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JPC/nd/22.7/1/1 13 June 2003

Sir David Tweedie
Chairman
IASB
30 Cannon Street
London EC4M 6XH

Dear Sir David,

RE: PERFORMANCE REPORTING

With reference to the field visit held between IASB and UNICE on Monday 9 June 2003, we would like to thank you for the opportunity to discuss this important topic and would like to offer the following comments.

UNICE is concerned by the approach taken by IASB on the above issue, and in particular concerning the impact it could have on business.

The attached presentation, which is based on views that were discussed during the above-mentioned field visit, includes an alternative approach which is more acceptable to UNICE. This alternative approach meets IASB's stated objectives and also has the merit of meeting the needs of users.

This is an issue of high importance to business and we would be very happy to discuss our alternative further with members of the Board.

We look very much forward to your reply.

Yours sincerely,

(original signed by)
Jérôme Chauvin
Director, Company Affairs

Encl : 1

Union of Industrial and Employers' Confederations of Europe – Union des Confédérations de l'Industrie et des Employeurs d'Europe
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Performance reporting

European preparers' view

Evolution or Revolution

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Main areas of disagreement with the proposed model

- No sub-levels of income, free of fair value changes, is available for financial communication
- The total column proposes sub-totals, none of which can be read or understood without requiring disaggregation and analysis
- Financing defined as all expenses and income derived from liabilities is not relevant
- Changes in estimates and changes in fair value are of very different natures and should not be mingled

Main areas of disagreement with the proposed model

- There is no available data to link the elements of income to the equity section of the balance sheet, where retained earnings should be divided into earnings arising from net income and other variations in equity
- Other variations in equity should continue to be identified within equity by nature of holding gains and losses
- *Critical to keep internal and external information aligned; avoid drive to proforma accounting*
- *None of the analysts indicated need for radical changes*

The essential features on which reporting performance should be based

- Whether one or two statements are retained, **net income should remain the level at which performance is measured**:
  - it indeed reflects the performance derived through management's strategy and stewardship of the entity's operations
  - it is the level at which management monitors performance internally
- As consequences:
  - Changes in fair value (that is holding gains and losses) should be clearly separated from realised gains and losses and changes in estimates
  - Recycling should be maintained

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The essential features on which reporting performance should be based

- Financing needs to be a **net figure** including:
  - the **cost of debt financing**, debt financing excluding provisions, accruals and accounts payable to suppliers, employees and social and tax authorities
  - **income derived from financial assets** (excluding accounts receivable that are operating assets)
- As such it is consistent with how entities manage treasury

The essential features on which reporting performance should be based

- The reporting format should remain **set out within a single column:**
  - to enhance readability, of the statement itself, of the comparatives, of any pro forma statements required in other standards...
  - to ensure that sub-levels of income used for financial communication are meaningful, each on a stand-alone basis, without requiring disaggregation or supplementary information
  - to ensure a consistent standardised format applicable to both the entity as a whole and segment reporting

Other considerations critical to the IASB project

- In the area of performance reporting, **convergence** is highly critical:
  - future income statement (or more generally financial statement formats) should be a joint - project between IASB-(ASB) and FASB
  - at present, the definition of net income is consistent with both frameworks
  - levels at which performance is measured should remain consistent with both frameworks until such times when, as a joint project, changes are made to the frameworks, and only if jointly thought necessary

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Other considerations critical to the IASB project

- **Financial statements** should be regarded **as a whole:**
  - no exposure-draft should be issued before a statement of cash-flows and of changes in equity are analysed and proposed
  - consistency and inter-relations between the different statements should be ensured, and hence no statement can be addressed separately from others

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Other considerations critical to the IASB project

- Remodelling from head to toe the presentation of performance right after a large number of significant entities adopt IFRS for the first time is **highly untimely**:
  - no standard should deal with the presentation of accounts (apart from standardisation requirements) before users and preparers are used to communicate on the basis of IFRS compliant accounts (2008 - 2010?)
  - the IASB aims at introducing more fair value accounting as time goes by: first the need for such a progression should be assessed under an adequate due process; secondly, such an evolution is one more reason to call for changes in fair value to be shown separately, in order to ensure some consistency in the presentation of accounts from period to period

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Other considerations critical to the IASB project

- The IASB claims that the proposed changes are requested by users of financial statements:
  - no analyst, no investor that we have met is happy with the IASB proposals
  - users call for **standardised formats** that ensure easy access to the understanding of performance
  - users call for an income statement that is **not intended as a side-product of presenting a balance sheet**, but rather helps to appraise the potential of performance in future years
  - users might be interested in changes in fair value of financial assets and liabilities, but insist that it should not be at the cost of losing readability of **income resulting from realised transactions and changes in estimates**

Improvements that can be valuably sought

- **More standardisation** in the presentation and definition of subtotals would be welcome
  - There can be some gain in readability from presenting all gains and losses, whether operating or holding, with the same prominence
  - There can be some gain in readability in identifying variations in equity arising from financial performance separately from variations arising from transactions with owners
- **This objective**, claimed as the sole objective sought by the Board, **can easily be achieved through appropriate alternatives**

Revenue	**XXX**	
Cost of sales	(xxx)	Including impairment or write-down of inventories
Research and development	(xx)	
Distribution costs	(xx)	Including impairment or write-down of receivables
Administrative costs	(xx)	
		Including in each function: related variations in provisions, cost of pensions (full pension cost in accordance with present practice)

