Hong Kong Institute of
Certified Public Accountants
香港會計師公會

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28 September 2020

Mr Hans Hoogervorst
International Accounting Standards Board
Columbus Building
7 Westferry Circus
Canary Wharf
London E14 4HD
United Kingdom

Dear Hans,

IASB Exposure Draft ED/2019/7
General Presentation and Disclosures

The Hong Kong Institute of Certified Public Accountants (HKICPA) is the only body authorised by law to set and promulgate standards relating to financial reporting, auditing and ethics for professional accountants, in Hong Kong. We are grateful for the opportunity to provide you with our views on this Exposure Draft (ED).

The HKICPA appreciates the IASB's efforts to improve how information is communicated in the financial statements, with a focus on information about performance in the statement of profit or loss. The HKICPA generally agrees with the IASB's proposals to require more comparable information in the statement of profit or loss and a more disciplined and transparent approach to the reporting of management-defined performance measures.

However, most of our stakeholders do not agree with allowing an accounting policy choice under paragraph 51 of the ED because the option in paragraph 51(b) of the ED may distort the financial performance of non-financial institution entities that provide financing to customers as one of their main business activities. The HKICPA suggests that non-financial institution entities, which provide financing to customers as one of their main business activities, should classify income and expenses from financing activities, and from cash and cash equivalents that relate to the provision of financing to customers, in the operating category unless impracticable to do so. We also recommend the IASB provide illustrative examples relevant to non-financial institution entities on the allocation of income and expenses from financing activities, and from cash and cash equivalents between the operating and financing categories, in order to help these entities to apply the requirements under paragraph 51(a) of the ED consistently.

In addition, some of our stakeholders questioned the usefulness of the IASB's proposal for the split of 'integral' and 'non-integral' associates/joint ventures and considered that the related cost, complexity and potential inconsistencies to preparers of providing the split may outweigh the value to users of financial statements, given there are already requirements under IFRS 12 *Disclosure of Interests in Other Entities* to disclose information related to significant associates/joint ventures. The HKICPA recommends the IASB consider strengthening the existing disclosure requirements in IFRS 12 to request an entity to provide more information about the main business activities of the associates/joint ventures, the subtotals of the statement of profit or loss and the nature of unusual items of the associates/joint ventures, instead of requiring the split of 'integral' and 'non-integral' associates/joint ventures.

Many stakeholders raised concerns that the proposed definition of unusual income and expenses in paragraph 100 of the ED is unclear and highly judgemental. Although the IASB has explained in paragraph BC136 of the ED why past occurrence of income or expense is not considered in the proposed definition, some of our stakeholders still questioned why the proposed definition focuses only on forward-looking information, which may reduce application consistency and increase difficulties for audit and enforcement. The HKICPA recommends the IASB to reconsider incorporating historical occurrence as a relevant factor for the determination of unusual income and expenses, and to provide more illustrative examples on the identification of unusual items.

The HKICPA welcomes the IASB's proposal to define management performance measures (MPM) to address the need of users of financial statements. However, many stakeholders expressed their views that the scope of MPM in paragraph 103 of the ED is too restrictive. Therefore, we recommend the IASB to consider broadening the scope of MPM to cover other financial-related non-GAAP measures which are derived from numbers measured in accordance with IFRSs, to enhance comparability and reduce audit difficulties. We also suggest the IASB should articulate in the Standard clearly the relationship between MPM and the management measures disclosed for segment reporting under IFRS 8 *Operating Segments* to avoid diversity in practice in MPM disclosures.

Some of our stakeholders raised concerns that the principles for classification of fair value gains and losses on derivatives and of foreign exchange differences, as summarised in paragraphs 56-58 and B39-B40 of the ED, are complicated and significantly increase the workload for preparers, and also provide limited information to investors. The HKICPA recommends that the IASB reconsiders the costs and benefits of these proposals before pursuing them.

Our detailed responses to the questions raised in this ED are in the Appendix.

If you have any questions regarding the matters raised in this letter, please contact Joni Kan (jonikan@hkicpa.org.hk) or Katherine Leung (katherineleung@hkicpa.org.hk) Associate Directors of the Standard Setting Department.

