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International
Accounting Standards
Board

INFORMATION FOR OBSERVERS

Board Meeting:	**22 March 2007, London**
Project:	**Financial Statement Presentation**
Subject:	**Other Comprehensive Income Presentation (Agenda Paper 9B)**

INTRODUCTION

1. The purpose of this memorandum is to present the Boards with an additional alternative for presenting other comprehensive income (OCI) and other income and expense items on the financial statements (in addition to the alternatives discussed in October and December 2006). This memorandum also addresses other presentation issues related to OCI items and presents alternatives for achieving the Boards' long-term goal (as discussed in October and December 2006). The memorandum is organized as follows:

    Issue 1: Presentation of OCI Items on the Statement of Comprehensive Income

    Issue 2: Classification of OCI Items in the Working Format

    Issue 3: Plan for Achieving the Boards' Long-Term Goal

    Issue 4: Initial Discussion Document

ISSUE 1: PRESENTATION OF OCI ITEMS ON THE STATEMENT OF COMPREHENSIVE INCOME

Background

2. At the October 2006 joint meeting, the Boards decided that the initial discussion document should present principles and guidance for presentation of information in the complete set of financial statements that reflects their long-term goal of recognizing all current period changes in assets and liabilities in one of the functional sections or categories on the statement of comprehensive income. The Boards noted that application of the cohesiveness principle would preclude presentation of a separate OCI category. However, the Boards decided that, as an interim step, the final standard produced by this project may need to continue to permit the presentation of OCI items in a separate section of the statement of comprehensive income.

3. Recognizing that changes to current standards that require recognition of an amount in OCI will need to be made to achieve their long-term goal, the Boards directed the staff to develop a presentation format that can be used in the interim (until the long-term goal can be achieved).

December Board Meetings

4. In December 2006, the staff presented the Boards with the following alternatives for presenting OCI items on the statement of comprehensive income (the alternatives are illustrated on the following page):

   a. **Alternative A—**Present OCI items within the functional section or category to which the events or transactions relate and recycle (if necessary) within the section or category.

   b. **Alternative B—**Presentation is the same as Alternative A, except that each category or section that has an associated OCI item would have a subcategory to distinguish OCI items from non-OCI items.

   c. **Alternative C—**Present OCI items in a separate section (that would be presented with equal prominence as the business, financing, income tax, and discontinued operations sections). OCI items that are recycled would be recycled among sections and categories. The OCI section would include operating, investing, and financing categories. The OCI section would have a subtotal like the other sections.

   d. **Alternative D—**Presentation is the same as Alternative C, except that OCI items would be presented on a net of tax basis. This presentation is the most consistent with the current presentation of OCI items and the sum of the business, financing, discontinued operations, and income taxes sections would equal net income, as currently presented.

5. As discussed in December, and consistent with the Boards' prior decisions, the mechanism of recycling would be maintained in the near-term in each of the above alternatives. However, where and how OCI items are classified and reclassified (recycled) varies in the alternatives—OCI items are recycled **within** the business, financing, and investing categories in Alternatives A and B and **among** the sections or categories in Alternatives C and D.

The following examples are for illustration only and do not purport to provide definitive guidance from the Boards.

Alternative A Statement of Comprehensive Income	2006	2005
	(in millions)	
BUSINESS		
Operating Income		
Net sales	11,292	10,055
Costs and expenses:		
Cost of products sold	(2,815)	(2,446)
R&D expense	(1,113)	(951)
SG&A expense	(3,537)	(3,092)
Pension expense	(142)	(131)
Actuarial (loss) on pension oblig	(9)	(5)
"Recycled" gain on CF hedges *	20	10
Gain on cash flow hedges - OCI	26	36
Litigation charges	(100)	(654)
Goodwill impairment	(364)	
Other operating expense	(179)	(294)
Translation adjustment	(14)	63
Comprehensive operating income	3,066	2,589
Investing Income		
Realized gain (loss) on AFS	12	3
Unrealized gain (loss) on AFS	1	(16)
Comprehensive investing income	13	(13)
Comprehensive business income	3,079	2,576
FINANCING		
Financing income		
Interest income	203	100
Financing expenses		
Interest expense	(116)	(55)
Comprehesnive financing income	87	45
INCOME TAXES		
Provision for income taxes	(615)	(740)
Total comprehensive income	2,552	1,882

Alternative B Statement of Comprehensive Income	2006	2005
	(in millions)	
BUSINESS		
Operating Income		
Net sales	11,292	10,055
Costs and expenses:		
Cost of products sold	(2,815)	(2,446)
R&D expense	(1,113)	(951)
SG&A expense	(3,537)	(3,092)
Pension expense	(142)	(131)
"Recycled" gain on CF hedges *	20	10
Litigation charges	(100)	(654)
Goodwill impairment	(364)	
Other operating expense	(179)	(294)
Net operating income	3,062	2,495
Other comprehensive income:		
Gain on cash flow hedges	26	36
Translation adjustment	(14)	63
Actuarial (loss) on pension oblig	(9)	(5)
Comprehensive operating income	3,066	2,589
Investing Income		
Realized gain (loss) on AFS	12	3
Net investing income	12	3
Other comprehensive income:		
Unrealized gain (loss) on AFS	1	(16)
Comprehensive investing income	13	(13)
Comprehensive business income	3,079	2,576
FINANCING		
Financing income		
Interest income	203	100
Financing expenses		
Interest expense	(116)	(55)
Comprehesnive financing income	87	45
INCOME TAXES		
Provision for income taxes	(615)	(740)
Total comprehensive income	2,552	1,882

