

STAFF PAPER

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Project	Conceptual Framework		
Paper topic	Initial strategy: Profit or loss and other comprehensive income		
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Purpose of the paper

1. This paper outlines alternative approaches to developing the proposals on the use of profit or loss (P&L) and other comprehensive income (OCI) for the upcoming Exposure Draft on the *Conceptual Framework for Financial Reporting* (the Conceptual Framework ED).

Structure of the paper

2. This paper provides:
 - (a) a brief overview of the relevant proposals in the Discussion Paper *A Review of the Conceptual Framework for Financial Reporting* (the Conceptual Framework DP) (paragraphs 3-5);
 - (b) a brief overview of the feedback received on those proposals (paragraphs 6-9);
 - (c) a brief overview of the work performed by the IASB on the use of P&L and OCI prior to finalising the Conceptual Framework DP and the lessons learnt (paragraphs 10-28);
 - (d) a discussion of the alternative approaches to developing the proposals on the use of P&L and OCI for the upcoming Conceptual Framework ED (paragraphs 29-51); and

- (e) staff recommendation and a question for the IASB (paragraphs 52-54).

P&L and OCI proposals in the Conceptual Framework DP

3. The Conceptual Framework DP:
 - (a) discussed the purpose of the statement(s) of P&L and OCI;
 - (b) set out the IASB’s preliminary view that the Conceptual Framework should require a total or subtotal for P&L;
 - (c) proposed to distinguish between items included in P&L and OCI by describing the types of items that could be included in OCI;
 - (d) set out the principles that underpin the proposed distinction between items included in P&L and OCI;
 - (e) described three categories of items that could be included in OCI:
 - (i) bridging items;
 - (ii) mismatched remeasurements; and
 - (iii) transitory remeasurements;
 - (f) explored two approaches to OCI—and related approaches to recycling—based on the three categories of items listed above:
 - (i) a ‘narrow’ approach to OCI, that captures bridging items and mismatched remeasurements; and
 - (ii) a ‘broad’ approach to OCI, that also captures transitory remeasurements;
 - (g) set out the IASB’s preliminary view that the Conceptual Framework should permit or require at least some items included in OCI to be recycled to P&L, specifically:
 - (i) bridging items and mismatched remeasurements would always be recycled; and
 - (ii) transitory remeasurements would be recycled when, and only when, the recycling results in relevant information.
4. The Conceptual Framework DP also discussed an alternative view whereby:

- (a) All items of income and expense would be included in P&L or OCI only once, ie items included in OCI would not be recycled to P&L.
 - (b) The Conceptual Framework would not require a total or subtotal for P&L.
 - (c) There would be no need for the Conceptual Framework to describe or define items of income and expense included in P&L or OCI.
5. Each view discussed in the Conceptual Framework DP followed a consistent logic in its approach to the three interrelated issues: a total or subtotal for P&L, recycling and determining which items to include in OCI.

Feedback received

6. Views expressed on most P&L and OCI proposals in the Conceptual Framework DP were mixed. In addition, the views expressed by respondents on a total or subtotal for P&L, recycling and items that could be included in OCI did not necessarily follow the logic proposed in the Conceptual Framework DP. The following key themes emerged:
- (a) Many respondents believed that the use of P&L and OCI requires further thought and analysis. Some urged the IASB to explore the broader question of performance reporting and consider the use of P&L and OCI within that broader context.
 - (b) Some respondents expressed the view that the use of P&L and OCI and measurement of assets and liabilities are interrelated topics and that this interaction should be considered.
 - (c) Most respondents agreed that a total or subtotal for P&L should be required. Many respondents stated that such a requirement would emphasise the prominence of P&L, which they considered appropriate. On the other hand, some respondents disagreed with requiring a total or subtotal for P&L and advocated a single statement of performance.
 - (d) Many respondents asked the IASB to directly define or better describe P&L and its purpose. However, only a few made suggestions as to how the

IASB might approach defining or describing P&L. Some suggested identifying particular items that should be included in OCI.

