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International Accounting Standards Board

INFORMATION FOR OBSERVERS

Board Meeting:	**December 2008, London**
Project:	**IFRS for Private Entities (formerly IFRS for SMEs)**
Subject:	**Outstanding Issues on Financial Statement Presentation (Agenda Paper 5A)**

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1. For the December 2008 Board meeting, the private entities agenda papers are organised as follows:
   - **Agenda Paper 5 –** Overview
   - **Agenda Paper 5A –** Outstanding issues on financial statement presentation
   - **Agenda Paper 5B –** Redeliberation of approach for impairment of non-financial assets (Section 26)
     - **Attachment to 5B –** Redraft of Section 26
   - **Agenda Paper 5C –** Redeliberation of approach for financial instruments (Section 11)
     - **Attachment to 5C –** Partial redraft of Section 11 (Section 11A)
2. Agenda Paper 5A (this agenda paper) sets out the following new issues on financial statement presentation
   - Require that all items of income and expense be presented in a single statement of comprehensive income

- Do not require a statement of financial position to be presented as at the beginning of the earliest comparative period
- Format of statement of comprehensive income for private entities

3. The issues in this paper are presented in numerical order. Those numbers are based on the section in the Exposure Draft (ED) of a proposed IFRS for SMEs to which the issue relates. Issues have been allocated a new number, ie one that has not been used for an issue in previous Board agenda papers.

Section 3 Financial Statement Presentation

Issue 3.5 (new): Require that all items of income and expense be presented in a single statement of comprehensive income

4. **Additional staff issue.** In May 2008, the Board decided the final standard should incorporate the requirements of IAS 1 *Presentation of Financial Statements* (as revised in 2007). IAS 1 (revised 2007) requires all items of income and expense recognised in a period to be presented in:
   - a single statement of comprehensive income, or
   - two statements: a separate income statement displaying components of profit or loss and a statement of comprehensive income beginning with profit or loss and displaying components of other comprehensive income (OCI).

5. At the November 2008 meeting, during the discussion of recognition of actuarial gains and losses in OCI, staff asked the Board whether staff should study whether private entities should be required to present all items of income and expense recognised in a period in a single performance statement, namely the statement of comprehensive income. The Board encouraged the staff to consider this issue and bring a recommendation to the Board at a future meeting.

6. **Staff comment.** The relevant requirements proposed in the ED, which were based on the pre-2007 version of IAS 1, are:

   3.15 The financial statements of an entity shall include:

   (a) a balance sheet;

   (b) an income statement;

   (c) a statement of changes in equity showing either:

   (i) all changes in equity; or

   (ii) changes in equity other than those arising from transactions with equity holders acting in their capacity as equity holders;

   (d) a cash flow statement; and

   (e) notes, comprising a summary of significant accounting policies and other explanatory information.

3.16 If the only changes to the equity of an entity during the periods for which financial statements are presented arise from profit or loss, payment of dividends, corrections of prior period errors, and changes in accounting policy, the entity may present a statement of income and retained earnings in place of the income statement and statement of changes in equity.

7. In light of the decision in May 2008 to incorporate IAS 1 (revised 2007), in June 2008 the Board decided to update ED paragraph 3.16 as follows.

> A private entity would be permitted to present a combined statement of comprehensive income and retained earnings in place of the statement of comprehensive income and the statement of changes in equity if the only changes to its equity during the period arise from profit or loss, payment of dividends, corrections of prior period errors, and changes in accounting policy. If an entity has other equity transactions with owners, a statement of changes in equity would be required. [IASB Update June 2008]

8. **Staff recommendation.** Staff propose that private entities should be required to present only a statement of comprehensive income and not have the option to also present a statement of income. The principal conceptual benefit of doing so is that all items of income and expense – that is, all changes in equity other than those resulting from transactions with owners – are presented in a single financial statement, with appropriate line items and subtotals. There is no conceptual basis in Section 2 of the ED for presenting a few items of income and expense in a separate performance statement from all of the other items of income and expense. Among the practical benefits of doing so are:

   a. eliminating an accounting policy option - users of financial statements say options impede comparability,

   b. presenting a single statement of comprehensive income makes it easier for users to understand and use the financial information because they will need to look to only one financial statement for information on all items of income and expense recognised in a period,

   c. simplifying preparers' implementation of the standard by requiring only one financial statement in place of two,

   d. eliminating the need for private entities to assess and make a judgement on which presentation is more appropriate, and

   e. since most private entities will have no items of OCI (see next paragraph), the income statement and the statement of comprehensive income would have the same bottom line figure, so a two-statement presentation makes little sense.

