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Japanese Bankers Association

Comments on the International Accounting Standards Board's Exposure Draft
ED/2019/7 *General Presentation and Disclosures*

The Japanese Bankers Association (the "JBA")[1] is pleased to provide comments on the Exposure Draft ED/2019/7 *General Presentation and Disclosures* (the "ED") issued by the International Accounting Standards Board (the "IASB").

The JBA appreciates the IASB's efforts to consider improving how information is communicated in the financial statements, responding to the strong demand from stakeholders. While we support many of the proposals in the ED, we would like to provide some specific comments from the viewpoint that information included in financial statements should be presented or disclosed in consideration of the characteristics of each industry in order to increase its information value.

Answers to specific questions

Question 1—operating profit or loss
Paragraph 60(a) of the Exposure Draft proposes that all entities present in the statement of profit or loss a subtotal for operating profit or loss. Paragraph BC53 of the Basis for Conclusions describes the Board's reasons for this proposal. Do you agree with the proposal? Why or why not? If not, what alternative approach would you suggest and why?

Question 2—the operating category
Paragraph 46 of the Exposure Draft proposes that entities classify in the operating category all income and expenses not classified in the other categories, such as the investing category or the financing category.

[1] The Japanese Bankers Association is an organization that represents the banking industry in Japan. Its members are banks and bank holding companies operating in Japan.

Paragraphs BC54–BC57 of the Basis for Conclusions describe the Board's reasons for this proposal.

Do you agree with this proposal? Why or why not? If not, what alternative approach would you suggest and why?

The JBA generally agrees with the proposal that all entities present the subtotal of operating profit or loss in the statement of profit or loss.

We, however, disagree with the approach of identifying operating profit as a mere residual. This is because operating profit or loss is the most material information for estimating the future or operating profitability of an entity and if it were to be identified as a residual, its information value would significantly decline.

It is not appropriate to exclude income and expenses classified in the investing, financing and other categories from the operating category for all entities in the same way even though they belong to different industries. We believe that a more useful approach would be for the IASB to elaborate on the basic positioning of operating profits and losses and provide minimum guidance that requires entities to disclose their calculation bases.

Question 5—the investing category

Paragraphs 47–48 of the Exposure Draft propose that an entity classifies in the investing category income and expenses (including related incremental expenses) from assets that generate a return individually and largely independently of other resources held by the entity, unless they are investments made in the course of the entity's main business activities.

Paragraphs BC48–BC52 of the Basis for Conclusions describe the Board's reasons for the proposal.

Do you agree with the proposal? Why or why not? If not, what alternative approach would you suggest and why?

The JBA respectfully requests the IASB to clarify that returns (e.g. dividend) from stocks held by entities as part of their business investments do not necessarily meet the conditions of the investing category, and can be classified in the operating category.

Stocks which are held by an entity in line with its business strategy are expected to generate returns in combination with other resources. For instance, they are expected to increase their corporate value through maintaining and deepening business relationships, establishing capital and business alliances, and supporting business revitalizations. We believe that returns from stocks meeting these conditions do not necessarily meet the conditions of the investing category of "returns

from investments that are generated individually and largely independent of other resources held by an entity" as set out in paragraph 47 of the ED. Rather, they should be considered as returns "generated in the course of its main business activities," which, as the ED states in paragraph 48, shall not be classified in the investing category and instead classified in the operating category.

Such returns should be classified in the operating category especially for financial institutions, taking into account that they integrally manage investments in securities and financing in terms of customer transaction profitability.

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

(a) The proposed new paragraphs 20A–20D of IFRS 12 would define 'integral associates and joint ventures' and 'non-integral associates and joint ventures'; and require an entity to identify them.

(b) Paragraph 60(b) of the Exposure Draft proposes to require that an entity present in the statement of profit or loss a subtotal for operating profit or loss and income and expenses from integral associates and joint ventures.

(c) Paragraphs 53, 75(a) and 82(g)–82(h) of the Exposure Draft, the proposed new paragraph 38A of IAS 7 and the proposed new paragraph 20E of IFRS 12 would require an entity to provide information about integral associates and joint ventures separately from non-integral associates and joint ventures.

Paragraphs BC77–BC89 and BC205–BC213 of the Basis for Conclusions describe the Board's reasons for these proposals and discuss approaches that were considered but rejected by the Board.

