

Issues paper - ED/2010/5 *Presentation of Items of Other Comprehensive Income (proposed amendments to IAS 1)*

INTRODUCTION

1. The intention of this paper is to address issues identified by AASB staff in Exposure Draft ED 197 *Presentation of Items of Other Comprehensive Income (proposed amendments to AASB 101)*. AASB staff note the IASB's objective for publishing ED/2010/5 is:
 - (a) to make it easier for users of an entity's financial statements to understand all non-owner changes in equity;
 - (b) help users to assess the relevance of individual income and expense items presented in other comprehensive income (OCI); and
 - (c) assess the potential effects that some OCI items may have on profit or loss.

AASB staff acknowledge the IASB's efforts to improve the presentation of financial statements through ED/2010/5. However, we are concerned that the proposals do not address some fundamental issues relating to the presentation of financial performance especially the recognition and measurement of items of OCI.

SCOPE OF THIS PAPER

2. Agenda paper 6.3 specifically addresses issues concerning the key proposals in ED/2010/5 (noted below) and considers the six questions¹ raised for comment by the IASB in the ED. This paper focuses on more fundamental issues relating to:
 - (a) financial performance reporting; and
 - (b) OCI items relating to discontinued operations and non-current assets (or disposal groups) held for sale.

¹ The questions raised by the IASB in the ED will be answered in an appendix to the Board's submission. The body of the submission will focus on the key issues addressed in the paper.

KEY PROPOSALS in ED 197

3. The key proposals in the ED are to require entities to:
 - (a) present all items of income and expense recognised in a period in a single statement with two sections – profit or loss and items of other comprehensive income;
 - (b) present separately items of OCI that will never be reclassified to profit or loss from those items that will be reclassified to profit or loss (recycled) in subsequent periods upon derecognition; and
 - (c) allocate income tax on items of other comprehensive income between items that might be subsequently reclassified to profit or loss and those that will not be reclassified subsequently to profit or loss.

FUNDAMENTAL ISSUES

(a) Financial performance reporting

4. IAS 1 *Presentation of Financial Statements* requires an entity to report the profit or loss, OCI, and total comprehensive income for the period. There are varying views regarding the line items that should be considered in measuring the financial performance of an entity which impacts on how financial performance related information should be presented. As such there are a range of differing views about how financial performance information should be identified, categorised and presented in the Statement of Comprehensive Income (renamed as the Statement of profit or loss and other comprehensive income in ED/2010/5). Without a consistent concept for identifying, categorising and presenting financial performance information, IFRSs present a mixed picture of financial performance and it remains unclear whether any one line item should be used to measure² financial performance.
5. Two fundamental issues relating to financial performance reporting that we think need to be addressed are:
 - (i) the basis for presenting items as part of net income versus OCI; and

2 This paper is intended to address the presentation and not the recognition and measurement of financial information. Therefore whenever the term ‘measure’ is used in this paper it is not addressing measurement principles within IFRS but rather used in the context of users assessing (‘measuring’) the financial performance of an entity based on the information presented in the Statement of profit or loss and other comprehensive income.

(ii) recycling/reclassification³.

These two issues are discussed in paragraphs 6-22 below.

(i) Items in net income versus OCI

6. The proposals in ED/2010/5 do not provide a conceptual basis for what should be presented as part of net income and what should be reported as part of OCI. AASB staff note that the IASB acknowledge this in paragraph BC15 of the ED, however, the IASB has not indicated how it plans to address this issue.
7. IFRSs currently include arguably inconsistent rules for what should be presented as part of net income or OCI. For example, paragraph 39 of IAS 16 *Property Plant and Equipment* requires an increase in an asset's carrying amount as a result of a revaluation to be recognised in other comprehensive income, whereas paragraph 35 of IAS 140 *Investment Property* requires a gain or loss arising from a change in fair value of investment property to be recognised in profit or loss.
8. The varying rules across IFRSs for presenting items 'above or below the line' in the statement of comprehensive income have added to concerns about measuring the financial performance of an entity. There is an implication that some users may place less weight on items below the line in assessing financial performance of entities, even though some items below the line may be of great relevance in assessing the financial performance of some entities. The concern is that this may result in inappropriate decisions being made.
9. AASB staff think that, ideally, a common principle would be developed to address this concern, which may be based on factors such as the nature, function, reoccurrence, and predictability of revenue and expense items. This may be outside the scope of the Financial Statement Presentation Project and therefore may be best addressed as part of the Conceptual Framework Project.

