VMEBF
Bilanzierung in Familienunternehmen

Mr. Hans Hoogervorst
International Accounting Standards Board – IASB
IFRS Foundation
Columbus Building
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London E14 4HD
United Kingdom

Weinheim, 29/09/20

Dear Mr. Hoogervorst,

RE: EXPOSURE DRAFT ED/2019/7

We appreciate the opportunity to comment on the IASB´s exposure draft ED/2019/7 "General Presentation and Disclosures". With this letter, we would like to contribute to the Board's due process and take part in the discussion on the proposals in the above-mentioned exposure draft (ED).

The Association for Participation in the Development of Accounting Regulations for Family-owned Entities (VMEBF) was founded in 2006 and consists of German companies with a strong family shareholder background. Beyond its members, the association represents a huge number of family-owned large and medium-sized entities in Germany, often legally organised in the form of partnerships. The objective of the VMEBF association is to make the role of German family businesses as stakeholders in the development of international financial reporting more visible and to act as a constructive partner for the standard setters. We work closely together with the German standard setter ASCG (Accounting Standards Committee of Germany) and the German Institute of Chartered Auditors (IDW – Institut der Wirtschaftsprüfer in Deutschland e.V.) as well as other political institutions.

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Summing up our comments on the ED, we would state that there is still room for improvements when carrying forward the discussions on the primary financial statements project. We have second thoughts about several of the proposals explained in the ED. In particular, we believe that some of the proposals will lead to an enormous increase in complexity when applying the new regulation and hence cause tremendous implementation costs (e.g. when presenting an analysis of operating expenses using the by-function method in the statement of profit or loss, inducing extensive additional disclosure requirements on a by-nature basis in the notes). From our point of view, the anticipated informational benefits of the proposals will not always be able to outweigh the costs incurred by the new regulations.

Moreover, we believe that especially the proposals on categories to be included in the statement of profit or loss are somehow immature as they do not provide a clear and distinct (principles-based) approach to categorise income and expenses, but instead require a considerable degree of judgement when applying the proposed regulation and hence might trigger a mass of different interpretations (leading to diversity in practice). Additionally, due to partly identical wording we assume that users of financial statement might misinterpret the categories in the statement of profit or loss in imitation of the cashflow from investing activities in the statement of cashflows, although the transactions included are different.

In respect of the discussion on the disclosure of management performance measures, we believe that the Board should not further pursue its deliberations concerning this matter as outlined in the ED. Instead, we suggest the Board should shift discussions on disclosure of a broader scope of performance measures (including alternative and non-GAAP measures) to the management commentary project.

Please refer to the appendix to this letter for our detailed answers to the questions asked in ED/2019/7. If you have any further questions, please do not hesitate to contact us.

Kind regards,

Association for Participation in the Development of
Accounting Regulations for Family-owned Entities (VMEBF)

Andreas Janssen	Santokh Advani	Dr. Michael Reuter
Axel Schade	Prof. Dr. Dieter Truxius	Dr. Thomas Ull

Appendix:
VMEBF comments on the additional questions

<u>Question 1 – operating profit or loss</u>

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 with the general idea that all entities present a standardised subtotal for operating profit or loss in their statement of profit or loss. In our experience, already today a huge number of entities uses and publishes however named subtotals for operating profit or loss as performance indicators. Nevertheless, those subtotals usually are not defined, calculated or labelled in a consistent and comparable way.

As a consequence, the IASB´s efforts to improve comparability of such subtotals are worth of support. However, the usefulness of that kind of information will depend on the specific definition of the subtotal and the components it will be composed of. Please refer to the answers to the questions below with regard to the composition of the different categories of income and expenses.

<u>Question 2 – the operating category</u>

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?

We understand the difficulties the IASB has faced defining the operating category. However, we believe that an approach combining a heavy residual element with the requirement to include information about income and expenses from an entity's main business activities when classifying the operating category might lead to rules requiring a considerable degree of judgement when applying them. Hence, the proposals are likely to trigger a mass of different interpretations of what could be meant by that kind of definition.