Alternative C Statement of Comprehensive Income	2006	2005
	(in millions)	
BUSINESS		
Operating Income		
Net sales	11,292	10,055
Costs and expenses:		
Cost of products sold	(2,815)	(2,446)
R&D expense	(1,113)	(951)
SG&A expense	(3,537)	(3,092)
Pension expense	(142)	(131)
"Recycled" gain on CF hedges *	20	10
Litigation charges	(100)	(654)
Goodwill impairment	(364)	
Other operating expense	(179)	(294)
Operating income	3,062	2,495
Investing Income		
Realized gain (loss) on AFS	12	3
Investing income	12	3
Business income	3,074	2,498
FINANCING		
Financing income		
Interest income	203	100
Financing expenses		
Interest expense	(116)	(55)
Financing income	87	45
OTHER COMPREHENSIVE INCOME		
Operating Income		
Translation adjustment	(14)	63
Actuarial (loss) on pension oblig	(9)	(5)
Gain on cash flow hedges	26	36
Investing Income		
Unrealized gain (loss) on AFS	1	(16)
Other comprehensive income	5	78
INCOME TAXES		
Provision for income taxes	(615)	(740)
Total comprehensive income	2,552	1,882

Alternative D Statement of Comprehensive Income	2006	2005
	(in millions)	
BUSINESS		
Operating Income		
Net sales	11,292	10,055
Costs and expenses:		
Cost of products sold	(2,815)	(2,446)
R&D expense	(1,113)	(951)
SG&A expense	(3,537)	(3,092)
Pension expense	(142)	(131)
"Recycled" gain on CF hedges *	20	10
Litigation charges	(100)	(654)
Goodwill impairment	(364)	
Other operating expense	(179)	(294)
Operating income	3,062	2,495
Investing Income		
Realized gain (loss) on AFS	12	3
Investing income	12	3
Business income	3,074	2,498
FINANCING		
Financing income		
Interest income	203	100
Financing expenses		
Interest expense	(116)	(55)
Financing income	87	45
OTHER COMPR INCOME (NET OF TAX)		
Operating Income		
Translation adjustment	(11)	48
Actuarial (loss) on pension oblig	(6)	(3)
Gain on cash flow hedges	18	28
Investing Income		
Unrealized gain (loss) on AFS	0.7	(12)
Other comprehensive income, net	2	61
INCOME TAXES		
Provision for income taxes	(611)	(723)
Total comprehensive income	2,552	1,882

* This example presents the "recycled" portion of the gain on cash flow hedges as a separate line item for illustrative purposes; it is possible to include this "recycled" gain as a portion of revenues.

6. In December 2006, the FASB decided that OCI items should be presented in a subcategory within the functional category to which the events or transactions relate. A subcategory within the functional categories would distinguish items of income and expense that are components of OCI from those that are not. (That is, the FASB agreed with the staff recommendation for Alternative B.)

7. At their December 2006 meeting, the IASB expressed mixed views on the four above alternatives and did not reach a consensus. The IASB asked the staff to develop an alternative that would present income and expense items in short-term and long-term subcategories on the statement of comprehensive income. The FASB indicated that it would be willing to consider a presentation format in which short- and long-term subcategories would be presented on the statement of comprehensive income if a reason other than a strict application of the cohesiveness principle would support that presentation format.

Additional Alternative—Short- and Long-Term Subcategories on the Statement of Comprehensive Income

8. In March, the staff would like the Boards to consider the following additional alternative method of presenting information on the statement of comprehensive income (the alternative is illustrated on the following page):

    Alternative E—Present short- and long-term subcategories in all categories and sections on the statement of comprehensive income. Changes in short-term assets and liabilities would be classified in a corresponding short-term subcategory on the statement of comprehensive income and changes in long-term assets and liabilities would be classified in a corresponding long-term subcategory on the statement of comprehensive income. For example, changes in short-term operating assets and liabilities would be classified in the short-term operating income subcategory on the statement of comprehensive income. Similarly, changes in long-term investing assets and liabilities would be classified in the long-term investing income subcategory on the statement of comprehensive income. Certain changes in long-term assets and liabilities (for example, depreciation expense) would be provided an exception—this is discussed in more detail in the analysis below.

    The staff (and the IASB Board member who proposed Alternative E) would like the Boards to discuss Alternative E absent consideration of cash flow hedges, which, according to the IASB Board member's proposal, are an aberration.

Alternative E Statement of Comprehensive Income	2006	2005
	(in millions)	
BUSINESS		
Operating Income		
Short-term		
Net sales	11,292	10,055
Costs and expenses:		
Cost of products sold	(2,815)	(2,446)
R&D expense	(1,113)	(951)
SG&A expense	(3,537)	(3,092)
Gain on cash flow hedges	26	36
"Recycled" gain on CF hedges *	20	10
Other operating expense	(179)	(294)
Total short-term operating income	3,694	3,316
Long-term		
Pension expense	(142)	(131)
Litigation charges	(100)	(654)
Goodwill impairment	(364)	
Translation adjustment	(14)	63
Actuarial (loss) on pension oblig	(9)	(5)
Total long-term operating income	(628)	(728)
Comprehensive operating income	3,066	2,589
Investing Income		
Short-term		
Realized gain (loss) on AFS	12	3
Long-term		
Unrealized gain (loss) on AFS	1	(16)
Comprehensive investing income	13	(13)
Comprehensive business income	3,079	2,576
FINANCING		
Financing income		
Short-term		
Interest income	203	100
Financing expenses		
Short-term		
Interest expense	(17)	(14)
Long-term		
Interest expense	(99)	(41)
Financing income	87	45
INCOME TAXES		
Provision for income taxes		
On short-term items	(429)	(649)
On long-term items	(186)	(91)
Income tax provision	(615)	(740)
Total comprehensive income	2,552	1,882

*The above example is for illustration only and does not purport to provide definitive guidance from the Boards.

