

STAFF PAPER

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Project	Conceptual Framework
Paper topic	Profit or loss and other comprehensive income—clarifying the proposed approach
CONTACT(S)	Yulia Feygina yfeygina@ifrs.org +44 207 332 2743

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Purpose of the paper

1. In April 2014, the IASB directed the staff to develop an approach to profit or loss and other comprehensive income (OCI) for the Exposure Draft of the *Conceptual Framework for Financial Reporting* that would:
 - (a) emphasise the role of profit or loss as the primary source of information about an entity's performance; and
 - (b) provide high level guidance to the IASB on how it could use OCI.
2. In June 2014, the staff presented to the IASB such an approach. The IASB tentatively agreed with the approach proposed by the staff but emphasised that profit or loss is not the only source of information about an entity's performance. For example, items included in OCI also provide such information. Accordingly, the IASB tentatively decided that the *Conceptual Framework* should also emphasise the role of OCI in reflecting an entity's performance for the period.
3. In addition, the IASB directed the staff to clarify particular aspects of the proposed approach:
 - (a) why profit or loss is the primary source of information about an entity's performance for the period; and

- (b) whether it is possible to find principles that identify some items of income and expense that can only be included in profit or loss rather than OCI, without providing a detailed list of such items.
4. Accordingly, this paper explores how to provide those clarifications.
 5. An extract from the June 2014 IASB Update that summarises the tentative decisions made by the IASB on the approach to profit or loss and OCI is provided in Appendix B.
 6. In June 2014, the staff also presented the proposed approach—including a verbal update on the tentative decisions made by the IASB—at a joint meeting with the Capital Markets Advisory Committee (CMAC) and the Global Preparers Forum (GPF). The members of CMAC and GPF expressed overall support for the direction taken by the IASB on its approach to profit or loss and OCI. In particular, most members:
 - (a) welcomed the acknowledgement of profit or loss as the primary source of information about an entity’s performance for the period, and
 - (b) agreed that the IASB should resort to OCI only for reporting particular changes in current measures of assets and liabilities.

Summary of staff recommendations

7. A summary of the proposed approach to profit or loss and OCI, including the tentative decisions made by the IASB in June 2014 and the clarifications that the staff recommend in this paper, is set out in Appendix A.

Structure of the paper

8. This paper:
 - (a) discusses profit or loss as the primary source of information about an entity’s performance for the period (paragraphs 9-17); and

- (b) explores the principles that could be used to identify some items of income and expense that must be included in profit or loss and those that could be included in OCI (paragraphs 18-38).

Profit or loss as the primary source of information about performance

9. The Discussion Paper *A Review of the Conceptual Framework for Financial Reporting* (the Discussion Paper) suggested that items of income and expense included in profit or loss provide the primary source of information about the return an entity has made on its economic resources in a period—and the IASB has tentatively confirmed that suggestion. If profit or loss as a *pool of items* of income and expense is the primary source of information about an entity's performance for the period, it follows that a *total or subtotal* for profit or loss is an important performance indicator.
10. A thorough understanding of an entity's performance requires an in-depth analysis of the items included in profit or loss—as well as other information included in the entity's financial statements, notably the items included in OCI. Nevertheless, a total or subtotal for profit or loss provides a highly summarised snapshot of the entity's performance for the period. Indeed, when entities issue their quarterly or annual financial statements, the headlines tend to focus on the total or subtotal for profit or loss.
11. The Discussion Paper acknowledged the important role of the total or subtotal for profit or loss in reporting performance and provided the basis for describing profit or loss as a pool of items of income and expense as the primary source of information about an entity's performance for the period. Specifically, it noted that:
 - (a) users of financial statements from all sectors incorporate profit or loss in their analysis, either as a starting point for further analysis or as the main measure of an entity's financial performance;
 - (b) profit or loss excludes remeasurement gains and losses that are potentially less predictive of future net cash inflows because they are subject to future changes in estimates and prices and may unwind over time;

