International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

1630-100

LETTER OF COMMENT NO. 36

3 April 2009

Discussion Paper, Preliminary Views on Financial Statement Presentation

Dear Sirs

The Roche Group has a turnover of CHF 46 bn. a year (EUR 29 bn.) derived from our worldwide healthcare business - pharmaceuticals and diagnostics - and employs over 80,000 worldwide. We have a market capitalisation (end 2008) of CHF 141 bn. (EUR 95 bn.) We have been preparing our consolidated financial statements according to IFRS/IAS since 1990 and therefore have a substantial interest in how these will develop.

Also, the theme specifically dealt with in this Discussion Paper is one of central importance to us as the effective communication of financial information on the performance and position of businesses from preparers to users is vital for the efficient functioning of the capital markets, on which we rely. While we do not believe that the present approach is fundamentally "broke", we are aware that many users – in particular analysts – think that certain aspects such as meaningful reporting of cash flow information and net debt movements could be improved, as the Board heard directly from the Corporate Reporting Users Forum last June. Indeed, we ourselves find the present IAS 7 approach unsatisfactory for meaningful, actionable cash flow reporting to management and sensible communication with analysts. Both internally and in our Financial Review ("management commentary") we therefore report on cash flows in a manner which, firmly rooted in the indirect method, diverges substantially from our current audited external cash flow reporting under IAS 7 (see the extract from our 2008 Financial Review in Appendix 2.) Consequently we are particularly interested in the Board's work on this topic as a help to both preparers and users – the primary parties involved in financial reporting – to have a commonly supported basis for optimal communication. This is why it is also crucial that any changes implemented should be accepted by both preparers and active users as improving current arrangements and eliminating or reducing existing deficiencies, resulting in benefits in excess of the additional initial and on-going costs of implementing them. It is also for this reason that we have devoted substantial resources and attention to considering the Discussion Paper and carrying out a mock-up of our consolidated

F. Hoffmann-La Roche AG CH-4070 Basel Switzerland
Corporate Finance Accounting & Controlling Bldg/Room 52/1205
Tel. +41 61 68 84234
Fax +41 61 68 84282
alan.dangerfield@roche.com

financial statements on the proposed basis. The valuable insights gained from that exercise have substantially informed our general conclusions set out below and the answers to the Board's *specific questions given in* Appendix 1.

In summary we support the thrust of the first part of the Discussion Paper on principles but try to make some constructive suggestions on how the application of the principles could be rounded to ensure that the information produced is practically useful and relevant and that the financial statements do not lose clarity and understandability. We do, however, miss the inclusion in the list of objectives for financial statement presentation that of helping users to assess the entity's performance, which for us is the key objective. We agree with the approach taken on disaggregation, namely focussing on detailed information which enhances understanding, but add that the Board has underestimated the ready availability, in industrial companies at any rate, of some of the required information on expense by nature within function.

Where we most definitely part company with the Board is on the **proposed method of presentation of the cash flow statement and the (closely related) reconciliation suggested. These proposals are in our opinion completely unacceptable.** This is for three main reasons, outlined below and analysed in more detail in the appendix:

1. We are extremely puzzled by the Board's bold assertions throughout the Discussion Paper, but especially in respect of the direct-method cash flows and the reconciliation, of "what users want". We have regular, intensive discussions and other contacts with the users of our financial statements and are quite unable to relate the Board's assertions to what we hear from our own active users. Naturally, just as preparers do not all agree exactly on financial reporting matters, so with users there are some divergences of views. However, our contacts show a sufficiently consistent picture of the views of active users for us to vigorously call into question the Board's assertions. Indeed, the Board itself heard last June directly from the Corporate Reporting Users Forum the areas where they would like improvements, and CRUF's explanations tie in exactly with what we are hearing from our own specific active users. (We also refer to PwC's surveys of investors' views published during 2007 and telling a very similar story to CRUF's.) All this suggests that the Board may not have exercised enough care in ensuring that it reflected sufficiently representative input from users: "representativeness" in terms of formal membership is not necessarily the same as representativeness of views. This is for us probably the greatest single weakness of the Discussion Paper and substantially diminishes its credibility. We hope that active users will respond to the Board in sufficient numbers and that, where there are divergences from its assertions of "what users want", the Board will give full weight to the representations of those active users in progressing the project. We are convinced that, if the proposals were implemented, we would have to continue to structure our management commentary to reflect cash flow and net debt information in the form we believe is preferred by the overwhelming majority of our users (see point 2 below) and focus financial information communicated on that part of our reporting and away from the IFRS financial statements, which, as predicted above, would degenerate into filing documents. The project presents the Board with an excellent opportunity to help the capital markets and its participants by structuring financial reporting so as to support communicating financial information in a more meaningful and decision-useful way, and we are very concerned that it is not making best use of that opportunity.

2. For internal management purposes we place considerable emphasis on cash generation but in parallel with profitability. They are in fact two sides of the same coin. The currently applied indirect-method cash flow information ensures a clear and understandable linkage between the two, enabling analysis to focus consistently on those aspects of the business where action is required. Receipts and payments are in this sense largely irrelevant and certainly not an object for presentation of business information which would help management to grasp what is happening and which areas they can influence for improvements. (Management can do something about sales and the level of receivables, gross receipts on the other hand are merely the arithmetic result of such action.) Consequently, rather than being able to have one single approach to internal and external cash flow reporting as we had hoped from the Board's project, we would continue to have in effect to run two sets of reporting – one for pure compliance purposes and the other, meaningful one for informing management in the same terms as the business operates. So a significant wedge between internal and external reporting would remain and a marvellous opportunity for improvement would regrettably be missed. We have over the years otherwise succeeded in developing management information on the same basis as external information, and this has brought both users and ourselves appreciable benefits in terms of understanding and integrity of data. If the Board passes up the opportunity to make the IFRS reporting of cash flows more practically useful and relevant in line with what is useful both internally and in communication with our users, it will be furthering the lapse of external IFRS reporting into a compliance and filing exercise.

3. Depending on the exact approach taken for preparing the cash flow statement by the direct method, it would be either very costly or prohibitively costly – perhaps even quite unfeasible from a practical viewpoint. On some approaches initial costs could well run to over CHF ½ billion, and on-going costs would also be substantial. Furthermore, in addition to the direct costs of these proposals, we are keenly aware of the opportunity costs which they would involve as scarce resources – particularly in terms of skilled finance and informatics experts – would be diverted from value-adding projects, and we reckon that such a major upheaval of our systems would involve a blockage of other developments – not to mention disruption of on-going operations - over several years. The Discussion Paper has completely understated these resource aspects.

If you have any questions on this letter, please contact directly Mr Alan Dangerfield in our Corporate Finance – Accounting & Controlling area who amassed a substantial amount of information on the Discussion Paper and the experience from our mock-up.

Sincerely,

F Hoffmann-La Roche AG

Dr. Erwin Schneider
Head of Corporate Finance
Accounting and Controlling

Alan Dangerfield
Corporate Finance Accounting & Controlling
External Relations

Appendix 1, Responses to Specific Questions in the Discussion Paper

QUESTIONS CONCERNING BASIC PRINCIPLES AND CLASSIFICATION OF ITEMS

Question 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.*

We think that it is broadly true that – with one major omission referred to below - the objectives proposed would contribute towards improving the usefulness of information. Indeed, the cohesiveness principle, if pragmatically applied, fits in well both with the way we understand users approach financial statements and with the way we look at the business. There are certain aspects, however, which need further consideration and refinement.

- It is not clear to us from the Discussion Paper that these specific objectives are subordinate to more general objectives. It will be necessary to explain how the financial statement presentation objectives relate to, and interact with, the objectives and qualitative characteristics in the Conceptual Framework. We assume, for example, that they are thought to flow from those characteristics and therefore do not overrule them in any way. An example of where a potential conflict is noticeable is between disaggregation and understandability. We have seen in our own financial statement mock-up under the proposals that understandability suffers substantially when disaggregation in the statements themselves leads to too many numbers on their face. The Board should bear this in mind, for instance, in considering whether to permit certain information – such as analysis of statement of financial position headings by measurement basis – to be disclosed in the notes instead. This problem is exacerbated by the increase in the number of dimensions and sub-totals which would appear, compared to to-day. The laudable common sense shown in respect of type-of-expense disaggregation, where this is limited to situations where the usefulness of the information is enhanced, needs to be applied more extensively in other areas of the Discussion Paper.