- (e) Some respondents acknowledged the difficulty of defining P&L, and defining financial performance, and pointed out that decades of research and numerous attempts at producing a definition have not yielded a satisfactory result.
 - (f) Views on items that could be included OCI and recycling varied, with most respondents supporting the broad approach to OCI and recycling for some, or all items included in OCI. Views on *which* items should be recycled and *when* they should be recycled were mixed.
 - (g) Views expressed on items that could be included in OCI and recycling did not necessarily link to the categories described in the Conceptual Framework DP (ie bridging items, mismatched remeasurements and transitory remeasurements) and to the rationale for those categories. Many respondents merely preferred a broad OCI and recycling or favoured flexibility in the use of OCI. Similarly, the views on whether a total or subtotal for P&L should be required did not necessarily link to the views on recycling in the way envisaged by the Conceptual Framework DP.
 - (h) Some respondents emphasised that the use of P&L and OCI and recycling should be addressed in the Conceptual Framework. Others expressed the view that it is more appropriate to address those topics in the relevant Standards.
7. Views on the P&L and OCI proposals in the Conceptual Framework DP—and on the way forward—expressed by the members of the Accounting Standards Advisory Forum (ASAF) were also mixed. Some ASAF members came forward with alternative proposals on the use of P&L and OCI or on performance reporting more broadly. Specifically:
- (a) The Accounting Standards Board of Japan presented a paper *Profit or Loss/OCI and Measurement* that explored definitions of comprehensive income, P&L and OCI, the nature of P&L and recycling and the interaction between the use of P&L and OCI and measurement.

- (b) Thomas J. Linsmeier, a member of the US Financial Accounting Standards Board (FASB), presented a paper *A Revised Model for Presentation in the Statement(s) of Financial Performance: Potential Implications for Measurement* that proposed a revised financial performance reporting model and explored its potential implications for measurement.
8. In discussing the way forward on the P&L and OCI proposals at their meeting in March 2014, many ASAF members expressed the view that the IASB should continue to place a high priority on completing the revisions to the Conceptual Framework, *including* the guidance on the use of P&L and OCI, whereas others suggested that the IASB should complete some sections of the Conceptual Framework according to the current timetable and subsequently undertake research on other sections, such as the statement(s) of financial performance.
9. Views expressed by users of financial statements were also mixed. Key themes in the user feedback were largely consistent with the rest of the feedback discussed above. The following additional themes emerged:
- (a) Many stated that performance is multi-dimensional and no single performance number could be suitable for all users' needs. They observed that analysts always adjust the P&L total or subtotal to arrive at a number that they will use in their analysis.
- (b) Many seemed to place a greater emphasis on operating profit than on the P&L total or subtotal.
- (c) Many stated that OCI and recycling are not well understood by the user community and are not looked at by many users.
- (d) In relation to the three categories of items identified in the Conceptual Framework DP for inclusion in OCI, many seemed not to find the three categories a helpful way of approaching this issue. They raised various concerns regarding the approaches considered in the Conceptual Framework DP.
- (e) Many emphasised the importance of appropriate disaggregation—regardless of whether OCI exists as a separate category of items and how broad it is—and the need for transparency around OCI and recycling.

- (f) Many asked the IASB to reactivate all or parts of the *Financial Statement Presentation* project.

Prior work on performance reporting and the use of P&L and OCI

10. Prior to finalising the P&L and OCI proposals in the Conceptual Framework DP, the IASB:
- (a) introduced improvements to presenting information in P&L (paragraph 12);
 - (b) undertook a project on performance reporting and presentation of financial statements (paragraphs 13-21);
 - (c) consulted on its agenda priorities and financial reporting needs, including the use of OCI (paragraphs 22-25); and
 - (d) considered a possible approach to performance reporting in developing the Conceptual Framework DP (paragraphs 26-28).
11. The avenues explored by the IASB, the feedback received and the lessons learnt in the process are summarised below.

Improvements to presenting information in P&L

12. In 2003, the IASB amended IAS 1 Presentation of Financial Statements as part of the *Improvements* project. Specifically, the IASB removed the requirement to present the results of operating activities as a line item in the income statement, and eliminated the category ‘extraordinary items’ from the income statement¹. In finalising those amendments, the IASB concluded that items treated as extraordinary are not distinct from other income and expenses and result from normal business risks faced by an entity. Hence, the IASB concluded that they do not warrant presentation in a separate component of the income statement.

¹ Extraordinary items were defined as ‘income or expenses that arise from events or transactions that are clearly distinct from the ordinary activities of the enterprise and therefore are not expected to recur frequently or regularly’.