- (c) profit or loss provides information that is useful for assessing an entity’s capacity to pay future dividends or to meet its obligations; and
 - (d) profit or loss can be more closely aligned to an entity’s business model than total comprehensive income.
12. The feedback received on the Discussion Paper, and notably the feedback received from users of financial statements, indicated not only broad support for establishing in the *Conceptual Framework* the prominence of profit or loss as the primary source of information about an entity’s performance for the period, but also broad support for the basis for doing so provided in the Discussion Paper. The feedback from users of financial statements on the profit and loss and OCI proposals in the Discussion Paper is summarised in paragraphs 38-56 of Agenda Paper 10M for the March 2014 IASB meeting.
13. Specifically, many users of financial statements stated that profit or loss is important as the bottom line profit left to shareholders and as the source of future dividends. They agreed that profit or loss gives a clear indication of the return management has made on the economic resources entrusted to it. Many users observed that profit or loss is the basis for calculating well established and commonly used ratios, such as the earnings per share and price to earnings ratios.
14. At the same time, many users emphasised that no single measure is sufficient to understand the performance of an entity, which is multi-faceted, and no single measure would satisfy all users’ information needs. Rather, they stated that they always adjust the total or subtotal for profit or loss to get to a number that they will use in their models. Moreover, different users make different adjustments, depending on the inputs they need for their models. So, although the total or subtotal for profit or loss is an important and convenient common starting point for many users, there is no single widely-accepted ending point. In deciding what adjustments to make, users consider various factors such as an entity’s industry or the desired degree of precision in their analysis. For example, some analysts follow a small number of entities and investigate the numbers in detail, making many adjustments, while other analysts follow a broader range of entities and rely more heavily on summary measures of performance.

15. However, many users agreed that they typically distinguish items of income and expense arising from transactions from those arising from remeasurements. Accordingly, many users stated that excluding particular remeasurements from profit or loss enhances its predictive value and hence its relevance. Some also stated that the relevance of including an item of income and expense in profit or loss or OCI depends on the entity's industry. Finally, many users emphasised the need for transparency and disaggregation of information in the financial statements, including the need for further subtotals within the statement of profit or loss¹ as a mechanism that enhances their understanding of the performance of an entity. For example, many users suggested that a subtotal for operating income would be useful.
16. Accordingly, the staff think that the basis provided in the Discussion Paper (and summarised in paragraph 11) for describing the items included in profit or loss as the primary—although not the only—source of information about an entity's performance for the period is appropriate and should be included in the Exposure Draft of the *Conceptual Framework for Financial Reporting*.
17. In addition, considering the feedback received on the proposals, the staff think that the Exposure Draft of the *Conceptual Framework for Financial Reporting* should also emphasise that no single number is sufficient for understanding an entity's performance. Rather, understanding performance involves analysis of items of income and expense included in profit or loss, as well as consideration of other relevant information in the financial statements, notably the items of income and expense included in OCI. The staff note that those clarifications would be consistent with the June 2014 tentative decision by the IASB to emphasise the role of OCI in reflecting an entity's performance for the period. The staff also think that such clarifications would be responsive to interested parties who expressed concerns that the focus on a single performance number oversimplifies performance of an entity and that users of financial statements may overlook important information included in OCI.

¹ Paragraph 10A of IAS 1 *Presentation of Financial Statements* permits an entity to present a single statement of profit or loss and OCI, with profit or loss and OCI presented in two sections, or two separate consecutive statements. In this paper, the staff use the term 'the statement of profit or loss' to refer to both a separate statement of profit or loss and a profit or loss section in a single statement of comprehensive income.

Question for the IASB

Does the IASB have any comments or questions on the discussion in paragraphs 9-17?

Principles for including items of income and expense in profit or loss or OCI

18. This section:
- (a) emphasises considerations related to the June 2014 tentative decisions by the IASB on the proposed approach to profit or loss and OCI:
 - (i) profit or loss is an inclusive source of information about performance—this is reflected in the rebuttable presumption on including items of income and expense in profit or loss (paragraphs 19-21);
 - (ii) profit or loss is a source of information about performance over time—this is reflected in the rebuttable presumption on reclassifying items of income and expense included in OCI to profit or loss (recycling) (paragraphs 22-24);
 - (iii) profit or loss is not the only source of information about performance—this is reflected in the decision to emphasise the role of OCI as one source of information about performance (paragraphs 25-26);
 - (b) discusses income and expenses that must be included in profit or loss and those that could be included in OCI:
 - (i) cost-based measures and current measures of assets and liabilities (paragraphs 27-32); and
 - (ii) classification and aggregation (paragraphs 33-37); and
 - (c) provides staff recommendations and a question for the IASB (paragraph 38).

