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Discussion Paper Preliminary Views on Financial Statement Presentation

The Swedish Enterprise Accounting Group (SEAG) is a forum for Chief Accountants from the largest Swedish listed companies. The Group is administered by the Confederation of Swedish Enterprise, to which most participating companies of SEAG are joined.

Representing preparers´ point of view, SEAG welcomes the opportunity to comment to the above-mentioned Discussion paper. We do not comment on all issues, but we answer below those of the specific questions in the Discussion Paper that we find most important. However, we would like first to highlight a few key themes:

The far-reaching changes due to the proposed presentation model may have been a proper starting point for the project on financial statement presentation, to portray a cohesive financial picture. However, after having studied the Discussion paper and especially answered a number of the questions, our conclusion is that the proposed model should be reconsidered. The complexity of the activities of many entities, and the variation between entities, are such that many compromises and adaptations are needed, to avoid the model to be a straitjacket to the disadvantage of users' needs. Modifications in the current presentation model may thus lead to the same quality of cohesiveness as the proposed model, without its far-reaching changes. Further, the analysts whom we are in contact with continuously do not express opinions that would give cause for such changes.

We strongly object to a direct method for operating cash flows. (To us the matter is not *presenting* operating cash flows with either a direct or an indirect method, but *achieving the data* needed for the direct method.) We are not convinced that it is at all possible to achieve a real direct method in many, more complex, entities and it would in most entities at least be costly not only to implement such a method but also to run it. Further, we do not find that analysts or users actually demand a direct method.—A so called indirect direct method is of course possible at minor costs, and the risk is obvious that many entities would use such a method, but it would in our opinion be worse than to continue with the indirect method.

Regarding disaggregation of expenses by nature, our objections are similar to those for operating cash flows. At least certain service providers and entities in trading businesses may be able to make such a disaggregation, with reasonable effort; but, at least with more complex manufacturers, we hold that it is unfeasible to make it.— Possibly, such disaggregation could be made with estimates, but we think that a standard should not require disaggregation based on more or less arbitrary estimates. Further, we experience the requirement to disaggregate expenses by nature as a convention rather than due to demand from users, while entity-specific, or industry-specific, disaggregations may be a real demand.

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.

Answer: We agree with the objectives proposed but are concerned regarding some proposals; would the objectives be reached with the proposed changes? The first question to be asked is in what sense the objectives are not reached with the current financial statements model. Basically, we believe that the current model is functioning and understandable, where one could add or change to increase cohesiveness without losing some of the advantages with this model. We aim already on having a cohesive set of statements. However, inconsistencies arise mainly due to the double-function of operating liabilities: part of the core business according to the management approach, but also interest-bearing and included in net debt as a way of funding the operations. We do not believe that these issues are solved with a new format and reconciliation schedules. The same issues will remain and be differently interpreted even with the new format in place. See further our answer on question 2.

We are also concerned that the proposal has a focus on the balance sheet and the changes therein instead of on the income statement, which we believe is more important for both users and preparers. In order to fulfil the cohesiveness objective as proposed, we foresee a production of information that firstly cannot easily be done in current reporting routines in an entity and secondly that we have not experienced being demanded by users and accordingly not assessed as useful. As we see it, e.g. the reconciliation of cash flows to comprehensive income does not give any further information about the performance of an entity, but have among other things a focus on fair value adjustments which, from our experience, not have been an important issue for users and also can be concluded from IFRS 7-disclosures.

We agree that usefulness and helping users make better decisions in their capacity as capital providers are important objectives. However, we do not believe that the proposal provides a major enhancement in these areas since we experience that it is not necessarily more disaggregated information that is needed, and even if so, surely not on the face of the financial statements. On the contrary, users require condensed statements for a better overview and understanding, and they prefer to find additional information in the notes, to be able to choose what information to look into and not get lost in the details or numbers.

Already with the existing format, we usually provide condensed statements in management commentary as a response to requests from users. Increased details would just add on the need for additional “understandable” statements.

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?

Answer: Partly yes, due to the following:

- Identification of the financing and the net debt is often a step in the evaluation of an entity’s enterprise value and for evaluating the capital structure. It is therefore beneficial to simplify the separation of the net debt from the operative net assets.
- Quite often entities have an organisational structure with a central treasury function being responsible for the net debt and an operating organisation responsible for the net assets. An external presentation that supports this is good.
- It will make the statements more transparent if the same classes are presented in all statements.

