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International Accounting Standards Board

INFORMATION FOR OBSERVERS

Board Meeting:	**16 November 2006, London**
Project:	**Annual improvement process**
Topic:	**Presentation of 'net finance costs' on the face of the income statement (Agenda Paper 2B)**

1. The IFRIC have recommended that the following issue would be most appropriately resolved via the annual improvements process (as agreed by the Board in July 2006).

   Issue: How should the conflict between the requirements of IAS 1 *Presentation of Financial Statements* and IFRS 7 *Financial Instruments: Disclosures* regarding the presentation of finance costs be resolved?

2. The purpose of this paper is to propose that the above issue be added to the Board's annual improvements project, to provide analysis on that issue and to propose a solution.

Staff recommendation

3. The staff recommends that:

- the Board should add the issue described in paragraph 1 to the annual improvements project; and
- paragraph IG 13 of IFRS 7 should be deleted in accordance with the proposed drafting in paragraph 21 of this paper.

Structure of the paper

4. The background to this issue, staff analysis and proposed drafting of amendments have been presented in the main body of this paper.

Background

5. In October 2004, the IFRIC discussed the presentation of 'net finance costs' and whether it is acceptable to present a line item 'net finance costs' (or a similar term) on the face of the income statement without showing the finance costs and finance revenue composing it. The IFRIC members noted that paragraph 81 of IAS 1 requires the face of the income statement to include line items that present, inter alia, amounts for revenue and finance costs. Paragraph 32 of IAS 1 disallows the offsetting of revenues and expenses (except where permitted by another Standard or Interpretation).

6. The IFRIC members agreed that taken together, paragraphs 32 and 81 of IAS 1 preclude presenting 'net finance costs' (or a similar term) on the face of the income statement without showing the finance costs and finance revenue composing it. However, this does not preclude presentation of finance revenue followed immediately by finance costs and a subtotal (e.g. 'net finance costs') on the face of the income statement. The IFRIC agreed not to develop an Interpretation on this issue. (Refer Appendix which sets out the various IFRS paragraphs in full.)

7. IFRS 7 *Financial Instruments: Disclosures* was issued in 2005 and is effective for annual periods beginning on or after 1 January 2007. IG 13 of IFRS 7 states that 'The total interest income and total interest expense disclosed in accordance with paragraph 20(b)[1] is a component of the finance costs, which paragraph 81(b) of IAS 1 requires to be presented separately on the face of the income statement. The line item for finance costs may also include amounts that arise on non-financial assets or non-financial liabilities'.

8. Therefore, IG 13 of IFRS 7 can be read as requiring interest income and interest expense to be presented <u>net</u> on the face of the income statement because IG 13 of IFRS 7 states that they are <u>components</u> of finance costs.

9. In light of this conflict, the staff have conducted analysis as to whether the requirements of IFRS 7 should prevail over the requirements of IAS 1. That is, should entities be permitted to present interest income and interest expense net ('net finance cost') on the face of the income statement, without presenting gross interest income and interest expense on the face of the income statement?

Staff Analysis

Should entities be allowed to present interest income and expense net on the face of the income statement without presenting gross interest income and expense?

10. IFRS 7 is a disclosure standard, the objective of which is to require entities to provide disclosures in their financial statements that enable users to evaluate (i) the significance of financial instruments for the entity's financial position and performance; and (ii) the nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the reporting date, and how the entity manages those risks (see IFRS 7.1).

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[1] IFRS 7.20(b) states that an entity shall disclose the total interest income and interest expense (calculated using the effective interest method) for financial assets or financial liabilities that are not at fair value through profit or loss.

11. IFRS 7.20(b) requires an entity to disclose total interest income and total interest expense (calculated using the effective interest method) for financial assets or financial liabilities that are not at fair value through profit or loss either on the face of the financial statements or in the notes.[2] It does not set out requirements for whether interest income and interest expense should be offset.

