

Investor Perspectives

Patrick Finnegan: Improving the picture of performance for investors

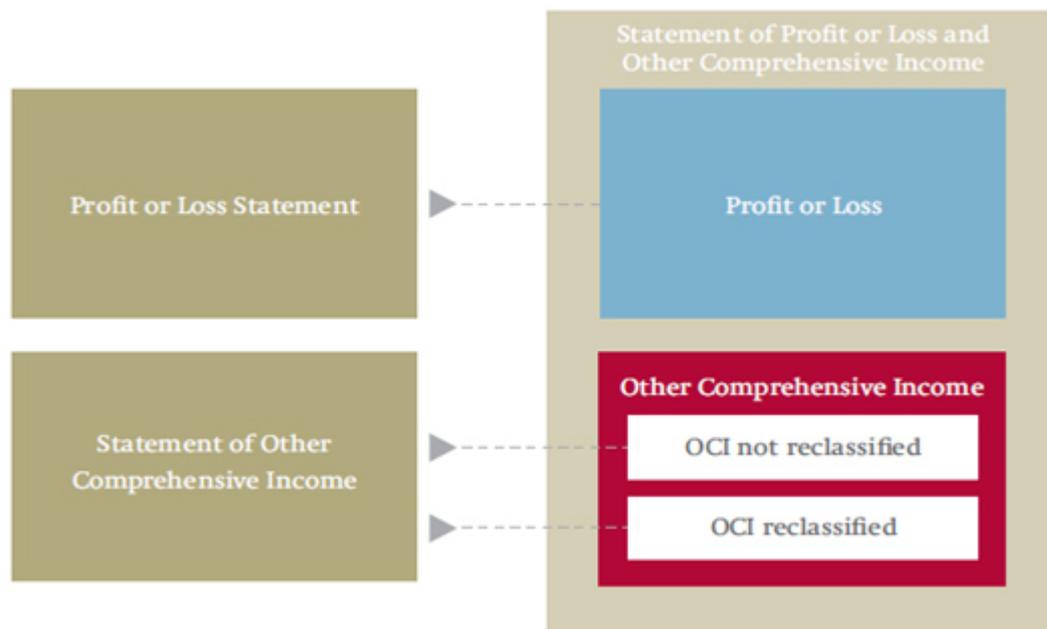


If investors are to understand how companies are creating value, they need to see a comprehensive picture of financial performance. This is the main goal of our most recently issued proposal, Presentation of Items of Other Comprehensive Income (OCI). We propose to require profit or loss and OCI be shown as separate sections of the Statement of Profit or Loss and Other Comprehensive Income (which is also the proposed new name for what we currently call the Statement of Comprehensive Income), and to require separate presentation of OCI items that will be reclassified (or recycled) and those that will not.

Current IFRSs allow an entity to present all items of income and expense recognised in a period either in a single statement of comprehensive income, or in two statements: 1) a statement displaying components of profit or loss (separate income statement) and 2) a statement beginning with profit or loss, and displaying components of OCI in a statement of comprehensive income.

OCI represents the items of revenues, expenses, gains and losses for a specific period that are not presented in profit or loss.

The FASB is proposing a similar change. Their current requirements allow an entity to present components of OCI directly in equity. By both boards making the change together, the total reported income of an entity would be presented on a more consistent basis whether the entity applies IFRSs or US GAAP.



Why are we proposing this change?

Based on recommendations from users of financial statements, and taking into consideration the increased use of OCI arising in other projects, we have concluded that a standard on reporting items of OCI would improve the clarity and visibility of a reporting entity’s activities. Additionally, it would clarify which components are recognised in OCI, and whether such amounts are reclassified subsequently into profit or loss.

The Board’s conceptual framework does not define profit or loss, and neither does it provide criteria for distinguishing the characteristics of items that should be included in OCI but not in profit or loss. Giving prominence to items of comprehensive income might lead an investor to draw conclusions about performance of a reporting entity that may reduce the comparability and neutrality of the reported information. Consequently, if there is no current basis for differentiating items of profit or loss from OCI, we believe that it is appropriate to require them to be reported in one place.