- The specific objectives also need to be applied with more balance and pragmatism than is evidenced in the Discussion Paper in order to ensure that the guiding principle of providing decision-useful information is achieved. Several specific problems arise in this connection through taking the categorisation in the statement of financial position as the determinant for that in the flow statements (income and cash flows) and through treating all flows from a single contract in the same manner. Apart from the fact that users are, by and large, far more interested in, and focussed on, transaction flows than positions, the resulting reduction in (direct) usefulness and meaningfulness of flow information on pensions, dividends and leasing is unhelpful.

- From a data preparation viewpoint the largest practical problem which we have found in the proposals arises from the rigid application of the cohesiveness principle at the line-item level between the cash flow and income statements in respect of operating cash outflows. This rigid interpretation in this context does not square with the statement of financial position where line-by-line cohesiveness with the flow statements would not be required. The largest practical stumbling-block is the need to break down operating cash outflows by function. We return to this point under question 20.

- The significant omission in the Discussion Paper's objectives is the total absence of an objective for "helping users to assess an entity's performance" – in fact that aspect of the entity in which the users are usually most interested. It is to be hoped that this topic – the definition of performance, the consequent reflections on the conceptual definition of net income and the matter of recycling – will soon come to the forefront of the Board's agenda, again with an emphasis on what is practically useful and meaningful for active users rather than on conceptual satisfaction. In the meantime the objective should at least be stated explicitly in an otherwise obviously incomplete list.

*Question 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?*

We believe that, subject to our view of applying cohesiveness with appropriate flexibility and ensuring that the financial statements are not "cluttered" with excessive disaggregation, communications between preparers and users should benefit from this separation. With proper reflection of the specific business model, it should support a better understanding of the way that an entity is managed. It also fits in well with the way we view the entity. We would even suggest building on this by requiring the cash flow statement to reconcile all other movements with the movement in the financing category of the balance sheet (which in effect would be considered "net debt"), rather than with the movement in cash (see our responses to Questions 6, 10, 19 and 25 below).

*Question 3 Should **equity** be presented as a section separate from the financing section or should it be included as a category in the financing section (see paragraphs 2.19(b), 2.36 and 2.52–2.55)? Why or why not?*

We agree with this proposal. For both users and preparers transactions and balances with equity holders are of a different nature from those with lenders. We see no reason to change the existing approach.

*Question 4 In the proposed presentation model, an entity would present its **discontinued operations** in a separate section (see paragraphs 2.20, 2.37 and 2.71–2.73). Does this presentation provide decision-useful information? Instead of presenting this information in a separate section, should an entity present information about its discontinued operations in the relevant categories (operating, investing, financing assets and financing liabilities)? Why or why not?*

We agree with presenting discontinued operations as a separate section as it is crucial information for both users and preparers to be able to identify sustainable underlying earnings from continuing operations. However, we think that there is a slight confusion in the Discussion Paper with regard to assets held for sale which are shown in this section in the Toolco example. We are not sure that inclusion with discontinued operations is the optimal solution for such assets.

Question 5 The proposed presentation model relies on a ***management approach*** *to classification of assets and liabilities and the related changes in those items in the sections and categories in order to reflect the way an item is used within the entity or its reportable segment (see paragraphs 2.27, 2.34 and 2.39–2.41).*

(a) Would a management approach provide the most useful view of an entity to users of its financial statements?

We agree with the "management approach", though – to avoid the impression that this gives total freedom to managements to categorise arbitrarily – we believe that it would be better referred to as the "business model approach", with its description focusing on this aspect. This view would be desirable so that preparers and users have a common understanding of the entity. However, we believe that it can conflict with the proposed restrictions of (a) a cohesiveness approach based on categorisation in the statement of financial position and (b) the financing section containing only financial assets or liabilities which, if given precedence, would make the information less useful. For example:

--- Under the management approach the presentation of *post-employment benefits* discussed in paragraphs 2.45-2.47 would, given our business model, require the net asset or liability to be reported in financing and the pension cost to be analysed between the business (service costs) and financing sections. Apparently users also tend to view this item in this way for most companies. Unfortunately, this splitting of costs between categories would no longer be permitted under the proposals.

--- On the basis of paragraphs 2.48 and 2.55, we foresee potential distortions for *dividends*. These are a distribution, and cost, of equity, but the fact that they first become theoretically a dividends payable liability would mean that they would according to these paragraphs be shown in the statement of cash flows as a financing flow, not an equity flow. In fact the timing of our dividend declarations and payments and our reporting cycle are such that we never have to report dividends payable, so possibly we could still consider the corresponding flow as an equity item, but we would have a disconnect if (say) a quoted subsidiary did have such liabilities in respect of non-controlling interests and therefore had to classify these flows as financing.

--- *Equity-settled share-based payments to employees* are another interesting case. Any income-statement presentation other than in operating would be counter-intuitive and unhelpful, while treatment in the statement of financial position as an equity item would seem incontrovertible. Where that leaves the corresponding cash flows (e.g. on exercise) is then not clear from the viewpoint of cohesiveness.

--- The effect of the cohesiveness principle on the presentation of *finance lease liabilities*, at least as illustrated in the "Toolco" example, also needs some clarification. It should not be the case that this has to be categorized in the same way as the corresponding asset as, at least in our case, it is generally interchangeable with other methods of financing the use of the asset.

To be useful, the management approach should not be subject to such restrictions. A balance needs to be struck between the various principles involved to ensure that information generated is meaningful. The Board needs to be aware that the problems associated with cohesiveness often arise from basing the categorisation on the statement of financial position, whereas preparers and users (the primary parties involved in financial reporting) are predominantly working with a flows perspective.

(b) Would the potential for reduced comparability of financial statements resulting from a management approach to classification outweigh the benefits of that approach? Why or why not?

We fully understand some users' concerns over the implications of the management approach for comparability. However, we think that they may be overdone, for the following reasons:

--- If the approach is defined – as we supported above – in terms of mandatory reflection of the entity's business model, there is unlikely to be inconsistency from period to period: if there is, the divergences would need to be documented in the disclosed accounting policies and openly explained, and they would reflect a real change in business model which users should be interested in. Similarly, differences in presentation between entities in the same industry should also reflect different ways of doing business and be relevant.

--- Experience shows that within an industry checking out competitors' approaches does happen – especially where pressure from outside (users) encourages it. Although we are naturally not bound to follow the policies of other large healthcare groups using IFRS, we naturally look at their reports and consider their approaches, bearing in mind that it helps our users to have some measure of comparability.

To assist users, the Board might like to consider some sort of disclosure, in addition to that foreseen in the Discussion Paper for accounting policy, which would be required where a departure from a given "normal" treatment has to be made to properly reflect the business model, so that users are able to make adjustments if they think it appropriate. This would need to be restricted to material major items like post-employment benefits etc. to keep the cost in balance with the benefits.

Question 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?

Since we also tend to view the entity in terms of the business operations (net) and how they are financed, this approach appears sensible to us, and we would imagine, from what we know of our users' needs, that they would also be comfortable with such an approach. Apart from facilitating certain ratios, it would also produce a benefit by bringing together assets and liabilities in the financing section, to show net debt. The movements in this could then be more easily and usefully reconciled as a whole, in line with common current practice among many users. However, we must stress that this depends on a more pragmatic application of the cohesiveness principle, as mentioned under Question 5 above.

We understand, however, that many users wish to see total assets and total liabilities as well as totals for long-term and short-term explicitly appear on the face of the statement of financial position. Although we would like the statements themselves presented as clearly, understandably and transparently as possible, and therefore relieved of details which can be relegated to the notes, we could support this wish as it should not seriously jeopardise the achievement of that aim.