Performance reporting and presentation of financial statements

13. In 2001, the IASB added to its agenda a project on performance reporting that focused on the income statement. The IASB developed a possible new model for reporting income and expenses and conducted preliminary testing. Similarly in 2001, the FASB added a project on performance reporting to its agenda, developed its own model and conducted preliminary testing. Initial feedback on both models was not supportive.
14. In 2004, the IASB and the FASB decided to continue further work on performance reporting as a joint project and expanded the scope of the project to address the contents of a complete set of financial statements (in 2006, the project was renamed the 'Financial Statement Presentation project').
15. The IASB conducted the project in two phases. Phase A, an IASB-only phase, resulted in the publication of the Exposure Draft *A Revised Presentation* in 2006 (the 2006 Exposure Draft) and subsequent revisions to IAS 1 in 2007. In those revisions:
 - (a) The IASB emphasised the equal prominence of all financial statements. The IASB noted that the financial performance of an entity is not assessed by a reference to a single financial statement or a single measure within a financial statement. Instead, the financial performance of an entity can be assessed only after all aspects of the financial statements are taken into account and understood in their entirety.
 - (b) The IASB required presentation of changes in equity resulting from transactions with owners in their capacity as owners separately from other changes in equity and permitted presenting non-owner changes in equity in a single statement or in two statements.
16. In the consultation process on the 2006 Exposure Draft, the IASB expressed a preference for a single statement of performance and expressed the view that there were no clear principles or common characteristics that could be used to separate income and expenses into two statements. However, many interested parties opposed the concept of a single statement of performance. They argued that a single statement of performance would place an undue emphasis on the bottom line of that statement and that it was premature for the IASB to require a single statement before addressing

the other aspects of presentation and display, namely deciding what categories and line items should be presented in a statement of performance.

17. Phase B, a joint phase, resulted in the publication of the Discussion Paper *Preliminary Views on Financial Statements Presentation* in 2008 (the 2008 Discussion Paper). The 2008 Discussion Paper proposed a single continuous statement of performance with separate P&L and OCI sections *and* an approach to disaggregating and presenting information in that statement. The responses were split:
 - (a) Some respondents supported a single continuous statement of performance and said that it would lead to greater transparency, consistency and comparability and make the process of calculating financial ratios easier.
 - (b) Some respondents opposed a single statement of performance and said that it would undermine the importance of profit or loss and confuse users of financial statements. They argued that items included in OCI are different from items included in P&L and that it is premature for the IASB to require changes to presentation until the IASB revises the guidance on what items should be included in OCI.

18. The 2008 Discussion Paper did not evolve into the next stage of the due process, ie a comprehensive Exposure Draft on presentation of financial statements. However, in 2009, the IASB and the FASB accelerated the portion of the project that would address presentation of items of OCI. In 2010, the IASB published the Exposure Draft *Presentation of Items of Other Comprehensive Income* that proposed a single continuous statement of performance with separate P&L and OCI sections within that statement.

19. Many respondents other than users of financial statements opposed a single statement of performance, their arguments being much the same as those received by the IASB and the FASB on the 2008 Discussion Paper. However, most users of financial statements supported the notion of a single statement of performance.

20. Regardless of their views on the proposed amendments, many respondents, including users, pointed out the lack of a conceptual basis for deciding whether and when to use OCI and whether and when to use recycling and asked the IASB to establish such a basis. However, they made these comments for different reasons. For example, those

who opposed a single statement of performance argued that items included in OCI are different from items included in P&L. On the other hand, users who supported a single statement of performance said that the lack of a conceptual basis for deciding when to use OCI made it difficult for them to distinguish the underlying economics of items included in P&L and those included in OCI.

21. In the light of the feedback received, the IASB decided not to mandate a single statement of performance and instead retained the option to present P&L and OCI as two separate consecutive statements in the 2011 amendments to IAS 1. The IASB acknowledged the requests to consider a conceptual basis for the use of OCI and recycling but noted that those topics were outside the scope of the project on presentation. The IASB noted that those topics could be added to its agenda on the basis of the feedback on *Agenda Consultation 2011*.

