

# STAFF PAPER

## IASB® Meeting

<b>Project</b>	<b>Primary Financial Statements</b>		
<b>Paper topic</b>	Better ways to communicate other comprehensive income (OCI)		
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### Accounting Standards Advisory Forum, December 2017, Agenda paper 1C

This paper was discussed at the Board meeting in November 2017.

## Purpose of this paper

1. This Agenda Paper seeks the Board's views on the staff's proposals about better ways to communicate information about other comprehensive income (OCI).

## Summary of staff recommendations in this paper

2. The staff recommend:
  - (a) renaming the two categories in the OCI section of the statement(s) of financial performance as follows:
    - (i) 'remeasurements reported outside profit or loss' (previously OCI items that will not be reclassified subsequently to profit or loss); and
    - (ii) 'income and expenses to be included in profit or loss in the future' (previously OCI items that will be reclassified subsequently to profit or loss).
  - (b) introducing a new subtotal between the two categories called 'income after remeasurements reported outside profit or loss'.

- (c) developing investor education material in the form of case studies that illustrate why it is important for users of financial statements to consider items of OCI in their analysis of companies.

## Overview

- 3. This paper is structured as follows:
  - (a) background (paragraph 4)
  - (b) what is the problem (paragraphs 5-6)?
  - (c) staff analysis (paragraphs 7-35)
    - (i) single statement of financial performance
    - (ii) improve the labelling and ordering of OCI items
    - (iii) remove existing presentation options in OCI
    - (iv) preparer guidance or education
    - (v) investor education
  - (d) Appendix—Items included in OCI

## Background

- 4. At the December 2016 Board meeting, when discussing the scope of the Primary Financial Statements project, the Board tentatively decided:
  - (a) to explore better ways to communicate information about OCI; but
  - (b) to focus on improving the presentation of items in OCI, and not to reconsider the distinction between OCI and profit or loss nor when reclassification (recycling) of OCI items to profit or loss should be required.

## What is the problem?

- 5. During our research and outreach with users of financial statements, we learned that:
  - (a) some users think the term OCI is confusing and see OCI as a black box or ‘dumping ground’ for anything controversial;

- (b) there is a lack of clarity among users about the roles of profit or loss and OCI, and the notion of recycling (ie when OCI items are reclassified to profit or loss); and
  - (c) many users do not analyse OCI items in detail either because of a lack of understanding of OCI or because they do not consider them to be operating flows from which they can infer long-term trends (for example, OCI items are often considered to have poor predictive value).
6. Some users said they do not think that improving the presentation of OCI would provide additional relevant information for their analysis. The few users that said they do use OCI in their analysis said they found sufficient information in the current presentation—these users either followed financial institutions or required only the OCI information about cash flow hedges. Our research did not show significant demand for improvements in presentation of OCI from users of financial statements. Nevertheless, based on the feedback we received from users during our outreach some users do not include OCI in their analysis because of a lack of understanding about OCI.

### Staff analysis

7. OCI includes important information about financial performance. The 2015 Exposure Draft *Conceptual Framework for Financial Reporting* says that, although the statement of profit or loss is the primary source of information about an entity's financial performance for the period, '...understanding an entity's financial performance for the period requires an analysis of all recognised income and expenses (including income and expenses included in other comprehensive income), as well as an analysis of other information included in the financial statements.' (paragraph 7.22, emphasis added).
8. The academic research we considered during our research generally concludes that total comprehensive income (the sum of profit or loss and OCI) is less value relevant—ie less associated with stock prices or stock returns—than profit or loss. However, it also shows that some individual components of OCI—such as gains or

losses on cash flow hedges and on available-for-sale financial assets—are value relevant<sup>1</sup>.