9. The standard currently provides for the following three types of gains or losses to be reported in OCI. (If revaluation of PP&E and intangibles through equity is allowed as an option, that would be a fourth type. And if the equity method is permitted for associates and jointly controlled entities (JCEs) and proportionate consolidation is permitted for JCEs, then the investor's share of the associate's or JCE's OCI would be presented in the investor's OCI – a fifth type.)

a. Foreign currency exchange differences arising from translating:

   i. a gain or loss on a non-monetary item that is recognised in other comprehensive income (ED paragraph 30.11).

   ii. a monetary item that forms part of a reporting entity's net investment in a foreign operation (ED 30.13).

   iii. the results and financial position of an entity whose functional currency is not the currency of a hyperinflationary economy into a different presentation currency (ED paragraph 30.18(c)).

b. Change in fair value of a hedging instrument that was effective in offsetting the change in fair value or expected cash flows of a hedged item that is (ED paragraph 11.37):

   i. the variable interest rate risk in a debt instrument measured at amortised cost,

   ii. the foreign exchange risk in a firm commitment or a highly probable forecast transaction,

   iii. the commodity price risk in a firm commitment or highly probable forecast transaction, or

   iv. the foreign exchange risk in a net investment in a foreign operation,

c. Actuarial gains and losses (Board decision November 2008).

10. The items in (a) above are required to be reported in OCI. Those in (b) are also required to be reported in OCI, but hedge accounting itself is optional, and many private entities may choose not to do it. Reporting the (c) items in OCI is optional – the gain or loss may also be reported in profit or loss. Staff believe that most private entities will have no transactions that would be recognised in OCI and hence the income statement and the statement of comprehensive income would have the same bottom line figure.

11. Those who oppose requiring a single performance statement say that such a presentation causes undue focus on the bottom line of the single statement. Staff believe this is less of an issue for private entities as their financial statements are not subject to the same level of scrutiny and analysis as publicly accountable entities.

12. **Rewording based on staff recommendations.** Staff propose rewriting the requirements in the ED as follows to take account of the discussion in paragraphs 8 to 12 (note Issue 3.7 discusses the requirement in IAS 1 (revised 2007) to produce a statement of financial position as at the beginning of the earliest comparative period).

3.15 The financial statements of an entity shall include:

(a) a statement of financial position as at the end of the period;

(b) a statement of comprehensive income for the period;

(c) a statement of changes in equity for the period;

(d) a statement of cash flows for the period; and

(e) notes, comprising a summary of significant accounting policies and other explanatory information.

3.16 If the only changes to the equity of an entity during the periods for which financial statements are presented arise from profit or loss, payment of dividends, corrections of prior period errors, and changes in accounting policy, the entity may present a combined statement of comprehensive income and retained earnings in place of the statement of comprehensive income and the statement of changes in equity.

<u>Question 3.5</u>

Does the Board agree with the staff recommendation that private entities should be required to present all non-owner changes in equity in a single statement of comprehensive income?

Issue 3.6 (new): Format of statement of comprehensive income for private entities

13. **Additional staff issue.** Paragraph 9 above identifies the three kinds of income and expense that would be reported in OCI. Staff believe that most private entities will have no transactions that would be recognised in other comprehensive income (OCI). Therefore "profit for the year" and "total comprehensive income for the year" will be identical amounts. Staff believe that the IFRS for Private Entities should provide some guidance on what the bottom part of the statement of comprehensive income would look like in such a case. Presented below are four possible formats for the bottom part of the statement of comprehensive income. These are based on the illustrate statement of comprehensive income in the Implementation Guidance for IAS 1 (2007) (Bound Volume 2008, page 947).

    a. **Format B.** Staff believe that Format B is the clearest presentation and should be illustrated in the IFRS for Private Entities.

    b. **Format A.** Staff believe that Format A is also consistent with the requirements in the IFRS for Private Entities.

