the financial position of a company rather than to overload them with detailed information which should be presented in the notes.

Principle of liquidity and financial flexibility

Our current presentation is in line with IAS 1 in the order of liquidity. Any additional proposals in the DP to present short-term items separately from long-term items, and to present a maturity analysis of short-term assets and liabilities would not be relevant for insurance companies, in particular not for the long-term life business. We believe that existing standards, notably IFRS 7 already provides appropriate disclosure requirements in this respect and we would recommend to avoid any duplications.

We recommend that the Boards add a principle of clarity and understandability of financial statements. This would imply to us that relevant detailed information should be presented in the notes.

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?

Yes, we support a division between business activities and financing activities as more decision useful information. We consider it useful for users to differentiate in the financial statements between the operating business (including investing business) and the funding of the business. It is also important to present how companies fund their growth (externally or internally).

We would like to note, that currently, all necessary information on business versus financing is already contained in the financial statements, however when carrying out the field test, the "Business" and "Financing" subtotals led to a clearer presentation.

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?

We believe that the current reporting requirements for equity are appropriate. Therefore we agree with the proposal in the DP that equity should be presented separately from financing.

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?

We support the proposal that assets and liabilities relating to discontinued operations (as defined in IFRS 5) should be presented in a separate section to help users identifying the continuing and discontinuing elements in the financial statements.

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?

Yes. Appropriate presentations should always follow the management approach. The disconnection of internal management reporting and external presentation of financial information would not provide decision useful information for investors.

(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?

We believe that the management approach actually provides more comparability for users. Furthermore, it would not be possible for standard setters to adopt a common framework for the presentation of financial statements for all industries in terms of operating, investing and financing elements without adopting a management approach for companies.

We expect that over time, there will be best practice developed in the way management will classify items in their financial statements within an industry. We support that best practice is developed by the companies rather than the standard setters.

We would further like to note that in the future XBRL reporting requirements will improve comparability of line items.

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 with the proposal to present assets and liabilities in a business and a financing section. We support also that the main KPI should be deducted from financial statements. This will make it easier for analysts to calculate key financial ratios. However, different industries have different needs.

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.

We believe it is necessary to make a segmental classification of assets and liabilities, because this is consistent with a management approach to reporting. We support the rules in IFRS 8 in this respect.

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.

We do not see the need to further increase the requirements of IFRS 8. IFRS 8 is based on a management approach. Further rules would be contradictory to the management approach and not provide decision usefulness for users.

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?

Conceptually, we do not agree that the classification between operating items and investing items should be restricted to core versus non core activities as proposed in the DP. From our field testing experience, the investing category was only insignificant because for insurance companies investing is generally part of the operating business.

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 disagree that the financing section should be restricted to financing assets and liabilities. If management sees a certain asset or liability as financing while it does not qualify as a financial asset or liability, this restriction contradicts a core principle of the DP, namely the management approach. We do not see why non-financial assets and non-financial liabilities should be excluded from the financing section.

Chapter 3: Implications of the objectives and principles for each financial statement

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?

For the insurance business a presentational split between short term and long term would not be appropriate. We support a presentation of assets and liabilities in the order of liquidity as more decision useful. This is in line with our current presentation format and regarded as best practice by preparers and users. In accordance with a management approach there should not be more guidance for distinguishing which entities should present a statement of financial position in order of liquidity. This choice should be left to the management.

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?

This presentation should be agreed as an accounting convention.

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?

This information should best be contained in the notes (as it is already presented under current reporting requirements). Presentation on the face would confuse and lengthen the financial statements and duplicate the information that has already to be presented in the notes.

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?

We disagree with the proposal to introduce a single statement of comprehensive income. Net income is one of the key performance indicators which companies communicate to the capital markets and it should be presented separately from other comprehensive income. Total comprehensive income is often diluted by unrealized gains and losses of Available for Sale investments, as a result of the current requirements in IAS 39. This is particularly relevant for the financial services industry. We believe that the IASB and FASB should address measurement and recognition issues in the relevant standards (such as IAS 39) first, before addressing presentational issues.

