Topic **Performance measurement and other comprehensive income**

This paper is also being presented at the SAC meeting in June 2009 as Agenda paper 5A. All references in the paper refer to that meeting.

1. The purpose of this paper is to ask SAC members to consider OCI (other comprehensive income) and share their opinions on whether we should try, in the short term, to abolish it.

2. The financial statement presentation team was asked last year to develop its proposals on the basis that, eventually, the items currently in OCI will be moved out of OCI and incorporated into one of the sections of the comprehensive income statement. We are not supposed to add items to OCI.

3. Yet, other projects have pushed us on this point. The project on post employment benefits has highlighted the discomfort some Board members have with presenting changes in pension obligations within profit and loss. The board has tentatively decided to report some 'remeasurement' items related to post employment benefits on a net of tax basis at the bottom of the income statement. The proposals to replace IAS 39 are also likely to suggest separating some changes in fair value measurements, with some being presented in profit and loss and some in OCI.

4. From relatively early on in the deliberations the financial statement presentation project team favoured an approach where all gains and losses were reported through profit and loss based upon an operating / investing / financing type classification.

5. The approach was referred to as a 'long-term' view as it depended on making changes to other standards and hence an interim position of having OCI items

reported as a separate component of each section was also considered. However, given the difficulty of getting the board and others to agree on a model for the statement of comprehensive income, it was decided that in order to meet a 2011 deadline there should essentially be no change to the treatment of OCI items. This was the position in the discussion paper.

6. Many comment letters have identified OCI and recycling as an issue that should be given greater priority. A typical comment is:

> We understand why the boards have limited the scope of the proposals; an incremental approach provides the best chance of progress in line with the 2011 target for the roadmap. However, we believe a number of issues ought to be dealt with sooner rather than later. In particular, the boards need to agree on the purpose of the income statements or statement of comprehensive income and how gains and losses should be categorized therein before final decisions can be made about presentation. Companies and users of accounts place a great deal of emphasis on the income statement and net income and clear underlying principles in the reporting of gains and losses are therefore vital. Deferring consideration of issues such as Other Comprehensive Income (OCI) and recycling continues to cause problems elsewhere as it is difficult to assess the impact of other proposals, for example on hedging, pensions accounting and fair value changes, without knowing how the income statement will reflect such items. This project was originally instituted to deal with these particular issues and it raises questions about the use of the boards' limited resources and priorities to have issued a Discussion Paper that does not address these questions when there are other pressing matters for the boards to address.

7. Clearly the difficulties of measuring performance and dealing with the OCI items and the issue of recycling have not changed. We are also that much closer to the 2011 deadline.

8. The simple question we are asking SAC members is whether we should extend (return) the scope of the financial statement presentation project to one that includes a focus on performance reporting, OCI items and recycling.

The June meeting and a pre-meeting task

9. At the June meeting we will be asking you to discuss the financial statement presentation project in small groups, as well as in a full session.

10. To help you prepare for that session, Stephen Cooper has developed an exercise in which you are asked to assemble data into a statement explaining the total changes in equity, excluding transactions with owners (ie dividends, capital contributions). That exercise is Agenda paper 5B.

11. If SAC members have the opportunity to send us their suggested solutions before the SAC meeting we will include their suggestions in the summary we are preparing.

12. The exercise, and this paper, are designed with the following questions in mind:

    (a) The term OCI is used widely. But what do you understand OCI to represent?

    (b) Do we need an OCI section for comprehensive income?

    (c) Assume that you are asked to present a statement showing all accounting revenues, expenses, gains and losses (which is what we are asking you to do in the exercise). What categories would you use in such a statement?

    (d) Do we need to separate 'core' or 'operating' or 'primary' performance from those aspects of performance that are not 'core' or 'operating' or 'primary'? Which items should go into these categories?

    (e) How should tax be presented? Should all items be presented gross, with one tax line, or could some items be presented net of tax?

    (f) Would you recycle from one section to another? Why, or why not?

The relative importance of the financial statements

13. There is a perception that both the IASB and the FASB give primacy to the Statement of Financial Position, to the detriment of the income statement.

14. The root of this perception is likely to be that, in developing its conceptual framework, the FASB gave primacy to the definition of an asset, from which the definition of a liability is derived. By doing so, the FASB framework anchored

the elements to the underlying economic resources and obligations of an entity. It is an approach that the IASB and FASB are following in the development of a common conceptual framework.

15. Giving conceptual primacy to the asset definition is not the same as relegating the income statement. The Discussion Memorandum the FASB published as part of its project stated that giving primacy to the definition of an asset (and therefore appearing to give primacy to the balance sheet) does not imply that the balance sheet provides more useful information than the income statement. The discussion memorandum stated that:

> [advocates of building the framework off the definition of an asset] … agree with advocates of the revenue and expense view that the information in the statement of earnings is likely to be more useful to investors and creditors than the information in a statement of financial position. That is, both groups agree that earnings measurement is the focus of financial accounting an financial statements.

16. This view was carried forward into Concepts Statement 1:

> The primary focus of financial reporting is information about an enterprise's performance provided by measures of earnings and its components. Investors, creditors, and others who are concerned with assessing the prospects for enterprise net cash flows are especially interested in that information.

17. The, soon to be published, first chapters of the joint framework will state the Boards do not place more importance on a particular statement. We know from our interactions with analysts and investors that for many such users the income statement is their starting point in valuing an entity. The neutral statement in the joint framework is not intended to imply that the boards are ignoring the approach many investors take in valuing an entity. Each statement has a role to play in helping investors and the financial statement presentation project is charged with ensuring that the method of presentation of each of the financial statements is as useful as possible.

18. The session at the SAC meeting in June will focus on how SAC members think we can make the statement of comprehensive income more useful, with a particular emphasis on what we should do with OCI.

What is in OCI today?

19. IFRS has five items in OCI, three of which are recycled and two which are not. US GAAP has four OCI items, all of which are recycled.

<table>
<tr><th>IFRS</th><th>US GAAP</th></tr>
<tr><td colspan="2">Not Recycled</td></tr>
<tr><td>Revaluation gains and losses on property, plant and equipment revaluations.</td><td></td></tr>
<tr><td>Actuarial gains and losses in relation to pension schemes.</td><td></td></tr>
<tr><td colspan="2">Recycled</td></tr>
<tr><td colspan="2">Unrealised gains and losses on available-for-sale securities</td></tr>
<tr><td colspan="2">Gains and losses resulting from cash flow hedges</td></tr>
<tr><td colspan="2">Foreign currency translation adjustments</td></tr>
<tr><td></td><td>Actuarial gains and losses, prior service costs and credits, and transition assets and obligations, in relation to pension schemes.</td></tr>
</table>

Currency translation differences

20. The currency exchange difference relates to subsidiaries of the reporting entity that operate in a currency different to that of the parent. IFRS use a translation method that creates a currency difference between the opening and closing net investment. That difference does not meet the definition of an asset or a liability so is included in OCI. There are no plans to change the way that IFRS translates subsidiaries.

Cash flow hedges

21. An entity might enter into a hedge against a future expense stream in a foreign currency. An effective hedge will protect the reporting entity from movements in the currency. The hedging agreement will create an asset or liability for the entity. However, because the expense stream will occur in the future, and the

entity is not obliged to incur the expenses, there is no corresponding asset or liability to off-set the hedging liability or asset. The effective component is therefore presented in OCI and recycled into profit and loss when the hedged item is settled.

Post employment benefits, AFS fair value changes, Fixed asset revaluations

22. All of these items are revaluation changes. Only the AFS changes are recycled.