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International Accounting Standards Board

INFORMATION FOR OBSERVERS

Board Meeting: **19 June 2008, London**

Project: **Financial Statement Presentation**

Subject: **Implications of Scope Change (Agenda Paper 9A)**

INTRODUCTION

1. At the April 2008 joint meeting discussion on updating the February 2006 Memorandum of Understanding (MoU), the Boards discussed making the following changes to the scope of the financial statement presentation project:

   a. Retain the existing guidance on presentation of other comprehensive income (OCI) in a statement of comprehensive income and make no change to existing standards on what is recognized outside profit and loss

   b. Do not include additional segment disclosures

   c. Do not include liquidity disclosures.

2. **Objectives of the June 2008** Board meeting on financial statement presentation are to (a) confirm the change in project scope the Boards agreed to in principle during the April joint meeting and (b) clarify the impact of those changes on the Boards' preliminary views. FASB memorandum 59D/IASB Agenda Paper 9D address the scope changes related to disclosures; this paper addresses the following issues:

- **Issue 1:** whether the Boards' long-term views on the presentation in the statement of comprehensive income should be included in the preliminary views document and if so how
- **Issue 2:** presentation of other comprehensive income items in the statements of comprehensive income, financial position and cash flows
- **Issue 3**: presentation of income taxes in the statements of comprehensive income, financial position and cash flows
- **Issue 4**: presentation of earnings per share and other per-share amounts

ISSUE 1: THE BOARDS' LONG-TERM VIEWS ON PRESENTATION IN THE STATEMENT OF COMPREHENSIVE INCOME

3. At the October 2006 joint meeting, the Boards decided that the preliminary views document should reflect their long-term goal of recognizing all current period changes in assets and liabilities in one of the functional sections or categories in the statement of comprehensive income and of eliminating the recycling mechanism. A brief description of the two formats for the statement of comprehensive income consistent with that long-term goal are described below:

    a. **Format A:** all current period changes in assets and liabilities (even those that give rise to OCI items) would be presented in one of the predefined sections or categories in the statement of comprehensive income. Because the separation of OCI items and the mechanism of recycling would be eliminated, former OCI items would be recognized and classified only once in the statement of comprehensive income.

    b. **Format B:** all current period changes in assets and liabilities (even those that give rise to OCI items) would be disaggregated into those that have an effect in the near future ("non-holding") and those that relate to a longer time span ("holding"). This non-holding/holding split would consider not only the short-term and long-term distinction drawn in the statement of financial position but also the "price changing" nature of gains and losses. The holding section would include market value changes in assets or liabilities and recognized changes in the value of tangible long-term assets and intangible assets, other than those closely associated with an entity's operating performance.

4. Recognizing that changes to current standards that require the recognition of an amount in OCI would need to be made to achieve their long-term goal, the Boards

agreed to two interim (or transitional) formats to be described and included in the preliminary views document in addition to the two long-term formats described above.

a. In **Format 1**, OCI items would be classified within the operating, investing, and financing categories; that is, each of those categories would have an OCI subcategory.

b. In **Format 2**, OCI items would be presented in a separate section similar to how an OCI section is presented in a stand-alone statement of comprehensive income following FASB Statement No. 130, *Reporting Comprehensive Income*, and IAS 1 (revised 2007) *Presentation of Financial Statements*.

5. At the April 2008 joint meeting, the Boards agreed that in order to complete Phase B of the financial statement presentation project by June 2011, the Boards would not seek to change existing standards relating to what items are recognized outside of profit or loss, thereby retaining the current ad hoc approach to items reported outside of profit or loss and the recycling mechanism. This would imply maintaining a separate OCI section in a statement of comprehensive income.

Staff Views

6. The staff interpreted the Boards' April 2008 scope discussion to mean that the preliminary views document would include only one format for presenting the statement of comprehensive income (Format 2 with a separate OCI section) and would not include or describe the other alternative formats, (Formats A, B, and 1). The staff views this as a reasonable approach because someone reading a preliminary views document that describes four alternative formats would find it hard to understand exactly what the Boards were trying to achieve. If the preliminary views document focuses on only one format—one that is attainable in the near term and is not dependent on future Boards making changes to existing standards on OCI items—the Boards' constituents will be able to focus their comments on the statement of comprehensive income and how it fits in with the Boards' other views on financial statement presentation matters.