9. The staff think that the problems we have identified in paragraph 5 suggest that we should consider ways to both:
  - (a) make OCI more understandable for users of financial statements; and
  - (b) highlight the importance of users considering OCI in their analysis.
10. The staff have identified the following ideas that we might consider to improve the presentation of OCI in the statement(s) of financial performance to address paragraphs 9(a) and (b):
  - (a) improve the labelling and ordering of OCI items (Suggestion 1—see paragraphs 14-22);
  - (b) remove existing presentation options for OCI (Suggestion 2—see paragraphs 23-25); and
  - (c) develop guidance for preparers to encourage better presentation of OCI (Suggestion 3—see paragraphs 26-29).
11. The staff think we might also consider investor education to improve understanding and highlight the importance of OCI (Suggestion 4—see paragraphs 30-35).

### ***Single statement of financial performance***

12. Paragraph 10A of IAS 1 *Presentation of Financial Statements* permits entities to present either:
  - (a) a single statement of financial performance—a single statement of profit or loss and OCI, with the profit or loss section followed directly by the OCI section; or
  - (b) two statements of financial performance—a statement of profit or loss and a statement of comprehensive income. The separate statement of profit or

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<sup>1</sup> Refer to the following literature review: Rees, L.L., and P.B. Shane. 2012. “Academic Research and Standard Setting: The Case of Other Comprehensive Income.” *Accounting Horizons*, vol. 26, no. 4 (December):789–815.

loss immediately precedes the statement presenting OCI, which begins with profit or loss.

13. One way we could improve the presentation of OCI and highlight its importance would be to require all entities to present a single statement of financial performance. However, the staff are concerned that this would involve reopening a controversial issue, which might delay other aspects of this project. In 2010 the Board proposed to eliminate the option to present two statements of financial performance.<sup>2</sup> However, in finalising the amendments the Board decided not to mandate the presentation of a single statement of financial performance because of the negative responses and resistance to the proposals from a majority of respondents<sup>3</sup>. The staff also think that a single statement could have limited effect in practice unless we mandate the statement to be presented on a single page. This is because companies could still present the OCI section of the statement(s) of financial performance on a subsequent page to the profit or loss section. Furthermore, the move towards electronic reporting and online viewing may mean that the advantages of having a single statement are reduced. For these reasons the staff have not included a discussion of a single statement of financial performance in this paper.

### ***Suggestion 1: Improve the labelling and ordering of OCI items***

#### *Description of Suggestion 1*

14. In June 2011, the Board published *Presentation of Items of Other Comprehensive Income* (Amendments to IAS 1) that changed the labelling and ordering of items in OCI by requiring items of OCI to be grouped into (paragraph 82A of IAS 1):
- (a) those that will not be reclassified subsequently to profit or loss (ie not recycled); and
  - (b) those that will be reclassified subsequently to profit or loss (ie recycled) when specific conditions are met.

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<sup>2</sup> May 2010 Exposure Draft *Presentation of Items of Other Comprehensive Income* (Proposed amendments to IAS 1).

<sup>3</sup> Paragraph BC54I of Basis for Conclusions accompanying IAS 1.

The amendments were intended to enable users of financial statements to more easily identify the potential impact that OCI items may have on future profit or loss.

15. In 2016, during our user outreach in determining the scope of the Primary Financial Statements project we sought feedback on building on the 2011 amendments to IAS 1 by making the following additional changes to the labelling and ordering of OCI items:

- (a) introducing a new label for those OCI items that are currently not recycled. The staff think that ‘remeasurements reported outside profit or loss’ would be a clearer description.<sup>4</sup> This category would include, for example, gains on revaluations of property, plant and equipment and remeasurements of defined benefit plans.
- (b) adding the subtotal ‘income after remeasurements reported outside profit or loss’ after the category in (a).
- (c) calling the remaining OCI items ‘income and expenses to be included in profit or loss in the future’. This category would include, for example, gains on cash flow hedges and exchange differences on translation of foreign operations.

(a)-(c) would change the existing requirements only to the extent of changing the current labelling for OCI items, and the addition of a new subtotal to more clearly distinguish between the two categories of OCI.