Question 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.*

We agree with the proposal, whereby assets and liabilities might be classified differently in different segments. Our understanding is that, if an entity has a segment mainly responsible for the financing of the other segments, then the related assets and liabilities would be classified as financing. It would be helpful if this could be clarified.

Guidance on how to present the *total entity* statements could be usefully given for entities which have significant divergences in cost structure between segments. An example would be a car manufacturing group with a vehicle leasing segment. Would it be necessary, for instance, for the total entity statements to present the same headings as in each segment, even if some of the headings become less meaningful at the entity level?

Question 8 The proposed presentation model introduces sections and categories in the statements of financial position, comprehensive income and cash flows. As discussed in paragraph 1.21(c), the boards will need to consider making ***consequential amendments to existing segment disclosure requirements*** *as a result of the proposed classification scheme. For example, the boards may need to clarify which assets should be disclosed by segment: only total assets as required today or assets for each section or category within a section. What, if any, changes in segment disclosures should the boards consider to make segment information more useful in light of the proposed presentation model? Please explain.*

This is primarily a question for users. For us, it is important to retain the principle that segment information should be presented in accordance with the management view. Any additional segment disclosures should not conflict with that management view and should be required only to the extent that the information is already provided to management.

It may nevertheless be useful for the Board to plan this aspect of the project in conjunction with any post-implementation review of IFRS 8, which we assume should in any case be carried out within two years. We have heard some dissatisfaction with certain aspects of that standard expressed by users and think that it would be a useful opportunity to consider as a whole the issue of segment reporting which is so important for them.

*Question 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?*

We refer back to our comments on Question 5 above that there should be no restrictions in the definitions that might prevent an entity reflecting its business model (applying the management approach).

The contents of the business section seem to us reasonably clear in this sense. The distinction between operating and investing is perhaps less clear. In discussions we have experienced other companies using precisely the same reasoning for categorizing an asset as operating as we used for classifying our almost identically "used" asset as investing. A clear, single principle would help, as could a couple of illustrative examples. Under what business circumstances should assets held for sale be regarded as investing, for instance?

*Question 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?*

The restriction of the financing section to financial assets and financial liabilities does not appear to us to be consistent with a management approach. Please refer to our remarks in Question 5 on this.

There is one related issue we have not yet been able to resolve for ourselves. As already mentioned our business model is such that post-employment benefits are regarded as financing items rather than operating. We understand that many users – some rating agencies, for example – also treat them as being part of their "net debt" calculations. We are not sure how users would best like this to be presented – it may be that some (others) would prefer to have financing limited to "pure" financing so that it corresponds to their notion of net debt. Perhaps the comment letters will give some insight on this issue.

QUESTIONS CONCERNING IMPLICATIONS FOR EACH FINANCIAL STATEMENT

*Question 11 Paragraph 3.2 proposes that an entity should present a **classified statement of financial position** (short-term and long-term subcategories for assets and liabilities) except when a presentation of assets and liabilities in order of liquidity provides information that is more relevant.*

We are aware of the current US GAAP requirements to distinguish deferred tax assets and liabilities between short- and long-term depending on the classification of the related items. We do not believe that the additional cost of providing this information can be justified by benefits to users. There is also lots of potential for confusion, e.g. where an entity is in an overall deferred tax liability position in a tax jurisdiction but in that same jurisdiction has a deferred tax asset in respect of short-term items. The resulting split does not seem to us very meaningful or helpful to users who in any case often already have enough difficulties in identifying the implications of deferred tax information for their purposes and which the recently published Exposure Draft on Income Tax will unfortunately do nothing to alleviate..

(a) What types of entities would you expect ***not*** *to present a classified statement of financial position? Why?*

We agree that a classification between short-term and long-term should usually reflect a one-year distinction based on the shorter of contractual maturity or expected realization/settlement, but we believe that entities should continue to have the option (as under the existing IAS 1) to use the length of their operating cycle if significantly different and clearly identifiable. Some users have confirmed that they would really find this more useful in many cases, and we also believe that using an operating cycle can be more appropriate for certain entities and provide more useful information in certain circumstances. The reasons would need disclosure.

(b) Should there be more guidance for distinguishing which entities should present a ***statement of financial position in order of liquidity****? If so, what additional guidance is needed?*

We consider that the guidance provided is acceptable and probably more than sufficient. At the Exposure Draft stage, it may be possible to pare it down to a few principles. It would probably be useful if entities applying a liquidity approach had to explain and disclose their reasons for doing so.

Question 12 Paragraph 3.14 proposes that ***cash equivalents*** *should be presented and classified in a manner similar to other short-term investments, not as part of cash. Do you agree? Why or why not?*

We support this proposal. We assume, however, that the cash equivalents could then be subsumed with other short-term investments on the face of the statement of financial position rather than having to be presented as yet another heading.

Question 13 Paragraph 3.19 proposes that an entity should present its similar ***assets and liabilities that are measured on different bases*** *on separate lines in the statement of financial position. Would this disaggregation provide information that is more decision-useful than a presentation that permits line items to include similar assets and liabilities measured on different bases? Why or why not?*

We are very much in favour of giving users insight into the different measurement bases applied to individual asset and liability classes, to improve their understanding of the financial statements. Our concerns are rather with the proposed manner of doing this. Firstly, it is not clear from the

Discussion paper what is meant by "different bases". We understand that the Board did not intend gross cost, depreciated/amortised cost and impaired cost to be regarded as different bases but all as "cost", but it is not clear what groupings would be necessary for "current values", of which the recent Conceptual Framework Phase B papers listed several variants. Neither is it clear how the measurement of post-employment benefit assets/liabilities and deferred income taxes should be viewed. Even if the options are boiled down to "cost" and "current value", there is potential for the statement of financial position to lose a substantial amount of clarity (because of the extra lines) and therefore understandability. (The "Toolco" example did not actually reflect this proposal, otherwise it could have become even more cluttered.) We therefore strongly recommend the Board to reconsider their insistence on showing this information on the face of the statement of financial position and permit an option for note disclosure.

Question 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?*

We do not agree with requiring a single statement of comprehensive income, for the following reasons:

--- The Board has decided against considering the question of "performance" at this stage. Yet by eliminating the option for preparers to present income in terms of the measures which both they and users at present consider to be so important to their understanding of the entity's performance, the Board would in effect be pre-judging the question. As there is generally no strong support among preparers or users for the approach to performance which the Board apparently has in mind, it would be particularly discouraging to constituents to impose a single statement as it would give the impression that the Board appears to be impervious to their views. Since the Board believes that the page-break is "no big deal" and that constituents should therefore not worry about it, the Board would presumably accept that it cannot at present be a big deal for them either and that they should leave the two-statement option until they have worked through the performance question to the point of having a solution capable of enjoying general support. We would also refer the Board back to the comments of the Corporate Reporting Users Forum on the importance of net income.

--- The assertions made in the Discussion Paper about the importance and usefulness of comprehensive income information reflect neither our own experience nor the manifest interests of the active users with whom we have regular, intensive contact. (We note that, after years of having comprehensive income information available in financial reporting, users in the US still show no signs of interest in it.) Indeed, there seems to be much more interest among users in having more clarity on measures helpful in assessing sustainable underlying earnings, for instance excluding remeasurements, than on bringing more to the fore other comprehensive income items.

--- At least at present, until the Board has convinced constituents otherwise, many may consider the single statement of comprehensive income to be a less helpful statement of income. Its imposition could encourage some preparers to present what they believe to be more relevant information of greater interest to users outside the audited financial statements (e.g. in the management commentary) and shift emphasis in that direction in their communications. This would be unlikely to mark a positive development in financial reporting.