3 AASB staff note that the IASB have replaced the term 'recycle' with the term 'reclassify'. However in certain paragraphs in this paper the term 'recycle' better describes the concept/issue. Therefore the terms 'recycle' and 'reclassify' will be used interchangeably throughout this paper.

10. AASB staff note that in 2001 and 2002, research, discussion and field testing on the Performance Reporting Project (now referred as the Financial Statement Presentation Project) were undertaken by the IASB and its staff in relation to the reporting of financial performance information. Part of their research involved the development of a matrix format for presenting financial performance information. The FASB conducted similar surveys and interviews on their own project on performance reporting at the same time as the IASB. The IASB and FASB decided not to pursue its consideration of the matrix as a proposed presentation format, however the reasons for doing so are not clear in the basis for conclusions of ED/2010/5 and the working draft ED on financial statement presentation⁴.
11. The Boards agreed that, as part of the project's long term goal, they should develop a financial statement presentation format that would classify all income and expense items in the same manner and that recycling should be eliminated. However, the working draft ED which is the intended outcome of the project's long term goal does not appear to address the concerns regarding the presentation of financial performance and the recycling issue.
12. One way of addressing these concerns would be to revive the matrix format considered by the IASB in 2001/2002 as part of the Performance Reporting Project for use as a presentation format for categorising information in the statement of profit and loss and other comprehensive income.
13. The matrix format considered by the IASB provides a columnar distinction between 'income flows' and 'valuation adjustments' and also captures the nature of an entity's activities. Appendix A provides an example of a matrix format which distinguishes 'income flows' and 'valuation adjustments' as well as business and financing activities. Income flows would include all income and expense items other than those relating to remeasurements, such as interest income, interest expense, depreciation, rent, employee service costs and past service costs. Valuation adjustments would include items such as impairment, actuarial gains/losses and changes in property

4 Paragraph BC4 of the staff draft ED that is expected to be published in quarter 1 of 2011 says "Stakeholders raised concerns about both models and about the fact that they were different".

values. The matrix format would also take into account the nature of activities, which would accommodate distinctions between business and financing activities. The distinction between business and financing activities could be considered more closely in the ED on Presentation of Financial Statements to replace IAS 1 and IAS 7 *Statement of Cash Flows* that the IASB plans to publish in quarter 1 of 2011.

14. The use of the matrix format would eliminate the distinction between profit or loss and OCI and remove the difficulty of trying to establish what should be reported above or below the line. The matrix format disaggregates information in such a way that it may be easier to analyse the line items that are predictive in nature and those items that are ‘one off’ adjustments, which could assist users in predicting the future financial performance of entities.

Changes in OCI line items

15. Recent changes to IFRSs and proposed changes in respect of OCI have been piecemeal. Some of them will add to the items presented within OCI and others will reduce the number of items presented within OCI. Items currently presented in OCI that are likely to fall away include changes in fair value of available-for-sale financial assets under IAS 39 *Financial Instruments: Recognition and Measurement* due to the introduction of IFRS 9 *Financial Instruments*. Examples of additional items that are likely to be presented in OCI include:
 - (a) the effect on the fair value of a financial liability that is designated under the fair value option attributable to changes in a liability’s credit risk (proposed in ED/2010/4 *Fair Value Option for Financial Liabilities*); and
 - (b) remeasurements of net defined benefit assets and liabilities [proposed in ED/2010/3 *Defined Benefit Plans (proposed amendments to AASB 119)*].

The two remaining phases of the financial instruments project addressing impairment and hedging may add further items that would be presented in OCI. The likelihood of ongoing piecemeal changes in the items being presented in OCI highlights the need to address the fundamental principles for presenting information that is useful for measuring financial performance rather than addressing the matter on a topic-by-topic basis.

