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To whom it may concern,

Exposure Draft: General Presentation and Disclosures (Primary Financial Statements)

We welcome the opportunity to respond to your Exposure Draft ED/2019/7 General Presentation and Disclosures (Primary Financial Statements).

The Quoted Companies Alliance *Accounting, Auditing and Financial Reporting Expert Group* has examined the proposals and advised on this response from the viewpoint of small and mid-size quoted companies. A list of Expert Group members can be found in Appendix A.

Our response includes several comments which highlight that setting a standard could lead to either the call for further definitions (e.g. of main business activities) or more subjective judgement. We believe that either outcome would lead to a disproportionate cost burden on the companies we represent.

If you would like to discuss our response in more detail, we would be happy to attend a meeting.

Yours sincerely,

Tim Ward
Chief Executive

Q1 – operating profit or loss

Paragraph 60(a) of the Exposure Draft proposes that all entities present in the statement of profit or loss a subtotal for operating profit or loss. Paragraph BC53 of the Basis for Conclusions describes the Board's reasons for this proposal. Do you agree with the proposal? Why or why not? If not, what alternative approach would you suggest and why?

We agree that the proposal to require entities to report an operating profit or loss subtotal in the statement of profit or loss will provide some value. As the Basis of Conclusions (BC53) correctly identifies, the reporting of operating profit or loss will help to increase comparability between entities.

However, it is often the case that investors will focus on EBITDA rather than operating profit, as the former excludes depreciation and amortisation, two common non-cash items that are included in operating profit. The cash flow statement is already required to include a line item for cash flows from operating activities.

Notwithstanding this, the proposal to require entities to report an operating profit or loss has the potential to significantly increase costs and timescales for preparers of financial statements. In order to report an operating profit or loss, it is likely to require changes by many preparers. Whilst UK companies already have to divide their income statement up according to type of expense, it is not necessarily a straightforward decision to determine whether or not certain items of expenditure are "operating or not". This is likely to take up a significant amount of time for senior management. As a result of this, the requirement will have a disproportionate impact on smaller entities. These smaller entities may not necessarily have the resources and capacity to cope with the additional requirements, as well as being challenged on their ability to report on this in a timely manner.

For the above reasons, if any such proposal is to be taken forward, consideration must be given to the impact on costs and timescales that this would have in order to ensure that it does not unfairly impede smaller entities.

Q2 – the operating category

Paragraph 46 of the Exposure Draft proposes that entities classify in the operating category all income and expenses not classified in the other categories, such as the investing category or the financing category. Paragraphs BC54–BC57 of the Basis for Conclusions describe the Board's reasons for this proposal. Do you agree with this proposal? Why or why not? If not, what alternative approach would you suggest and why?

In a similar vein to our answer to Q1, we agree that the proposal will bring consistency to what is included in the operating category, which will lead to improved comparability. However, it is likely to have an impact on smaller entities whose senior management will have to devote additional time and exercise judgement when determining what goes into what category. This too, will impact smaller entities disproportionately.

Q3 – the operating category: income and expenses from investments made in the course of an entity's main business activities

Paragraph 48 of the Exposure Draft proposes that an entity classifies in the operating category income and expenses from investments made in the course of the entity's main business activities. Paragraphs BC58–BC61 of the Basis for Conclusions describe the Board's reasons for this proposal. Do you agree with the proposal? Why or why not? If not, what alternative approach would you suggest and why?

We infer that the intention of proposing that an entity classifies in the operating category income and expenses from investments made in the course of the entity's main business activities is to enhance the understanding of an entity's operating performance for users, as well as provide greater comparability between entities.

However, some members of the QCA do not believe that a rule should be introduced in the first instance. Rather, the standard should set out the principle that income and expenses are categorised as operating, investing or financing, and companies should then interpret that principle and disclose how they have done so.