Sincerely,

Chris Joy

Chris Joy
Executive Director, Standards and Regulations

Work undertaken by HKICPA in forming its views

The Hong Kong Institute of Certified Public Accountants:

(i) issued an Invitation to Comment on ED/2019/7 on 19 December 2019 to our members and other stakeholders;

(ii) met with representatives from Hong Kong's financial reporting, securities and listing regulatory bodies;

(iii) sought input from its Disclosure Initiative Advisory Panel, Financial Instruments Advisory Panel and Small and Medium Practitioners Technical Issues Working Group, which are mainly comprised of technical and industry experts from large as well as small and medium accounting firms (collectively, Practitioners);

(iv) held a roundtable discussion on 23 June 2020, comprising investors, analysts, preparers and practitioners, with IASB staff participation;

(v) developed its views through its Financial Reporting Standards Committee, having reflected on its stakeholder views. The Committee comprises academics, preparer representatives from various industry sectors, regulators, as well as technical and industry experts from small, medium and large accounting firms;

(vi) conducted research in the following areas in 35 companies listed on the Main Board in Hong Kong (including in industries such as property and construction, telecommunications, information technology, industrials, energy, banks, and insurance) to better understand current reporting preferences in Hong Kong. This research included analysis of:
   a) structure and content of the statement of financial performance;
   b) presentation of operating profit, EBIT and EBITDA;
   c) presentation of share of results of associates/joint ventures; and
   d) use of management performance measures.

This submission outlines the HKICPA's views as well as most of our stakeholders' comments on the ED/2019/7. You may access our stakeholder responses to the ED/2019/7 here:
https://www.hkicpa.org.hk/en/Standards-and-regulation/Standards/Our-views/pcd/financial-reporting-submissions/2020

Detailed comments on IASB ED/2019/7

Structure of the statement of profit or loss

Question 1—operating profit or loss
Question 2—the operating category
Question 3—the operating category: income and expenses from investments made in the course of an entity's main business activities

Stakeholders' views

1. Most stakeholders did not agree with the IASB proposal to define the operating category as a default/residual category, noting that it would be difficult for an entity (especially for a conglomerate entity) to determine what income and expenses should be included in the operating category without a specific and direct definition.

2. As determination of an entity's main business activities is an important factor in the classification of all three proposed categories, most stakeholders recommended the IASB should define the 'entity's main business activities' and provide guidance on determining the 'entity's main business activities'.

3. Stakeholders shared the following examples in particular to illustrate their concerns.

These examples show how the fair value change of an investment property could distort operating profit if the entity considers the property rental is part of the entity's main business activities:

a) A trading/manufacturing company that holds an investment property for rental purposes. The fair value change may be large and could distort operating profit, which could significantly impact how a user of financial statements interprets the trading/manufacturing company's performance.

b) A real estate company may present the changes in the fair value of an investment property in the operating category under the proposals, instead of presenting it below operating profit as would generally be the case under current practice. Economically this is an unrealised gain, and including it in the operating category could affect how an investor assesses the operating profit of the entity, because many investors in practice view operating profit as realised profit.

HKICPA analysis and recommendation

4. The HKICPA considers that determination of an entity's main business activities is an important factor in determining what income and expenses should be classified in operating category. We recommend the IASB to provide clear guidance on determining the 'entity's main business activities' (e.g. consider using the definition of business in IFRS *3 Business Combinations* or ordinary activities in IFRS 15 *Revenue from Contracts with Customers* to provide guidance on an entity's main business activities*)*.

Question 4—the operating category: an entity that provides financing to customers as a main business activity

Stakeholders' views

5. Most stakeholders considered that the IASB's proposed requirements in paragraphs 48 and 51 of the ED, and the proposed illustrative example of a statement of profit or loss for an investment and retail bank, are generally consistent with the current practice of banks and investment funds. Most stakeholders apart from a group of banking industry preparers generally supported the IASB's proposal to give banks the accounting policy choice in paragraph 51 of the ED.

6. However, a group of banking industry preparers disagreed with having a free accounting policy choice, and considered that companies should be required to apply a policy that is appropriate to their business models. They considered that the accounting policy choice should only be allowed for companies providing finance to customers as the sole main business activity.

7. Most stakeholders considered that allowing such an accounting policy choice for a non-financial institution entity that provides financing to customers as a main business activity, for example a manufacturing entity or property development entity, could distort that entity's financial information.

8. Some financial instruments expert practitioners considered that for companies with a central treasury (which raises funding for all the company's activities, and both provides financing to customers and makes investments in the course of the company's main business activities), it may be subjective and arbitrary to allocate expenses from financing activities. For example, allocating interest expense from fund raising between providing financing to customers and investing in equity

instruments. They understand that the IASB has noted this difficulty in paragraph BC66 of the ED, and recommended the IASB provide more guidance to help companies perform the allocation in order to apply the option in paragraph 51(a) of the ED consistently.

9. Some stakeholders considered that instead of having an accounting policy choice, a viable alternative might be to have an impracticable exemption−i.e. require an entity that provides financing to customers as a main business activity to classify the income and expenses from financing activities and from cash and cash equivalents that relate to the provision of financing to customers in the operating category, unless impracticable to do so. If impracticable, then all such income and expenses should be classified in the operating category.