16. **Question 1.1**

Do Board members agree that a common principle for financial performance reporting should be established?

Question 1.2

Do Board members agree that this should be addressed as part of the Conceptual Framework Project?

Question 1.3

Do Board members agree with the staff proposal that the IASB reconsider the matrix format, as part of a possible solution?

(ii) Recycling/Reclassification

17. Paragraph 7 of IAS 1 says the components of OCI include:

- “(a) changes in revaluation surplus (see AASB 116 *Property, Plant and Equipment* and AASB 138 *Intangible Assets*);
- (b) actuarial gains and losses on defined benefit plans recognised in accordance with paragraph 93A of AASB 119 *Employee Benefits*;
- (c) gains and losses arising from translating the financial statements of a foreign operation (see AASB 121 *The Effects of Changes in Foreign Exchange Rates*);
- (d) gains and losses on remeasuring available-for-sale financial assets (see AASB 139 *Financial Instruments: Recognition and Measurement*); and
- (e) the effective portion of gains and losses on hedging instruments in a cash flow hedge (see AASB 139).”

18. The proposals in ED/2010/5 expand on the above explanations by proposing separate presentation of items of OCI that will be subsequently reclassified to profit or loss and those that will not. These proposals may reinforce the notion that there are ‘first class’ and ‘second class’ income and expense categories by creating the perception that profit or loss items are more relevant for measuring financial performance than OCI items which is not necessarily true. AASB staff consider that this is further evidence that a common concept needs to be developed to avoid the focus being on particular items of income and expenses or particular sub-totals.

19. There is no conceptual basis in IFRSs for determining the items that should be subsequently reclassified to profit or loss versus those that will never be reclassified

to profit or loss. AASB staff are also concerned that the proposals do not address the concept of recycling and why certain items should be recycled and others should not. We note that the recycling issue would no longer be of concern if the matrix format were applied.

20. In its submission on the Discussion Paper *Preliminary Views on Financial Statement Presentation*, the AASB recommended that this project should address the ‘recycling’ issue and emphasised that the AASB does not support the concept of recycling. AASB staff think the distinction between profit or loss and OCI and the notion of ‘recycling’ implies that there are effectively three classes of income and expense items:
- (i) those recognised immediately in profit or loss;
 - (ii) those recognised in OCI and subsequently re-recognised in profit or loss; and
 - (iii) those recognised in OCI and not recycled;
- and that the proposals in ED/2010/5 reinforce this implication. Accordingly, AASB staff propose that the AASB reiterates the recommendation in its submission to the IASB on ED/2010/5 that recycling is not appropriate and highlight that the matrix format, as discussed above, would avoid the recycling issue, by eliminating the distinction between profit or loss and OCI.

21. **Question 2**

Do Board members agree that recycling remains inappropriate and the IASB need to address the recycling issue as part of developing a common principle for financial performance reporting?

(b) OCI items relating to discontinued operations and non-current assets (or disposal groups) held for sale

22. AASB staff note that existing IFRSs and ED/2010/5 do not address the existence of items of OCI relating to discontinued operations and non-current assets (or disposal groups) held for sale.
23. The proposed paragraph 82(e) of ED/2010/5 states:
As a minimum, the profit or loss section of the statement of profit or loss and other comprehensive income shall include line items that present the following amounts for the period:
...
(e) a single amount for the total of discontinued operations (see IFRS 5); and ...
24. The requirements in IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* are similarly unclear regarding the presentation of OCI items relating to discontinued operations and non-current assets (or disposal groups) held for sale.
Paragraph 33A of IFRS 5 states:
If an entity presents the components of profit or loss in a separate income statement as described in paragraph 81 of AASB 101 (as revised in 2007), a section identified as relating to discontinued operations is presented in that separate statement.
25. Paragraph 82(e) of ED/2010/5 and IFRS 5 may imply that:
(i) only profit or loss items of discontinued operations and non-current assets (or disposal groups) held for sale are required to be separately presented; or
(ii) items of OCI relating to discontinued operations and non-current assets (or disposal groups) held for sale should be incorporated into the single amount shown in profit or loss.
26. Another possibility is that items of OCI relating to discontinued operations and non-current assets (or disposal groups) held for sale would be rare and that there is no need to deal with them. However, staff have been advised by Australian constituents that they have encountered items of OCI relating to discontinued operations and non-current assets (or disposal groups) held for sale and, when AASB staff raised the matter with IASB staff in 2009, they regarded it as significant.
27. IASB staff indicated that the matter would be considered as part of the Annual Improvements Project. Subsequently, at its December 2009 meeting, the IASB noted