Profit or loss is an inclusive source of information about performance

19. Describing the items of income and expense included in profit or loss as the primary source of information about an entity's performance for the period implies that the statement of profit or loss is the most inclusive source of that information. Including most items of income and expense in profit or loss is important for providing discipline in financial reporting and enhancing comparability across entities.
20. Accordingly, there is a high threshold for excluding items of income and expense from profit or loss and instead including them in OCI. It also follows that a decision by the IASB to require or permit including an item of income or expense in OCI cannot follow an automatic or semi-automatic process. Rather, such a decision will need to be made on a case-by-case basis and will require careful consideration by the IASB of whether including the item of income or expense in OCI will enhance the relevance of profit or loss as the primary source of information about an entity's performance for the period.
21. Those considerations were already reflected in the Discussion Paper. They were made even more prominent in the June 2014 tentative decision by the IASB on the rebuttable presumption for including items of income and expense in profit or loss.

Profit or loss is a source of information about performance over time

22. If profit or loss is the primary source of information about an entity's performance for *an individual period*, it follows that accumulated profit or loss over the life of the entity or for a sequence of individual periods is also the primary indicator of the cumulative performance of the entity over that time. Accordingly, there is high threshold for permanently excluding items of income and expense from profit or loss. Likewise, there is a high threshold for excluding items of income and expense from profit or loss over a sequence of accounting periods for which those items would be relevant for assessing performance, for example, over the term when particular management personnel were in charge. Including items of income and expense in profit or loss in the relevant period is important for assessing management stewardship of the resources entrusted to it and results in more relevant and comparable trend information.

23. Those considerations were also reflected in the Discussion Paper and made more prominent in the June 2014 tentative decision by the IASB on the rebuttable presumption on recycling. It follows that if there is no appropriate basis for recycling a particular item of income or expense in a subsequent period—ie recycling does not enhance the relevance of profit or loss as an indicator of performance in the individual period and over a sequence of periods—that could be an *indication* that it is not appropriate to exclude that item from profit or loss in the first place.
24. However, the absence of an appropriate basis for recycling in a subsequent period does not *automatically* lead to the conclusion that the item of income or expense should not be included in OCI. Rather, including that item in OCI will still be appropriate as long as the IASB concludes that doing so would enhance the relevance of profit or loss as the primary source of information about an entity's performance for that period.

Profit or loss is not the only source of information about performance

25. Describing the items of income and expense included in profit or loss as the primary source of information about an entity's performance for the period also implies that there are other sources of that information relevant to understanding an entity's performance for the period. For example, another relevant source of information about an entity's performance for the period is the items of income and expense included in OCI.
26. For example, in the *Insurance Contracts* project, the IASB has tentatively decided that the effects of changes in the discount rate on insurance contracts liabilities could be included in OCI. This is because these items of income and expense could be significant enough to obscure the underwriting performance of insurers. Therefore, segregating such items would allow users of financial statements to better assess the underwriting and investing performance of an entity that issues insurance contracts. Nevertheless, discount rate fluctuations cause real economic exposures for insurers and managing the effects of those exposures is an integral part of an insurer's business. Therefore, income and expenses arising from changes in the discount rate on insurance contracts liabilities, whether included in profit or loss or OCI, are important for understanding the performance of an insurer for the period.

Income and expenses on cost-based measures and current measures

27. Because the statement of profit or loss is the primary source of information about an entity's performance for the period, the question arises whether, in particular cases, items of income and expense could *only* be included in profit or loss—in other words, whether the rebuttable presumption for including items of income and expense in profit or loss discussed in paragraph 21 *cannot* be rebutted.
28. The Discussion Paper suggested that only *changes* in the current measures of assets and liabilities could be included in OCI rather than profit or loss. It followed that gains and losses recognised on initial recognition of an asset or a liability, as well as items of income and expense that arise from cost-based measures of assets and liabilities, could only be included in profit or loss.
29. In June 2014, the staff proposed to confirm those suggestions and, in order to provide additional guidance to the IASB in setting Standards, to also use them as the basis for identifying further particular types of income and expense that could only be included in profit or loss. However, the IASB concluded that providing a list of examples is not appropriate for the *Conceptual Framework* and directed the staff to instead explore the underlying principle. Accordingly, as a means of providing additional guidance to the IASB in setting Standards, the staff recommend reverting to and emphasising the principle included in the Discussion Paper:
- (a) only items of income and expense that arise from changes in current measures of assets and liabilities *could* be included in OCI; and
 - (b) items of income and expense that arise on assets and liabilities carried at cost-based measures *must* be included in profit or loss.
30. The staff note that many accept that items of income and expense that arise on assets and liabilities carried at cost-based measures are different from items of income and expense caused by changes in current measures. This is because such items have different predictive values. Current measures of assets and liabilities are subject to changes in estimates of future cash flows and changes in other factors, such as market prices. In addition, the effects of some of these changes (such as some changes in discount rates) unwind automatically over time. In contrast, items of income and expense that arise on cost-based measures do not behave in that manner.