The IASB believes that both profit or loss and OCI contain important and interrelated information about the financial performance of an entity. For instance, actuarial gains and losses related to pension obligations may be presented in OCI, and yet they can have a considerable impact on the overall financial performance of an entity. Not providing clear requirements on how to present all non-owner changes in equity makes it difficult for users to get a complete understanding of an entity’s financial performance.

Greater prominence of the use of OCI

As discussed above, we have recently expanded the use of OCI. This has been done in one new standard, IFRS 9— *Financial Instruments: Classification and Measurement*, and in two recent proposals – Fair Value Option for Financial Liabilities and Defined Benefit Plans.

The following are specific examples of the application of the proposals above:

- Within IFRS 9, an entity can elect on initial recognition to report directly in OCI the fairvalue changes on an equity investment that is not held for trading.
- The proposal dealing with own credit for financial liabilities that a reporting entity chooses to measure at fair value (FVO—fair value option) would address the volatility arising from the effects of own credit [1] by: 1) reporting the total fair value changes of liabilities under the FVO in profit or loss and 2) reversing the portion of such changes related to own credit from profit or loss, and recognising those changes in OCI.
- Our proposed amendments to IAS 19 *Employee Benefits* dealing with defined benefit plans would separate changes in a defined benefit obligation and the resulting changes in the fair value of plan assets into three components: service cost, finance cost and remeasurement. The remeasurement components would be reported in OCI.

Why are we making more use of OCI?

We have agreed that some changes in assets and liabilities, excluding transactions with owners in their capacity as owners, should not be presented in profit or loss, but should instead be presented in OCI. In addition, some items of OCI are reclassified to profit or loss, while others are not. Our proposal would make this clearer by grouping OCI items based on whether or not they may be reclassified.

We acknowledge that further work is needed to develop clear principles for measuring performance. In the interim, we believe that our proposal would enhance the transparency of all components of comprehensive income.

What does not change?

It is important to understand that we are not proposing any changes to what is presented in profit or loss and what is presented in OCI. In addition, we are not proposing to require the reporting of comprehensive income per share. Profit or loss (or net income) remains a key performance measure, and earnings per share will continue to be calculated based on profit or loss, and may be displayed underneath the total for profit or loss.

We believe that few investors today limit their analysis of performance only to the reported amounts of profit or loss. Investors and reporting entities alike calculate and analyse pro forma earnings amounts, which may be adjusted for some components of OCI.

There are some who believe that one of the goals of this project is to redefine performance, and even to eliminate the profit or loss measure. This is not so. We wish to encourage investors to focus on components of comprehensive income rather than limiting their analysis to only profit or loss and earnings per share. In summary, we believe that this proposal will enhance the clarity of performance, and improve the usefulness and transparency of the two statements by linking them together.

Why decouple this proposal from the FSP Project?

We decided to separate the reporting of comprehensive income from our project examining all aspects of Financial Statement Presentation because many of the proposals in that project will require significant study and evaluation. A further evaluation of the potential costs and benefits associated with them will also be required. This proposal does not require such a study, and we believe that its benefits are quite clear in light of the growing prominence of OCI.

Please tell us what you think.

[1] The concept of own credit for financial liabilities refers to the amount of change during a period, and also cumulatively, in the fair value of a financial liability that is attributable to changes in the credit risk of that liability. See paragraphs 10(a)(i) and B4 of IFRS 7 Financial Instruments: Disclosures for further discussion.

Patrick Finnegan is a Board member of the IASB. The views expressed in this article are those of the author as an individual and do not necessarily reflect the views of the International Accounting Standards Board (Board) or the IFRS Foundation (Foundation). The Board and the Foundation encourage members and staff to express their individual views. This article has not undergone the Foundation's due process. The Board takes official positions only after extensive review, in accordance with the Foundation's due process.