HKICPA analysis and recommendation

10. The HKICPA generally supports the IASB's proposal to give banks and other financial institution entities an accounting policy choice for the classification of income and expenses from financing activities, and from cash and cash equivalents, and we note from our stakeholders that the IASB's proposed requirements in paragraphs 48 and 51 of the ED, and the illustrative example of a statement of profit or loss for an investment and retail bank, is consistent with our understanding of the current practice of banks and investment funds. As the determination of an entity's main business activities is also an important factor in the proposals in paragraphs 48 and 51 of the ED, we recommend the IASB consider our comments in paragraph 4 above.

11. However, we are of the view that the accounting policy choice under paragraph 51 of the ED will reduce the comparability of the financial performance between non-financial institution entities that provide financing to customers as the entity's main business activity, and those that do not. Therefore, the HKICPA suggests that non-financial institution entities that provide financing to customers as one of the entity's main business activities, should be required to classify income and expenses from financing activities, and from cash and cash equivalents, that relate to the provision of financing to customers, in the operating category unless impracticable to do so. If impracticable, then all such income and expenses should be classified in the operating category. We also recommend the IASB to provide illustrative examples for a non-financial institution entity on the allocation of income and expenses from financing activities, and from cash and cash equivalents, between operating and financing categories in order to help these entities apply the requirements under paragraph 51(a) of the ED consistently.

Question 5—the investing category

Stakeholders' views

12. Stakeholders generally support the proposal. Some stakeholders however considered that applying paragraphs 47-48 of the ED would be subjective and difficult without clear guidance on how to interpret 'largely independently' and 'entity's main business activities'.

HKICPA analysis and recommendation

13. The HKICPA is generally supportive of the proposals in the ED. As noted above, we do however recommend clear guidance on determining the 'entity's main business activities'.

Question 6—profit or loss before financing and income tax and the financing category

Stakeholders' views

14. Stakeholders generally support the proposal. Some stakeholders considered it would be helpful for the IASB to provide clarification of the following:
    a) Why interest expenses on lease liabilities are classified in the financing category in cases where the leased assets are used in the production of goods.
    b) How to classify the effect of financing for a contract that has a significant financing component under IFRS 15.

HKICPA analysis and recommendation

15. The HKICPA is generally supportive of the proposals in the ED and supports our stakeholders' suggestion in paragraph 14 that the IASB should provide clarification of those examples in order to help the stakeholders to apply the proposal consistently.

Integral and non-integral associates and joint ventures

Question 7—integral and non-integral associates and joint ventures

Stakeholders' views

16. Regulators and preparers generally supported the proposed split of integral and non-integral associates and joint ventures, but acknowledged judgement would be required and that the proposed definition and indicators in proposed new paragraph 20D of IFRS 12 *Disclosure of Interests in Other Entities* are insufficient for companies to be able to distinguish between integral and non-integral associates/joint ventures. To ensure consistent application between entities, these stakeholders recommended that the IASB should develop sufficient guidance to help preparers distinguish between integral and non-integral associates/joint ventures, and help practitioners/investors assess how that distinction has been applied.

17. Investors and practitioners also considered that it would be difficult for preparers to split a portfolio of associates and joint ventures between integral and non-integral, particularly for a conglomerate company that has different businesses, which would increase the complexity of performing the split and would likely lead to diversity in practice.

18. A preparer recommended that the IASB should clarify whether finance costs incurred on a loan to integral associates and joint ventures (that forms part of the carrying amount of the net investment in these associates/joint ventures) should be grouped and presented above the proposed subtotal of operating profit and income and expenses from integral associates and joint ventures in the statement of profit or loss.

19. Some stakeholders questioned the usefulness of the distinction between 'integral' and 'non-integral' associates/joint ventures and the presentation and disclosure requirements. Some stakeholders considered that the related cost, complexity and potential inconsistencies may outweigh the usefulness of the resulting information given there are already requirements under IAS 24 *Related Party Disclosures* and IFRS 12 to disclose material related party relationships and information related to

significant associates/joint ventures.

20. An investor suggested the IASB should instead develop better disclosures about the characteristics and risk profile of associates/joint ventures in the notes. This stakeholder also commented that the proposed subtotal of operating profit and income and expenses from integral associates and joint ventures is misleading to users of the financial statements because the company does not have control over those investees.

21. A practitioner considered that the IASB's proposals do not fit all industries and business models and shared an example of a shipping company which jointly operates all of its ships through joint ventures. Applying the proposals, the shipping company would be required to present the income and expenses from joint ventures below operating profit. As a result, only the company's operating expenses will be classified in the operating category, which may result in an operating loss that is meaningless and misleading to the users of financial statements. It was noted that although the IASB has proposed a new subtotal 'operating profit or loss and income and expenses from integral associates and joint ventures', users often focus on operating profit or loss first, and as such, that manner of presentation could create unnecessary confusion.