Moreover, we consider the term "main business activities" to be insufficiently defined. The main business activities of an entity are a key element of the classification scheme proposed in the ED. Said that, it is essential to an understanding of the proposals that the concept of an entity's main business activities is properly defined. The problems accompanying the missing definition of main business activities already become apparent when looking at the example in par. B26 of the ED. The IASB states that an entity may have more than one main business activity. For example, a car manufacturer that also provides financing to his customers may determine that manufacturing cars as well as providing financing to the customers can be the main business activities of that entity. Without a clear and distinct definition of what is meant by an entity's main business activities, the decision of whether providing financing to customers in the example has to be classified as operating income or expense seems to be rather discretionary and would therefore frustrate the efforts to increase comparability of financial statements.

Furthermore, the IASB uses similar terms to "main business activities" in other standards, e.g "ordinary activities" in IFRS 15 or "business activities" in IFRS 8. We would propose the Board to provide further clarification regarding the potential differences and overlaps of those similar terms.

<u>Question 3 – the operating category: income and expenses from investments made in the course of an entity's main business activities</u>

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 agree with the proposal to include income and expenses from investments made in the course of the entity's main business activities in the operating category. However, as already stated in our answer to question 2, the IASB should provide a clear and distinct definition of what is meant by an entity's main business activities.

In reference to par. B27 of the ED we noticed that the Board lists investment entities, investment property companies and insurers as entities that are likely to invest in the course of their main business activities. In our experience, a large number of industrial companies also invests in start-ups developing industry-specific technology that might prove useful for the investor in the future. We would propose the Board to provide additional guidance on when to categorise such entities in the operating category and when not (as the term "main business activities" is not sufficiently defined).

<u>Question 4 – the operating category: an entity that provides financing to customers as a main business activity</u>

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?

Although we understand the IASB's reasons for providing the above-mentioned accounting policy choice, we do not agree with the "free" accounting policy choice in par. 51(b) of the ED. According to par. 51 of the ED a car manufacturer providing financing to his customers could completely refrain from presenting a financing category. From our point of view, even in that scenario presenting a financing category would provide relevant information to the users of financial statements. As a consequence, an entity providing financing to customers as a main business activity should further on have to classify in the operating category income and expenses from financing activities, and from cash and cash equivalents, that relate to the provision of financing to customers. However, the scope of the policy choice provided in par. 51(b) should be limited to entities that provide financing to customers as their predominant business activity. The predominance of a business activity could be assessed on a business segment level according to IFRS 8. Furthermore, the IASB could think about allowing the policy choice in par. 51(b) if an entity is unable to allocate income and expenses from financing activities on a meaningful basis or would face excessive costs by doing so.

<u>Question 5 – the investing category</u>

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 principally support the idea of introducing an investing category in the statement of profit or loss. Presenting a separate investing category may provide useful information to users of financial statements about the returns from investments that are not part of the entity's main business activities. As already pointed out in our answer to question 2, the definition of what is to be understood as an entity's main business activities will also play a central role when classifying income and expenses in the investing category.

However, we are concerned that implementing the investing category might cause additional complexity as a considerable degree of judgement is required when allocating income and expenses to the particular category. As we believe the amounts classified in the investing category should not be material in most cases, we are not sure whether the benefits of implementing that category would outweigh the costs of doing so.

Moreover, due to partly identical designation we assume that users of financial statement might misinterpret the investing category in the statement of profit or loss in imitation of the cashflow from investing activities in the statement of cashflows, although the transactions included are different.

<u>Question 6 – profit or loss before financing and income tax and the financing category</u>

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?

We support the proposal to require a defined "profit or loss before financing and income tax" subtotal. This should lead to a performance measure similar to Earnings before Interest and Taxes (EBIT). As there is no common and consistent definition of EBIT, the Board´s proposal might be able to satisfy the demand from users of financial statements to be provided with a performance measure (subtotal) similar to EBIT. However, the usefulness of such a subtotal will depend on how the IASB deals with the classification problems described above.