Question 15 Paragraph 3.25 proposes that an entity should indicate the category to which items of ***other comprehensive income*** *relate (except some foreign currency translation adjustments) (see paragraphs 3.37–3.41). Would that information be decision-useful? Why or why not?*

We have considerable doubts on the decision-usefulness of such categorized information on other comprehensive income. Neither do we share the Board's belief that the categorization would not be a difficult process. Revaluations of available-for-sale securities and cash flow hedges could each impact more than one category, and categorization might well be arbitrary in situations such as hedges of inter-company positions comprising a whole variety of transactions. However, with the proposed pragmatic exclusion of cumulative translation differences from this requirement, which would have been a major practical problem and generated information without decision-value, these practical problems would at least for many industrial companies be surmountable.

Question 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?*

Looking at this question from the viewpoint of an industrial company, we support the Discussion Paper's preference for the functional approach, which is the sole basis used for our internal management information. We nevertheless appreciate that other forms of business may lend themselves more to a by-nature analysis and so welcome the flexibility proposed. Also from the industrial angle, we fully understand that users confronted with a "black-box" cost of sales figure representing 70% of sales would like more detail as a basis for projection. Indeed, although our own cost of sales represents only around 30% of sales, we already show in our management commentary a statistical analysis of key cost elements by operating division to help users in this.

For us the question of further disaggregation by nature is rather one of how the usefulness could be enhanced within the limits of practical feasibility, and here several factors play a role.

- We very much welcome the Discussion Paper's practical approach to focus on disaggregation where it enhances the usefulness of information and, where necessary to preserve the clarity and understandability of the financial statements themselves, to permit such disaggregated information to be given in the notes.

- There appears to be an assumption in the Discussion Paper that the analysis by nature within function is already available internally to management, or at least readily obtainable. This is far from being the case. So that we are sure that the Board fully appreciates how internal accounting and reporting systems work in companies like ours nowadays, we would like to devote a little space to describing some of the circumstances which would make such analysis far from easy.

--- The Toolco example appears to be based on an old-textbook approach whereby cost of sales is derived by accumulating production costs incurred and adjusting them by changes in inventories. Modern manufacturing systems like ours are by contrast generally based on a standard costing approach under which output is transferred into inventories at a total single standard cost value, with variances from actual costs of production being separated out, also in total. At this point the breakdown by individual type of expense gets lost. Breaking down final cost of sales for a period by original cost by nature is no longer possible at this point without a root-and-branch re-configuration of operating systems, which in no way could be justified in terms of internal benefits. Bear in mind, too, that product may pass through many different manufacturing processes and inventories before being sold, as well as through different group companies with different functional currencies, making robustly reconcilable by-nature information quite unfeasible. We do not believe that we differ particularly from many other industrial companies in this respect. Apart from meaning that substantial additional costs would arise to provide it for external reporting, if this is even feasible, this also implies that it is not found to be of any great use for management. In Roche operating expense by nature is only found in the expense reports at the local cost-centre and company level: the only such information collected centrally is that necessary for external reporting compliance, e.g. personnel expenses, depreciation, and even this reflects production costs incurred, not the amounts included in cost of sales. (The cost of sales analysis shown in our management commentary and mentioned above is collected as a statistical exercise.)

--- The same complexity is caused by non-reported functions (service cost centres.) Costs may first arrive in a service cost centre rather than directly on a main function like production. For instance, personnel costs of the Informatics service cost centre may first be accumulated into a charge-out (perhaps even at a convenient total budgeted tariff) and then passed on in a lump-sum charge to a user cost centre – perhaps another service cost centre like HR administration which also has its own personnel costs in addition to those included in the charge-in from Informatics, now unidentifiable separately as personnel costs. From there, HR may finally make a charge to production, the "ultimate destination" function, again based on a general tariff. Thus, to arrive at an all-in "personnel cost" for production, an enormous "back-tracking" though previous stages of cost accumulation – possibly in other group companies in other countries, continents and currencies - would be necessary.

--- While it may be possible to collect by-nature-within-function information on a robust, reconcilable basis for a simple single entity, the difficulties become appreciable for *consolidated* information for a complex group operating in many currencies and countries: the data required for the eliminations alone would be substantial.

This is, of course, not to say that reasonable estimates are not possible, but the matter then already enters the realms of robustness, accuracy and auditability. Our recommendation to the Board would be that it should clarify in requirements on the finer levels of disaggregation that the usefulness-enhancing information may be based on reasonable estimates where exact data is not already available internally, e.g. for production in the form of approximate percentage shares of personnel costs, materials, depreciation and other (depending on the individual cost structure.)

There is one final, extremely important point we would like to make on disaggregation in the statement of income. We strongly believe that the proposed requirement to present exactly the same line-items (by nature within function) in this statement as in the statement of cash flows could have a highly damaging effect on the level of information presented in the former, especially (but not only) if the Board imposes the direct method of preparing the latter. The practical difficulties which would be associated with deriving the information at this level of granularity would be enormous and costly and lead preparers to minimize disaggregation in the income statement, to the detriment of users. Indeed, the Toolco example itself even gives up on this by using different headings for the flows of property, plant and equipment (cash flows: total capital expenditure, all under "General and administration"!; income statement: depreciation by function.) We would strongly recommend the Board not to insist on the line-for-line requirement if they wish to ensure the practicability and acceptance of their proposals and to maximize decision-useful information for users.

Question 17 Paragraph 3.55 proposes that an entity should allocate and present ***income taxes*** *within the statement of comprehensive income in accordance with existing requirements (see paragraphs 3.56–3.62). To which sections and categories, if any, should an entity allocate income taxes in order to provide information that is decision-useful to users? Please explain.*

Paragraph 3.60 says that the Board believes that it would be highly arbitrary and potentially misleading (and more complex, requiring significant effort), and therefore unlikely to be of benefit to users, to allocate tax between categories of income from continuing operations and are therefore in agreement with the approach proposed (basically, retention of the status quo.) We agree with this statement. Moreover, we still do not favour the allocation of income taxes to individual items of other comprehensive income, to which we believe the same objections apply (highly arbitrary and potentially misleading, more complex, requiring significant effort, unlikely to be of benefit to users) and would encourage the Board to revise IAS 1 accordingly.

Question 18 Paragraph 3.63 proposes that an entity should present ***foreign currency transaction gains and losses****, including the components of any net gain or loss arising on remeasurement into its functional currency, in the same section and category as the assets and liabilities that gave rise to the gains or losses.*

(a) Would this provide decision-useful information to users in their capacity as capital providers? Please explain why or why not and discuss any alternative methods of presenting this information.

In principle it seems logical that foreign currency transaction gains and losses associated with individual assets and liabilities should be allocated to the same category as the related item(s). We can also see that, in some entities and situations, it could be useful for users to be aware of which areas give rise to gains and losses. On the other hand, we find a contradiction here with the management approach. Under our own current business model, for instance, FX exposures are centralised and managed centrally on a macro basis as part of the finance function. Because of the accumulation of operating and financing transactions covered, e.g. in the inter-company amounts transferred, categorisation of the gains and losses arising – including those on FX derivatives – would be pretty time-consuming and costly and at best arbitrary. These objections naturally become even more valid if segregation went even further, into separating gains and losses arising on financing assets from those on financing liabilities. We would prefer to continue to apply the management approach, which would mean that we would show all gains and losses in financing: additional information to users on the source of gains and losses could be given on a qualitative and/or approximative basis.

(b) What costs should the boards consider related to presenting the components of net foreign currency transaction gains or losses for presentation in different sections and categories?

See (a) above.

Question 19 Paragraph 3.75 proposes that an entity should use ***a direct method of presenting cash flows*** *in the statement of cash flows.*

We can unfortunately in no way support the Board's proposal to impose the direct method of presenting cash flows, for the following reasons:

- Contrary to the Board's assertions of "what users want", our frequent contacts with users have not brought to light any significant desire for direct-method information. Indeed, the view is generally that such information as they need can be obtained by the indirect method, which has the advantage of making much clearer the link to the income statement and to the actual transactions, the focus of their attention for getting at "sustainable underlying earnings". The indirect-method information gives a better explanation of the underlying business developments: more can be achieved with information on sales and changes in accounts receivable than with a receipts-from-customers number.