Operating income	**XX**	
Gains and losses on disposal of fixed assets	+/- x	
Impairment of fixed assets		
- of which PPE	+/- x	
- of which intangibles	+/- x	
- of which goodwill	+/- x	
Income from associates	+/- x	

Other Business	**x**	

Business profit	**XX**	
Return on equity investments	x	
Other financial income	x	Including impairment or write-down or gains and losses on disposal of financial assets
Fair value gains and losses on trading	x	

Financial	**x**	
Interest expense	**x**	All realised gains and losses incurred from and changes in estimates made to debt financing
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Cost of financing	**X**	
Tax expense	+/- x	
Discontinuing operations (post tax)	+/- x	

Net income	**XX**	
- group	XX	
- minority interests	X	

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Net income	XX
Fair value gains and losses on investment property	x
Revaluation	x
Cash-flow hedges	x
Currency differences on net foreign investments	x
Gains and losses in fair value related to business activities	X
Fair value gains and losses on AFS	x
Fair value changes on debt instruments	x
Gains and losses in fair value related to financing	X
Tax expense related to gains and losses in fair value	x
Total gains and losses in fair value, net of tax	X
Change in equity other than from transactions with owners	XX

Answers to questions raised by the IASB

- The first four questions relate to present practice. Although there are some common features in the way entities present financial information today, there is no way those questions can be answered as a group

Common features in present practice (Questions 1 - 4)

- Reporting financial performance is based on the present generally accepted income recognition criteria: elements of income are accounted for when "they can be measured reliably and have a sufficient degree of certainty"

➡ Holding gains and losses, with the exception of those arising from trading activities, are presented in the statement of changes in equity

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Common features in present practice (Questions 1 - 4)

- Generally, entities aim at identifying a sustainable level of income:
  - in isolating relevant sub-totals of income such as operating profit, and/ or
  - in isolating, within the operating profit, non-recurring items, and/or
  - in disclosing non-recurring items, either in the MD&A or in the notes,
  - through consistent means of presentation from period to period, in order to support readability of financial statements and of the notes by users

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Common features in present practice (Questions 1- 4)

- Generally isolated subtotals include:
  - operating profit,
  - profit before interest and tax,
  - interest cost, net of related interest income,
  - tax,
  - discontinued operations, net of tax,
  - net consolidated income,
  - minority interest,
  - net income.

Common features in present practice (Questions 1 - 4)

- The income statement is analysed by function and/ or by nature:
  - most (but not all) manufacturing and servicing entities present operating profit analysed by function, the other elements of performance being presented by nature
  - financial institutions (banks, insurance companies) present performance analysed by nature

What do you think of the disaggregation into “profit before remeasurements” and remeasurements? (Question 8)

- A format of income statement that does not provide direct readability of the different sub-levels of income without some disaggregation needed is neither relevant to users, nor consistent with entities’ internal reporting
- A disaggregation of information, presented in groups of rows, is however needed to define relevant sub-levels of income: **the relevant separation is, in our view, to isolate changes in fair value (that is holding gains and losses) from other elements of income**
- Changes in estimates may be, if thought needed beyond present requirements, be further disclosed in the notes

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Should there be a separate presentation of financing expenses and financing income? (Question 5)

- In our view:
  - all liabilities are not providers of financing, only financial debts are
  - cost of financing should be presented net of financial income
  - interest expense and financial income can however be presented in separate categories within cost of financing

Should tax be reported in a separate category, and in the total column only? (Question 6)

- In our view the income statement should remain presented in one single column
- Tax expense (income) related to elements of net income should be presented as such
- Tax expense (income) related to changes in fair value should be presented as part of the changes in fair value category

Should there be an “other business profit” category? What should be included? (Question 7)

- Yes, there should be an “Other business profit” category.
- It should include:
  - impairment of long-term assets, either tangible or intangible or goodwill
  - gains and losses on disposal of assets
  - income from associates
- Fair value changes (tangible assets, investment property) and FX gains and losses on net investments do belong to the “changes in fair value” caption

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Should income from associates be reported within operating profit, other business profit or financial income? (Question 12)

- Ideally income from associates should be presented in the category best reflecting management’s intention

- However, for the sake of standardisation, if only one single category should be elected, income from associates should be presented within other business

Should discontinuing activities be presented net, after tax, on a single line, at the foot of the statement? (Question 9)

- Discontinuing activities should be presented net, after tax, separately, either:
  - on a single line, at the foot of the statement, or,
  - divided into operating and financing components.

Should income and expenses arising on designated fair value hedging instruments be presented alongside income and expenses on the hedged item? (Question 10)

- Yes, they should, since such a presentation allows to measure income and expenses on the hedged items on the basis of the hedged conditions

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Should there be a separate category for cash flow hedges? Do you agree with the proposed presentation? (Question 11)

- We agree with the "recycling" mechanism which is incorporated in the proposed income statement
- A presentation in groups of rows as we suggest would however, in our view, offer a more relevant approach:
  - changes in fair value of the hedging instrument would be presented along with other changes in fair value, on a separate line "cash-flow hedges"
  - when the forecast transaction (for example) occurs, the hedged transaction would be measured on the basis of the hedging conditions within operating profit, while the cumulated changes in fair value on the hedging instrument would be shown on the "cash-flow hedges" line

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