Do you agree with the proposals? Why or why not? If not, what alternative approach would you suggest and why?

The JBA suggests the IASB to clarify that a business conducted by an associate or joint venture in which an entity invested as part of its business strategy is "integral" to its main business activities.

We are concerned that considerable ambiguity remains in the examples of the classification criteria currently proposed in the ED. For example, almost all associates or joint ventures would be identified as "not-integral" if "significant interdependency" is assessed using the criteria such as "sharing a name or brand with the associate or joint venture" and "difficulty replacing without significant business disruption," which are exemplified as "[a] significant interdependency between an entity and an associate or joint venture" (new paragraph 20 D of IFRS 12), namely, a criterion that indicates an associate or joint venture accounted for using the equity method are "integral" to the main business activities of the entity. On the other hand, depending on the interpretation of

"having integrated lines of business with the associate or joint venture," almost all of them can be qualified as "integral."

When an entity invests in an associate or joint venture and exercises "significant influence" (i.e. a criterion for using the equity method), it is usually carried out in line with the business strategy of the entity in the first place. Therefore, an investment in an associate or joint venture as part of an entity's business strategy should be qualified as "integral" to its main business activities.

Question 9—analysis of operating expenses
Paragraphs 68 and B45 of the Exposure Draft propose requirements and application guidance to help an entity to decide whether to present its operating expenses using the nature of expense method or the function of expense method of analysis. Paragraph 72 of the Exposure Draft proposes requiring an entity that provides an analysis of its operating expenses by function in the statement of profit or loss to provide an analysis using the nature of expense method in the notes. Paragraphs BC109–BC114 of the Basis for Conclusions describe the Board's reasons for the proposals. Do you agree with the proposals? Why or why not? If not, what alternative approach would you suggest and why?

Paragraph 72 of the ED requires an entity presenting an analysis of expenses classified in the operating category using the function of expense method to also disclose in a single note an analysis of total operating expenses using the nature of the expense method. In light of the unique characteristics of the revenue structure described below, financial institutions should be allowed to disclose expenses in accordance with their nature of each item, instead of disclosing the analysis of total operating expenses in a single note.

Financial statements of financial institutions include items that are net of profits and losses such as "Net trading income" and "Net income from financial assets at fair value through profit or loss." Even if these items are aggregated by product, by investment or loan, or any other criteria, they may not adequately present the actual status of business operations, and therefore have low information value. Nonetheless, it is cumbersome and impractical to calculate gross profit or loss based on profits and losses from changes in market value, and the value derived from such information does not outweigh additional costs that would be incurred to the financial institution.

In addition, interest expense, which is a funding cost, is equivalent to cost of sales of non-financial entities. Therefore, the usefulness of such information would not be relevant even if it is disclosed together with other expenses.

Therefore, we request to allow the exceptional treatment above if information value obtained from an analysis of total operating expenses using the nature of the expense method does not outweigh its

cost. As stated in BC 112 of the Basis for Conclusions in Exposure Draft, the IASB considered "[r]equiring this analysis would provide users of financial statements with information to help them better forecast an entity's functional line items." Hence, the JBA believes this would realize the approach that the IASB considered to introduce at the initial stage.

Question 11—management performance measures
(a) Paragraph 103 of the Exposure Draft proposes a definition of 'management performance measures'. (b) Paragraph 106 of the Exposure Draft proposes requiring an entity to disclose in a single note information about its management performance measures. (c) Paragraphs 106(a)–106(d) of the Exposure Draft propose what information an entity would be required to disclose about its management performance measures. Paragraphs BC145–BC180 of the Basis for Conclusions describe the Board's reasons for the proposals and discuss approaches that were considered but rejected by the Board. Do you agree that information about management performance measures as defined by the Board should be included in the financial statements? Why or why not? Do you agree with the proposed disclosure requirements for management performance measures? Why or why not? If not, what alternative disclosures would you suggest and why?

The definition of management performance measures ("MPMs") in ED Paragraph 103 is not clear, and there is a concern that various indicators such as management accounting indicators that are not directly linked to financial accounting and profit indicators based on GAAP other than IFRS fall under MPMs and could be subject to disclosure depending on the interpretation. Therefore, we suggest clarifying the indicators included in MPMs are profit indicators calculated from IFRS-based figures.