Alternative E: Short- and Long-Term Subcategories on the Statement of Comprehensive Income

Advantages of Alternative E

9. The Board member who proposed Alternative E believes that all recognized changes in assets and liabilities form part of comprehensive income and that all income and expense items should be a component of income only once—at the time of recognition—and therefore is opposed to recycling. The objective of that Board

member in proposing Alternative E is to develop a principle that would allow for separation of income and expense items, and gains and losses into those that have an effect in the near term and those that relate to a longer time span. Proponents of Alternative E believe that linking the short and long-term classification on the statement of financial position with a similar required classification on the statement of comprehensive income will provide the necessary principle to achieve the desired result. That is, Alternative E provides a disciplined way of separating "short term" and "long-term" income, expense, gains, and losses on the statement of comprehensive income.

10. The Board member who proposed Alternative E believes that most items originally recognized as a component of OCI (again, absent consideration of cash flow hedges) relate to long-term items on the statement of financial position and would therefore be classified as long-term in the statement of comprehensive income if such a separation was required. That is, foreign currency translation adjustments, gains and losses on available-for-sale securities, actuarial gains and losses, prior service costs and credits (FASB only), and revaluation gains and losses relate to long-term items in the statement of financial position. (While available-for-sale securities are not technically long-term, the Boards could revise their standards to require that all financial instruments be marked to market and identified as either "trading" (short-term) or "long-term." As such, securities currently identified as available-for-sale would need to be classified as either long-term or as trading.)

11. Proponents of Alternative E believe that items originally recognized as a component of OCI have little to do with the present operating cycle and thus Alternative E would effectively divide income and expense items into those that relate to current operations and those that do not. The OCI items that might be classified as short-term in the statement of comprehensive income are gains and losses on the effective portion of cash flow hedges and gains and losses on available-for-sale securities (unless and until the Boards were to change the related literature as suggested above). In addition, not all foreign currency translation adjustments relate to long-term assets and liabilities, thus it is possible that some adjustments would have to be classified as short-term.

12. Alternative E requires that **all** changes in assets and liabilities recognized in the statement of comprehensive income be classified as either short-term or long-term, not only OCI items. The Board member who proposed Alternative E noted that as part of his proposal, depreciation expense, while related to a long-term asset, would be presented in the short-term portion of income and expense while revaluations of long-term assets and impairments would be in the long-term portion. That Board member explained that the principle to achieve this presentation would be that the long-term portion of the statement of comprehensive income should deal with price changes while the short-term portion would deal with the consumption of the asset. The staff notes that that principle is different from the principle that would guide classification of all other changes in assets and liabilities as either short or long-term on the statement of comprehensive income. That is, an exception to the principle would be provided for depreciation expense.

13. The staff is of the view that the reconciliation of statements of financial position discussed in Memo #50A and Agenda Paper 9A is the appropriate place to make that distinction. As discussed in that paper, price changes (long-term) would be classified in remeasurements and consumption of an asset (short term) would be classified in non-remeasurements.

Classifying Changes in Long-Term Assets and Liabilities on the Statement of Comprehensive Income

14. One could argue that many income and expense items arising from long-term assets and liabilities generally are not sufficiently different from income and expense items arising from short-term assets and liabilities to warrant separate categorization on the statement of comprehensive income. However, under Alternative E all changes in long-term assets and liabilities (with the exception of depreciation expense, as noted above) would be classified in the long-term subcategory, not just OCI items. The staff notes that if income and expense items are to be classified in two separate categories (short- and long-term), those categories should have similar characteristics in terms of their ability to assist in predicting future cash flows. Changes in the following long-term assets and liabilities would be classified as long-term on the statement of

comprehensive income; however, they may not be similar to other “long-term” OCI items in terms of assisting in predicting future cash flows.

a. Property, plant, and equipment (other than depreciation)
b. Intangible assets
c. Pension and other postretirement benefit obligations
d. Loans payable and receivable
e. Lease obligations.

Disadvantages of Alternative E

15. Those who do not support presenting short- and long-term subcategories on the statement of comprehensive income point to the practical difficulties of such a classification due to the high level of interaction between short- and long-term assets and liabilities. That interaction might lead, in some instances, to changes in long-term assets and liabilities being classified in a short-term subcategory on the statement of comprehensive income (along with changes in short-term assets and liabilities). For example, the sale of inventory results in the recognition of costs of goods sold—the costs capitalized as inventory (and subsequently recognized as costs of goods sold) is a combination of changes in short-term assets and liabilities [for example, direct labor (accrued compensation expense) and direct material (accounts payable)] and long-term assets and liabilities [for example, pension expense (pension obligation)]. Including only the effects of changes in short-term operating assets as a measure of costs for manufacturing goods would not be useful. In addition, an attempt to separate items such as cost of goods sold into a short- and long-term classification might result in less decision-useful information.