Agenda Consultation 2011

22. *Agenda Consultation 2011* sought feedback on the IASB's strategic priorities and the most pressing financial reporting needs. It identified the conceptual and practical issues associated with the use of OCI as one such potential financial reporting need.
23. Responses to *Agenda Consultation 2011* cited the concepts of P&L and OCI and recycling and their role in reporting an entity's performance as high priority topics for the IASB to consider—those topics were given a high level of importance by most respondents, including users, and across all jurisdictions.
24. Some respondents, notably users of financial statements, expressed concerns about the role of OCI. For example, some expressed the view that, because of the lack of a clear definition, OCI has become a “dumping ground” for anything controversial. Consequently, many users stated they ignore it. Some users said they do not consider items included in OCI to be ‘income’ because those items are not caused by operating flows from which long-term trends can be inferred. Some users requested more transparency and clarity around what is included in OCI and what is recycled to P&L and when—so that they could include or exclude items in their analyses as they find appropriate.

25. Different views were expressed on what a project addressing financial performance and the concepts of P&L and OCI and recycling might entail. Some respondents believed that such a project would need to define ‘performance’ and ‘income’. Others thought that the discussion about P&L and OCI is about the geography of the presentation, rather than a conceptual matter, and hence transparency is the key need. Many respondents believed the IASB should address those issues in the Conceptual Framework—a project which was also given a high degree of priority by many.

Developing the Conceptual Framework DP

26. In light of the feedback received on *Agenda Consultation 2011* and its earlier work on presentation, the IASB decided to consider the use of P&L and OCI, including recycling, in its Conceptual Framework project.
27. In developing the Conceptual Framework DP, the IASB considered a possible approach to performance reporting. That approach envisaged introducing sections for groups of items included in OCI under the current Standards and the IASB’s ongoing projects and proposed an approach to presenting those sections in the statement of performance while maintaining the current concept of P&L. Specifically, that approach would group and present OCI items as follows:
- (a) Group A, individual items—presented in a separate subsection in P&L and not recycled;
 - (b) Group B, bridging items—presented in a separate subsection of P&L and recycled; and
 - (c) Group C, mismatched remeasurements²—presented outside P&L and recycled.
28. The IASB did not pursue that approach to performance reporting. However, the approach to grouping OCI items has evolved into the three categories—transitory remeasurements, bridging items and mismatched remeasurements respectively—which were discussed in the Conceptual Framework DP.

² At the time this approach was discussed, items included in Group C were labelled ‘incomplete remeasurements’.

Alternative approaches to developing proposals on P&L and OCI

29. The staff note the following themes from the IASB's work on performance reporting and presentation since 2001:
- (a) The IASB has consistently expressed the view that financial performance is a multi-faceted notion and a one-cut distinction between types of income and expenses is not meaningful or helpful. The IASB also stated that there are no clear principles or common characteristics that could be used to separate two types of income and expenses in a meaningful way.
 - (b) Over the years the IASB has come forward with various innovative proposals for how the financial performance of an entity could be portrayed. However, those proposals have not received wide support.
 - (c) Many preparers have generally opposed changes in performance reporting, notably the proposals for a single statement of performance. Many preparers have also advocated the primary role of P&L in performance reporting and the appropriateness of a separate statement of P&L.
 - (d) Users of financial statements have generally acknowledged their lack of understanding of, and lack of attention to, OCI and requested increased transparency around the use of OCI and recycling. Many users have also emphasised the importance of the meaningful disaggregation of information and the use of subtotals, such as a subtotal for operating profit.
30. In the light of the prior work by the IASB on performance reporting and presentation and the feedback received on the Conceptual Framework DP, the staff have identified the following approaches to developing the P&L and OCI proposals in the Conceptual Framework project:
- (a) Approach 1—do nothing in the Conceptual Framework (for now). Undertake a research project on performance reporting and consider the use of P&L and OCI in that project (paragraphs 32-36).
 - (b) Approach 2—provide high level principles in the Conceptual Framework. Do not attempt to draw a conceptual line between P&L and OCI (paragraphs 37-46).

- (c) Approach 3—fine-tune and finalise the specific proposals included in the Conceptual Framework DP (paragraphs 47-54).
31. The staff note that, alongside each of the approaches identified above, the IASB could also engage in outreach with users of financial statements and explore whether and how the IASB could help to increase their understanding of OCI and recycling. The IASB could also consider undertaking a project that would explore whether and how the IASB could increase transparency around the use of OCI and recycling.

