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Dear Stig,

### **PAAinE discussion paper on Performance Reporting**

On behalf of the German Accounting Standards Board (GASB) I am writing to comment on the PAAinE discussion paper "THE PERFORMANCE REPORTING DEBATE: What (if anything) is wrong with the good old income statement?" We welcome the EFRAG intention to initiate a comprehensive debate on Performance Reporting which is intended to integrate views of users, preparers, auditors, standard setters and other groups involved in financial reporting. In our view the EFRAG discussion paper on Performance Reporting represents a useful contribution to a process of developing a high quality presentation model which at the same time would be widely accepted by different groups of market participants. We specially appreciate a comprehensive and well balanced discussion of differing views on Performance Reporting presented in the discussion paper. However, this discussion paper was designed as a high level paper and is therefore less controversial. We are looking forward to the second EFRAG discussion paper on Performance Reporting which aims at developing presentation proposals.

Please find below our detailed comments to the questions raised in the discussion paper. If you would like any clarification of these comments do not hesitate to contact me.

Yours sincerely

Prof. Dr. Harald Wiedmann



**A Is there a need to have a key line in the statement(s) of income and expense that succinctly summarises entity performance, acts as a headline number in corporate communication and can be used as a starting point for further analysis? If so, what should this (or these) key line(s) represent?**

We think key lines are necessary. The following rationales support this view (although the list is not necessarily exhaustive):

- In some situations it is not possible to give consideration to all potentially relevant data. In a case of decisions taken under severe time pressure, concentration on few key figures is indispensable.
- Concentration on a limited set of essential data is typical for information processing by humans.
- Valuation approaches based on earnings or revenue multiples are per virtue based on key lines.
- Key lines are indispensable for financial market communication, especially for communication through business journals and newspapers.

In our opinion there should be a well-balanced combination of standardized key lines and key lines based on the management approach. Key measures such as revenue, bottom line figure (net income) and a few (one or two) additional key lines should be standardized and required to be reported by all entities to allow comparisons between different companies. The standardized key lines should include a “before taxes” key line. The rest should be left to the discretion of the management. These additional key lines selected by the management should reflect the way the business is managed internally.

**B What are the attributes of ‘performance’ in the context of financial reporting of an entity? Are there different types of performance (for example, management performance, entity performance) and if so, what are the types? What do they encapsulate and how can/should they be differentiated?**

We think that the discussion about the definition of financial performance is based on an unrealistic expectation that there is a definition of performance that could suit all purposes. In our view “performance” is:

- a) what is understood as “performance” by a particular market participant in a particular decision-making situation, and
- b) what is defined as “performance” by accounting standards (based on the most appropriate and widely accepted views by the constituents thus being accepted as a convention).

**C Is ‘net income’ (in its current form or a variation thereof) a meaningful and necessary notion? If so, what should it represent and how are items included in net income to be differentiated from other items of income and expense?**

We think net income is useful and necessary. It derives its value from its widespread use and acceptance in practice by both preparers and users, like analysts. We see net income as a convention which is a key measure for the financial success of a company. It determines other key financial measures like Earnings per Share and Return on Equity. As already set out above, we believe that the standardisation of key lines such as revenue, net income and a few additional figures is necessary (for details see the answer to the question A).



**D Does the bottom line of a statement of income and expense bear more weight and significance than other lines of the statement simply by virtue of being at the bottom? Consequently, how many statements of income and expense should there be and why?**

The fact that net income bears more weight and significance than other lines of the statement is of course not based simply on its presentation at the bottom of the income statement. The essential question is what this bottom line represents. As we already set out in our answer to the question C, net income is commonly understood as a key measure for the financial success of a company and derives its value from its widespread use and acceptance in practice. However, the presentation of this key line as a bottom line is in common use and corresponds with the habits of users, preparers and other parties involved in financial reporting.

**E Is recycling needed? If so, what should it be used for and on what criteria should it be based?**

Whereas recycling is less important in the application of the one-statement approach, the recycling procedure is indispensable within the two-statement approach. Given our preference for the two-statement approach and the importance of the realization principle we see recycling as necessary.

Furthermore, we would like to point out that at present recycling is embedded in a number of IFRSs. Whereas the conceptual decision on recycling issue might be taken within the financial presentation project, any change in the application of recycling should be thoroughly discussed in the context of relevant IFRSs and handled according to the due process of the IASB. Some of the presentation proposals currently favoured by both the IASB and the FASB would change the existing measurement standards through the backdoor because items currently shown in equity before recycling would be shown in the individual line items of the income statement. In such a case, the foundation of e.g. cash flow hedging and the currency translation adjustment would be eliminated. Therefore, changes which eliminate the separate presentation of changes to amounts currently recognised in equity would need a detailed discussion in the context of the relevant IFRS.

**F Disaggregation criteria**

According to the project plan the discussion of disaggregation criteria will be part of the second EFRAG discussion paper on Performance Reporting. We therefore decided to defer our discussion of this topic until the second discussion paper has been issued.

**G Are the current IFRS provisions in relation to the netting of items of income and expense appropriate? What (if any) are the specific areas where the current requirements allow information essential for analysis to be concealed or, alternatively, do not permit netting where it would result in more useful information?**

We do not consider current IFRS netting provisions to be appropriate. There are examples in practice where the current provisions result in an inappropriate presentation that does not reflect the substance of the economic transaction in question. For instance, for the service businesses showing gross travel expenses reimbursed by the customer as part of revenues results in a decreased usefulness of operating margin ratios. Another example is the prohibition to offset reinsurance income and related reinsurance expense which does not allow the decision-relevant netted presentation.



**H What is the underlying nature of the adjustments made by entities when reporting non-GAAP measures in their communications with the markets? What are the adjustments seeking to achieve? Please provide specific examples illustrating this. Should any of these non-GAAP measures be incorporated into the IFRS financial reporting model? If that would be desirable, is it feasible and how should it be done?**

In our opinion non-GAAP measures should remain non-GAAP measures and should not be standardized and incorporated into IFRSs. However, as noted above, we believe that key lines in the income statement should be reported based on the management approach. We do not consider such key lines as non-GAAP measures. Any measures however that are neither

- widely used and as such required to allow comparisons across companies
- nor based on the management approach and as such in line with the reporting entity's internal reporting

should not be reported in financial statements under IFRS.

Furthermore we would like to point out that non-GAAP measures presented in financial statements should be reconciled to the GAAP measures when their calculation scheme can not be immediately understood from the income statement.

**I In determining the optimum degree of standardisation of the reporting formats, what is the right balance between comparability and flexibility? In other words, is the level of standardisation in the current IAS 1 appropriate or should more precise formats be prescribed? If the latter, what are the specific areas that should be more stringently prescribed?**

In our opinion there should be a well-balanced combination of standardized key lines and key lines based on the management approach (for details see our answer to the question A). We see the current level of standardisation in the IAS 1 in some areas as going too far (for instance, the separately required presentation of finance costs in the profit and loss statement).