- For internal purposes we have a very intense focus on cash and cash generation, alongside our profitability measures. Our management information on cash generation is presented on an indirect-method basis as its link with the development of the business is much more transparent on this basis: receipts and payments would have little or no decision-useful information content. Hence, indirect-method cash flows are what management can relate to, which would not be the case for direct-method data.

- The practical difficulties which would be associated with collecting and preparing direct-method information – both in initial system set-up and in on-going running costs - would be very, very significant. We give more explanation of this under Question 20.

(a) Would a direct method of presenting operating cash flows provide information that is decision-useful?

Along with most users we have talked to, we are absolutely convinced, for the reasons outlined above, that the indirect-method presentation of cash flows gives more decision-useful information than direct-method. Our users as well as we ourselves find income-statement information has become less and less transparent over recent years as more remeasurements and other non-cash entries cloud the picture of how cash is being generated. Having taken a look back at our own financial statements over recent years, however, we note that the divergence between underlying operating profit and cash flows can generally be very well understood by adjustment for remeasurements and "exceptional items" – in fact by the items which the Discussion Paper proposes to identify in columns D-F of the reconciliation – and by considering the items such as movements in working capital which are explicitly identified in the indirect-method cash flow statement.

Parallel to our focussing on cash generation internally, we have developed, outside the financial statements, corresponding presentation of indirect-method (reconciled) cash flow for external users in terms of operating free cash flows, etc., even at the segment level, and this has been received with overwhelming approval by our analysts as useful for their purposes, too. It is illustrated by the extracts from our Financial Report 2008 shown in Appendix 2. On the basis of our regular discussions with analysts, we are convinced that active users of industrial companies' financial statements would be best served, at considerably less expense of real scarce resources, with:

- An *indirect*-method statement of cash flows in the proposed category format (but without any line-item cohesiveness), in which the operating category begins with "Total operating income" (many analysts complain about many current cash flow statements having to start pedantically with "Net income" followed by a jumble of book-keeping numbers);
- Disclosure of more information on changes in components of working capital where this enhances the usefulness of the information; and
- Reconciliation of the flows to net debt.

In fact, we suspect that users would end up pretty disappointed with the information they would get from receipts and payments data. We understand that in Australia, where the direct method has been applied for the statement of cash flows, information is given in the notes based on the indirect method as this is what users focus on.

(b) Is a direct method more consistent with the proposed cohesiveness and disaggregation objectives (see paragraphs 3.75–3.80) than an indirect method? Why or why not?

The direct method is no more consistent with the cohesiveness principle at the category level than the indirect method. For us, the most significant practical difficulties involved with the whole Discussion Paper - apart from the dysfunctionality of having to present and discuss cash flow data in a form which both our users and we ourselves believe irrelevant for understanding the business - would arise from the proposed extension of the cohesiveness principle to the *line-item* level between the income and cash flow statements, despite the fact that it is not so applied in the statement of financial position. We believe that rigid application of this single principle in such a manner would result in a retrograde step in financial reporting and a deterioration in the decision-useful information contained in the financial statements.

Furthermore, the direct method would appear to us less consistent with the disaggregation principle which stresses application to the extent that usefulness of information is enhanced. As should be clear from our observations above, we think that usefulness would be dis-enhanced by using this method.

(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?

It seems to us that the indirect-method information could only be available from the proposed reconciliation statement if considerable additional information on the contents of column C, "Accruals, allocations and other", were provided. We would not support this duplication.

*Question 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?*

Below we give details of the cost implications. The crux is that, while some short-cut approaches may make the application of the Discussion Paper's proposals less costly, both the initial and on-going costs would in any case be very significant, without any internal or – as we understand our users' requirements - external benefit. We would insist that the Board should carry out and publish a very much more thorough cost-benefit analysis – based on detailed input from a broad range of active users – before taking any decision to proceed with this part of the proposals.

The additional on-going costs of running systems changed for the Discussion Paper's requirements – assuming they were even practically feasible – should not be underestimated or minimized (as the Discussion Paper unfortunately tends to do.) In the notes below we consider together the impact of the proposals for direct-method statement of cash flows and reconciliation of that with the statement of comprehensive income, as they would be closely linked.

- Our consolidated data is based on data on an IFRS basis submitted by subsidiaries, and locally too we try to get as much of the data as possible automatically out of the basic transaction systems (where all transaction data is already recorded on an IFRS basis) without need for manual intervention. Consequently, the implementation of the DP would mean root-and-branch changes to systems at all levels throughout the group. The extent and costliness of those changes depend partly on the approach taken but would in any case be significant.

- Overall, the cost question should be seen from the perspective that the costs involved would in our estimation generally be regarded by preparers as pure compliance costs, as there would be no internal benefit at all to be derived and no significant benefit for the overwhelming majority of our users. So reporting entities are going to tend to minimize the required system changes to a level compatible with deriving data which meets absolute minimum audit requirements.

- The method of deriving direct cash flows would influence the costs, above all data on operating cash outflows by function and nature. By far the most costly variant would be to have to analyse the actual cash movements themselves and to reconcile these to the corresponding income figures excluding remeasurements (columns B+C.) We don't believe that this maximal approach is even practically feasible, for the reasons given further below, so any cost estimate would in any case be quite hypothetical. At the other end of the spectrum would be an indirect/direct approach in which one worked back from income-statement numbers by splitting up all movements in net operating assets by function and nature. The practicability of such an approach depends on systems to analyse balance sheet positions by nature within function, including extremely difficult items like payables and net pension liabilities. The cost depends very much on whether existing systems can even be correspondingly modified or whether new systems have to be developed. Our initial assessment suggests that, while some balance sheet positions could be identified to function and nature by a somewhat more granular coding, many key items would require a more complex approach. For instance, creditors ledger balances ("open positions") might be analysed by computer on the basis of the corresponding debits, but items which do not lend themselves to such automated analysis (e.g. pre- and part-payments, discounts taken, contras with receivables accounts, etc.) would have to be analysed by other means and/or allocated on some assumed percentage key. A case where the "other means" (usually manual) would have to prevail would be assets and liabilities relating to personnel costs, in particular pension liabilities which may in any case refer predominantly to retirees and thus not to any function in continuing operations. The more the analysis has to be undertaken by "other means" than automatically, the higher the on-going costs would be. Something closer to the "full" variant would entail initial costs of a very significant or even prohibitive magnitude, since it would boil down to a re-configuration of the transaction and reporting systems, possibly even of CHF ½ billion. This is without even considering the opportunity costs of diverting scarce resources such as IT and accounting specialists for a substantial period of time from real value-adding activities.

Practically, one should also consider that increased coding for ledger posting introduces more chance of error, so there would be a need for more quality control processes to compensate this risk. This would also be the effect of the higher level of complexity of cross-checks with such a large amount of data – on differing bases. (Everything else except the cash book is, of course, on an accruals basis.)

- The real "killer" from a cost and efforts perspective would be the requirements for cohesiveness between the statement of cash flows and the statement of comprehensive income in the operating category *on a line-by-line basis* (by nature within function) with reconciliation of the two also on this basis. By contrast it would be relatively easy – and inexpensive – to produce an Australian-style statement of operating cash flows ("Cash received from customers" minus "Cash paid to suppliers and employees"), but that could be insufficient for users, who would probably want supplementary indirect-method disclosures to understand better the link between operating profit and operating cash flows, which actual receipts and payments are unhelpful for.

- We have heard the view expressed that the required IT investments to support the direct method are affordable by companies. We absolutely cannot relate to that generalized claim, as we trust will be clear from the foregoing explanations of our own specific circumstances. We understand ours is similar to the position of many other preparers.

- Based on Australian experience, users would probably still want indirect-method information anyway, to be able to make a systematic and understandable link to income, so there would be double costs.