7. The staff has questioned whether the preliminary views document should summarize and discuss the Boards' expressed long-term goal for the statement of comprehensive

income. Several Board members have stated their belief that the preliminary views document should at least provide a brief summary of the Boards' long-term goal highlighting the Boards' preference for eliminating OCI items and recycling, and include some questions about the alternative formats.

Staff Recommendation

8. The staff recommends that the preliminary views document **present the Boards' views on only one format—**a stand alone statement of comprehensive income consistent with existing standards that requires the segregation of OCI items and the presentation of all components of comprehensive income (including earnings) in the same financial statement. The staff is of the view that excluding the other alternative formats from Phase B of the project (two of which the Boards concluded could not be achieved without undertaking initiatives separate from this project) will not deter the Boards from achieving its objectives for Phase B.

9. If the Boards want to mention their long-term goal in the document, the staff recommends including language similar to the following in the Chapter that addresses the statement of comprehensive income:

> During its discussion about presenting information in the statement of comprehensive income, the Boards expressed a preference for presenting OCI items in a manner similar to how other non-owner changes in assets and liabilities are presented. However, because pursuing that view would inevitably involve recognition and possibly measurement issues, which are beyond the scope of a project on financial statement presentation, and may necessitate making changes to existing standards, the Boards agreed to focus on a presentation that was consistent with current standards for reporting OCI items. The Boards may address those individual standards in other standard-setting projects.

10. The staff recommends that the Boards' preliminary views document not describe in detail or ask for input on what has previously been described as the long-term goal. The staff also recommends that the document not illustrate Formats A and B. The staff is of the view that describing or illustrating the long-term goals and related formats will only distract the Boards, staff, and constituents from addressing (and making progress on) the fundamental presentation issues being addressed in Phase B. In the staff's view, asking for input on the Boards' long-term goal will delay the

project because it will open discussion on how items in the statement of comprehensive income could be presented using other perspectives, which seems inconsistent with the Boards' goal of finishing Phase B of the project by June 2011.

11. In addition, even though the Boards have discussed a couple of alternatives for achieving their long-term goal, those alternatives (particularly Format B) have not been thoroughly discussed to provide a clear understanding of how items in the statement of comprehensive income could be presented. History indicates that the debate about financial performance and its components is a controversial one (see for example the UK ASB's FRED 22, *Revision of FRS 3 Reporting Financial Performance*). A discussion about alternate formats for the statement of comprehensive income and underlying rationale could easily become a separate project itself.

Questions for the Boards:

Q1. Do the Boards agree that the project should not seek to change existing standards relating to what items are recognized outside of profit or loss, thereby retaining the current ad hoc approach to items reported outside of profit or loss and the recycling mechanism?

Q2. Do the Boards agree that an entity should present a stand alone statement of comprehensive income with OCI items displayed in a separate section?

Q3. If so, do the Boards agreed that that would be the only preliminary view on this issue included in the preliminary views document?

Q4. Do the Boards want the preliminary views document to mention what has been referred to as the Boards' long-term goal for the statement of comprehensive income?

Q4a. If so, should the document include (1) a detailed description of the Boards' long-term goal and the two possible formats for the statement of comprehensive income or (2) a more general description of the Boards' long-term goal of eliminating OCI items and recycling (see the suggestion following paragraph 9)?

Q4b. If so, should the document include specific questions on that long-term goal?

Q4c. If so, should the document include illustrations of Formats A and B?

ISSUE 2: PRESENTATION OF OTHER COMPREHENSIVE INCOME ITEMS IN THE FINANCIAL STATEMENTS

12. The purpose of this issue is to clarify the Boards' position regarding the presentation of other comprehensive income items in the OCI section in the statement of comprehensive income and whether the presentation of related items in the statements of financial position and cash flows should be similarly separated.

Issue 2a. Disaggregating the OCI Section into Operating, Investing, and Financing Categories

13. In December 2006 when the Boards discussed what is described in paragraph 4 as Format 2, the Boards agreed that the OCI section should include operating, investing and financing categories. After reviewing illustrations with those categories, the staff believes those categories (and related headings) result in unnecessary clutter in the statement of comprehensive income.