16. To illustrate:

Current presentation	Revised presentation
<b>Revenue</b> .... <b>Pre-tax profit</b> Taxation <b>Profit</b> OCI items that will not be reclassified subsequently to profit or loss OCI items that will be reclassified subsequently to profit or loss	<b>Revenue</b> .... <b>Pre-tax profit</b> Taxation <b>Profit</b> Remeasurements reported outside profit or loss <b>Income after remeasurements reported outside profit or loss</b>

<sup>4</sup> During our outreach we initially suggested calling this category ‘specified long-term revaluations’. However, we think ‘remeasurements reported outside profit or loss’ is a more accurate and clearer description. For example, this category would include remeasurements that are not revaluations, for example remeasurements of defined benefit plans.

<b>Comprehensive income</b>	Income and expenses to be included in profit or loss in the future <b>Comprehensive income</b>
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17. Feedback during outreach on the revised presentation was mixed. Some investors said it appeared more understandable than the current approach, but others did not see how the changes would add value. Nevertheless, the staff think the Board should consider the labelling and ordering described in paragraph 15 as one way of improving the presentation of OCI.

*Advantages and disadvantages of Suggestion 1*

18. The staff thinks that introducing the two categories and subtotal as described in paragraphs 15 and 16 has the following advantages:
- (a) removing reference to OCI in the labels used in the statement(s) of financial performance, a term that is not well understood, and dividing OCI items into two clearly labelled categories may improve understandability and mean that information about OCI is less likely to be ignored by users.
  - (b) the issue of whether all income and expenses should be included in profit or loss is of great importance to many. Whilst we are not reconsidering which items should be in profit or loss versus in OCI as part of this project, the additional subtotal would exclude only those items of income and expense that will be reclassified to profit or loss in a later period (ie the subtotal would reflect a ‘clean-surplus’<sup>5</sup>) and would also help clarify the effect of OCI items on current and future profit.
19. The staff thinks that introducing the two categories and subtotal as described in paragraphs 15 and 16 has the following disadvantages:
- (a) we have heard that some investors do not look at items presented below profit or loss. Therefore the changes could have limited effect.
  - (b) introducing new sections to the statement(s) of financial performance might be controversial with some stakeholders. The term OCI has been around for a long time and so it might cause confusion for those familiar with OCI.

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<sup>5</sup> By ‘clean surplus’ the staff mean that all income and expenses would be included in this subtotal either in the current period (for all income/expenses except those that will be reclassified at a future date) or future periods (for the income/expenses that will be reclassified at a future date).

- (c) we made changes to the presentation of OCI in 2011 (see paragraph 14).  
We may be criticised for following a piecemeal approach if we make further relatively minor changes to the presentation of OCI.

*Staff recommendation*

20. The staff support introducing the two categories and the subtotal as described in paragraphs 15 and 16 for the reasons in paragraph 18.
21. We think that simply changing the existing terminology has the potential to enhance awareness about items outside profit and loss and break preconceptions that OCI is difficult to understand. Even though we have not heard strong demand to make improvements to the presentation of OCI this appears to be partially because of a lack of understanding of OCI, rather than such improvements are not necessary. Furthermore, we do not think we need to be concerned that the changes might appear to be minor and piecemeal (paragraph 19(c)) because our changes are being considered as part of our bigger project to improve the structure of the statement(s) of financial performance.
22. If we produce a Discussion Paper as our first due process document, we could also ask respondents to suggest other approaches that might improve the labelling and ordering of items in OCI. We could also seek feedback on whether there is clearer terminology than ‘remeasurements reported outside profit or loss’.

**Question 1**

The staff recommend renaming the two categories in the OCI section of the statement(s) of financial performance as ‘remeasurements reported outside profit or loss’ and ‘income and expenses to be included in profit or loss in the future’.

The staff also recommend introducing a new subtotal ‘income after remeasurements reported outside profit or loss’.

Do you agree?