HKICPA analysis and recommendation

22. The HKICPA appreciates the IASB's proposed split of 'integral' and 'non-integral' associates/joint ventures to reduce the diversity in practice in the presentation of an entity's share of profit or loss of associates/joint ventures. However, we consider that the IASB's proposal for the split of 'integral' and 'non-integral' associates/joint ventures will add burden for preparers, especially for entities that have a portfolio of associates/joint ventures, and the cost of the proposals may outweigh their benefit.

23. The HKICPA recommends the IASB considers strengthening the existing disclosure requirements in IFRS 12 to require entities to provide more information on the main business activities of associates/joint ventures (e.g. nature of the business), and the subtotal of the statement of profit or loss and nature of unusual items of the associates/joint ventures, instead of proposing the split of 'integral' and 'non-integral', in order to help users of financial statements understand how the company invests in the associates and joint ventures to develop its business.

24. If the IASB were to proceed with its proposal on the split of 'integral' and 'non-integral' associates/joint ventures, the HKICPA strongly recommends that the IASB should provide more guidance on how to do the split, and provide more key and commonly used indicators, other than significant interdependency as provided in paragraph 20D of IFRS 12 in the ED, that the entity should consider when assessing whether an associate or joint venture is integral or non-integral to an entity's main business. Such indicators could include the investment objective in the associate or joint venture and how management evaluates the performance of the associate or joint venture.

Roles of financial statements, aggregation and disaggregation

Question 8—roles of the primary financial statements and the notes, aggregation and disaggregation

Stakeholders' views

25. A regulator supported the proposed principles and requirements for the aggregation and disaggregation of information because they often encounter difficulties in understanding the significant line items named 'others' in the financial statements. The proposals would allow them to understand the nature and amount of the items included in 'others' more clearly.

26. Another regulator commented that:
    a) the IASB should define the term 'characteristics' in order to avoid different understanding of the intended meaning of this term and diversity in practice as many stakeholders may find it novel to determine whether items can be aggregated by using the term 'characteristics'; and

    b) the IASB's proposed disclosure requirements for groups of immaterial items in paragraph 28 of the ED is difficult to apply without a quantitative threshold for separate disclosure of the immaterial items and expressed concern about difficulties in the enforcement of the disaggregation principles and requirements.

27. Some practitioners considered that the cost of the IASB's proposed disclosure requirements for groups of immaterial items in paragraph 28 of the ED will outweigh the benefits to the users of the financial statements.

HKICPA analysis and recommendation

28. The HKICPA generally supports the proposed description of the roles of the primary financial statements and the notes and the IASB's proposal to improve disaggregation of information in the financial statements which could help users of the financial statements to understand the nature and amount of the items. We agree with the reasons stated in paragraph BC26 of the ED for not providing quantitative thresholds for disaggregation.

Question 9—Analysis of operating expenses

Stakeholders' views

29. Stakeholders generally supported the IASB's proposals about the analysis of operating expenses and the corresponding application guidance, including the proposed disclosure requirements for the analysis of operating expenses by nature in the notes if an entity presents its operating expenses by function in the statement of profit or loss.

30. A group of banking industry preparers agreed with the IASB's proposals. Nonetheless, they would like further guidance in a form of illustrative examples from the IASB on distinguishing the nature of expense and function of expense methods, in order to eliminate existing confusion over the distinction between these methods.

31. Investors generally considered that primary statements should not be overly detailed. An investor questioned why the option to present the analysis of operating expenses in the notes is proposed to be removed in the ED. He noted that investors

usually analyse the primary statements together with the corresponding notes, and so the detailed analysis should be disclosed in the notes so that the statement of profit or loss could be more concise and uncluttered. This investor also suggested the IASB should provide additional examples to illustrate the minimum line items to be presented in the statement of profit or loss (i.e. an example which shows only the required line items in the statement of profit or loss without presenting additional line items).

HKICPA analysis and recommendation

32. The HKICPA supports the IASB's proposed requirements in paragraphs 68 and B45-47 of the ED to present an analysis of operating expenses using the single method that would provide the most useful information to the users of financial statements, including the corresponding application guidance.

33. The HKICPA also agrees with the proposed disclosure requirements in paragraphs 72 and B48 of the ED to provide analysis by nature in the notes for an entity that provides analysis of operating expenses by function in the statement of profit or loss to facilitate investors in performing forecasts.

Question 10—Unusual income and expenses

Stakeholders' views

Definition

34. Stakeholders generally considered the proposed definition of unusual income and expenses in paragraph 100 of the ED is unclear, highly judgemental and subject to interpretation. They observed that unusual income and expenses vary across entities and this is subject to manipulation because management might exercise bias on these items in order to present a better performance of the entity.

35. Many stakeholders questioned why the identification of unusual income and expenses focuses only on forward-looking information. A few stakeholders suggested the identification of unusual items should be based on their nature and amount. The management's rationale for such identification should be clearly disclosed in the financial statements.