If this proposal is introduced, however, there is a need to produce further guidance on what constitutes "investments made in the course of main business activities". We believe that, as the proposal currently stands, it is formed on the basis of significant judgement, which would, inadvertently, impede comparability. That is, the practice of determining what constitutes an investment made in the course of an entity's main business activities requires the exercise of significant judgement. This, in turn, limits the possibilities for making comparisons between entities. As such, guidance would help to ensure consistency and thus enabling comparability between entities.

Additionally, we would also argue that certain entities will have to incur higher costs than others when they have more than one main business activity. Therefore, consideration needs to be given to these entities and the extent to which they will have to incur higher costs.

Q4 – the operating category: an entity that provides financing to customers as a main business activity

Paragraph 51 of the Exposure Draft proposes that an entity that provides financing to customers as a main business activity classify in the operating category either:

- **income and expenses from financing activities, and from cash and cash equivalents, that relate to the provision of financing to customers; or**
- **all income and expenses from financing activities and all income and expenses from cash and cash equivalents.**

Paragraphs BC62–BC69 of the Basis for Conclusions describe the Board's reasons for the proposals. Do you agree with the proposal? Why or why not? If not, what alternative approach would you suggest and why?

We agree with the proposal to classify income and expenses from financing activities and cash and cash equivalents in the operating category. In particular, it will provide users with useful information on an entity's operating performance.

However, as highlighted in our response to Q3, we believe that additional clarification on what constitutes a "main business activity" is provided if this proposal is enacted.

Q5 – the investing company

Paragraphs 47–48 of the Exposure Draft propose that an entity classifies in the investing category income and expenses (including related incremental expenses) from assets that generate a return individually and largely independently of other resources held by the entity, unless they are investments made in the course of the entity's main business activities. Paragraphs BC48–BC52 of the Basis for Conclusions describe

the Board's reasons for the proposal. Do you agree with the proposal? Why or why not? If not, what alternative approach would you suggest and why?

We agree with the proposals insofar that they may provide useful information to users of financial statements, but, as noted above, if these proposals are introduced, further clarification on what constitutes "main business activities" is needed. Once this is provided, it will reduce the need for subjective judgements to be made.

Q6 – profit or loss before financing and income tax and the financing category

a) **Paragraphs 60(c) and 64 of the Exposure Draft propose that all entities, except for some specified entities (see paragraph 64 of the Exposure Draft), present a profit or loss before financing and income tax subtotal in the statement of profit or loss.**
b) **Paragraph 49 of the Exposure Draft proposes which income and expenses an entity classifies in the financing category.**

Paragraphs BC33–BC45 of the Basis for Conclusions describe the Board's reasons for the proposals. Do you agree with the proposals? Why or why not? If not, what alternative approach would you suggest and why?

The proposal to require an entity to classify specified income and expenses into a financing category and present profit or loss before financing and income tax subtotal in its statement of profit or loss will likely create additional costs. For instance, the costs are likely to come in the form of making changes to internal systems and processes, as well as communicating the changes to stakeholders. This is likely to be expensive and disproportionately impact smaller entities, who typically have fewer resources and less cash to make sizeable changes to their systems and procedures.

Q7 – integral and non-integral associates and joint ventures

a) The proposed new paragraphs 20A–20D of IFRS 12 would define 'integral associates and joint ventures' and 'non-integral associates and joint ventures'; and require an entity to identify them.
b) Paragraph 60(b) of the Exposure Draft proposes to require that an entity present in the statement of profit or loss a subtotal for operating profit or loss and income and expenses from integral associates and joint ventures.
c) Paragraphs 53, 75(a) and 82(g)–82(h) of the Exposure Draft, the proposed new paragraph 38A of IAS 7 and the proposed new paragraph 20E of IFRS 12 would require an entity to provide information about integral associates and joint ventures separately from non-integral associates and joint ventures.