***Suggestion 2: Remove existing presentation options in OCI***

*Description of Suggestion 2*

23. IAS 1 currently provides entities with the following presentation options for the OCI section:



- (a) presenting items of OCI either net of related tax effects, or before related tax effects with one amount shown for the aggregate amount of income tax relating to those items (see paragraph 91 of IAS 1); and
- (b) presenting reclassification adjustments in the statement(s) of profit or loss and OCI or in the notes. An entity presenting reclassification adjustments in the notes presents the items of OCI after any related reclassification adjustments (see paragraph 94 of IAS 1).

Paragraphs BC65-BC73 of the Basis for Conclusions accompanying IAS 1 explain why we have the options in (a) and (b).

24. We have not had feedback that allowing these particular presentation options is problematic for investors, nor had feedback on which of these presentation options investors prefer. However, one reason that we have had limited feedback is because many users ignore OCI in their analysis. Therefore we could explore whether it would be helpful to remove these presentation options.

*Staff recommendation*

25. Presentation options can add complexity and make information presented less comparable, particularly if the options involve a free choice, rather than being based on an entity's specific circumstances. Some users told us that they would prefer not to have to spend as much time making information more comparable.<sup>6</sup> For this reason the Board has tentatively decided to explore as part of this project removing some of the options for presentation of income and expenses in existing IFRS Standards. Consequently, the staff suggest that we should explore whether there is any support for removing these presentation options either by doing outreach or in a Discussion Paper if issued.

**Question 2**

The staff think that we should explore whether there is demand to remove these options either by doing outreach or in a Discussion Paper if issued.

Do you agree?

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<sup>6</sup> Refer to paragraph 12(b) of [Agenda Paper 21D](#) in November 2016.

### **Suggestion 3: Preparer guidance or education**

#### *Description of Suggestion 3*

26. Part of the reason why some users of financial statements may pay less attention to OCI is because some preparers give it less prominence than profit or loss. For example, some entities provide less disaggregation and explanatory disclosures about items of OCI than items of profit or loss. Poor presentation and insufficient disclosures for OCI items were discussed in the 2015 CFA Institute publication *Analysing bank performance: Role of comprehensive income* as a contributor to investors ignoring OCI information.
27. The staff think the Board could consider adding guidance to IFRS Standards or developing educational material that emphasises that the same presentation and disclosure considerations apply to both items of OCI and items of profit or loss.

#### *Advantages and disadvantages of Suggestion 3*

28. The staff thinks that developing guidance for preparers has the following advantages:
  - (a) it could encourage behavioural changes to improve the presentation of OCI in the financial statements; and
  - (b) one way of signalling the importance of OCI to users would be enhanced presentation and disclosure in the financial statements.
29. The staff do not think there are any disadvantages of developing guidance for preparers. However, unless the guidance is mandatory it might be ignored. Therefore the staff think that rather than develop separate education material it may be better to incorporate this type of guidance into our work on minimum line items and aggregation/disaggregation. We could do this by ensuring we consider OCI as well as profit or loss when developing our proposals in these areas and clarifying that aggregation/disaggregation principles that we develop apply to all income/expenses.

### Question 3

The staff do not think that we should provide separate guidance or educational material on OCI for preparers. Nevertheless we think we should consider both profit or loss and OCI when developing our proposals for better aggregation/disaggregation and additional minimum line items and also clarify that aggregation/disaggregation principles apply to all income/expenses.

Do you agree?

### **Suggestion 4: Investor education**

#### *Description of Suggestion 4*

30. Based on our user outreach we found that users following financial institutions and companies using significant hedging transactions consider OCI as part of their analysis. However, we have found that many users of other entities' financial statements ignore OCI and this is partially because of a lack of understanding of OCI. We could help to address that lack of understanding and enhance awareness of OCI through investor education. Such investor education might be in the form of case studies that illustrate why OCI might be important to users' analysis even when entities are not financial institutions or using significant hedge accounting. The case studies could be provided in educational material on our website or delivered through webinars.
31. The staff suggest that case studies should:
  - (a) present examples of scenarios where the OCI items would be important to the analysis of users of financial statements of straightforward non-financial entities; and
  - (b) explain how investors might incorporate OCI in their analysis, for example in assessing credit risk or in making business valuations.
32. Examples of possible case studies:
  - (a) an entity has foreign operations in a country where the exchange rate has declined significantly. This would indicate a significant decline in the value of underlying value/profitability of the operations. Furthermore, if the entity

expects to sell those foreign operations in the future it would realise significant exchange losses.