31. Accordingly, the IASB may conclude that including in OCI an item of income or expense that arises from changes in the current measure of an asset or a liability is appropriate and would enhance understandability and the predictive value of profit or loss. However, as discussed in paragraph 25, even though items of income and expense that arise on current measures of assets and liabilities can reverse or, in some cases, unwind over time, these items also provide relevant information about an entity's performance.
32. In addition, in particular cases, it may be appropriate to identify components within an overall change in a current measure of an asset or a liability and to classify and aggregate those components separately. For example, under the upcoming completed version of IFRS 9 *Financial Instruments*, the overall change in the carrying value of a debt instrument measured at fair value through OCI is broken down into the amortised cost component and the remaining change in value. In such cases, consistently with the analysis above, if an identified component of the overall change relates to a cost-based measure that component must be included in profit or loss. The remaining component of the overall change could be included in OCI if the IASB concludes that using OCI would enhance the relevance of profit or loss as the primary source of information about an entity's performance for the period.

Classification and aggregation

33. The staff note that including a change in the current measure of an asset or liability—or a component of such a change—in OCI is consistent with the general principles of classification and aggregation suggested in the *Presentation and disclosure* section of the Discussion Paper.
34. The Discussion Paper described classification as the sorting of items based on shared qualities, and aggregation as the adding together of individual items within those classifications. The Discussion Paper also suggested that classification and aggregation are important for achieving effective communication in the financial statements and making information understandable. In Agenda Paper 10F for this month's meeting, the staff recommend that the IASB confirms those suggestions in the Exposure Draft of the *Conceptual Framework for Financial Reporting*.

35. Accordingly, separating items of income and expense into different categories based on shared qualities *within* a statement of profit or loss or separating them into different categories for inclusion in profit or loss *and* OCI, are both forms of classification.
36. For example, the IASB has concluded that the effects of changes in the discount rate on insurance contracts liabilities should be presented separately from the underwriting results—and that could be achieved either within the statement of profit or loss or by including the effects of changes in the discount rate in OCI.
37. Alternatively, consider presenting items of income and expense on financial assets under the upcoming completed version of IFRS 9:
- (a) For financial assets measured at amortised cost, an entity will be required to present in the statement of profit or loss impairment losses and reversals of impairment separately from other items of income and expense arising on such assets, such as interest income. This is an example of using shared qualities to classify and aggregate items of income and expense within the statement of profit or loss.
 - (b) For debt investments measured at fair value through OCI, an entity will be required to present impairment losses and reversals, interest income and gains and losses on sale in the statement of profit or loss. The remaining change in the current measure of the asset attributable to changes in other factors (such as market interest rates) will be included in OCI. This is an example of using shared qualities to classify items of income and expense between two statements (and to aggregate those items within each statement)—or between and within two sections of a single statement of performance.

Staff recommendations

38. Accordingly, the staff recommend that the Exposure Draft of the *Conceptual Framework for Financial Reporting*:

- (a) proposes that the presumption for including items of income and expense in profit or loss cannot be rebutted for items of income and expense that arise on assets and liabilities carried at cost-based measures,
- (b) proposes that the presumption for including items of income and expense in profit or loss can only be rebutted for changes in current measures of assets and liabilities, and only if including those changes—or components of those changes—in OCI enhances the relevance of profit or loss as the primary source of information about an entity’s performance for the period, and
- (c) emphasises that including items of income and expense resulting from changes in current measures of assets and liabilities—or components of those changes—in OCI is an application of the classification and aggregation principle for presentation and disclosure, designed to provide effective communication of financial information and to make that information more understandable.

Question for the IASB

Does the IASB agree with the staff recommendations in paragraph 38?

