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Proposals to revise presentation of financial statements

On 16 March 2006, the International Accounting Standards Board (IASB) issued an Exposure Draft (ED) of proposed amendments to IAS 1 **Presentation of Financial Statements**. The ED results from the first stage (known as 'Segment A') of the IASB's project on performance reporting and, if adopted, would bring IAS 1 largely into line with the equivalent US standard as regards the matters addressed.

Under the ED's proposals, an entity would be required to present all income and expenses separately from changes in its equity that arise from transactions with its owners. Entities would have a choice of presenting income and expenses in a single statement or in two statements. An entity would also be required to include in its financial statements a statement showing its financial position (balance sheet) at the beginning of the comparative period.

The IASB has requested comments on the ED on or before 17 July 2006.

Background

The IASB's Performance Reporting Project has been underway since 2001. The initial focus was the presentation of information in the income statement. Readers may recall the work carried out on developing the matrix of information to be reported – distinguishing "remeasurements" from other types of income and expense.

At the same time, the US Financial Accounting Standards Board (FASB) was conducting a separate project on this topic, which differed in important respects from the IASB project. As part of their convergence programme, the boards suspended their individual projects in late 2003 and, in November 2004, a joint project was launched, with the scope expanded to address presentation and display not only in the income statement, but also in the other financial statements.

The project has been split into two segments. Segment A addresses the statements that constitute a complete set of financial statements and the periods for which they are required to be presented. The current ED is the product of the IASB's deliberations on Segment A, and proposes to bring IAS 1 largely into line with the US standard – Statement of Financial Accounting Standards No. 130 **Reporting Comprehensive Income**. The FASB has decided to consider Segment A and Segment B issues together, and therefore will not publish an ED related to Segment A issues only.

In the course of its work on Segment A, the IASB has taken the opportunity to reorder sections of IAS 1 to make the Standard easier to read. It has also made non-substantive changes to the words of some paragraphs for consistency within the Standard and with other Standards.

Proposals for a complete set of financial statements

The ED proposes that a complete set of financial statements should comprise:

- a statement of financial position (balance sheet) as at the beginning of the period;
- a statement of financial position as at the end of the period;
- a statement of recognised income and expense for the period;
- a statement of changes in equity for the period;
- a statement of cash flows for the period; and
- notes, comprising a summary of significant accounting policies and other explanatory information.

Each of the statements would be presented with equal prominence.

Statement of financial position

The ED proposes this new title for the balance sheet, on the basis it better reflects the function of the statement. Note, however, that use of the new title would not be mandatory.

No substantive changes are proposed as regards the content of this statement. However, the ED does propose that a statement of financial position should be presented as at the beginning of the reporting period, in addition to a statement as at the end of the period. This is considered to be useful for investors and others for the purpose of evaluating the performance of the entity in the period. In practice, this means that entities presenting comparative information for the previous period would be required to include, as a minimum, three statements of financial position in their financial statements.

Statement of recognised income and expense

Under the current version of IAS 1, items of income and expense are presented in two different statements. The vast majority are presented in the income statement. However, certain designated items that meet the definitions of income and expense set out in the **Framework for the Preparation and Presentation of Financial Statements** (e.g. certain revaluation movements and certain foreign exchange gains and losses) are excluded from the income statement and are presented either in a statement of recognised income and expense or in a comprehensive statement of changes in equity. There is no conceptual distinction between items presented in the income statement and those that are excluded – the treatment has generally arisen as a result of historical practice.

The proposals in the ED start with the basic premise that, because all items of income and expenses share the characteristic that they are "non-owner movements in equity", they should always be presented separately from "owner movements in equity". The principal change here is that entities would no longer have the option of presenting the separate components of recognised income and expense in a statement of changes in equity – they would have to be presented in the statement of recognised income and expense, and the total carried to the statement of changes in equity.