Paragraphs BC77–BC89 and BC205–BC213 of the Basis for Conclusions describe the Board's reasons for these proposals and discuss approaches that were considered but rejected by the Board. Do you agree with the proposals? Why or why not? If not, what alternative approach would you suggest and why?

The identification of integral and non-integral associates and joint ventures will likely result in significant new costs for preparers. This proposal would translate to a requirement for the entity/preparer to establish a process to make the distinction between integral and non-integral associates and joint ventures. Not only this, but the entity would also need to exercise judgement in this area as well. As noted above, some members of the QCA believe that the standards should be more principles-based.

If the proposal is introduced, further guidance could be produced in order to ameliorate these additional costs. This would go some way to help an entity make the distinction between associates and joint ventures that are integral or non-integral.

Q8 – roles of the primary financial statements and the notes, aggregation and disaggregation

a) **Paragraphs 20–21 of the Exposure Draft set out the proposed description of the roles of the primary financial statements and the notes.**
b) **Paragraphs 25–28 and B5–B15 of the Exposure Draft set out proposals for principles and general requirements on the aggregation and disaggregation of information.**

Paragraphs BC19–BC27 of the Basis for Conclusions describe the Board's reasons for these proposals. Do you agree with the proposals? Why or why not? If not, what alternative approach would you suggest and why?

On balance, we agree with the proposals relating to the roles of the primary financial statements and the notes. We believe that this will help assist prepares when they decide whether they should include information in their entity's primary financial statements or in the notes.

However, we do not agree with the proposals in relation to the general requirements on the aggregation and disaggregation of information. Our reasoning for this is that it will result in increased costs for entities, particularly regarding the need to establish a system or process for disaggregation. This is likely to impact smaller entities the greatest.

Q9 – analysis of operating expenses

Paragraphs 68 and B45 of the Exposure Draft propose requirements and application guidance to help an entity to decide whether to present its operating expenses using the nature of expense method or the function of expense method of analysis. Paragraph 72 of the Exposure Draft proposes requiring an entity that provides an analysis of its operating expenses by function in the statement of profit or loss to provide an analysis using the nature of expense method in the notes. Paragraphs BC109–BC114 of the Basis for Conclusions describe the Board's reasons for the proposals. Do you agree with the proposals? Why or why not? If not, what alternative approach would you suggest and why?

We do not agree with the proposals here due to the likely impact it will have on companies. The change in current practice whereby more emphasis is placed on the nature of the expense rather than its functional classification will cause additional work for companies. That is, companies will either have to change the way they present their income statement from function to nature or, if they continue to use function, they will be required to provide additional disclosures on the nature of the expenses in the notes.

For the above reason, we would argue that a cost-benefit analysis of the proposed requirements needs to be conducted in the first instance. A situation must not arise whereby the impact on companies outweighs the perceived value added from the change in practice.

Q10 – unusual income and expenses

a) **Paragraph 100 of the Exposure Draft introduces a definition of 'unusual income and expenses'.**
b) **Paragraph 101 of the Exposure Draft proposes to require all entities to disclose unusual income and expenses in a single note.**

c) **Paragraphs B67–B75 of the Exposure Draft propose application guidance to help an entity to identify its unusual income and expenses.**
d) **Paragraphs 101(a)–101(d) of the Exposure Draft propose what information should be disclosed relating to unusual income and expenses.**

Paragraphs BC122–BC144 of the Basis for Conclusions describe the Board's reasons for the proposals and discuss approaches that were considered but rejected by the Board. Do you agree with the proposals? Why or why not? If not, what alternative approach would you suggest and why?

It is likely that the proposals here relating to unusual income and expenses will mean that entities have to incur additional costs. Entities will have to exercise significant judgement in order to identify unusual income and expenses. This will increase both management and audit time, and thus, translate to additional costs. It is likely that this will have a disproportionate impact on smaller entities. As a result, we would suggest that more consideration on the potential impact that this will have on smaller entities needs to be considered in the first instance.