- To help the Board understand better some of the practical difficulties of their proposals on cash flows and reconciliation, we summarise below some of the issues met when carrying out our internal financial statement mock-up on the Discussion Paper:

--- This area of the Discussion Paper is based on an extremely simplistic view of the various aspects of recording and tracking transactions in a complex, modern industrial enterprise. Just to take the example of cash received from customers, movements in trade accounts receivable are not simply a matter of adding sales and deducting cash collections from customers but must also take into account the value added tax (VAT) charged on top of the sales amount on invoices to customers, as well as other non-sales amounts like gross amounts received where acting as agent, offsetting charges, transfers to deferred income, write-offs of bad debts, etc. This will mean that the link between cash collected and sales, which in the reconciliation must perforce end up in "Accruals, allocations and other", will be an incomprehensible rag-bag of very little use to analysts.

° Further, the output VAT for the period does not flow into the statement of comprehensive income but into a balance-sheet account for offsetting with input VAT and eventual payment. However, the DP states that "all changes in operating assets and liabilities should be presented in the operating category of the statement of comprehensive income … and in the statement of cash flows." (2.32.) And of course VAT is not the only cash flow that does not affect the statement of comprehensive income. Loans and advances to employees are just one other simple example.

° Apparently treatment of VAT is one of the difficult areas involved in the direct-method cash flows produced by Australian groups. When one sees that, even then, the only numbers they usually give in "net cash from operations" – apart from interest, dividends and taxes – are "cash collected from customers" and "cash paid to suppliers and employees for goods and services received", one wonders what benefit such "information" can bring for analysts. This probably explains why they include an indirect-method reconciliation of operating profit and operating cash flow in the notes.

--- Here we are considering part of the audited consolidated financial statements, so any information disclosed must be sufficiently robust to meet ever stricter audit requirements as well as the qualitative criteria stipulated by IFRS. This would certainly be difficult to ensure for line-by-line breakdowns of cash-flow numbers derived in respect of creditors ledger and pension and other personnel cost flows. In most industrial groups the whole transaction recording and tracking process is built up on the basis of the accruals principle. The incurrence of a cost becomes separated from the payment for it, which is no longer linkable with the subsequent "career" of the transaction. So the analysis of cash movements can only ever be an assumption – in many cases a reasonable one, but for all that an assumption – about where in the statement of comprehensive income it will end up (if at all.) Just a few of the practical impediments:

° Costs do not necessarily enter immediately into the main functions (manufacturing, R&D, etc.) but often go first into service cost centres which provide services to those main functions and to each other. By the time they get to manufacturing the original by-nature details are submerged through the application of charge-out rates and over- and under-recoveries and are no longer identifiable in anything other than an arbitrary and costly way. Also, this information would be of no use internally.

° Once in manufacturing the submergence of by-nature cost information does not end. The service charges received enter into product costs (and thus into inventories) via overhead loading rates and standard costs which may or may not be in line with actual costs, so that there would be no straightforward identification with what costs are inventoried and what are expensed as "abnormal" variances. And again the loading rates carry with them no by-nature break-down and standard costs often do not do so directly either.

° Another impediment is that costs do not necessarily stay in the function which they are first assigned to on recording in e.g. the creditors ledger. For instance, materials purchases initially classified as "manufacturing" because they are intended to go into production and thus cost of sales may actually end up being withdrawn as final product for marketing samples or as materials or product for development.

In short, articulation from cash or even creditors ledger to income is in practical terms not feasible in a normal, complex industrial environment with the degree of "faithful representation" and absence of arbitrary allocations necessary for audited financial statements.

--- The problems are of a substantially greater magnitude for analysis of operating expense – especially by function – than for operating income, particularly in respect of payments from the creditors ledger and of pensions and other personnel expenses. A rough analysis of creditors payments on the basis of allocating to each payee-account a simple vendor-type code would appear achievable without great expense, but we have considerable doubts whether the degree of accuracy which could be assured in such an approach would be sufficient. A push-back of the account-code information from the individual invoice into the payment details to derive more accurate information would require more substantial expenditure and would in any case still be accompanied with difficulties (e.g. part- and pre-payments and the ubiquitous VAT) and would not solve the other practical problems mentioned above. This expenditure also would be pure compliance cost (both initial and on-going): the information would have no internal value. If it did, we would be collecting it already, of course. Similarly, allocation to functions of the contributions paid to pension funds would be very approximative (and, in respect of such as relate to retirees, totally meaningless) – and internally without value.

It is also probably worth mentioning that even working back to the operating cost cash flows from operating income, as we did in the mock-up, is fraught with practical difficulties, too. System changes to permit analysis of outstanding creditors ledger amounts by account code charged would be pretty costly – and again pure compliance costs – and would also not solve many of the problems of cash flow/income articulation outlined above. And the analysis of the net post-employment defined benefit plan balances would be a real challenge, especially bearing in mind the "functionlessness" of retired plan members, as already mentioned. The biggest show-stopper overall in practical preparation is having to meet the proposed requirement for a break-down of payments by function in an accurate and meaningful manner.

--- The approach taken for our mock-up was to try to do the reconciliation first, i.e. work backwards from the statement of comprehensive income via some approximative allocations of balance sheet changes to derive a cash flow by expense-type within function. The values so derived were then the basis for the statement of cash flows. There was no approximative data available on cash receipts and payments, even in total: these are not collected, needed or used anywhere in the Group.

Question 21 On the basis of the discussion in paragraphs 3.88–3.95, should the effects of basket transactions be allocated to the related sections and categories in the statement of comprehensive income and the statement of cash flows to achieve cohesiveness? If not, in which section or category should those effects be presented?

In considering "basket transactions" we have focussed primarily on acquisitions and divestments as we think that this covers the more important items involved, though we do not deny that there are others.

We believe that applying cohesiveness to such transactions would in many cases not be possible (see below) and not generate information of use to users that could not be handled better in note disclosures. The central problem is with the statement of financial position and with acquired businesses which are integrated, as so often happens, into the acquiring entity's operations. Where such an integration takes place, the separate cash and income flows and financial position of the acquired business are no longer discernible.

Our suggestion would be the following:

--- For the statements of income and cash flow only, present in a separate section
° for acquisitions the directly related costs of acquisition (now expensed under IFRS 3 revised) but not the subsequent income and cash flows;
° for divestments not presented as discontinued operations the relevant gains and losses on divestment and corresponding cash flows.
--- For the statement of financial position, no separate section.
--- For details of effects on the statement of financial position from the acquisition or divestment at the date of transaction and estimates of income and cash flows subsequent to acquisition, make note disclosures as now.

We understand that most analysts would be quite happy with such an approach. We also understand that the absence of a viable proposed solution in the Discussion Paper for presentation of the income and cash flows related to M&A activity is a key criticism among many other preparers and users as these flows must be clearly understood for meaningful analysis.

QUESTIONS CONCERNING THE PROPOSED ADDITIONAL NOTES TO THE FINANCIAL STATEMENTS

Question 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?*

We would suggest that this aspect should be dealt with in the context of IFRS 7 rather than within this project, though we have no objections to the idea.

Question 23 Paragraph 4.19 proposes that an entity should present a schedule in the notes to financial statements that reconciles cash flows to comprehensive income and disaggregates comprehensive income into four components: (a) cash received or paid other than in transactions with owners, (b) accruals other than remeasurements, (c) remeasurements that are recurring fair value changes or valuation adjustments, and (d) remeasurements that are not recurring fair value changes or valuation adjustments.

(a) Would the proposed ***reconciliation schedule*** *increase users' understanding of the amount, timing and uncertainty of an entity's future cash flows? Why or why not? Please include a discussion of the costs and benefits of providing the reconciliation schedule.*

We very much support the idea of separating out the income-statement effects of remeasurements. We repeatedly hear from users that, particularly in the operating category, they would like to be able to strip out such effects. (This was pointed out strongly in the UBS paper in which Steve Cooper had a hand, for instance.) As we explain under Question 26, we would also be very open to ideas on how to present the "unusual" items, though we are not clear ourselves whether this is practical in the financial statements (as opposed to management commentary) because of the difficulties of definition.