Approach 1—do nothing in the Conceptual Framework

What it entails

32. Under Approach 1, the IASB would proceed with the Exposure Draft and finalising the revisions to the Conceptual Framework *without* including guidance on the use of P&L and OCI. In order to develop such guidance, the IASB would start a comprehensive research project focused on performance reporting and would consider the use of P&L and OCI and recycling in that project. That project would aim to answer the fundamental question of how the performance of the entity is best portrayed in the financial statements and would entail extensive outreach, notably with users of financial statements, and a thorough analysis of the available academic resources and empirical studies.

Analysis

33. The main advantage of this approach is that it would be responsive to the requests from respondents, including users, to consider comprehensively how performance could be best portrayed in the financial statements.
34. However, as discussed in paragraph 29, the staff note that the IASB has performed a significant amount of work on performance reporting since 2001 and the various proposals set out by the IASB have not received wide support. The staff therefore think that if the IASB were to undertake a comprehensive research project on performance reporting, such a project would be likely to take a significant amount of time. In addition, there is no guarantee that any proposals developed would receive wide support, because of the diversity of views and the apparent reluctance of many to

embrace a change in reporting performance—despite the requests by many to address that topic.

35. The staff also note that a comprehensive overhaul of reporting performance could result in conclusions that are not consistent with the current and proposed use of P&L and OCI in the Standards and the IASB's ongoing projects and hence could raise the question on whether amendments to those Standards are needed.
36. Finally, while this project is under way, there would be no guidance on the use on P&L and OCI in the Conceptual Framework, despite such guidance being identified as a top priority need in *Agenda Consultation 2011*.

Approach 2—high level principles in the Conceptual Framework

What it entails

37. Under Approach 2, the IASB would aim to articulate in the Conceptual Framework high level principles for the use of P&L and OCI but would not attempt to define those notions precisely—nor consider the broader question of reporting financial performance—and would not attempt to draw a conceptual distinction between items included in P&L and items included in OCI.
38. This approach would:
 - (a) build upon the principles discussed in the Conceptual Framework DP and the requirements on the use of P&L and OCI included in IAS 1 today³;
 - (b) emphasise the role of P&L as the key—although not the only—source of information about the entity's performance and confirm the proposals for a total or subtotal for P&L;
 - (c) require items of income and expense to be included in P&L unless, exceptionally, the IASB concludes that including an item of income and expense in OCI enhances the relevance of P&L for the period; and

³ IAS 1 paragraph 88 requires that an entity shall recognise all items of income and expense in a period in profit or loss unless an IFRS requires or permits otherwise.

- (d) possibly impose qualifying conditions on the use of OCI by the IASB and require the IASB to provide a rationale for why including the item in OCI enhances the relevance of P&L for the period.
39. This approach would *not* aim to develop the specific proposals on the three categories of items that could be included in OCI under the Conceptual Framework DP.
40. If the IASB decides to pursue this approach, the staff will develop and present to the IASB at a future meeting:
- (a) concrete suggestions for the high level principles that could be included in the Conceptual Framework;
 - (b) alternatives for approaches to recycling—specifically, whether items included in OCI should be always, sometimes or never recycled; and
 - (c) a detailed analysis of why a one-cut distinction between types of income and expense would not result in the best reflection of the entity’s performance.
41. Pursuing this approach would not preclude the IASB from undertaking a project on performance reporting in the future. The staff note that the IASB has no current plans to undertake a project on this topic.

Analysis

42. This approach, unlike Approach 1, does not involve a fundamental consideration of the meaning of ‘performance’. Moreover, it would not establish precise criteria for when the IASB must use OCI and when it must not use OCI. Consequently, it would not result in conclusions that invalidate the IASB’s past decisions in particular standard-setting projects. However, as noted above, this approach would not preclude the IASB from doing further work on performance reporting in the future.
43. This approach recognises that, whereas arguably *each* individual case of the existing or proposed use of OCI has a conceptual basis, there is no *single* conceptual basis that underlies all uses of OCI today. This approach is based on the view that an attempt to establish such a comprehensive single basis for the use of OCI would:
- (a) necessarily fail because in reality there is no common property that is unique to all items that should be included in OCI rather than P&L;

- (b) contradict the existing academic research and empirical evidence that seem to suggest that a one-cut distinction between items of income and expenses would:
 - (i) be artificial and would not reflect the multi-faceted nature of an entity’s performance; and
 - (ii) make a binary distinction using characteristics (eg recurring or non-recurring) that are not discrete but instead fall on a continuous spectrum (eg in terms of how often they recur).