However partly no:

a) Financing of an enterprise can also be achieved with changed payments terms from/to customers and suppliers. Therefore a strict separation will never be achieved.
b) It must be possible to put debt financing of e.g. customer financing in the same category (business or financing) to make the presentation useful.
c) Questions arise regarding the classification of pension assets and liabilities. This classification seems not to be dealt with in the Discussion Paper despite being an important issue.

Concludingly, we strongly believe that the separation of business activities from financing activities must be based on the management approach and not be regulated in detail.

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?

Answer: Partly yes, due to the following:

- We approve a model with the separation of the activities based on the simple model:

  - Net operating assets - Operating profit
  - + /- Net Debt - Financial net
  - +/- Net income taxes - Income tax
  - = Equity

- This model would simplify the calculation of return measures and capital structure ratios. This is true provided the financing assets and liabilities of an “operating character” are well defined and described.
- See further our answer on question 9 regarding financial services activities.
- From this model follows that the statement of cash flows should reconcile the movement in net debt rather than in cash, as the business and taxes cash flows

results in a movement in net debt that needs to be funded or invested by the treasury (assuming such a function exists).

However, the separation of assets and liabilities related to business and financing activities, respectively, can easily be made within the current format of the statement of financial position, i.e. one asset side (or business and investing) and one liability and equity side (or financing), rather than to redo the format of this statement and present it on a net basis. We also believe that it would be easier to find the components of the working capital in the current format for the statement of financial position. Many key ratios are also based on total assets, and hence we believe it is important to remain with the concept of having a total for assets and for liabilities incl. equity.

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.

Answer: We believe that the classification in the segment reporting and in the consolidated statement of financial position should be the same. From this follows that various items in the balance sheet must be classified based on their use rather than by the type of instrument.

As mentioned before, we support the management approach, and consequently we believe that the classification in the statement of financial position should be based on the management view and be used for each segment. For entities that have both manufacturing and financial services, it is essential that loans, from a financial services perspective, can be placed in the operating category.

Generally speaking, the relation between the proposed financial statement presentation and the segment reporting, under IFRS 8, is a rather complicated issue that needs to be dealt with more than has been done in the Discussion Paper. This issue includes the handling of different reconciliations.

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?

Answer: At large yes. However:

- It should be clarified that both financial assets and financial liabilities for e.g. financial services activities should be put in the same category (business or financing) so that the borrowing related to those assets is not presented in another category. If this is not the case, both assets and liabilities in the same category, it is difficult to calculate key ratios.
- We are concerned about the distinction of operating and investing categories. We understand that the proposal is that a split between the categories should be based on core and non-core activities. The definition of a non-core activity is not obvious in the proposal, and it may not even be possible to have a workable definition. Sale of property, plant and equipment is often considered as non-core activities by management, but is to be reported in the operating category. Furthermore investments in associates and financial assets are suggested to be reported in the investing category in some cases. The definition of an associate is an investment that the entity has significant influence in, and we would expect this always to be a core activity. Since the distinction of the two categories is not obvious, and we don’t see any increased information value for the users, our opinion is that the categories should be limited to operating and financing. We also believe that this would

increase the transparency in the financial statements and the comparability between entities.

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?

Answer: Yes, but see our answer on question 9 to which this is related. To a large extent, the financing section should generally include financial assets and liabilities. However, the definitions should be more clear. A financial asset or a financial liability generally correspond to the definitions of IAS 32, but a lot of entities would argue that liabilities according to IAS 17 Leases and IAS 19 Employee Benefits are to be included in the financial category.

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

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?

Answer: Preferably there should only be a single statement of income, with the conventional net income highlighted. We believe that it would be utterly confusing for the users to have two statements of income where one keeps the title (the income statement) of the present statement prior to the revision of the IAS 1 effective in 2009.

We want to raise two important issues regarding the comprehensive income in a single statement:

1. As we believe it, it is important for both users and preparers to focus on the entity's performance and consequently net income has to remain as a measure for the entity's performance. We believe that keeping net income an important measure will be necessary to help capital providers to take decisions based on their view of management's stewardship or accountability of the entity.

2. In order to have comparability between entities, it would be unfortunate to have two different possibilities to present the income statement. However there are advocates of a single statement as well as of two separate statements.