36. A regulator acknowledged that the IASB considered past occurrence in the identification of unusual items as explained in BC136 of the ED, but commented that the proposed definition's focus on the future may reduce application consistency and increase the difficulties for enforcement by regulators. This regulator recommended the IASB should re-consider whether past occurrence of an item can be a relevant factor for the identification of unusual income and expenses.

37. Practitioners shared similar comments as the regulator on the proposed forward-looking definition of unusual income and expenses, and noted that it may lead to loss of comparability among entities given that identification involves significant judgement. They also expressed concerns on how these items would be audited. A practitioner also commented that the introduction of unusual items adds complexity for preparers that may not justify the benefits of the resulting information.

38. On the other hand, an investor said he welcomed the IASB's proposals, particularly the determination of unusual income and expenses being based on forward-looking information, which is consistent with how investors use forward-looking information

for their cash flow forecasts. This investor also shared his observations that an increasing number of entities are disclosing non-recurring or similarly described items in their financial statements, and users would find it helpful to have a reconciliation of those items to the IFRS specified totals or subtotals to facilitate an understanding of how those items are determined.

39. Stakeholders generally recommended the IASB should provide more guidance or examples to illustrate and clarify how to apply the guidance for identification of unusual income and expenses to increase consistent application and reduce interpretation. Specific comments and suggestions included:

    a) During the outbreak of Covid-19, certain additional costs incurred in the current year may or may not continue to be incurred in future years. It is difficult to make predictions under the current uncertain situation and hence determine whether these costs would meet the proposed definition of unusual items. For example, an entity may determine the additional costs incurred related to Covid-19 are unusual expenses in 2020 because it is expected that Covid-19 is unlikely to reoccur in the following few years. However, if there is an outbreak of Covid-19 again in 2021, it is unclear whether the entity should continue to classify the related additional costs as unusual. Classifying those costs as unusual in 2020 would therefore be inappropriate and require a prior year adjustment to be made.

    b) Requests to clarify the meaning of ‘several future reporting periods’ in the application guidance through example scenarios.

Disclosures

40. Nevertheless, stakeholders generally agreed with the proposed required disclosures of the unusual income and expenses as summarised in paragraph 101 of the ED. However, a group of banking industry preparers did not support the IASB’s proposal considering there are disclosure requirements with similar purposes (i.e. to require provision of information to facilitate users of financial statements to understand more about the entity’s financial performance), for example, IFRS 8 *Operating Segments* requires explanation of the measurement of segment information and reconciliation between segment information and the entity’s financial performance reporting under IFRS standards.

41. These stakeholders suggested the IASB considers other means of disclosure, such as presentation as part of the management performance measures (MPM) and narratives.

42. A preparer and a practitioner also showed support for the suggestion that the IASB should include unusual income and expenses as part of the scope of MPM instead of separately defining it, due to its unclear and highly judgemental definition.

HKICPA analysis and recommendation

43. The HKICPA appreciates the IASB’s proposal to define unusual income and expenses and its proposed disclosure requirements because this would increase the transparency and comparability across entities, and reduce entities’ opportunistic classification of expenses as unusual. In view of the comments from stakeholders on the proposed definition in paragraph 100 of the ED, we suggest the IASB should take into account both the past occurrence and the future expectations of an item for determination of unusual income and expenses, and clearly state in the Basis for Conclusions that the past occurrence is not a decisive

factor. This could help to reduce interpretation which would improve comparability across entities, and reduce difficulties for audit and enforcement.

44. The HKICPA also recommends the IASB to provide more illustrative examples (as suggested by our stakeholders in paragraph 39) on how the determination of unusual income and expenses should be made in order to improve the application consistency.

Management performance measures

Question 11—Management performance measures

Stakeholders' views

Scoping

45. Many stakeholders raised concerns that the scope of MPM in paragraph 103 of the ED is too restrictive as it only focuses on subtotals of income and expenses, which may reduce the benefits to investors. Stakeholders shared their observations that entities disclosed other performance measures (e.g. current ratios), including non-financial performance measures.

46. Regulators shared their observations and expressed the following concerns about the IASB's proposals on MPM:

a) Management disclose many measures, other than those covered by the proposed definition of MPM, for example, measures related to the financial position and cash flows of an entity. It is considered that all these measures should also be subject to the MPM requirements.

b) Organisations such as the Hong Kong Stock Exchange Limited (HKEx) and the Board of the International Organisation of Securities Commissions have issued guidance on the presentation of non-GAAP measures. It is recommended the IASB should widen the scope of MPM to cover all non-GAAP measures to have a consistent presentation and disclosures, and to enhance the comparability among entities.

c) The proposed definition of MPM does not restrict measures to those only based on amounts recognised and measured in accordance with IFRSs. Allowing the use of MPM prepared on a different basis or in conflict with IFRSs may raise difficulties for verification of the adjustments by auditors and how much audit work should be performed to assure the reliability and fairness of the information presented. Allowing the use of MPM prepared not in accordance with IFRSs may also be abused by entities and it is questioned how such usage could be safeguarded.

d) It is acknowledged that the IASB explains in paragraph BC155 of the ED the reasons why limited restrictions have been applied in the proposals, however, such proposals are inconsistent with the guidance issued by the HKEx on the presentation of non-GAAP measures. The guidance states 'a listing applicant should not use individually tailored accounting principles, including certain adjusted revenue measures'. For example, it is observed that one of the reconciling items for the MPM is revenue adjustment in Note 2 of pages 11-13 of the illustrative examples accompanying the ED, which is not allowed under the guidance from the HKEx. There hence may be unintended regulatory consequences from such proposals.