- (b) an entity has a defined benefit pension plan. Service costs and interest costs are included in profit or loss and actuarial gains and losses are included in OCI. Actuarial assumptions in past years have been overly optimistic and this is likely to increase service costs significantly in future periods.
- (c) a manufacturing entity that has previously not used hedge accounting decides to start hedging payments in foreign currency or commodity prices, for example for a fuel intensive company.

*Advantages and disadvantages of Suggestion 4*

33. The staff thinks that developing investor education material in the form of case studies and webinars has the following advantages:
- (a) it would be responding directly to findings that many users do not analyse OCI items in detail because of a lack of understanding of OCI;
  - (b) it would enhance awareness of OCI and highlight the importance of users considering OCI in their analysis;
  - (c) it would help to engage more investors in the Primary Financial Statements project;
  - (d) these days we see more and more ‘straight-forward’ companies entering into more complex transactions, for example hedging, which can result in significant amounts of OCI. This means investors following such companies may also need to change their mind-set about the importance of OCI.
34. The staff do not think there are any disadvantages of developing investor education material. However, the staff acknowledge that there may be challenges involved in encouraging users to look at education material or listen to webinars if they do not think OCI is important to their analysis. However we can work with our investor liaison team to mitigate these challenges.

*Staff recommendation*

35. The staff think that we should develop investor education material in the form of case studies that illustrate why it is important for users of financial statements to consider items of OCI in their analysis of companies. If we produce a Discussion Paper as our first due process document, we could seek feedback on examples of case studies that might be useful to develop and also on methods for best delivering investor education.

**Question 4**

The staff recommend developing investor education material in the form of case studies that illustrate why it is important for users of financial statements to consider items of OCI in their analysis of companies. Do you agree?

**Any other suggestions?**

**Question 5**

Do the Board have any other suggestions from improving the presentation of OCI that they would like the staff to develop for future Board meetings and/or for inclusion in a Discussion Paper, if issued?

**Appendix: Items included in OCI**

See IAS 1, paragraph 7

Table includes IFRS 9 *Financial Instruments* but excludes IFRS 17 *Insurance Contracts*.

<b>Item</b>	<b>Reference</b>
<b>Not recycled</b>	
Revaluation of property, plant and equipment	IAS 16, para. 39–40
Revaluation of intangible assets	IAS 38, para. 85–86
Remeasurements of defined benefit plans	IAS 19, para. 120(c)
Gains and losses from investments in equity instruments designated at fair value through other comprehensive income	IFRS 9, para. 5.7.5
Change in fair value attributable to changes in the liability's credit risk for particular liabilities designated as at fair value through profit or loss	IFRS 9, para. 5.7.7(a)
Gains and losses on hedging instruments that hedge investments in equity instruments measured at fair value through other comprehensive income	IFRS 9, para. 6.5.8(a)
<b>Recycled</b>	
The effective portion of gains or losses on hedges of net investments in foreign operations	IFRS 9, para. 6.5.13(a)
Gains and losses arising from translating the financial statements of a foreign operation	IAS 21 para. 32, 37 and 38–49
Gains and losses on financial assets measured at fair value through other comprehensive income in accordance with paragraph 4.1.2A of IFRS 9.	IFRS 9, para. 4.1.2A
The effective portion of gains and losses on hedging instruments in a cash flow hedge	IFRS 9, para. 6.5.11(b)
Changes in the value of the time value of options	IFRS 9, para. 6.2.4(a)
Changes in the value of the forward elements of forward contracts	IFRS 9 para. 6.2.4(b)