Q11 – management performance measures

a) **Paragraph 103 of the Exposure Draft proposes a definition of 'management performance measures'.**
b) **Paragraph 106 of the Exposure Draft proposes requiring an entity to disclose in a single note information about its management performance measures.**
c) **Paragraphs 106(a)–106(d) of the Exposure Draft propose what information an entity would be required to disclose about its management performance measures.**

Paragraphs BC145–BC180 of the Basis for Conclusions describe the Board's reasons for the proposals and discuss approaches that were considered but rejected by the Board. Do you agree that information about management performance measures as defined by the Board should be included in the financial statements? Why or why not? Do you agree with the proposed disclosure requirements for management performance measures? Why or why not? If not, what alternative disclosures would you suggest and why?

We do not agree with the proposals due to the significant costs that entities would have to incur in order to identify and provide disclosures in the notes for management performance measures. The costs would arise both in terms of the initial implementation costs for the preparers of financial statements and in the ongoing costs in making such disclosures.

Moreover, bringing management performance measures into the financial statements will result in further ongoing costs as doing so means that they will be subject to audit. This could result in potentially significant costs as some management performance measures are subjective and rely on information outside the accounting systems which auditors do not currently look at. Existing guidance on providing assurance on management information tends to assume that negative assurance is given, whereas this proposal would bring management performance measures into the scope of a true and fair opinion, which is a much higher threshold.

Q12 – EBITDA

Paragraphs BC172–BC173 of the Basis for Conclusions explain why the Board has not proposed requirements relating to EBITDA. Do you agree? Why or why not? If not, what alternative approach would you suggest and why?

We do not agree with the Board's decision not to define EBITDA in this project. EBITDA is a frequently used measure in communications with users of financial information, and there is a lack of consensus about what it represents. Furthermore, investors commonly used EBITDA as a starting point when assessing an entity's performance, as opposed to using operating profit.

It is the belief of some members within the QCA that EBITDA is the sub-total that the Board should have focussed on.

Q13 – statement of cash flows

a) **The proposed amendment to paragraph 18(b) of IAS 7 would require operating profit or loss to be the starting point for the indirect method of reporting cash flows from operating activities.**
b) **The proposed new paragraphs 33A and 34A–34D of IAS 7 would specify the classification of interest and dividend cash flows.**

Paragraphs BC185–BC208 of the Basis for Conclusions describe the Board's reasons for the proposals and discusses approaches that were considered but rejected by the Board. Do you agree with the proposals? Why or why not? If not, what alternative approach would you suggest and why?

We agree with both the proposals relating to the statement of cash flows as they would engender greater consistency and thus comparability between entities. At present, entities use different means for calculating their operating cash flows, as well as presenting interest and dividend cash flows in different places.

Q14 – other comments

Do you have any other comments on the proposals in the Exposure Draft, including the analysis of the effects (paragraphs BC232–BC312 of the Basis for Conclusions, including Appendix) and Illustrative Examples accompanying the Exposure Draft?

We have no comments.

<u>Appendix A</u>

The Quoted Companies Alliance *Accounting, Auditing and Financial Reporting Expert Group*

Matthew Howells (Chair)	Smith & Williamson LLP
Rochelle Duffy (Deputy Chair)	PKF Littlejohn LLP
Edward Beale	Western Selection PLC
Matthew Brazier	Invesco Asset Management Limited
Anna Hicks	Saffery Champness LLP
Mark Hodgkins	Trackwise Designs PLC
Michael Hunt	ReNeuron Group PLC
Clive Lovett	Bilby PLC
Laura Mott	Haysmacintyre
Giles Mullins	Grant Thornton UK LLP
James Nayler	Mazars LLP
Elisa Noble	BDO LLP
Matthew Stallabrass	Crowe UK LLP
Helena Watson	KPMG LLP
Peter Westaway	Deloitte LLP