that any amendments to reflect the presentation and disclosure issues relating to OCI would be considered as part of the IASB's project on Financial Statement Presentation. However, neither ED/2010/5 nor the IASB *Post Ballot Draft Exposure Draft Discontinued Operations* (this post ballot was circulated to National Standard Setters members on 4 August 2010) address the matter. AASB staff believe the IASB should be reminded of issues concerning the presentation of OCI items attributable to discontinued operations and non-current assets (or disposal groups) held for sale and advised to address these issues as part of the remaining parts of the Financial Statement Presentation Project.

28. **Question 3**

Do Board members agree that the IASB should be reminded of issues relating to the presentation of OCI items attributable to discontinued operations and encouraged to provide clarity on the matter?

RDR IMPLICATIONS OF PROPOSED AMENDMENTS

29. AASB staff note that paragraphs 90-92 of AASB 101 are not included in the Reduced Disclosure Requirements, as there is no equivalent in the *IFRS for SMEs*.

Paragraphs 90-92 state:

90 An entity shall disclose the amount of income tax relating to each component of other comprehensive income, including reclassification adjustments, either in the statement of comprehensive income or in the notes.

91 An entity may present components of other comprehensive income either:
(a) net of related tax effects; or
(b) before related tax effects with one amount shown for the aggregate amount of income tax relating to those components.

92 An entity shall disclose reclassification adjustments relating to components of other comprehensive income.

30. ED/2010/5 proposes to amend paragraph 91 by inserting the following in a new paragraph immediately after paragraph 91(b):

“If an entity elects alternative (b) above, then it must allocate the tax between the items that might be reclassified subsequently to the profit or loss section and those that will not be reclassified subsequently to the profit or loss section.”

31. AASB staff think that there is nothing in the proposed change to paragraph 91 in ED/2010/5 that should cause the AASB to change its existing view that paragraphs 90 to 92 should be excluded from the RDR.

32. On a separate note, AASB staff will also consider the RDR implications of the IASB *Post Ballot Draft Exposure Draft Discontinued Operations* once it is finalised as an ED.

33. **Question 4**

Do Board members agree with the staff view regarding RDR?

APPENDIX A – Complied Example of a Matrix Format⁵

<u>Nature of Activity</u>	Total	<u>Accounting Measurement</u>	
		Income (e.g. sales for the period)	Valuation Adjustment (e.g. fair value changes)
Business <i>(Operating and investing activities)</i>			
Revenue	500	500	
Selling, general, admin	(250)	(250)	
Interest income - deposits	100	100	
Depreciation	(50)	(50)	
Impairment of goodwill	(150)		(150)
Revaluation of property, plant and equipment	35		35
Revaluation of investment property	25		25
Disposal gain - property, plant and equipment	50		50
FX loss on net investment	(10)		(10)
Share of profits in associates	50	50	
Total business profit/loss	XXX	XX	XX
Financing <i>(effects of price changes in financial markets)</i>			
Interest expense on debt	(70)	(70)	
Pension financing expenses – change in pension obligation discount rate	(30)		(30)
Pension financing expenses – unwinding of discount rate	(10)	(10)	
Total financing profit/loss	XX	X	X
Profit before tax	XXX	XX	XX
Income Tax	XX	X	X
Net profit/(loss)	XXX	XX	XX

5 AASB staff have compiled this matrix taking into consideration the matrix format that was proposed to the IASB by its staff in October 2002 and a matrix format that was considered by Richard Barker (IASB Research Fellow) in his paper, *Identifying Income Components for Performance Reporting*, issued in October 2001. This matrix is not a complete worked example displaying all amounts and totals. Amounts have been included to help illustrate the concept.