Therefore, the statement of recognised income and expense required under the revised IAS 1 would effectively combine the current content of the income statement and the statement of recognised income and expense. But the proposals do not abandon the previous distinction – the statement of recognised income and expense would continue to present separately components of "profit or loss" (those items previously included in the income statement) and "other recognised income and expense". The components of other recognised income and expense would be:

- changes in revaluation surplus (see IAS 16 **Property, Plant and Equipment** and IAS 38 **Intangible Assets**);
- gains and losses arising from translating the financial statements of a foreign operation (see IAS 21 **The Effects of Changes in Foreign Exchange Rates**);
- gains and losses on remeasuring available-for-sale financial assets (see IAS 39 **Financial Instruments: Recognition and Measurement**);

- the effective portion of gains and losses on hedging instruments in a cash flow hedge (see IAS 39); and
- actuarial gains and losses on defined benefit plans recognised in accordance with paragraph 93A of IAS 19 **Employee Benefits**.

Although the Board acknowledges that the items included in profit or loss do not possess any unique characteristics that distinguish them from items that are included in "other recognised income and expense", they believe that the practice of striking a subtotal for profit or loss is deep-rooted. Therefore, this sub-total will continue to be a requirement for the present – although it will be redebated in Segment B of the Performance Reporting Project.

One statement or two?

The previous paragraphs summarise the Board's consensus regarding the most appropriate presentation of all recognised income and expenses in a single statement. However, many commentators disagree strongly with this conclusion, on the basis that it would result in undue focus on the bottom line of the single statement, and that it is premature for the Board to conclude that presentation of income and expenses in a single statement is an improvement in financial reporting without also addressing the other aspects of presentation and display, namely deciding what categories and line items should be presented on the face of the statement of recognised income and expense.

In the light of these views, although it prefers a single statement, the Board proposes to allow entities the option of presenting all income and expenses recognised in a period either in one statement or in two statements. Where the two statement option is selected, a "statement of profit or loss" is required to be displayed immediately before the "statement of other recognised income and expense".

Therefore, for the present at least, entities that have previously presented a statement of recognised income and expense would not be required to change their presentation. The only real impact of the new proposals would be that entities would have the option of presenting all recognised income and expenses in a single statement – which is not currently permitted.

Dissenting views

When these proposals were first debated, the strongest objections were heard from those who wish to retain the separate income statement. Their concerns have largely been addressed (at least temporarily) by allowing the option for two statements.

Objections to the ED are now likely to come from those (including four Board members who have expressed their alternative view in the ED) who argue that all income and expenses should be presented in a single statement and who believe that the option to divide the statement into two separate statements is "both conceptually unsound and unwise".

Other objectors are likely to point to the very limited impact of the proposals in the ED, and to encourage the Board to wait until the outcome of Segment B of the project is known before making any changes to IAS 1.

Statement of changes in equity

Under the proposals, a "statement of changes in equity" would reconcile opening to closing equity by presenting:

- the total recognised income and expense for the period;
- the effect of changes in accounting policies and corrections of errors on equity accounted for in accordance with IAS 8 **Accounting Policies, Changes in Accounting Estimates and Errors**; and
- changes in equity arising from transactions with owners in their capacity as owners (i.e. owner changes in equity).

This statement of changes in equity would be presented with equal prominence as the other statements. Under the current version of IAS 1, where the statement of recognised income and expense option is selected, the owner movements in equity are presented in the notes.

Note that entities would no longer be permitted to present dividends on the face of the statement of recognised income and expense, because that statement should present only non-owner movements in equity. Therefore, dividends would be presented in the statement of changes in equity, or in the notes.

Illustrative examples

The following pages illustrate the ED's proposals for the presentation of the statement of recognised income and expense, and the statement of changes in equity.

Comment deadline

The comment deadline for the proposals is 17 July 2006.

What's next?