47. Preparers also shared similar comments that the scope of MPM is not comprehensive as it only forms a sub-set of the Alternative Performance Measures as defined in ESMA Guidelines on Alternative Performance Measures. Preparers also considered there is insufficient knowledge and time for users of financial statements to understand how MPM proposals would provide them with useful information and comment on the proposals. Preparers suggested the IASB should carry out a separate project to broaden the scope of MPM, and should provide more targeted education about the current use of MPM to users and allow sufficient time for their feedback.

48. Some practitioners expressed concerns that the proposals cover all public communications (used in the definition of MPM) is too wide and may lead to audit difficulties and recommended the IASB should restrict the public communications to those published together with the annual/interim reports and covering the same reporting period as the audit/review. A practitioner recommended the IASB should explain in the Basis for Conclusions whether other measures, which do not meet the proposed definition of MPM, could be presented in the financial statements and whether the IASB has any plan to address these measures.

Disclosures

49. Some stakeholders suggested the IASB should articulate in the Standard clearly the relationship between MPM and the management measures disclosed under segment reporting to avoid diversity in practice in MPM disclosures.

50. A group of banking industry preparers agreed with the IASB's proposal to include MPM in the financial statements and the proposed disclosure requirements, which would be useful for all users including those who previously had no knowledge on how to derive those measures. However, they would like the IASB to consider whether to implement these disclosures as voluntary requirements for:

    a) highly regulated entities (e.g. authorised institutions supervised by the Hong Kong Monetary Authority) which have already made other extensive regulatory disclosures reflecting various aspects of their performance and published concurrently with the financial statements; and

    b) unlisted entities where the cost of preparing such additional disclosures may exceed their benefit.

51. This group of stakeholders also suggested the IASB should consider providing a specific list of required disclosures for MPM to promote consistency among entities and consider other commonly used performance measures other than sub-totals only.

52. Some practitioners from small and medium firms shared similar thoughts that the proposed requirements for MPM should only apply to public entities, and not to private companies.

53. Preparers commented that the proposed disclosure requirements in paragraph 106 of the ED are excessive and would significantly increase the workload and costs for them. A preparer shared that although entities may provide additional disclosures to sophisticated analysts and investors to address their needs, providing such

extensive disclosures to less sophisticated users would be overwhelming and may be confusing for them as they are less familiar with IFRSs.

54. Preparers also raised concerns about the practical difficulties and complexity in providing sufficient information about how MPM is calculated for auditors' verification.

55. Investors have split views on the MPM proposals. Even though the proposals on MPM may provide some useful information to investors, the extent of details should be balanced with the incremental costs incurred by preparers. It is noted that the most critical disclosure would be the reconciliation from MPM to the nearest IFRS specified total or subtotal, which could provide users with a better understanding of the underlying performance of the business.

56. An investor commented that it is currently difficult to understand the MPM disclosed by entities. This investor is also sceptical of the usefulness of MPM as they could be easily manipulated by management.

HKICPA analysis and recommendation

57. The HKICPA appreciates the IASB's proposal to define MPM to provide insight to investors on how management views and manages an entity's financial performance. To address the comments from stakeholders that the proposed scope of MPM in paragraph 103 of the ED is too narrow, we recommend the IASB to widen the scope to cover other financial-related non-GAAP measures which are derived from numbers measured in accordance with IFRSs, to reduce audit difficulties and enhance the comparability among entities with required disclosures for all MPM.

58. The HKICPA also suggests the IASB restricts the 'public communications' criterion of the definition of MPM to those communications published together with the annual/interim reports and covering the same reporting period to minimise audit difficulties, given the current proposed scope of public communications appears very wide.

59. Furthermore, the HKICPA recommends the IASB to clarify the linkage between MPM and segment reporting under IFRS 8 to avoid diversity in practice in MPM disclosures, as the relationship is not clear in paragraph B83 of the ED. We also suggest the IASB clarifies whether a change in the adjustment for unusual items, for example when new items meet the proposed definition of unusual items, constitutes a change in calculation of the MPM (if MPM adjusts for unusual items).

