IFRS Foundation
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28th September 2020

Dear Board Members and Staff,

Thank you for the opportunity to comment on your exposure draft for General Presentation and Disclosures (Primary Financial Statements). ELFA is a trade association comprised of European leveraged finance investors. Our members rely on the application of current reporting standards for their day-to-day credit analysis as well as within the financial covenants in lender agreements and bond documentation.

Our members have increasingly struggled with the opacity and variability in company's financial reporting and are keen to support any initiative to simplify, improve and harmonise this.

We recently conducted a survey on financial covenant transparency, which relies on financial reporting, amongst members. The survey drew responses from 140 investors. The overwhelming feedback (86%) was that investors are unable to accurately calculate financial covenants due to extensive adjustments made to EBITDA (i.e. use of MPMs) by management and the limited disclosure of these.

Our largest concern therefore is around the reporting of operating profit, EBITDA and adjusted EBITDA. Furthermore we often find the link between operating profit or EBITDA and operating cash flow difficult to reconcile, so would also support any standardisation of this reporting.

Our high level feedback to your draft is that:

- We're supportive of the addition of Operating Profit as a distinct line item.
- We think the definition of Operating Profit before depreciation & amortisation is very close to our own view of EBITDA and therefore strongly support the use of that, regardless of whether it's termed Operating Profit or EBITDA. **However we would urge you to require this line item to be reported rather than the current proposal, which is to make it optional.**
- We strongly support the proposal to incorporate unusual items within reporting. We do however have concerns about the definition of these and whether it is too narrow (e.g. in your scenario slide 19, Y1).
- We remain concerned about the ability for management teams, under the use of MPMs, to adjust EBITDA (or operating profit before D&A) at their own discretion. We are keen to support any measures that not only provides a bridge of these items, but also includes a more tightly defined set of parameters as to what can be adjusted for by IASB and for any MPMs used to be independently verified (e.g. by audit).

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This issue of adjustments is of great importance to investors given the increasing use of MPMs by management teams to represent an estimation of earnings which is hard for investors to verify and often appears unrealistic versus the business performance. We regularly see examples of significantly increased operating profit or EBITDA (in some cases by 50%+) thanks to all sort of assumptions, from planned cost savings, the run-rate benefits of a new initiative or even adverse weather. Covid-related add-backs for lost earnings has become the latest in this list, despite no certainty these earnings will be recovered.

Therefore our ambition is to work with IASB towards a more regulated definition of adj. operating profit / adj. EBITDA. This would enable earnings to be more fit-for-purpose when used in lender documentation, reporting and it would allow institutional investors to compare financial performance across all companies.

Going forward we would also value a dialogue on working towards a more formal definition of financial debt, to include factoring and other debt that is currently either reported elsewhere in the balance sheet or not at all. Please see our feedback on your reverse factoring proposal.

In relation to your explicit questions:

Do you agree with the Board's proposals for subtotals and categories in the statement of profit or loss? Why? How would you use the information provided?

Yes, it would enable consistency to reported operating profit and operating before depreciation and amortisation, with the latter being a key measure of profitability and proxy for operating cash flow generation for lenders. However we would want to see OP before D&A become mandatory for reporting, not optional.

We would however value a breakout of the "other income" line (on slide 6) as it contributes to the calculation of operating profit and EBITDA, and can be used to hide one-off items.

Is the split between integral and non-integral associates and joint ventures useful for your analysis? Do you make a similar split today? If so, how?

It is helpful but we remain unsure how the definition of integral is verified?

Do you agree with the Board's proposals for disaggregation including the general guidance, analysis of operating expenses and unusual items?

Yes, this information is highly valuable to lenders and investors who wish to understand where changes in operating expenses are coming from. We particularly support a line item focused on unusual items.

However we do agree the definition of unusual items appears too narrow and would like to see an item like Y1 on slide 19 meet the definition of an unusual expense.

Do you agree with the Board's proposals for management performance measures?

Anything to increase transparency and consistency of MPMs is a step in the right direction and of particular importance to ELFA members. We would be grateful to see MPMs in a consistent location and would particularly value audit verification of these numbers.

Do you agree with the Board's proposals for the statement of cash flows?

A consistent starting point is something we would strongly support to help enable our reconciliation from EBITDA or operating profit before D&A to operating cash flow.

Do you agree with the Board's proposals for interim reporting?

We support the additional proposals but would ideally also have visibility on operating expenses by nature or function on an interim basis.

Kind regards,

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