Staff Recommendation

14. To simplify the presentation, the staff recommends that an entity be required to **indicate** (parenthetically or otherwise) whether an OCI item relates to operating, investing, or financing activities, but not present them in categories. Paragraphs 3.27-3.28 of the May 30 preballot draft (repeated below) and the illustration on page A-9 of Appendix A to that draft reflect the staff's recommendation:

> 3.27 **An entity should identify whether each item in the OCI section relates to an operating, investing, or nonowner financing item in the statement of financial position, except:**
>
> a. **For gains and losses on cash flow hedges, an entity should identify the category in the statement of financial position that will be affected by the forecasted transaction when it occurs.**
>
> b. **For FCTAs on consolidated subsidiaries (and proportionately consolidated joint ventures) because they may be related to more than one category in the statement of financial position.**
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> 3.28 **An entity should reclassify an OCI item, as required by existing standards, from the OCI section to the earnings section of the statement of comprehensive income, classified in the same category as the related item in the statement of financial position.**

Issue 2b. An OCI Section in the Statements of Financial Position and Cash Flows

15. In reviewing the staff draft of the preliminary views document, a Board advisor questioned whether to help achieve cohesiveness an entity should present a similar separate OCI section in the statements of financial position and cash flows. Having not previously thought about that issue, the staff considered whether a similar separate section for OCI items would add any information content to those statements.

Staff Analysis and Recommendation

Statement of Financial Position

16. In U.S. GAAP, a balance for accumulated OCI is presented in the statement of financial position and the accumulated balance for each OCI item is to be presented either in that statement or in the statement of changes in equity. IAS 1 (as revised in 2007) does not specifically require an accumulated OCI balance in the statement of financial position (as a minimum line item) but implicitly considers it as a component of equity. IAS 1 requires an entity to display the beginning and ending balance of each component of equity in the statement of changes in equity, including the accumulated balance of each class of other comprehensive income.

17. The staff believes it would be inappropriate to present accumulated OCI balances in an OCI **section** in the statement of financial position separate from the equity section because accumulated OCI might be interpreted as no longer a component of equity. If the Boards were in favor of separately presenting OCI items from other equity items in the statement of financial position, the accumulated balance (either in total or for individual OCI items) could be presented in an "OCI category" within the equity section.

18. If the Boards wanted to align the line items in the statement of financial position with the statement of comprehensive income, the accumulated balance for **each** OCI item could be **required** to be presented in the statement of financial position. Furthermore, to be in complete alignment with the statement of comprehensive income, the accumulated balance in the statement of financial position for each OCI item could include a parenthetical indicating the category to which the OCI item relates.

Statement of Cash Flows

19. The staff also considered whether the statement of cash flows should display a separate category or section for OCI items. OCI items do not result in cash inflows or outflows until they are realized; this occurs when the OCI item is recycled (or reclassified) to profit or loss. Thus, when an OCI item is initially recognized in the statement of comprehensive income, the related transaction is not considered a cash activity. Currently, information about non-cash activities is required to be presented in the notes. [Note: the staff inadvertently omitted the Boards' preliminary view on that disclosure from the May 30 preballot draft.]

Staff Recommendation

20. The staff believes presenting accumulated balances for **individual** OCI items in the statement of financial position (possibly in an "OCI category' within the equity section) would add confusion and clutter to that statement. The staff recommends that a single accumulated OCI balance be presented as a line item in the equity section (as in present practice).

21. Similarly, the staff recommends **not** presenting a separate category or section for OCI items in the statement of cash flows.

Questions for the Boards:

Q5. Do the Boards agree that within the OCI section an entity should indicate (parenthetically or otherwise) what category each OCI item relates to as described in paragraph 14?

Q6. Do the Boards agree that there should be no further separation of OCI items in the statement of financial position?

Q7. Do the Boards agree that there should be no further separation of OCI items in the statement of cash flows?

ISSUE 3: PRESENTATION OF INCOME TAXES

22. In March 2008, the Boards agreed that the preliminary views document should not include a preliminary view on the presentation of income taxes. Instead, the

document should explore and illustrate both alternatives (separate income tax section and income tax allocation) in order to effectively solicit comments on the issue.

23. Given the change in scope (making no changes to the presentation of OCI items), the staff believes that components of OCI should continue to be presented in the statement of comprehensive income either net of related tax effects or before related tax effects with an aggregate income tax amount shown. This issue addresses extending intraperiod tax allocation to other sections and categories in the statement of comprehensive income and aligning the presentation of income tax effects in the statements of comprehensive income, financial position, and cash flows.