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 refer to our comment to question 14 and have no further comment.

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?

As mentioned above, we support a management approach to financial reporting. Whether the most appropriate format is by function or by nature or both depends on the way business is managed. We would disagree with a required disaggregation in form of a matrix. To reflect different sector's reporting needs, we support the option to report by a combination of nature and function.

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 proposal to present income taxes within the statement of comprehensive income in accordance with existing requirements.

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?

We disagree with the proposal of presenting foreign currency transaction gains and losses in the same section and category as the assets and liabilities. As field testers, currently we are not in a position to split foreign currency effects at this transaction level. The proposal would require a significant cost in amending existing data systems. These costs will in our view outweigh any benefit. Furthermore, we doubt whether applying the cohesiveness principle at this level would result in decision useful information.

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 disagree with the proposal to use a direct method of presenting cash flows. We are not convinced that a direct cash flow presentation would provide information that is more decision-useful than the indirect method of presentation. Furthermore, significant costs would be required to pro-

duce a direct cash flow statement. It is impossible to produce with current IT systems in place. For the insurance companies, at several stages intermediaries (brokers, agents, reinsurers) are involved, which leads to a complex netting of balances. A gross up of those net balances and transactions with the counterparties would require significant process changes in the way the insurance business is operated with intermediaries and significant and time consuming changes to IT systems (for the company and its intermediaries) would be required.

Furthermore, we believe that the Cash Flow Statement of an insurance company, be it direct or indirect, has limited value to help users of financial statements predict future cash flows.

In addition, we understand from analysts that what they have different needs in presenting shareholder's cash which we deal with in our embedded value reporting. Analysts' objectives when reviewing financial information is to establish free cash flow and its usage (share buy-back, dividend, acquisitions etc).

We note that only very few companies are applying a direct cash flow statement today. We therefore question the usefulness of the proposal.

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?

There would be very significant one-off as well as ongoing application costs not only at the company level, but also for third parties (brokers, agents, reinsurers). We refer to our comments to question 19.

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 believe that it should be left to management whether to allocate the effects of basket transactions to sections and categories depending on the transactions and how the management sees it affects the company.

Chapter 4: Notes to financial statements

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?

Please refer to our comment to question 11. We do not believe that for an insurance company to present assets and liabilities into short term and long term transactions is useful for users of financial statements, as the insurance business cycle is generally long-term. Therefore, we disagree with the proposal to present maturities of short-term contractual assets and liabilities in the notes.

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 re-measurements, (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 disagree with the proposed reconciliation schedule. As field test participant we experienced a very complex exercise to prepare the schedule. Not only would such a long and detailed schedule be time consuming to prepare, but also difficult to understand for users. We doubt that the proposed line-by-line item reconciliation is useful. For some line items reconciliation actually provides information that is decision useful, but for other items it does not. Most importantly we question the procedural method to establish a reconciliation schedule. As noted in our answer to question 19, we do not believe that a direct cash flow statement is feasible and useful to prepare. Therefore, we do not believe that reconciling cash flow positions into the income statement position will enhance users understanding of our financial statements. For the purpose of the filed testing we approached the reconciliation starting with the income statement, establishing a direct-indirect method. However, that is neither the procedure proposed in the DP, nor would this information be appropriate for presentation in our financial statements, audit and SOX requirements.

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 believe that the Boards should deal with measurement issues first before addressing presentational issues.

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 believe that existing standards already deal with reconciliation of relevant line items in the financial statements, such as the indirect cash flow method.

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?

As we do not support the proposed reconciliation schedule we do not support that information about unusual or infrequent events or transactions is provided in a memo column in the reconciliation schedule. We believe that information about unusual events should be better presented and described in the management commentary.

If you would like to discuss any aspects of this comment letter in more detail, please do not hesitate to contact us.

Yours sincerely,

A handwritten signature in black ink, appearing to read "Louise Jordan", is written over a solid horizontal line.

Louise Jordan

Head of Accounting Policy Allianz Group