- 44. By emphasising the role of P&L as the key source of information about the entity’s performance, this approach would both:
 - (a) be responsive to those who advocate the primary role of P&L in depicting an entity’s performance; and
 - (b) result in a limited use of OCI by the IASB, which would arguably to some degree address concerns around using OCI as a ‘dumping ground’.

- 45. This approach could be criticised as not sufficiently responsive to requests for a conceptual distinction between P&L and OCI.

- 46. This approach would not provide the IASB with specific guidance on the use of P&L and OCI going forward. However it would provide the IASB with high level and timely guidance that it can use when developing Standards.

Approach 3—Develop the proposals included in the Conceptual Framework DP

What it entails

- 47. Under Approach 3, the IASB would look to build on the proposals in the Conceptual Framework DP, fine-tuning them to address the feedback received. Under this approach, the IASB would:
 - (a) confirm a total or subtotal for P&L;
 - (b) consider whether to pursue the narrow or the broad approach to OCI for the upcoming Conceptual Framework ED; and
 - (c) consider whether or not to confirm the related recycling proposals.

48. Like Approach 2, this approach would not preclude further work on performance reporting in the future.

Analysis

49. The staff note that, even though respondents did not necessarily engage with the analysis in the Conceptual Framework DP—or requested more analysis or a better conceptual distinction between P&L and OCI—they did not oppose that analysis. Consequently, this approach would not be inconsistent with the feedback received and would provide detailed guidance to the IASB on the use of OCI.
50. As stated above, like Approach 2, this approach would not preclude further work on performance reporting in the future. However, because this approach would entail more specific guidance on the use of P&L and OCI in the Conceptual Framework, such future work could lead to a need to consider further amendments to the Conceptual Framework.
51. Unlike Approach 2, as noted in the Conceptual Framework DP, this approach would entail guidance that is not entirely consistent with the existing and proposed use of P&L and OCI.

Staff recommendation and a question for the IASB

52. On balance, the staff recommend Approach 2. That approach would provide principle-level guidance to the IASB that, in the staff view, reflects both the reality and the merits of the use of P&L and OCI—that is, items of income and expense would be recognised in P&L except for the few cases when the IASB concludes that including an item of income and expense in OCI enhances the relevance of P&L for the period. Approach 2 also reflects the idea of the multi-faceted nature of performance that has long been held by the IASB and some interested parties, in that it does not attempt to draw a one-cut line between two types of income and expenses.
53. The staff acknowledge that Approach 2 does not provide specific guidance to the IASB on the use of P&L and OCI and could be criticised as not sufficiently responsive to *Agenda Consultation 2011*. However, the staff are of the view that the only approach that *could* lead to such guidance and fully satisfy those requests would

be Approach 1—and that approach would involve research outside of the current Conceptual Framework project and is not guaranteed to result in conclusions that would receive wide support. Besides, the staff note that the IASB could decide to undertake such a project *in addition* to providing high level guidance in the Conceptual Framework in the meantime under Approach 2, rather than *instead of* providing any guidance, as would be the case under Approach 1.

54. The staff acknowledge that Approach 3 would provide more specific guidance to the IASB on the use of P&L and OCI than Approach 2. However, the staff note that, while being more specific, that guidance would still not answer the question of when the IASB *must* use P&L and when it *must* use OCI. Instead, it sets out when the IASB *could* use OCI. The staff also note that respondents to the Conceptual Framework DP generally did not find the proposed distinction between P&L and OCI—and the rationale for that distinction—convincing or helpful and cited the need for further thought and analysis—which, in the staff view, as stated above, could only be attempted under Approach 1. Consequently, the staff note that the benefits of the more specific guidance under Approach 3 relative to Approach 2 are limited.

Question for the IASB

Does the IASB agree with the staff recommendation in paragraph 52 to pursue Approach 2 to developing the proposals on the use of P&L and OCI for the upcoming Conceptual Framework ED?