The IASB discussed the objectives and planning for Segment B of this project at its March 2006 meeting. This second stage, which has been given the working title 'Financial Statement Presentation for Business Entities', is being undertaken jointly with the FASB and will address more fundamental issues, including:

- consistent principles for displaying and aggregating information in each financial statement;
- the totals and subtotals that should be reported in each financial statement;
- whether components of other recognised income and expense should be reclassified (recycled) to profit or loss and, if so, the characteristics of the transactions and events that should be reclassified and when reclassification should be made; and
- whether the direct or the indirect method of presenting cash flows from operations provides more useful information.

llustrative examples

The following examples illustrate the alternatives for the presentation of the statement of recognised income and expense proposed in the ED and also the presentation of the statement of changes in equity. Note that in order to focus attention on what would be changed by the ED, these illustrations do not present all the items required to be presented on the face of the financial statements by IAS 1 and other Standards.

The ED also includes some discussion of the presentation of the tax effects of other recognised gains and losses and of reclassification adjustments. Readers are referred to the examples published with the ED for illustrations of the options permitted for these items.

Statement of recognised income and expense (single statement)

	20X7	20X6
Revenue	390,000	355,000
Expenses	(250,000)	(275,000)
Profit before tax	140,000	80,000
Income tax expense	(25,000)	(15,000)
Profit for the year from continuing operations	115,000	65,000
Loss for the year from discontinued operations	(30,500)	–
Profit for the year	84,500	65,000
Other recognised income and expense:		
Exchange differences on translating foreign operations	5,000	10,000
Available-for-sale financial assets	2,400	3,500
Cash flow hedges	1,200	2,200
Gains on property revaluation	8,000	7,000
Actuarial gains (losses) on defined benefit pension plans	(667)	1,333
Share of other recognised income and expense of associates	400	(700)
Income tax relating to components of other recognised income and expense	(4,000)	(3,900)
Other recognised income and expense for the year, net of tax	12,333	19,433
Total recognised income and expense for the year	**96,833**	**84,433**

Presentation of recognised income and expense in two statements

Note: where this option is selected, the statement of profit or loss would be required to be presented immediately before the statement of recognised income and expense. The ED does not specify whether the statements should be presented on the same or separate pages.

Statement of profit or loss

	20X7	20X6
Revenue	390,000	355,000
Expenses	(250,000)	(275,000)
Profit before tax	140,000	80,000
Income tax expense	(25,000)	(15,000)
Profit for the year from continuing operations	115,000	65,000
Loss for the year from discontinued operations	(30,500)	–
Profit for the year	84,500	65,000

Statement of recognised income and expense

	20X7	20X6
Profit for the year	84,500	65,000
Other recognised income and expense:		
Exchange differences on translating foreign operations	5,000	10,000
Available-for-sale financial assets	2,400	3,500
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Other recognised income and expense for the year, net of tax	12,333	19,433
Total recognised income and expense for the year	**96,833**	**84,433**

Statement of changes in equity

	Share capital	Retained earnings	Translation of foreign operations	Available for-sale financial assets	Cash flow hedges	Revaluation surplus	Total equity
Balance at 1 January 20X6	600,000	118,100	(4,000)	1,600	2,000	–	717,700
Changes in accounting policy	–	400	–	–	–	–	400
Restated balance	600,000	118,500	(4,000)	1,600	2,000		718,100
Changes in equity for 20X6							
Dividends	–	(10,000)	–	–	–	–	(10,000)
Total recognised income and expense for the year	–	66,333*	10,000	3,500	2,200	2,400**	84,433
Balance at 31 December 20X6	600,000	174,833	6,000	5,100	4,200	2,400	792,533
Changes in equity for 20X7							
Issue of share capital	50,000	–	–	–	–	–	50,000
Dividends	–	(15,000)	–	–	–	–	(15,000)
Total recognised income and expense for the year	–	83,833*	5,000	2,400	1,200	4,400**	96,833
Balance at 31 December 20X7	650,000	243,666	11,000	7,500	5,400	6,800	924,366

* Profit for the year + actuarial gains/losses on defined benefit pension plans.

** Gains on property revaluation + share of other recognised income and expense of associates + income tax relating to components of other recognised income and expense (for simplicity, all assumed to relate to revaluation movements in this example).

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