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?

Answer: As a general comment, we believe that disaggregation in the actual statements should be kept to a level that does not make the statements unusable for the reason of information overload, with a saying one should not miss the forest for all the trees. As a practical guidance, a statement must be presentable on one front page. Already today, users focus on the summary statements on the front page of the interim reports. If the statements become cluttered with detail, they will be reduced to statistics of mainly academic interest.

We question whether the disaggregation by nature gives the users more information about the entity's future cash flows. The first reflection is that by nature could inform on fixed and variable costs, but we believe that in practice e.g. cost of consultants could be as fixed as cost of staff. Likewise, the cost of leasing could be nearly as fixed as that of depreciation.— Disaggregation also by nature seems to be more of a convention, and it should be explained how such a disaggregation can enhance the prediction of future cash flows. At least in more complicated manufacturing entities, disaggregation by nature has to be done roughly or with approximation. How does that affect the actual usefulness of the information?

However, if the disaggregation should be disclosed, it should rather be done in the notes.

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 cohensiveness [*sic*] 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?

Answer: We strongly disagree with the mandatory use of a direct method for cash flow and for the proposed reconciliation schedule. From our practical experience, there is no demand what so ever for the information provided by a direct method by the users. On the contrary, analysts, when questioned, say that they would not trust the direct method. Furthermore, practical tests have shown it virtually impossible to produce real direct cash flow data already for a single entity. For the consolidated level of a large multinational company, the task is close to impossible. The cost and amount of work in reprogramming systems, changing account structures, changing recording processes and changing reporting processes are not motivated by the arguments put forward in the Discussion Paper.

If the information provided by the direct method were in such demand and so useful it would have been implemented long ago. It is further directly contradictive to management approach to make the direct cash-flow mandatory, since we know that it is not the way managements have chosen to follow the cash-flow of its operations for the very majority of all entities.

In the Discussion Paper, to use an indirect method to produce a direct presentation method is discussed. We believe that such an "indirect direct method" would make the information less reliable than staying with the current indirect method. Since the cost of implementing the direct method is considered to be high, the mandatory use of the direct method should be derived from strong requirements from users rather from a requirement to achieve the cohesiveness objective and a reconciliation schedule.

We are also concerned about how to treat currency exchange rate differences when applying the direct method. An additional concern is the elimination of internal cash transactions in the consolidation process. The transparency of the internal transactions is a difficult area and poses a risk of having a negative impact on the quality of the statement of cash flows.

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?

Answer: As the direct cash flow is not in demand by the users, it is not worth investigating in detail the different costs. Still we know from experience that the direct cash flow even by using an "indirect direct method" would require substantial changes to accounts and recording processes. We simply do not see the change as practically achievable. However, if the direct method should be mandatory, we foresee that every transaction must be monitored in two different systems, one for reporting purposes and one for cash flow purposes. The message is that the cost would be the same as setting up a new accounting system in each subsidiary and a new consolidation system for group accounting. Also the systems must carry the increased complexity of dealing with exchange rate currency differences. In the current reporting system, it is not possible to refer these differences to certain items in the income statement. It is not less complicated due to that some of the currency exchange rate differences are realised and some are unrealised. Furthermore, some are presented in the income statement and some in the equity section of the statement of financial position.

It will be interesting to see whether large multinational companies participating in the field test have really investigated the cost of implementing a direct cash flow method that is not according to an indirect direct method and if, having done that, any of them are in favour of the proposed direct method.

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?

Answer: Requirements for information about maturities already exist in IFRS 7, for the most significant balance sheet items. It would be unfortunate to have these requirements in at least two different standards. IFRS 7 is already comprehensive, and to enlarge the maturities disclosures further would give rise to a risk that there is too much information. The way at present to present the assets and liabilities on the face of the statement of financial position together with the disclosures according to IFRS 7 gives the sufficient information to assess the future cash flow of an entity. The proposed disclosure seems to be addressed to entities that are not being considered to have going concern business, and further this information is most probable out of date when the financial statements are published. There could also be a timing difference between contractual maturities and real realisation which in many cases could not be predicted in advance. At least under normal circumstances, financing is an ongoing process, and thus maturities are a formality. When assessing the liquidity of an entity, it would be more interesting with information about unutilised credit facilities.

We are pleased to be at your service in case further clarification to our comments will be needed.

Yours sincerely,

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