However, as you will have gathered from our previous answers, we do not believe that receipts and payments information helps to understand much about future cash flows. Depending on dates of funds transfers, for instance, these items can be quite erratic. We have also already mentioned that information on the remeasurements and "unusual" items included in income, together with (possibly expanded) information derived by the indirect method on significant changes in (e.g.) net working capital items and provisions, is generally quite adequate – and in many ways better – for the understanding which users are seeking. This approach also has the key advantage of being directly linked to the income statement, which is central for users looking for sustainable underlying earnings.

We would also like to mention that the reconciliation is in any case a rather indigestible mass of figures. This presentation – in contrast to a rather more selective display of certain key items - is not conducive to improving users' understanding of anything.

One specific item which we would like to point out in the Discussion Paper is the presumption that all operating cash flows should be reflected somewhere in the operating income. This is erroneous: we mention under Question 20 the issue of operating cash flows which affect balance-sheet positions only (e.g. VAT, advances to employees.)

Please refer also to our responses to Questions 19 and 20 above which impinge on Question 23.

(b) Should changes in assets and liabilities be disaggregated in the components described in paragraph 4.19? Please explain your rationale for any component you would either add or omit.

We would not split items 4.19 a) and 4.19(b) for the reasons given in (a) above. (In any case we do not view changes in assets and liabilities as particularly relevant per se, focus should be on the statement of comprehensive income.)

(c) Is the guidance provided in paragraphs 4.31, 4.41 and 4.44-4.46 clear and sufficient to prepare the reconciliation statement? If not, please explain how the guidance should be modified.

On the whole the guidance seems reasonable, though we did have some doubts about changes in estimates. Let us suppose for instance that a provision is set up for an environmental liability arising out of contamination of part of a factory site for a present value of CHF 100. In the next year this is increased to CHF 125 because of (1) the previous estimate based on assumptions of cost developments which turns out to be CHF 5 too light, (2) a second area of contamination discovered on the site which had not previously been known or considered (+CHF 17) and (3) discount unwind of CHF 3. Which, if any, of these effects could be considered remeasurements in contrast to accruals?

Also, we were puzzled why in para. 4.45 (e) foreign currency translation adjustments were considered as non-recurring, since they have to be made at the end of each period.

*Question 24 Should the boards address further disaggregation of **changes in fair value** in a future project (see paragraphs 4.42 and 4.43)? Why or why not?*

No, we do not see the benefit of considering any further disaggregation of changes in fair value.

*Question 25 Should the boards consider other **alternative reconciliation formats** for disaggregating information in the financial statements, such as the statement of financial position reconciliation and the statement of comprehensive income matrix described in Appendix B, paragraphs B10–B22? For example, should entities that primarily manage assets and liabilities rather than cash flows (for example, entities in the financial services industries) be required to use the statement of financial position reconciliation format rather than the proposed format that reconciles cash flows to comprehensive income? Why or why not?*

As already mentioned under Question 19 above, we would very much support the call made by the Corporate Reporting Users Forum (CRUF) at their meeting with the Board last June for a net debt reconciliation. Indeed, it could be so designed as to fit in very easily with the Board's proposals on cohesive categories by adapting the statement of cash flows (indirect-method) to actually take this form: the "financing" category in the statement of financial position would be the "fund" instead of cash, and disclosures would show the effects on net debt of exchange rate changes, debt issued and repaid, etc. The reconciliation of net debt appears to be widely esteemed by active users and should involve preparers in no significant extra costs.

Deciding what information best meets the needs of active users should be based upon input sought from a broad selection of such users.

Question 26 The FASB's preliminary view is that a memo column in the reconciliation schedule could provide a way for management to draw users' attention to ***unusual or infrequent events or transactions*** *that are often presented as special items in earnings reports (see paragraphs 4.48–4.52). As noted in paragraph 4.53, the IASB is not supportive of including information in the reconciliation schedule about unusual or infrequent events or transactions.*

(a) Would this information be decision-useful to users in their capacity as capital providers? Why or why not?

Since most users with whom we have regular contacts are keenly interested in trying to derive information on *sustainable* underlying earnings for their forecasting purposes, we can readily understand that such information would be useful to them. Indeed, we already attempt to ensure that our reports give them such information, but most of it is outside the audited financial statements, for instance in the management commentary. The crucial question for the standard-setter is around how best to provide such information. We see two key problem-areas:

- By definition this information does not fit into a mould. Standard solutions may therefore hinder rather than help transparency, and the choice of items to include is often extremely subjective. Rules would probably only lead to exclusion of some useful information or inclusion of un-useful information.

- Once the selection of relevant information has been determined, there is a presentational problem. We already have significant concerns about the loss of clarity, transparency and understandability of the financial statements, so we would be very sceptical about the wisdom of adding a further column.

On balance we think that it would be best for users to avoid standardised selection and presentation but to reflect the information in the management commentary, where the form most appropriate to the circumstances can be adopted.

(b) APB Opinion No. 30 Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions, *contains definitions of* unusual *and* infrequent *(repeated in paragraph 4.51). Are*

those definitions too restrictive? If so, what type of restrictions, if any, should be placed on information presented in this column?

See (a) above.

(c) Should an entity have the option of presenting the information in narrative format only?

See (a) above.

OTHER COMMENTS

We note that the question of the presentation of non-controlling interests is not covered at all in the Discussion Paper. It would be quite unacceptable to us to proceed with a project on Financial Statement Presentation which ignores this matter. The Conceptual Framework Phase D on the Reporting Entity is still at an early stage, and we are not aware that the entity approach proposed in it has received substantial support. It would be undesirable for the Board to give constituents the impression that it has already decided to impose the entity approach by continuing to ignore non-controlling interests in the next phase of the Financial Statement Presentation project. The importance for many users of the information on net income and equity attributable to parent company shareholders must not be dismissed.

It is puzzling to us that, despite standard-setters' assertions of trying to help the capital markets, they have undertaken so little investigation of non-GAAP information and, more particularly, what information gaps in current financial reporting standards are indicated by the frequent use of specific non-GAAP measures. It may well be that such measures are occasionally misused by certain preparers to "accentuate the positive and eliminate the negative", but a considerable amount of non-GAAP information is avidly sought by users, especially in Europe. An open-minded survey of frequently used non-GAAP measures combined with a critical review by active users (e.g. CRUF) could indicate practical areas for improvement of financial reporting standards.

Appendix 2, Extracts from Roche Finance Report 2008 (Financial Review) - Cash Flow/Net Cash

Pharmaceuticals operating results [Example of divisional cash flow information]

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Pharmaceuticals Division results

	2008 (mCHF)	2007 (mCHF)	% change (CHF)	% change (local currencies)
Sales	**35,961**	36,783	-2	+5
Royalties and other operating income	**2,148**	2,057	+4	+12
Cost of sales	**(8,963)**	(9,502)	-6	0
Marketing and distribution	**(6,696)**	(7,018)	-5	+2
Research and development	**(7,904)**	(7,598)	+4	+11
General and administration	**(1,572)**	(1,680)	-6	0
Operating profit before exceptional items	**12,974**	13,042	-1	+8
- margin, % of sales	**36.1**	35.5	+0.6	
Operating free cash flow	**12,053**	10,044	+20	+31
- margin, % of sales	**33.5**	27.3	+6.2	

....

Operating free cash flow

All three sub-divisions of the Pharmaceuticals Division continue to generate strong cash flows. The cash generated supports the expansion of the business with the investments in new production facilities and in intellectual property through in-licensing deals. At Genentech in particular, a significant part of the free cash flow has usually been used in their equity compensation plans, including the purchase of their own equity to maintain Roche's ownership percentage. In 2008 this was equivalent to 109 million Swiss francs (2007: 1,071 million Swiss francs) with the considerable fall in 2008 being due to the prepayment of some repurchases by Genentech at the end of 2007 and the increased cash inflows from exercise of options by Genentech employees. Overall operating free cash flow increased by 31% in local currencies driven by improved net working capital management and lower capital expenditures and outflows for equity compensation plans. As a percentage of sales, operating free cash flow of the Pharmaceuticals Division increased to 33.5% compared to 27.3% in 2007.