<u>Question 7 – integral and non-integral associates and joint ventures</u>

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?

We understand that identifying and separately presenting information on integral and non-integral associates and joint ventures can provide useful information to users of financial statements. A clear distinction between integral and non-integral associates and joint ventures might show which associates and joint ventures are closely linked to an entity's main business activities and which are not. However, the usefulness of the information provided will – again – depend on how an entity´s "main business activities" are defined. Besides, we apprehend that the proposed requirements would lead to an increase in complexity and cause considerable implementation costs.

In Appendix A of the ED integral and non-integral associates and joint ventures are defined as associates and joint ventures accounted for using the equity method that are integral to the main business activities of an entity and hence do not generate a return *individually and largely independently of the other assets of the entity*. As a consequence, to be an integral associate or joint venture the activities of the investee have to somehow depend on the other assets of the entity. From a practical point of view, it could be useful to broaden the definition of integral associates and joint ventures as there are several examples of associates and joint ventures that are closely linked to an entity *without* the above-mentioned interdependencies and therefore are integral in substance. In this context, we think about associates or joint ventures of an entity working in the same industry as the entity itself and even entering into business relations with it. However, most of the revenues of those associates or joint ventures might be generated independently of the investor and its assets. Nevertheless, in the internal reporting of a group such relationships are often treated as part of its operating business and therefore as integral associates or joint ventures. Another example might be the geographically structured business activities of an international group. In such group structures specific associates or joint ventures often do business in predefined regions exclusively, whereas the investor refrains from doing business in those regions. Again, such associates or joint ventures commonly are treated as integral associates or joint ventures in the internal group reporting. According to the above-mentioned definition, the associates or joint ventures in our examples might have to be treated as non-integral associates or joint ventures, although they commonly are treated as integral in internal group reporting. In summary, applying the definitions of integral and non-integral associates and joint ventures seems to require a considerable degree of judgement and does not necessarily lead to a clear and economically meaningful distinction between integral and non-integral associates and joint ventures. Hence, we would appreciate the IASB adding further guidance on how to apply the definitions in the ED in the situations described. The IASB could even think about applying the management approach when distinguishing between integral and non-integral associates and joint ventures.

Additionally, there is no guidance on how to account for an associate or joint venture if the interdependencies described above change over time.

Regarding the separate presentation of a subtotal for operating profit or loss and income and expenses from integral associates and joint ventures we tend to agree with the proposals if the entity has significant shares of profit or loss of integral associates and joint ventures. Such a subtotal might provide additional and useful information to the users of financial statements. However, according to the amended par. 38A of IAS 7 an entity shall classify dividends received from associates and joint ventures accounted for using the equity method as cashflows from investing activities in the statement of cashflows. By contrast, in the statement of profit or loss only the share of profit or loss of non-integral associates and joint ventures would be presented within the investing category. The share of profit or loss of integral associates and joint ventures would instead be presented within in a separate category outside the investing category. We would propose the IASB to align the presentation requirements in order to increase consistency between presentation in the statement of profit or loss and the statement of cashflows.

Question 8 – 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?

We agree with the proposals regarding the roles of the primary financial statements and the notes as well as with the principles and requirements on aggregation and disaggregation of information in the financial statements. However, we would like to point to the fact that implementing a “multidimensional” classification regime for financial information will lead to an increasing need for coordination within the entity or group and strain system-based plausibility checks.

Question 9 – 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 expens-

es 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 principally agree with the proposal to continue requiring entities to present their operating expenses using either the nature of expense method or the function of expense method of analysis. However, the IASB should retain the "free" choice between the by-function and the by-nature method presenting operating expense. We believe that the guidance proposed in the ED on how to decide on a by-function or by-nature analysis of operating expense requires a considerable degree of judgement and would lead to almost discretionary decisions. Moreover, entities presenting operating expense by function already today provide additional information about the nature of their operating expenses according to IAS 1.104, so we do not see any need to modify existing regulation. From a preparer's point of view, the proposals in the ED could result in vast additional costs as an entity using the by-function method would have to adjust internal processes as well as their ERP systems to provide a detailed by-nature analysis of operating expenses as proposed in the ED. We do not think that the benefits of the proposals can outweigh the costs of the extensive adjustments that would have to be made to the internal processes and systems in order to meet the requirements as proposed by the IASB.