Question 12—EBITDA

Stakeholders' views

60. Stakeholders shared mixed views on whether the IASB should define EBITDA. Some stakeholders noted that EBITDA and EBIT are widely used and there is diversity in practice in how to calculate these measures. Defining EBITDA or EBIT could reduce the diversity and misleading use of the terms. On the other hand, some stakeholders noted it is not necessary to define EBITDA because how it is determined is clear from the MPM required disclosures.

61. An investor supported the IASB's proposals not to define EBITDA, but suggested the IASB should instead identify 'operating profit or loss before depreciation, amortisation and impairment' as an IFRS specified subtotal to provide users with better insight on the free cash flows of an entity.

HKICPA analysis and recommendation

62. The HKICPA supports the IASB not to define EBITDA for the reasons explained in paragraphs BC172 and BC173 of the ED.

Statement of cash flows

Question 13—Statement of cash flows

Stakeholders' views

63. Stakeholders generally supported the IASB's proposed targeted improvements to the statement of cash flows and the proposed clarification of financing activities in IAS 7 *Statement of cash flows*.

64. A group of banking industry preparers considered the principle for classification of the cash flow statement should align with the classification of the corresponding income or expenses in the statement of profit or loss. These stakeholders suggested the IASB clarifies whether all interest and dividend cash flows should be classified as operating if an entity provides financing to customers as a main business activity and selects the accounting policy choice under paragraph 51(a) of the ED, and update the relevant Illustrative Example accompanying the ED upon clarification.

65. The financial instruments expert practitioners generally supported the IASB's proposals to remove the accounting policy choice and require entities with particular business activities, including banks, to classify cash flows from interest received/paid and dividends received depending on the classification of the related income and expenses in the statement of profit or loss, and classify cash flows from dividends paid as cash flows from financing activities.

66. Some financial instruments expert practitioners recommended the IASB should review IAS 7 more broadly to align its categorisation with the statement of profit or loss for consistency purposes, and to further clarify the definition of cash and cash equivalents given the current definition is unclear (i.e. what does it mean by readily convertible to a known amount of cash and subject to an insignificant risk of changes in value), particularly when practitioners attempt to apply it to the variety of modern types of money market funds.

67. Some practitioners shared their observations that the IASB's proposal may change the classification of the following related cash flows:

    a) cash flows related to Tier 2 instruments that are not classified as equity for banks would potentially change from the financing to operating category; and

    b) cash flows related to interest paid on loans would potentially change from the operating to financing category.

68. An investor commented that it is helpful to have the split of dividends paid from integral and non-integral associates and joint ventures, but that the cost versus benefits of this proposal should be considered carefully.

HKICPA analysis and recommendation

69. The HKICPA supports the IASB's proposals on the targeted improvements to the statement of cash flows, particularly to eliminate options for the classification of interest and dividend cash flows under IAS 7 to improve comparability across entities. In addition, we recommend the IASB should review IAS 7 as a separate project to align the categorisation in the statement of cash flows with those used in the statement of profit or loss, and reconsider the definition of cash and cash equivalents.

Others

Question 14—Other comments

Stakeholders' views

Structure of the statement of profit or loss

70. Some stakeholders commented that the three proposed categories in the statement of profit or loss are named similarly to the three activities in the statement of cash flows and this may confuse preparers and users of financial statements.

71. Some stakeholders considered that the IASB should clearly identify the linkage and differences between each of the categories in these two statements in the Basis for Conclusions (e.g. as done for the investing category in paragraph BC51 of the ED). A preparer suggested clarifying this within the Standard, not just in the Basis for Conclusions, to ensure clarity. In addition, a group of banking industry preparers suggested the IASB consider altering the category names in the statement of profit or loss to distinguish them from those in the statement of cash flows.

Classification of fair value gains and losses on derivatives and of exchange differences

72. A group of financial instruments expert practitioners generally agreed with the proposals in paragraphs 56-59 of the ED. The proposals are considered to be conceptually sensible, though it may not be very clear in practice how to apply the principles in the ED in some scenarios. Some of these practitioners shared similar views that further guidance in a form of illustrative examples on classification for fair value gains and losses on derivatives and hedging instruments would be appreciated.

73. Examples suggested by the financial instruments expert practitioners to be clarified by the IASB include:

    a) Whether the classification of fair value gains and losses on embedded derivatives (e.g. conversion option separately accounted for and not classified as equity in a convertible bond) follows the general proposal for derivatives or depends on where the embedded derivatives originate (e.g. because the fair value gains and losses originate from a convertible bond, so it should be classified as financing).

    b) How to classify the fair value gains and losses of a hybrid financial instrument which has been designated as a fair value through profit or loss financial instrument as a whole.

c) For an interest rate swap with two legs separated and designated for different purposes, whether the corresponding changes in fair value of the interest rate swap should be classified according to the risks being managed by the entity or wholly recognised under the investing category, e.g. whether part of the change in fair value of the swap goes into one line item of the statement of profit or loss and the other part goes through a different line item.

d) Whether the ineffective portion of the fair value changes of a qualified hedging instrument should be classified in a different line item in the same category as the effective portion, or in the investing category by default.