We understand that the purpose of defining MPMs in the ED is to avoid confusion among investors between IFRS-based figures and profit indicators calculated from IFRS-based figures that are used by entities adopting IFRS outside their financial statements with a view to ensuring investor confidence and transparency. However, including profit indicators that are not calculated from IFRS-based figures in the scope of MPMs does not solve the inherent issues of lack of transparency in how the management-defined performance measures are calculated (BC 147 (a)) and leaves difficulties for users trying to reconcile the measures to the related measures specified by IFRS Standards (BC Section 147 (c)). Rather, it may promote misunderstanding.

In addition, requiring notes to financial statements and compliance with the IFRS standards even in cases where they are used for communications outside financial statements independent of IFRS,

would go beyond the scope of accounting standards to be defined as rules, and there are also concerns in terms of auditability, as described in paragraph BC 148 (c) of the Basis for Conclusions.

Therefore, we request that the IASB clarify that the scope of MPMs is limited to profit indicators calculated from IFRS-based figures. The IASB should allow other indicators (such as figures for management accounting and non-IFRS based indicators) to be excluded from the scope of MPMs or stipulate the disclosure of such figures as voluntary.

Question 14—other comments
Do you have any other comments on the proposals in the Exposure Draft, including the analysis of the effects (paragraphs BC232–BC312 of the Basis for Conclusions, including Appendix) and Illustrative Examples accompanying the Exposure Draft?

First of all, in light of the unique nature of the financial industry, the ED for the first time defines the industry in IFRS Standards. For example, the ED grants an entity that provides financing to customers as a main business activity an option to classify income and expenses from financing activities and from cash and cash equivalents in the operation category. In addition, it provides an example of disclosure in the statement of profit or loss. We welcome such development as the first step to reflect the characteristics of the industry into IFRS standards and to promote more appropriate disclosures.

We request the IASB, from the same perspective of the uniqueness of the industry, to further promote this development and to consider allowing an entity that provides financing to customers as a main business activity to exclude the statement of cash flows from the scope of their primary financial statements.

Regarding banks and other entities that provide financing to their customers as a main business activity, information about cash equivalents and the statement of cash flows have different meanings from that of non-financial entities. Therefore, there are questions about its usefulness, including[2]:

(i) Information disclosed in the statements of cash flows does not reflect the actual practice of financial institutions' cash management and liquidity management. In addition, with regard to financial institutions' cash management and liquidity management, we believe that disclosures of risks under IFRS 7 and disclosures under global regulations such as the Basel framework satisfy investors' needs.

(ii) Because financial statements of financial institutions do not have a classification of current

[2] For a more detailed discussion, see the following academic paper: Ásgeir Brynjar Torfason (2014), *Cash flow accounting in banks – a study of practice*, Gothenburg University Sweden. See in particular Chapter 6 (Review of past public comment letters on banks' preparation of statements of cash flows) and Chapter 8 (interviews with bankers) of the paper for reasons why banks' cash flow statements are not used.

assets [liabilities]/ non-current assets [liabilities] (or fixed assets) and the IFRS does not set out a basic concept to supplement the lack of this classification, under current practice of preparing the statement of cash flows, for example, the following classifications depend on the judgments of an entity:

- Cash flows related to securities can be classified as an operating activity for trading transactions and as an investing activity for FVPL and FVOCI.
- Cash flows related to funding can be classified as a financing activity only if the funding is subordinated borrowings, etc.

Given the current practice above, comparability is limited not only between banks and non-financial entities but also between banks, and hence the usefulness of the information is questionable.

In this regard, the statement of cash flows of financial institutions does not necessarily satisfy the following objectives, qualitative characteristics, and cost constraints set out in the Conceptual Framework of IFRS ("CF"): respectively, to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions relating to providing resources to the entity (CF 1.2), relevance (CF 2.6), comparability (CF 2.23), and that the benefit of providing the information needs to justify the cost of providing and using the information (CF 2.39). Accordingly, we respectfully request that an entity that provides financing to customers as a main business activity be allowed to exclude the statement of cash flows from their primary financial statements.

If the above proposal is accepted, it will pave the way for expanding the adoption of IFRS by financial institutions in jurisdictions where the voluntary application of IFRS Standards is permitted in place of local accounting standards because preparing the statement of cash flows is particularly burdensome for financial institutions.

(End)