12. IAS 32 *Financial Instruments: Presentation* does not address offsetting of interest income and interest expense.

13. The issue as to whether interest income and interest expense can be offset on the face of the income statement is a presentation matter addressed by IAS 1. IAS 1.32 states that income and expenses should not be offset unless required or permitted by a Standard or an Interpretation. IAS 1.33 notes that offsetting is not allowed unless it reflects the substance of the transaction or other event.

14. IAS 18 indicates that interest income is one of the significant categories of revenue, which should be disclosed in the financial statements in accordance with IAS 18.35(b). Moreover, IAS 1.81 requires that, as a minimum, the face of the income statement should present (i) revenue and (ii) finance costs.

15. For the above reasons, the staff believes that interest income and interest expense should not be presented net on the face of the income statement (unless, as previously decided by the IFRIC, the gross amounts of interest income and interest expenses are also shown on the face of the income statement).

16. The staff acknowledges that IG 13 of IFRS 7 is confusing. Indeed, the staff believes that interest income is not always a component of 'finance costs' for presentation purposes. For entities engaging in money-lending businesses, interest income may be classified as revenue. The staff has considered the financial statements of some financial institutions which early adopted IFRS 7.

[2] Same disclosure requirement as in paragraph 94(h)(i) of IAS 32 *Financial Instruments: Disclosure and Presentation*.

All of them present gross interest income and interest expenses separately on the face of the income statement.

17. Furthermore, since the Guidance on Implementing IFRS 7 is not part of IFRS 7, the staff believes that entities should refer to IAS 1 for presentation requirements (e.g. offsetting requirements) and IFRS 7 for disclosure requirements. However, in order to avoid confusion, the staff believes that IG 13 of IFRS 7 should be deleted.

18. The staff also considered whether to amend IG13 of IFRS 7. The staff do not believe an amendment is appropriate since IAS 1 deals directly with the presentation requirements, and further guidance is not necessary.

Staff recommendation

19. The staff recommend that paragraph IG13 of IFRS 7 be deleted.

20. **Does the Board agree?**

Drafting

21. The following revisions are proposed to IFRS 7 *Financial Instruments: Disclosure* should the Board agree with the staff recommendations:

~~Total interest income and total interest expense (paragraph 20(b))~~

IG13 ~~The total interest income and total interest expense disclosed in accordance with paragraph 20(b) is a component of the finance costs, which paragraph 81(b) of IAS 1 requires to be presented separately on the face of the income statement. The line item for finance costs may include amounts that arise on non-financial assets or non-financial liabilities.~~

Basis for Conclusions on IFRS 7 *Financial Instruments: Disclosures*

Conflict with IAS 1 *Presentation of Financial Statements*

BC1 Following the issue of IFRS 7, the Board became aware in 2006 that the guidance in IG 13 conflicted with the requirements of IAS 1. IG 13 stated that total interest income and total interest expense disclosed in accordance with paragraph 20(b) were a component of finance costs. However, paragraph 81 of IAS 1 requires the face of the income statement to include line items that present, inter alia, revenue and finance costs. Paragraph 32 of IAS 1 prevents the offsetting of revenues and expenses (except where permitted by another Standard or Interpretation). By requiring total interest income and total interest expense disclosed in accordance with paragraph 20(b) to be presented net as a component of finance costs, the guidance in IG 13 was in conflict with the requirements of IAS 1. Therefore, the Board decided to delete IG 13.

Appendix

The IFRS paragraphs referred to in paragraphs 5 and 6 have been reproduced below:

IAS 1 *Presentation of Financial Statements*

Offsetting

32 Assets and liabilities, and income and expenses, shall not be offset unless required or permitted by a Standard or an Interpretation.

Information to be presented on the face of the income statement

81 As a minimum, the face of the income statement shall include line items that present the following amounts for the period:

- **(a) revenue;**
- **(b) finance costs;**
- **(c) share of the profit or loss of associates and joint ventures accounted for using the equity method;**
- **(d) tax expense;**
- **(e) a single amount comprising the total of (i) the post-tax profit or loss of discontinued operations and (ii) the post-tax gain or loss recognised on the measurement to fair value less costs to sell or on the disposal of the assets or disposal group(s) constituting the discontinued operation; and**
- **(f) profit or loss.**