16. The Boards decided in October 2006 that the mechanism of recycling would need to be maintained, at least in the short-term, until the Boards can address the individual standards that give rise to recognition of an OCI item. Alternative E, as proposed by the Board member, would require that the mechanism of recycling be eliminated before the Boards are able to address each standard that gives rise to an OCI item individually. The staff notes, however, that if Board members decide to pursue Alternative E, the model could be modified to maintain the mechanism of recycling in the short-term.

17. As noted in paragraph 9, the classification of assets and liabilities into short- and long-term subcategories on the statement of financial position is what would provide discipline to the similar classification scheme on the statement of comprehensive income. However, if, as discussed in February 2007, entities are not required to present a classified statement of financial position, one could argue that that discipline would not exist. While it would be possible for a financial institution that does not present a classified statement of financial position to determine which assets and liabilities are long-term and which are not, there would be no such classification scheme on their statement of financial position and thus no "cohesiveness" to be achieved.

Staff Recommendation

18. Due to the interaction of short- and long-term assets and liabilities on the statement of financial position, the staff is of the view that classifying the changes in short-term and long-term assets and liabilities as short-term and long-term on the statement of comprehensive income (Alternative E) would not be useful to users of financial statements. Therefore, the staff recommends that the sections and categories on the statements of comprehensive income **not** be further classified into their short- and long-term components.

19. The staff has reconsidered Alternatives A-D as presented to the Boards in December 2006. Consistent with the December staff recommendation, the staff recommends that the statement of comprehensive income be presented in accordance with Alternative B. The staff notes that the FASB agreed with the staff recommendation (it was the preference for all but one FASB member) while the IASB expressed mixed views and did not reach a consensus. At the March meetings, the staff would like the Boards to, at a minimum, narrow the list of potential presentation schemes to Alternative B and Alternative C for purposes of the initial discussion document (DP/PV).

Narrowing the Alternatives

20. The staff is hopeful that the second preference of those Board members who favor Alternative A would be Alterative B, as they are quite similar. Similarly, the staff is hopeful that the second preference of those Board members who continue to favor

Alternative D would be Alternative C (or maybe even B). The staff notes that a majority of both Boards have agreed to eliminate intraperiod tax allocation. Alternative D is not consistent with that decision. The staff believes that the package of Board decisions should be consistent regardless of Board member views on individual issues.

21. Alternatives B and C provide the same information, organized slightly differently. However, the different organization of that information is likely to result in presenting different subtotals.

22. Under Alternative B, cohesiveness is achieved without exception. Under Alternative C, an exception to the cohesiveness principle is provided. That is, under Alternative C, certain income and expense items are classified in the **Other Comprehensive Income** section when a corresponding section does not exist on the statement of financial position. Thus, Alternative C would require a user to reclassify certain information (the OCI items) to create a cohesive picture of an entity.

23. Presenting a separate OCI section overrides the cohesiveness principle and the staff cannot develop a conceptual basis for this override. If Alternative C is to be presented in the initial discussion document, the staff would appreciate the Boards' reasoning for supporting that Alternative.

Questions for the Boards:

1: How should other comprehensive income items and other income and expense items be presented in the statement of comprehensive income?

ISSUE 2: CLASSIFICATION OF OCI ITEMS IN THE WORKING FORMAT

Background

24. If in Issue 1 the Boards decide to present the statement of comprehensive income in accordance with Alternatives A, B, or C, all OCI items must be assigned to a financial statement section or category, even if that item is the result of the interaction of assets and liabilities in different sections or categories. This issue is particularly troublesome when considering foreign currency translation adjustments. For a consolidated foreign subsidiary and the related foreign currency translation adjustment, a single asset or

liability does not exist on the statement of financial position to dictate the classification of those changes on the statement of comprehensive income. Accordingly, the issue of how to classify foreign currency translation adjustments is addressed separately (Issue 2A).

25. For the other OCI items, an asset or liability on the statement of financial position can be identified, and the changes therein would be classified accordingly in the statement of comprehensive income. For OCI items other than foreign currency translation adjustments, the challenge is classifying the underlying asset or liability into one of the functional sections or categories, not classifying the OCI item itself (Issue 2B).

Issue 2A: Classification of Foreign Currency Translation Adjustments

26. In theory, foreign currency translation adjustments would be classified in the same category as other activities related to the foreign subsidiary or equity method investment. However, in the case of a consolidated foreign subsidiary, it is impossible to link the translation adjustment to a single asset or liability recognized on the face of the statement of financial position. Thus, the classification of foreign currency translation adjustments may require a practical solution.

27. Under current guidance, foreign currency translation adjustments arise under three methods of accounting:

    a. *Consolidation* (for foreign subsidiaries),
    b. *Equity method* (for affiliates and joint ventures (FASB); for associates and joint ventures that are applied paragraph 38 of IAS 31, *Interests in Joint Ventures* (IASB)), and
    c. *Proportionate consolidation* (for joint ventures that are applied paragraph 30 of IAS 31 (IASB only[1])).

Alternatives for Board Consideration

28. The staff has identified the following alternatives for presenting the foreign currency translation adjustment in the statement of comprehensive income:

    a. **Alternative A**—Allocate foreign currency translation adjustments to various categories, based on the classification of the assets and liabilities of the investee.