74. A financial instruments expert practitioner raised concerns about how to operationalise the 'undue cost or effort' exemption in paragraph 58 of the ED, in particular from an audit perspective. This practitioner thought that an entity should be expected to understand the objectives of holding derivatives, and hence should not have to incur undue cost or effort to determine the classification of the corresponding fair value gains and losses. The practitioner recommended the IASB to provide more clarity in the application of the proposed requirements.

75. A group of banking industry preparers considered the proposed requirements in paragraph 58 of the ED for derivatives used to manage risks but not designated as hedging instruments could effectively imply an introduction of a new category of 'hedging' which could create confusion and complication in the existing hedge accounting framework, and could result in inconsistency in application and interpretation. They suggested the IASB reconsiders the cost and benefit of the proposal and whether it should be pursued.

76. This group of stakeholders also considered the proposed requirements in paragraphs 56 and B39 of the ED would require significant and complicated changes to accounting systems in order to allocate foreign exchange differences based on the originating activity for which it arises. Foreign exchange risks are often be managed centrally (e.g. by a central treasury function) even though the foreign exchange exposure arises from various types of activities. Presenting all foreign exchange differences in an aggregated total could be equally relevant, if not more appropriate, for users of the financial statements as that can better reflect the actual risk management activities and resulting economic position of an entity. They suggested the IASB revisiting the cost and benefit of the proposal and whether it should be pursued.

77. A preparer raised concerns that the principles for the classification of fair value gains and losses on derivatives and of exchange differences in paragraphs B39-B40 of the ED are complicated and difficult to understand. This preparer questioned why the presentation of fair value gains and losses on derivatives would not be differentiated based on whether the derivatives are designated as hedging instruments (i.e. fair value changes on derivatives used to manage risks and not designated as hedging instrument should follow different classification principle with those fair value changes on derivatives designated as hedging instruments), meaning such presentation may not be useful to investors. This preparer considered the existing disclosure requirements under IFRS 7 *Financial Instruments: Disclosures* on financial risk management are sufficient for investors to understand the hedging relationships designated by an entity and how management manages the financial risks of the entity. Moreover, this preparer also commented that the incremental costs incurred by preparers to perform the proposed separate classification appeared to outweigh the benefits to users, unless there is a strong need for such information by users.

78. Investors generally agreed with the preparer's view (paragraph 77) and considered that the proposals for classification of fair value gains and losses on derivatives and of exchange differences would provide limited benefits to them. An investor commented that a balance should be made between the information needs of investors, the work done by preparers, and the competitive disadvantages of disclosing too much information to the public, particularly for public interest entities.

Other comments

79. Some practitioners noted changes in terminology used in the ED, for example 'equity shareholders of the company' used under IAS 1 *Presentation of Financial Statements* is replaced by 'holders of claims against parent classified as equity' in page 6 of the illustrative examples accompanying the ED. They questioned the reasons for the change as this increases the difficulties in understanding the financial statements and creates confusion for users.

HKICPA analysis and recommendation

Structure of the statement of profit or loss

80. Based on the HKICPA's research on the presentation of the statement of profit or loss in Hong Kong, the HKICPA observed that operating profit or loss is one of the most commonly used subtotals. We also observed that various different subtotals are used by companies in the statement of profit or loss, and there is diversity in practice in the labelling and calculation of these subtotals. Therefore, we support the IASB's proposals for introduction of subtotals and categories in the statement of profit or loss to reduce the diversity in practice and improve the comparability of financial information between entities.

81. The HKICPA understands that the IASB is not seeking full alignment between the categories in the statement of profit or loss and those in the statement of cash flows. However, in view of our stakeholders' concerns above about the similarly named categories in both statements, we suggest the IASB should explain more clearly the linkage and differences between each category in these two statements in the Basis for Conclusions.

Classification of fair value gains and losses on derivatives and of exchange differences

82. Based on the stakeholders' feedback, the HKICPA considers the proposals summarised in paragraphs 56-59 and B39-B40 of the ED are complicated and significantly increase the workload for preparers, but provide limited information to investors. We recommend the IASB aim to balance the costs and benefits and reconsider whether to pursue the proposals.

83. We also recommend the IASB to carefully consider the points noted from our stakeholders with regard to the classification of fair value gains and losses on derivatives noted in paragraphs 73-75 to ensure that entity's risk management activities are appropriately and consistently represented.

Other comments

84. The HKICPA generally agrees with the stakeholders' recommendations. Particularly, we recommend the IASB should minimise the change in terminology as mentioned in paragraph 79 to reduce misunderstanding, and if necessary, explain clearly the reasons for such change in the Standard.

~ End ~