Appendix A—Proposed approach to P&L, OCI and recycling

- A1. The items of income and expense included in profit or loss provide the primary source of information about an entity's performance for the period. Users of financial statements from all sectors incorporate profit or loss in their analysis, either as a starting point for further analysis or as the main measure of an entity's performance for the period. Profit or loss is used as the basis for calculating common and well established performance indicators, such as the earnings per share ratio and price to earnings ratio.
- A2. However, the items of income and expense included in profit or loss—or the total or subtotal for profit or loss—do not provide a complete picture of an entity's performance for the period. Other components of financial statements also provide relevant information about an entity's performance for the period, notably the items of income and expense included in OCI.
- A3. The objective of profit or loss is to depict the return that an entity has made on its economic resources during the period and to provide information that is helpful in assessing prospects for future net cash inflows to the entity and in assessing management's stewardship of the entity's resources.
- A4. There is a rebuttable presumption that an item of income and expense must be included in profit or loss.
- A5. Items of income and expense that arise on assets and liabilities carried at cost-based measures must be included in profit or loss.
- A6. The IASB could require, or permit, an item of income and expense—or a component of that item—to be included in OCI only if that item results from a change in a current measure of an asset or a liability, and only in limited circumstances when the IASB concludes that doing so would enhance the relevance of profit or loss as the primary source of information about an entity's performance for the period.
- a. Such circumstances could arise when the IASB concludes that one measurement basis is appropriate for an asset or a liability in the statement of financial position and a different measurement basis is appropriate for the statement of profit or loss. In such cases, the resulting difference would be included in OCI. If the IASB decides to

disaggregate the change in the current measure of an asset or a liability into a change in a cost-based measure and the remaining change in the current measure, the change in the cost-based measure must be included in profit or loss.

- b. The IASB could also conclude that including in OCI an item of income and expense that results from a change in a current measure of an asset or liability would enhance the relevance of profit or loss as the primary source of information about an entity's performance for the period in other circumstances.

- A7. Classifying items of income and expense between profit or loss and OCI is one application of the general classification and aggregation principle for presentation and disclosure in the financial statements.
- A8. Profit or loss is the primary source of information about an entity's performance for an individual period and over time. Accordingly, there is a rebuttable presumption that an item of income and expense included in OCI must be recycled to profit or loss. Recycling takes place when doing so enhances the relevance of profit or loss as the primary source of information about an entity's performance for the period. The IASB could consider prohibiting recycling only in limited circumstances when the IASB concludes that recycling would undermine the relevance of profit or loss for the period. That could be the case, for example, when there is no clear basis for recycling.
- A9. If there is no appropriate basis for recycling a particular item of income or expense that could be an indication that it is not appropriate to exclude that item from profit or loss in the first place. However, the absence of the appropriate basis for recycling in a subsequent period does not automatically lead to the conclusion that the item of income or expense should not be included in OCI. Rather, including that item in OCI will still be appropriate if the IASB concludes that doing so would enhance the relevance of profit or loss as the primary source of information about an entity's performance for that period.

Appendix B—Extract from the June 2014 IASB Update***Profit or loss and other comprehensive income (OCI)(Agenda Paper 10B)***

The IASB tentatively decided that the *Conceptual Framework* should:

- (a) require profit or loss as a total or subtotal.
- (b) describe profit or loss as the primary source of information about an entity's performance for the period but emphasise that it is not the only source of such information. For example, items included in OCI also provide information about an entity's performance.
- (c) describe the dual objectives for profit or loss as depicting the return that an entity has made on its economic resources during the period, and providing information that is helpful in assessing prospects for future cash flows.
- (d) include a rebuttable presumption that all items of income and expense should be included in profit or loss unless the IASB concludes in a particular Standard that including an item of income and expense—or a component of such an item—in OCI would enhance the relevance of profit or loss as the primary source of information about an entity's performance for the period.
- (e) state that one example when the rebuttable presumption discussed in (d) above could be rebutted is when the IASB concludes that one measurement basis is appropriate for an asset or a liability in the statement of financial position and another measurement basis is appropriate for profit or loss. In such cases, the resulting difference would be reported in OCI.
- (f) include a rebuttable presumption that all items of income and expense included in OCI should be recycled to profit or loss.

The IASB directed the staff to clarify particular aspects of the proposed approach:

- (g) why profit or loss is the primary source of information about an entity's performance for the period; and

- (h) whether it is possible to find principles that identify some items of income and expense that can only be included in profit or loss rather than OCI, without providing a detailed list of such items.