[1] The staff acknowledges that the IASB is currently undertaking a project on the accounting for joint ventures that will consider eliminating the option of using the proportionate consolidation method.

b. **Alternative B—**Allocate foreign currency translation adjustments to the corresponding category in which the investment is classified in the statement of financial position. For *consolidated subsidiaries* and *proportionately consolidated joint ventures*, this classification will be based on the classification of the investment prior to the consolidation process.

c. **Alternative C—**Present all foreign currency translation adjustments in a separate **foreign currency translation adjustments** section.

29. The Boards may decide to adopt the same Alternative for all three methods of accounting discussed in paragraph 27. Alternatively, the Boards may decide to adopt different Alternatives for each of the three methods.

Alternative A: Allocation Based on Assets and Liabilities of the Investment

30. Alternative A would analyze foreign currency translation adjustments and allocate them to the assets and liabilities of the investee that gave rise to foreign currency translation adjustments. Some may view Alternative A to be the most consistent with the cohesiveness principle.

31. The staff is of the view that foreign currency translation adjustments can be determined for each category in the same manner as determining the overall foreign currency translation adjustments:

a. To the translated amount of assets and liabilities of the category as of the end of the prior period using the foreign exchange rate as of the end of the prior period, add translated amounts of income and expense using the foreign exchange rate at the dates on which those elements are recognized (or the weighted average exchange rate);

b. Translate the assets and liabilities of the category as of the end of the current period using the foreign exchange rate as of the end of the current period;

c. Report the difference between (a) and (b) as accumulated other comprehensive income in the equity section; and

d. Report the difference between beginning and ending accumulated other comprehensive income as other comprehensive income for the category.

32. Under Alternative A, foreign currency translation adjustments would be calculated for each category. This would require more work than is required under existing guidance (foreign currency translation adjustments are calculated in the aggregate).

33. While cohesiveness would be achieved under Alternative A, the staff notes that the presentation of gains and losses arising from the sale or (substantially) complete

liquidation of the foreign investment would be troublesome. If foreign currency translation adjustments are recycled within each category, gains and losses arising from the sale or liquidation would be dispersed in the various categories.

34. The staff acknowledges that further research is necessary regarding the classification of items related to consolidation and business combinations. Nevertheless, the staff notes that a foreign investment is likely to meet the definition of a component of an entity, and while the sale or liquidation of a foreign investment may not be presented as discontinued operations, details regarding the sale or liquidation would be provided in the notes.

Alternative B: Allocation Based on Classification of the Investment

35. Alternative B would allocate the foreign currency translation adjustments to the corresponding category in which the investment is classified in the statement of financial position. For example, if the investment was classified as an operating asset in the statement of financial position, foreign currency translation adjustments related to that investment would be classified in operating income.

36. Alternative B is straightforward for *equity method investments*. However, for *consolidated subsidiaries* and *proportionately consolidated joint ventures*, the investments are eliminated in the consolidation process.

37. One way to resolve this problem is to determine the category the investment would have been classified in *separate financial statements*, as defined in IAS 27, *Consolidated and Separate Financial Statements.* If an entity does not present separate financial statements, this is equivalent to the category the investment would have been classified in prior to the consolidation process. That is, an entity would classify the investment prior to the consolidation process and foreign currency translation adjustments would be categorized accordingly in the statement of comprehensive income. The consolidation process would replace the investment with assets and liabilities that comprise the investment, and those assets and liabilities are likely to be classified in various categories (operating, investing, financing, and the like).

38. Cohesiveness would **not** be achieved under this Alternative. However, the gains and losses arising from the sale or (substantially) complete liquidation of the foreign investment would be presented in the category the investment is classified in.

Alternative C: Present in a Separate "Foreign Currency Translation Adjustments" Section

39. Alternative C would present foreign currency translation adjustments as a separate section. If cohesiveness cannot be fully achieved, Alternative C would make those exceptions clear to users of financial statements.

40. Applying Alternative C to foreign currency translation adjustments would create exceptions to the cohesiveness principle when cohesiveness can otherwise be achieved.

Staff Recommendation

41. The staff recommends that Alternative A should be adopted for *consolidated subsidiaries* and *proportionately consolidated joint ventures* and Alternative B should be adopted for *equity method investments*. The staff is of the view that Alternative A would achieve the highest level of cohesiveness; however, the staff believes Alternative A is not practical for equity method investments. Equity method investments should be viewed as a single asset rather than representing a portion of the various assets and liabilities of the investee. The staff notes that Alternative C in this Issue would be inconsistent with the staff recommendation in Issue 1.

Question for the Boards:

2: In what category or section should the following items be classified on the statement of comprehensive income:

a. Foreign currency translation adjustments related to consolidated subsidiaries and proportionately consolidated joint ventures?

b. Foreign currency translation adjustments related to equity method investments?

Issue 2B: Classification of OCI Items Other than Foreign Currency Translation Adjustments

42. The Boards should consider whether to provide guidance regarding the classification of OCI items other than foreign currency translation adjustments. The following

paragraphs have been excerpted from the December 2006 memorandum on OCI presentation and explain where the OCI items other than the foreign currency translation adjustment could potentially be classified in the statement of comprehensive income.

Unrealized Gains and Losses on Available-for-Sale Securities

43. Unrealized gains and losses on AFS securities would be classified in the same category as the related security is classified (for non-financial institutions, generally, financing or investing categories; for financial institutions, generally, the operating category).