Intraperiod Income Tax Allocation – Extend To Other Sections and Categories?

24. Current guidance in Statement 109 requires an entity to allocate income tax expense or benefit among continuing operations, discontinued operations, extraordinary items, other comprehensive income, and items charged or credited directly to equity. Statement 109 provides guidance for making those allocations. IAS 12 has less detailed intraperiod tax allocation guidance than Statement 109.[1]

25. As mentioned in the March 2008 meeting materials, there are several alternatives for the components to which an entity could allocate income taxes:

    a. Allocate all income tax effects to each category/section in the financial statements. As a result, every category/section would be calculated on an after-tax basis.

    b. Allocate income tax effects to selected categories, such as the *operating* category, and the *other comprehensive income* and *discontinued operations* sections. Allocation to those categories/sections would be similar to the allocation that is done under existing standards (allocation to the *operating* category would be instead of allocation to *continuing operations*).

    c. Allocate income tax effects to each component of OCI (or to the OCI section as a whole) and allocate the remaining income tax amount to profit or loss.

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[1] The Boards are working to converge their intraperiod tax allocation guidance as part of their short-term convergence project on income taxes. The IASB plans to publish an Exposure Draft amending IAS 12 in 2008. In that Exposure Draft, the IASB will propose adopting the intraperiod tax allocation guidance in Statement 109. In deciding to adopt that guidance, the IASB noted that any allocation method will have its shortfalls, and although the intraperiod tax allocation guidance in Statement 109 is not ideal, it is more complete than the guidance in IAS 12.

26. The following paragraphs from the May 30 preballot draft (3.52-3.54) explain the staff's concerns with extending intraperiod tax allocation to other sections and categories and the staff's rationale for wanting to retain the existing intraperiod tax allocation guidance.

> 3.52. The Boards observed that if the existing allocation process were extended to include more categories, the arbitrary nature of those allocations would increase. In addition, the allocation process could become more complex if an entity had to trace the income tax effects to the operating, investing, or financing transactions. For example, a long-term lease provides the lessee with both an asset for use in its primary operations and an arrangement for financing the use of that asset. Extending the intraperiod allocation of income taxes to categories would require separating the tax benefits from the lease into its operating and financing components. Thus, the Boards did not support requiring further allocation of income tax expense or benefit.
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> 3.53. The Boards also considered whether to eliminate the present allocation of income taxes to discontinued operations. That change would result in presenting discontinued operations on a pre-tax basis, and income taxes would be allocated to individual OCI items, to the sum of the business, financing, and discontinued operations sections, and directly to equity for the tax effects associated with transactions with owners. That would have the benefit of retaining the net-of-tax presentation for OCI items and be a step closer to aligning all of the sections in the statements of financial position, comprehensive income, and cash flows. That is, if an entity had no items of other comprehensive income, it would present income tax expense or benefit in only one section in each of those statements and present all of the other sections on a "pre tax" basis.
>
> 3.54. The Boards heard from a number of users and preparers who favor keeping OCI items and their income tax effects separate from income from continuing operations. Much of the support for intraperiod income tax allocation arises because it allows for the reporting of *after-tax income from continuing operations*, a metric that many of the Boards' constituents find important in making their decisions. Therefore, the Boards decided to retain the existing intraperiod tax allocation guidance.

Aligning Presentation of Income Tax Information in the Financial Statements

27. One reason the Boards favored presenting income taxes in a single section in the statement of comprehensive income as well as the statements of financial position

and cash flows was that income tax presentation would be aligned (cohesive) across the statements. The staff is of the opinion that income taxes should still be presented in a separate section in the statement of financial position and the statement of cash flows.

28. The staff considered the alternative of requiring an entity to present income tax assets, liabilities, and cash flows in the same categories and sections that contain income tax expense (benefit) so that the statements would align. For the presentation model to be internally consistent, an entity would need to first classify its income tax assets and liabilities into sections and categories and then similarly classify the related changes.

29. The staff asserts that disaggregating and presenting income tax assets, liabilities, and cash flows in the operating, investing, and financing categories would require complex and arbitrary allocations that are unlikely to provide information that is useful in assessing future cash flows. In addition, the staff believes that allocating income taxes in the statement of comprehensive income is important to achieving the disaggregation objective, which is more important than strict adherence to the cohesiveness objective.