Question 10 – 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?

We welcome the Board's efforts to define "unusual income and expenses" and require disclosure on those items. Already today, many jurisdictions require entities to disclose on however defined unusual income and expenses. Such kind of information enables users of financial statements to distinguish recurring from non-recurring items of income and expense and consequently better predict future earnings or cashflows.

However, we do not agree with the definition of unusual items as proposed in the ED. According to par. 100 of the ED, items of income or expense are defined as unusual if it can reasonably be expected that no items of income or expense that are similar in type and amount will arise for several future annual reporting periods. This could be read in a way that e.g. costs for a restructuring exercise of an entity enduring more than one year would not be presented as unusual items, regardless of whether those costs are considered to be recurring or not. We would suggest the Board to widen the definition of unusual items and also include items of income or expense that only arise "for a limited period of time".

Finally, we agree with the proposal to disclose unusual items in a single note and not include them as a separate line item in the statement of profit or loss. This is due to the fact that the statement of profit or loss is structured by using either the nature of expense method or the function of expense method. An additional requirement or choice on how to show unusual income or expense in a separate line item would perforate the chosen principle of how to analyse and present income and expense in the statement of profit or loss (especially when using the by-function method). Additionally, we would like to point to the fact that par. 101 of the ED requires an entity to disclose "all" unusual items of income and expense. This might – taken literally – conflict with the concept of materiality and lead to excessive costs collecting and processing the information.

Question 11 – 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.

d) 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?

Although we acknowledge the importance of the disclosure of management performance measures from an informational point of view, we do not think that the notes or even the financial statements of an entity are the best place to present such measures. Moreover, the IASB limits the scope of management performance measures to be disclosed to subtotals of income and expenses. We think that this kind of disclosure will not nearly satisfy users' demands for disclosure on management performance measures. In our experience, users of financial information demand detailed information on financial ratios, growth measures or even non-GAAP measures used by management in decision-making. With that in mind, we believe that management commentary would be the best place to show information on a broader scope of management performance or even non-GAAP measures used to manage an entity. Please also allow us to point out, that regulators like for example ESMA already defined own requirements regarding disclosure of alternative or non-GAAP performance measures.

In summary, we believe that the IASB should not further pursue its deliberations on disclosing management performance measures as proposed in the ED. Instead, the Board should shift the discussions on disclosure of a broader scope of performance measures (including alternative and non-GAAP performance measures) to the management commentary project.

<u>Question 12 – EBITDA</u>

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?

Although we see the importance of EBITDA as a performance indicator, we understand the problems the IASB faces when trying to define EBITDA. Thus, we agree with the Board in not proposing requirements relating to EBITDA.

<u>Question 13 – statement of cash flows</u>

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 principally agree with the proposal to require entities to use operating profit or loss as starting point for the indirect method of reporting cashflows as it should increase comparability and might to some extent harmonise the adjustments made to operating profit or loss in the operating cashflow. However, as already stated above, the IASB uses identical labels for the categorisation in the statement of profit or loss and in the statement of cashflows although the categories are defined and composed in different ways. We therefore suggest to intensify discussions on that problem before finalising the project on primary financial statements.

As to the reduction of presentation alternatives regarding interest and dividend cashflows, we agree with the proposals in the ED as this will improve comparability and increase the usefulness of the information provided.

Question 14 – 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 observe that some of the changes proposed in the ED seem to be quite costly to implement without considerable benefits on a preparers' as well as on a users' side. We would ask the IASB to attach great importance to the cost-benefit ratio of the proposals when carrying forward the discussions on the primary financial statements project.