    c. **Format D.** Staff believe that Format D could be confusing and should not be regarded as consistent with the requirements in the IFRS for Private Entities.

    d. **Format C.** The ED does not mention a statement of comprehensive income at all. Staff have not yet drafted the revised section of the ED that will incorporate IAS 1 (2007). Format C appears to be inconsistent with IAS 1.82(f), which seems to require the profit or loss line even if it is identical in amount to the total comprehensive income line. Application guidance in the IFRS for Private Entities could say that if the entity has no items of other comprehensive income (OCI), the 'profit or loss' subtotal can be omitted, in which case Format C would be permitted. Alternatively, the IFRS for Private Entities could say that if the entity has no items of OCI, then that fact should be presented as a separate line on the statement of comprehensive income and a profit or loss subtotal should be presented (in which case Format C would be prohibited). Or the IFRS for Private Entities could be silent on this issue, in which case Format C would not be prohibited. Staff's recommendation is to be silent, which means Format C could be used.

    e. Staff note that the formats below presume that an entity presents all items of income and expense in a single statement of comprehensive income.

FORMAT A

Profit before tax	161,667	128,000
Income tax expense	(40,417)	(32,000)
Profit for the year from continuing operations	121,250	96,000
Loss for the year from discontinued operations	–	(30,500)
PROFIT FOR THE YEAR	121,250	65,500
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	121,250	65,500

FORMAT B

Profit before tax	161,667	128,000
Income tax expense	(40,417)	(32,000)
Profit for the year from continuing operations	121,250	96,000
Loss for the year from discontinued operations	–	(30,500)
PROFIT FOR THE YEAR	121,250	65,500
Gains and losses recognised but not included in profit for the year	–	–
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	121,250	65,500

FORMAT C

Profit before tax	161,667	128,000
Income tax expense	(40,417)	(32,000)
Profit for the year from continuing operations	121,250	96,000
Loss for the year from discontinued operations	–	(30,500)
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	121,250	65,500

FORMAT D*

Profit before tax	161,667	128,000
Income tax expense	(40,417)	(32,000)
Profit for the year from continuing operations	121,250	96,000
Loss for the year from discontinued operations	–	(30,500)
PROFIT FOR THE YEAR	121,250	65,500

*A note would state that the entity has no items of other comprehensive income.

Question 3.6
Does the Board agree with the staff recommendation that format A, B and C are consistent with the proposed requirements when presenting a single statement of comprehensive income under the IFRS for Private Entities after incorporating IAS 1 (revised) and that format D is not consistent with those requirements? Does the Board agree that format B should be the one illustrated in the final standard?

Issue 3.7 (new): Do not require a statement of financial position at beginning of earliest comparative period

14. **Additional staff issue.** In May 2008, the Board decided the IFRS for Private Entities should incorporate the requirements of IAS 1 (revised 2007). IAS 1 (revised 2007) requires a statement of financial position to be presented as at the beginning of the earliest comparative period when an entity applies an accounting policy retrospectively or makes a retrospective restatement of items in its financial statements, or when it reclassifies items in its financial statements.

15. **Staff recommendation.** For cost-benefit reasons, staff propose not to require private entities to present a statement of financial position as at the beginning of the earliest comparative period under the circumstances prescribed by IAS 1 (revised 2007). The exposure draft that led to IAS 1 (revised 2007) proposed to require a third (opening) statement of financial position in all cases. Paragraph BC31 in the Basis for Conclusions of IAS 1 (2007) states:

> “many respondents expressed concern that the requirement would unnecessarily increase disclosures in financial statements, or would be impracticable, excessive and costly”.

For cost-benefit and practicability reasons the Board decided not to require the prior year statement to be presented every year by entities applying full IFRSs. Instead, IAS 1 (revised 2007) requires the third statement of financial position only if there have been prior period restatements or reclassifications. Staff feel that requiring this level of detail is unnecessarily burdensome for non-publicly accountable entities whose financial statements are not subject to the same level of scrutiny and trend analysis as publicly accountable entities.

Question 3.7

Does the Board agree with the staff recommendation that private entities should not be required to present a statement of financial position as at the beginning of the earliest comparative period when an entity applies an accounting policy retrospectively or makes a retrospective restatement of items in its financial statements, or when it reclassifies items in its financial statements?