Staff Recommendation

30. The staff recommends that an entity present income tax assets, liabilities, and cash flows in a separate section in the statements of financial position and cash flows, but that income taxes be allocated in the statement of comprehensive income (consistent with current guidance). The staff notes that if an entity has no (a) discontinued operations, (b) OCI items, or (c) taxable equity transactions, income taxes will be presented in a similar manner (aligned) in the statements of financial position, comprehensive income, and cash flows.

31. The March 2008 agenda paper contained details of how to improve the note disclosure regarding income taxes, and the improvements were motivated in part to make up for the information that would be lost if income taxes were not allocated. Given the staff's recommendation that income taxes continue to be allocated (and the Boards' preference to limit new note disclosures), the suggestions for improving the income tax note disclosures were not included in the May 30 preballot draft and

can be forwarded to the short-term convergence income tax team if the Boards would like those disclosures to be pursued.

Question for the Boards:

Q8. Do the Boards agree that income taxes should continue to be allocated in the statement of comprehensive income (consistent with current guidance)?

Q9. Do the Boards agree that an entity should present income tax assets, liabilities, and cash flows in a separate section in the statements of financial position and cash flows, respectively?

Q10. Do the Boards want the short-term convergence project team to consider the income tax disclosures addressed by the Boards in March 2008?

ISSUE 4: THE IMPACT ON PRESENTATION OF EARNINGS PER SHARE

32. In March/April 2006, the Boards decided that they would not deliberate whether EPS or other per-share amounts should be presented in the financial statements prior to issuing a preliminary views document. That is because the Boards wanted to address those issues after they had the benefit of constituent input on the Boards' preliminary views on presentation in the statement of comprehensive income. For example, constituents' views on whether there should be an "earnings" subtotal would influence Board member views on whether there should be an "earnings" per share amount.

33. Now that an earnings or profit or loss subtotal will be retained in this phase of the project, the staff believes it is appropriate for the Boards provide their view on presentation of per-share amounts in the preliminary views document. In Phase A, the Boards decided not to amend their standards on earnings per share as a consequence of their decision to require a single statement of comprehensive income and confirmed that:

    a. An entity will continue to be required to present basic and diluted earnings per share on the face of the statement of earnings and comprehensive income.

    b. An entity will continue to be permitted to disclose basic and diluted comprehensive income per share in the notes to financial statements.

    c. An entity will continue to be required to disclose the weighted average number of shares used as the denominator in calculating per share metrics in the notes to financial statements.

34. The IASB Exposure Draft of IAS 1–*A Revised Presentation* included the Boards' Phase A tentative decisions noted above. The majority of respondents to that Exposure Draft agreed with the IASB that earnings per share should be the only per share measure permitted or required in the statement of comprehensive income.

35. At the May 2008 IASB meeting related to the short-term EPS convergence project, the IASB discussed whether the 2007 amendments to IAS 1 that introduced a total comprehensive income amount indicate a need for further amendments to IAS 33. The IASB decided that the introduction of a comprehensive income per share measure is beyond the scope of that short-term convergence project. The staff suggests that any changes to the EPS calculation or presentation should take into account the outcome of the Liabilities and Equity project.

36. The introduction of predefined sections and categories, as well as totals and subtotals for each of those sections and categories, raises the question of whether alternative per-share measures (for example, *operating income per share*) would be useful. The staff believes that this issue was left open by the IASB, as stated in paragraph BC102 of IAS 1 (revised 2007):

> The Boards did not support including alternative measures per share until totals and subtotals, and principles for aggregating and disaggregating items, are addressed and discussed as part of the next stage of the financial statement presentation project.

Staff Recommendation

37. The staff recommends that for purposes of the preliminary views document the Boards confirm their Phase A decisions (which are consistent with Statement 128 and IAS 33) that:

    a. An entity will continue to be required to present basic and diluted earnings per share (EPS) on the face of the statement of comprehensive income.

    b. An entity will continue to be permitted to disclose alternative measures per share, such as basic and diluted *comprehensive income* per share in the notes to financial statements.

    The staff also recommends that the preliminary views document include a question as to whether other per share amounts should be encouraged or required to be presented in the notes to financial statements.

Question for the Boards:

Q11. Do the Boards agree with the staff recommendation described in paragraphs 37 (a) and (b)?

Q12. Should the preliminary views document include a question about whether alternative per-share measures should be encouraged or required in the notes, or do the Boards prefer to address that issue in the Exposure Draft stage?