Gains and Losses Resulting From the Effective Portion of Cash Flow Hedges

44. Gains and losses on the hedging instrument would be presented in the same section of the comprehensive income statement that will be affected by the forecasted transaction. The effective portion of those gains or losses would be presented in OCI and the ineffective portion would be presented in a non-OCI component of comprehensive income. The hedging instrument would be presented in the section of the statement of financial position that corresponds to the classification of the gains or losses in the comprehensive income statement. That is, if the gain or loss were in the operating category of the comprehensive income statement, the hedging instrument would be in the operating category of the statement of financial position.

Actuarial Gains and Losses and Prior Service Costs and Credits (FASB Only)

45. As discussed at the October 2006 joint meeting, it is unlikely that pension and other postretirement benefit obligations would be presented in a section or category other than operating. Thus, actuarial gains and losses and prior service costs and credits would be classified in the operating income category.

Actuarial Gains and Losses (IASB Only) (Not Recycled)

46. For the reasons noted above, actuarial gains and losses would similarly be classified in the operating income category.

Revaluation Gains and Losses (IASB Only) (Not Recycled)

47. Property, plant, and equipment, and intangible assets that are subject to IAS 16, *Property, Plant and Equipment*, or IAS 38, *Intangible Assets*, would likely be presented in the operating category. Accordingly, revaluation gains arising from those

assets would be classified in the operating income category on the statement of comprehensive income. It is less likely that the relevant property, plant, and equipment, and intangible assets would be classified in the investing category. If, however, that was the case, revaluation gains arising from those assets would be classified in the investing income category on the statement of comprehensive income.

Alternatives for Board Consideration

48. The staff has identified the following alternatives for providing guidance on the classification of OCI items other than foreign currency translation adjustments:

    a. **Alternative A—**Do not prescribe additional classification requirements. The assets and liabilities would be classified on the statement of financial position according to the existing classification guidance and all changes in those assets and liabilities (including OCI items) would be presented in the corresponding category on the statement of comprehensive income.

    b. **Alternative B—**Prescribe additional classification guidance or requirements. Assets and liabilities which give rise to OCI items would be required to be presented in a specified category and the subsequent initial recognition of an OCI component would be recognized in the same category on the statement of comprehensive income.

Alternative A: Do Not Prescribe Additional Classification Requirements

49. Alternative A would allow an entity flexibility in classifying its assets and liabilities on the statement of financial position. The Boards have developed broad, principles-based guidance for classifying assets and liabilities to accommodate inherently different and dynamic business enterprises. Under Alternative A, the statement of financial position classification of assets and liabilities would dictate the classification of all changes in assets and liabilities (regardless of whether they are recognized as a component of OCI). That is, the cohesiveness principle would be adhered to without exception.

Alternative B: Provide Additional Classification Guidance

50. Alternative B would provide additional classification guidance or requirements for either (a) assets and liabilities that give rise to OCI items or (b) individual OCI items (that is, individual income and expense items) that would override the classification of the related asset or liability. In case (a), the Boards would provide prescriptive guidance for the assets and liabilities that give rise to OCI items. In case (b), an

explicit exception to the cohesiveness principle would be granted for OCI items. In either case, the Boards would need to prescribe a category in which each OCI item (other than foreign currency translation adjustment) would be classified.

Staff Recommendation

51. The staff believes that no additional classification guidance should be provided for OCI items other than foreign currency translation adjustments (Alternative A). The staff believes that classification guidance should be provided for the classification of assets and liabilities on the statement of financial position and not for individual items of income and expense (with the exception of foreign currency translation adjustments, as discussed above). Further, to the extent possible, the staff believes that the classification guidance should be principles-based and not prescriptive.

52. As previously decided by the Boards, the overall goal of the working format for presenting information in the financial statements is to present a cohesive financial picture of an entity such that the relationships between items on the different financial statements are clear. Therefore, the staff believes that developing additional classification guidance for individual items of income and expense (rather than for assets and liabilities) could potentially compromise the cohesiveness of the financial statements. That is, the classification of all changes in assets and liabilities should be driven by the related asset or liabilities classification on the statement of financial position. If the Board wishes to provide additional classification guidance for certain assets and liabilities (for example, available-for-sale securities), the staff believes that guidance should be provided for the asset or liability's initial classification on the statement of financial position.

53. In addition, the Boards decided to develop principles-based classification guidance that would apply to all entities. This broad guidance was developed to accommodate different and dynamic business enterprises. Developing specified classification requirements for certain assets or liabilities or certain income and expense items may negate the advantages of such principles-based guidance. Accordingly, the staff recommends that the Boards not provide additional classification guidance for OCI items other than foreign currency translation adjustments (Alternative A).

Question for the Boards:

3: Should additional classification guidance be provided for items currently recognized as a component of OCI (other than foreign currency translation adjustments)? If yes, in which category or section should the following OCI items be classified on the statement of comprehensive income:

a. **Unrealized gains and losses on available-for-sale securities?**
b. **Gains and losses resulting from the effective portion of cash flow hedges?**
c. **Actuarial gains and losses and prior service costs and credits (FASB only)?**
d. **Actuarial gains and losses (IASB only) (not recycled)?**
e. **Revaluation gains and losses (IASB only) (not recycled)?**

ISSUE 3: PLAN FOR ACHIEVING THE BOARDS' LONG-TERM GOAL

Background

54. The following is an excerpt from the Action Alert / IASB Update summarizing the discussion and decisions reached at the October 2006 joint meeting:

> The Boards decided that the project should develop a financial statement presentation format that would accommodate their long-term goal of other comprehensive income items being classified in the same manner as all other changes in assets and liabilities. However, in the short-term, it may be necessary to keep other comprehensive income items in a separate section of the statement of comprehensive income.
>
> The Boards decided that none of the subtotals on the statement of comprehensive income should have a "timing" difference; that is, the subtotals should be based on changes in assets and liabilities that have occurred in the current period and, thus, the mechanism of recycling should be eliminated. However, in the short-term, the changes in assets in liabilities that are currently reclassified (recycled) between other comprehensive income and net income may need to be shown separately from the current period changes. The Boards acknowledged that given those decisions and the proposed working format there would not be a *net income* subtotal in the statement of comprehensive income.
>
> Recognizing that changes to current standards that give rise to other comprehensive income items will need to be made to achieve those long-term goals, the Boards directed the staff to develop a presentation format that can be used in the interim (until the long-term goal can be achieved). The Boards also directed the staff to develop a plan for achieving that long-term goal,

such as whether those issues would be addressed in separate projects or as part of the financial statement presentation project.

55. Issues 1 and 2 of this memorandum attempt to address the first Board request—a presentation format that can be used until the long-term goal can be achieved. Issue 3 attempts to address the second request—a plan for achieving the long-term goal.

Current State of OCI Items and Recycling

56. The following table presents the current guidance that gives rise to OCI items and the status of any related current Board projects:

OCI Item	Guidance	Current Projects/Research Projects
Gains and losses resulting from the effective portion of **cash flow hedges**	IAS 39, and FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*	IASB and FASB: (Research Project) Agreed in April and October 2005 to long-term objectives to improve, simplify, and converge financial reporting requirements for financial instruments. The project would include a review of hedge accounting and other financial instruments, including available-for-sale securities. The Boards intend to issue an initial discussion document in late 2007.
Unrealized gains and losses on **available-for-sale securities**	IAS 39 and FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*	IASB and FASB: (Research Project) Agreed in April and October 2005 to long-term objectives to improve, simplify, and converge financial reporting requirements for financial instruments. The project would include a review of hedge accounting and other financial instruments, including available-for-sale securities. The Boards intend to issue an initial discussion document in late 2007.
Actuarial gains and losses, prior service costs and credits, and transition assets and obligations	IAS 19, *Employee Benefits*, and FASB Statement No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*	IASB: (Current Project) Added a project to its agenda in July 2006, which would include a fundamental review of all aspects of post-employment benefit accounting. The project is expected to yield a standard in 2010. FASB: (Current Project) Added a project to its agenda in November 2005 to comprehensively reconsider the accounting for postretirement benefits. The FASB will discuss the project plan for Phase 2 of this project in the first quarter of 2007.
Foreign currency translation adjustments	IAS 21, *The Effects of Changes in Foreign Exchange Rates*, and FASB Statement No. 52, *Foreign Currency Translation*	IASB and FASB: No current standard or research project being considered.
Revaluation gains and losses	IAS 16, *Property, Plant and Equipment*, and IAS 38, *Intangible Assets*	IASB and FASB: (Intangible Assets) Currently contemplating undertaking an active project on the initial accounting for internally generated and separately purchased intangible assets, and subsequent accounting for all intangible assets. The Boards have undertaken to consider and make a decision about the scope and timing of a potential agenda project on intangible assets by 2008. IASB and FASB: (Property, Plant and Equipment) No current standard or research project being considered.

57. In addition to the Financial Instruments research project, the staff notes that the provisions of FASB Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*, are similar to the provisions related to a fair value option for financial instruments in IAS 39 and provide an option for entities to recognize the change in the fair value of certain financial instruments in earnings rather than OCI. Both standards permit entities to elect to measure securities previously classified as available-for-sale at fair value and to recognize gains and losses in those securities for which the fair value option is elected in earnings. Similarly, both standards allow entities to elect the fair value option to potentially achieve an offsetting effect for the change in the fair values of related assets and liabilities (recognized in earnings) without applying complex hedge accounting provisions. That is, both fair value options permit entities to recognize the change in the fair value of certain financial instruments (including available-for-sale securities and hedging instruments) in earnings rather than in OCI.

58. According to the table above, revaluation gains and losses on property, plant and equipment and the foreign currency translation adjustment are the only OCI items that are not currently in the scope of an active agenda/research project.

Alternatives for Consideration

59. The staff has identified the following alternatives for achieving the Boards' long-term goal of other comprehensive income items being classified in the same manner as all other changes in assets and liabilities:

    a. **Alternative A—**Address all of the current standards that give rise to OCI items (and recycling, if necessary) in the financial statement presentation project.

    b. **Alternative B—**Address only select current standards that give rise to OCI items (and recycling, if necessary) in the financial statement presentation project. For example, the Boards may want to address the accounting for available-for-sale securities if the Boards believe that addressing those items would not significantly delay the project. Alternatively, the Boards may wish to address only foreign currency translation adjustments as part of the financial statement presentation project because a project to address those items does not currently exist. All other OCI items not addressed in the financial statement presentation project would be addressed individually in separate projects.

c. **Alternative C—**Address all of the current standards that give rise to OCI items (and recycling, if necessary) individually in separate projects.

d. **Alternative D—**Address only the portion of the current standards that give rise to OCI items (and recycling, if necessary) in a single, comprehensive project on OCI and recycling.

Alternative A: Address OCI Items in the Financial Statement Presentation Project

60. Alternative A would require the Boards to consider accounting issues other than those related to presentation matters in the financial statement presentation project. Opponents of Alternative A stress that the scope of the financial statement presentation project is limited to **presentation** issues; recognition and measurement issues were explicitly excluded from the scope of the project. In addition, the Boards established the accounting for OCI items on a piecemeal basis—each item was initially recognized as a component of OCI for a different reason.