Pharmaceuticals Division - Operating free cash flow

2008	Roche Pharmaceuticals (mCHF)	Genentech (mCHF)	Chugai (mCHF)	Elimination within division (mCHF)	Pharmaceuticals Division (mCHF)
Operating profit	**6,646**	**5,998**	**591**	**(233)**	**13,002**
Operating profit cash adjustments 2)	**1,290**	**2**	**204**	**-**	**1,496**
(Increase)/decrease in net working capital	**(281)**	**179**	**(146)**	**233**	**(15)**
Investments in PP&E	**(907)**	**(850)**	**(264)**	**-**	**(2,021)**
Investments in intangible assets	**(169)**	**(240)**	**-**	**-**	**(409)**
Operating free cash flow	**6,579**	**5,089**	**385**	**-**	**12,053**
- as % of sales	***29.7***	***48.6***	***11.5***	**-**	***33.5***

1) Unrealised internal profits on inventories that have been sold from one subdivision to another but which have not yet been sold on to external customers at the balance sheet date are eliminated as a consolidation entry.

2) Operating profit cash adjustments consist of the elimination of depreciation, amortisation and impairment charges and the replacement of the operating income expenses for provisions, equity compensation plans and disposals of property, plant and equipment and intangible assets with their cash equivalents. A detailed breakdown is provided on pages xx-xx.

Cash flows and net cash [Total Roche Group]

Free cash flow

2008	Pharmaceuticals (mCHF)	Diagnostics (mCHF)	Corporate (mCHF)	Group (mCHF)
Operating profit	**13,002**	**1,187**	**(265)**	**13,924**
Operating profit cash adjustments	**1,496**	**1,122**	**(7)**	**2,611**
(Increase)/decrease in net working capital	**(15)**	**(464)**	**(2)**	**(481)**
Investments in property, plant and equipment	**(2,021)**	**(1,237)**	**(1)**	**(3,259)**
Investments in intangible assets	**(409)**	**(8)**	**-**	**(417)**
Operating free cash flow	**12,053**	**600**	**(275)**	**12,378**
Treasury activities				**166**
Taxes paid				**(3,514)**
Dividends paid				**(4,051)**
Free cash flow				**4,979**

2007 ....

The free cash flow of the Group in 2008 was strong and increased by 1.0 billion Swiss francs to 5.0 billion Swiss francs. This increase was primarily due to a higher operating free cash flow and lower tax payments. These factors more than compensated for the lower cash generation from treasury activities and for the higher dividend payments.

The operating free cash flow increased by 16%, mainly due to significantly lower net cash outflow from equity compensation plans, despite strong currency translation effects. The underlying business continues with good cash generation, partly absorbed by growth in net working capital as the business expands. **Operating profit cash adjustments consist of** the elimination of depreciation, amortisation and impairment charges and **the replacement of the operating income/expenses for provisions, equity compensation plans and disposals of property, plant and equipment and intangible assets with their cash equivalents. This** includes the net impact of the Group's equity compensation plans, including cash received from employees upon exercise, cash used by Roche to purchase own equity for delivery to employees and cash used by Genentech for their stock repurchase programme which maintains Roche's ownership percentage. **A detailed breakdown of this is provided on pages xxx-xx.** Operating free cash flow also includes cash movements in working capital and the cash payments for capital expenditure on property, plant and equipment and intangible assets, the latter mainly arising through in-licensing deals.

Treasury operations showed positive cash generation, mainly from interest income. Cash flows from treasury activities decreased by 80% due to lower interest received, driven by lower funds held, lower interest rates and a weaker US dollar against the Swiss franc. Total taxes paid in 2008 decreased considerably compared to 2007 which included significant final settlement payments of previously accrued amounts. Dividend payments increased by 34%, or 1.0 billion Swiss francs, compared to 2007.

Net cash

	Roche (mCHF)	Genentech (mCHF)	Chugai (mCHF)	Group (mCHF)
31 December 2007				
Cash and cash equivalents	1,869	1,157	729	3,755
Marketable securities	14,496	5,209	742	20,447
Long-term debt	(1,270)	(2,564)	-	(3,834)
Short-term debt	(2,357)	(675)	-	(3,032)
Net cash at beginning of period	12,738	3,127	1,471	17,336
Free cash flow for 2008	**1,623**	**3,392**	**(36)**	**4,979**
Transactions in own equity instruments	**(141)**	-	-	**(141)**
Business combinations	**(2,964)**	-	-	**(2,964)**
Changes in ownership interests in subsidiaries	**(2,219)**	-	-	**(2,219)**
Currency translation, fair value and other movements	**(707)**	**275**	**123**	**(309)**
Net change in net cash	**(4,408)**	**3,667**	**87**	**(654)**
31 December 2008				
Cash and cash equivalents	**1,036**	**3,057**	**822**	**4,915**
Marketable securities	**8,380**	**6,740**	**736**	**15,856**
Long-term debt	**(498)**	**(2,474)**	-	**(2,972)**
Short-term debt	**(588)**	**(529)**	-	**(1,117)**
Net cash at end of period	**8,330**	**6,794**	**1,558**	**16,682**

Net cash position of the Group is 16.7 billion Swiss francs, down by 0.7 billion Swiss francs during 2008. The free cash flow of 5.0 billion Swiss francs was primarily used to finance the acquisitions of Ventana (3.8 billion Swiss francs) and the increase of the ownership in Chugai (0.9 billion Swiss francs). The release of previously restricted cash relating to the City of Hope litigation at Genentech increased net cash by 0.9 billion Swiss francs, offsetting the 0.5 billion Swiss francs paid to City of Hope which is included within the operating free cash flow. The Group also repaid debt of 2.3 billion Swiss francs mainly for the 'Rodeo' bonds and the euro-denominated European Medium Term Notes. This reduced debt and liquid assets, but had no impact on net cash.

Supplementary Operating Free Cash Flow Information

Divisional operating free cash flow information *in millions of CHF*

	Pharmaceuticals Division		Diagnostics Division		Corporate		Group	
	2008	2007	2008	2007	2008	2007	2008	2007
Depreciation, amortisation and impairments								
Depreciation of property, plant and equipment	**1,022**	957	**649**	599	**5**	4	**1,676**	1,560
Amortisation of intangible assets	**511**	645	**458**	331	**-**	-	**969**	976
Impairment of property, plant and equipment	**20**	4	**8**	2	**-**	-	**28**	6
Impairment of intangible assets	**99**	58	**5**	-	**-**	-	**104**	58
Total	**1,652**	1,664	**1,120**	932	**5**	4	**2,777**	2,600
Other adjustments								
Add back								
- Expenses for equity-settled equity compensation plans	**476**	560	**36**	29	**14**	14	**526**	603
- Net (income)/expense for provisions	**304**	403	**128**	226	**(15)**	4	**417**	633
- Net gain from disposals	**(397)**	(309)	**13**	8	**(5)**	-	**(389)**	(301)
Deduct								
- Net cash flow from equity compensation plans	**(174)**	(1,210)	**(21)**	(41)	**(5)**	(17)	**(200)**	(1,268)
- Utilisation of provisions	**(864)**	(574)	**(179)**	(101)	**(18)**	(21)	**(1,061)**	(696)
- Proceeds from disposals	**499**	295	**25**	68	**17**	-	**541**	363
Total	**(156)**	(835)	**2**	189	**(12)**	(20)	**(166)**	(666)
Operating profit cash adjustments	**1,496**	829	**1,122**	1,121	**(7)**	(16)	**2,611**	1,934
EBITDA								
Operating profit before exceptional items	**12,974**	13,042	**1,187**	1,648	**(265)**	(222)	**13,896**	14,468
Depreciation, amortisation and impairments								
- Total Group	**1,652**	1,664	**1,120**	932	**5**	4	**2,777**	2,600
- Add back exceptional item	**(36)**	-	**-**	-	**-**	-	**(36)**	-
EBITDA	**14,590**	14,706	**2,307**	2,580	**(260)**	(218)	**16,637**	17,068
- margin, % of sales	**40.6**	40.0	**23.9**	27.6	**-**	-	**36.5**	37.0