61. Additionally, addressing the recognition and measurement of each OCI item in the financial statement presentation project may significantly delay the project.

Alternative B: Address a Subset of OCI Items in the Financial Statement Presentation Project

62. A number of Joint International Group (JIG) members, at the September 2006 meeting, indicated that the recognition of certain items in income and expense as a component of OCI (rather than earnings) is appropriate while such recognition is inappropriate for other items of income and expense. Specifically, a number of JIG members stated that OCI items arising from gains and losses on the effective portion of cash flow hedges and foreign currency translations are the only OCI items that are warranted and that OCI items arising from available-for-sale securities and pension obligations are inappropriate for recognition in OCI. Certain Financial Institution Advisory Group (FIAG) members, albeit a minority, expressed similar sentiments in October 2006 discussions.

63. The Boards may believe that certain OCI items are less controversial to address and less conceptually based than other OCI items. As indicated by JIG members, certain constituents believe that the Boards should address the accounting for available-for-sale securities and pension obligations before addressing the accounting for cash flow

hedges and foreign currency translation adjustments. If the Boards agree with that assessment, the Boards may wish to address select OCI items in the financial statement presentation project and address other OCI items in different projects.

64. Another approach under this alternative would be to address foreign currency translation adjustments and asset revaluations (IASB only) because projects on those items do not currently exist. That is, the Boards may believe that they do not need to address the OCI items other than foreign currency translation adjustments or asset revaluations (IASB only) because they are currently being examined as part of another project.

Alternative C: Address OCI Items Individually in Separate Projects

65. In October 2006, the staff discussed with FIAG members, among other issues, the presentation of OCI items and the best method for achieving the Boards' long-term goals. Views were mixed, not least because different OCI items affect different financial institutions. Although there was some support for a single-statement of comprehensive income without recycling, the strong balance of opinion—whether or not a single statement was supported—was that any changes to the recognition and measurement of OCI items should be addressed in one or more projects aimed at those underlying standards and not in the financial statement presentation project.

66. Alternative C is consistent with the views expressed by Board members at their October 2006 joint meeting related to how they should address recognition and measurement of OCI items to achieve their expressed long-term goals. That is, Board members directed the staff to develop an "interim" presentation model in the financial statement presentation project that can be easily adaptable once the Boards have been able to address each OCI item individually.

67. Alternative C would require that the Boards add projects to their agenda to address IAS 21 and Statement 52 (foreign currency translation adjustments) and the IASB to add a project to address IAS 16 (revaluation of buildings).

Alternative D: Address the Concept of OCI and Recycling Comprehensively

68. If the Boards' are more concerned with the concept of OCI and the mechanism of recycling than with the individual items that give rise to OCI, the Boards may wish to

consider all OCI items comprehensively in a single project. Such a project would allow the Boards to decide if there is a conceptual basis for recognizing certain income and expense items in current earnings while excluding others. In a comprehensive project, the Boards would consider all items currently giving rise to OCI items, but would focus only on the portion of the accounting that gives rise to the OCI item. For example, such a project may only consider the recognition principles related to the gains and losses on cash flow hedges rather than comprehensively revisiting the accounting for derivatives and hedging activities.

Staff Recommendation

69. The staff is of the view that, consistent with the Boards' leaning in October 2006, the current standards that give rise to OCI items be examined individually. That is, the staff recommends Alternative C.

70. The staff believes that addressing the recognition and measurement of items currently giving rise to OCI is out of the scope of the financial statement **presentation** project. Additionally, the staff is of the view that addressing each OCI item in the financial statement presentation project will significantly delay the project and would potentially detract from the other significant improvements in financial reporting that are being proposed by the project. Said differently, the staff believes that constituents may place undue focus on the accounting for OCI items while ignoring the other improvements being proposed in the project.

71. The staff also believes that because OCI items were created on a piecemeal basis, that is the best way to reconsider the accounting for those items. That is, the Boards determined that each OCI item has certain characteristics sufficiently different from other items of income and expense to warrant initial recognition outside of current earnings. As such, each OCI item is sufficiently different from the other OCI items that individual consideration is warranted.

72. In addition, and as a practical matter, the Boards have already undertaken at least research level projects that have the potential to address the accounting for the majority of the OCI items. Therefore, a single comprehensive project to review all OCI items may not be practical at this time.

Question for the Boards:

4: How do the Boards want to progress to achieve their long-term goal of other comprehensive income items being classified in the same manner as all other changes in assets and liabilities?

ISSUE 4: INITIAL DISCUSSION DOCUMENT

73. The staff plans to draft the initial discussion document (DP/PV) based on the Boards' decision on Issue 1—how OCI should be presented in the financial statements in the near term (that is, until the Boards have modified the necessary standards to achieve their long-term goal). For example, if the Boards agree with the staff recommendation for Alternative B in Issue 1, the DP/PV would include principles and sample financial statements to illustrate that decision. The staff also plans to include in the DP/PV a discussion of the Boards' long-term goal, how the Boards plan to achieve that goal (as decided in Issue 3), and possibly another set of sample financial statements that would illustrate that long-term goal. However, the focus of the initial discussion document would be the interim presentation format, as decided in Issue 1.

Question for the Boards:

5: Do the Boards agree with the staff's suggested approach to drafting the initial discussion document?