EFRAG

European Financial Reporting Advisory Group

Jörgen Holmquist
Director General
European Commission
Directorate General for the Internal Market
1049 Brussels

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DRAFT ENDORSEMENT ADVICE

Comments should be sent to Commentletter@efrag.org by 15 October 2007

Dear Mr Holmquist

Adoption of Amendments to IAS 1 *Presentation of Financial Statements (Revised 06.09.2007)*

Based on the requirements of the Regulation (EC) No 1606/2002 of the European Parliament and of the Council on the application of international accounting standards we are pleased to provide our opinion on the adoption of the Amendments to IAS 1 Presentation of Financial Statements (Revised 06.09.2007)—henceforth 'IAS 1 Revised'. The revisions were issued in an exposure draft which EFRAG commented on.

IAS 1 Revised contains the following main amendments to existing IFRS:

(a) all owner changes in equity are to be presented separately from non-owner changes in equity in a statement of changes in equity;

(b) all non-owner changes in equity are to be presented in one or two statements of comprehensive income;

(c) the following non mandatory titles for the primary financial statements are introduced: statement of changes in equity, statement of cash flow, statement of comprehensive income and statement of financial position;

(d) entities are required to present of a statement of financial position as at the beginning of the corresponding period where restatements have occurred;

(e) entities are required to disclose 'reclassification adjustments'; and

(f) entities are required to disclose income tax relating to each component of other comprehensive income; and

(g) entities are required to present dividends and related per-share amounts on the face of the statement of changes in equity or in the notes.

IAS 1 Revised becomes effective for annual periods beginning on or after 1 January 2009. Earlier application is permitted. Financial statements for prior years that are reported as comparative information for the initial year of application shall be restated to conform to the requirements of IAS 1 Revised, unless the necessary information is not available and the cost to develop it would be excessive.

EFRAG has carried out an evaluation of IAS 1 Revised. [As part of that process, EFRAG issued a draft version of this letter for public comment and, when finalising its advice and the content of this letter, it took the comments received in response into account. EFRAG's evaluation is based on input from standard setters, market participants and other interested parties, and its discussions of technical matters are open to the public.]

EFRAG supports IAS 1 Revised and has concluded that it meets the requirements of the Regulation (EC) No 1606/2002 of the European Parliament and of the Council on the application of international accounting standards in that:

- it is not contrary to the 'true and fair principle' set out in Article 16(3) of Council Directive 83/349/EEC and Article 2(3) of Council Directive 78/660/EEC; and

- it meets the criteria of understandability, relevance, reliability and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management.

For the reasons given above, EFRAG believes that it is in the European interest to adopt IAS 1 Revised and, accordingly, EFRAG recommends its adoption. EFRAG's reasoning is explained in the attached 'Appendix - Basis for Conclusions'.

On behalf of the members of EFRAG, I should be happy to discuss our advice with you, other officials of the EU Commission or the Accounting Regulatory Committee as you may wish.

Yours sincerely

Stig Enevoldsen
EFRAG, Chairman

Appendix
Basis for Conclusions

This appendix sets out the basis for the conclusions reached and for the recommendation made by EFRAG on IAS 1 Financial Statement Presentation (Revised 06.09.2007)*.*

1 When evaluating IAS 1 *Financial Statement Presentation* (Revised 06.09.2007)—henceforth IAS 1 Revised— in the light of endorsement, EFRAG considered the following key questions:

(a) Are the requirements of IAS 1 Revised consistent with the IASB's *Framework for the Preparation and Presentation of Financial Statements*?

(b) Would the revised standard's implementation result in an improvement in accounting?

(c) Does the accounting that results from the application of the revised standard meet the criteria for EU endorsement?

Approach adopted to the evaluation of IAS 1 Revised

2 IAS 1 Revised involves a number of in some ways relatively minor changes to existing IFRS that are not particularly linked. As a result, EFRAG has found it necessary to consider the above questions for each of the changes in turn. Those changes are:

(a) all owner changes in equity are to be presented separately from non-owner changes in equity in a statement of changes in equity;

(b) all non-owner changes in equity are to be presented in one or two statements of comprehensive income;

(c) the following non mandatory titles for the primary financial statements are introduced: statement of changes in equity, statement of cash flow, statement of comprehensive income and statement of financial position;

(d) a statement of financial position as at the beginning of the corresponding period to be presented where restatements have occurred;

(e) disclosure of 'reclassification adjustments' (ie recycling)

(f) disclosure of income tax relating to each component of other comprehensive income; and

(g) presentation of dividends and related per-share amounts on the face of the statement of changes in equity or in the notes.

Are the requirements of IAS 1 Revised consistent with the IASB's Framework?

3 EFRAG has first considered whether the requirements of IAS 1 Revised are consistent with the IASB's Framework. There are several aspects of the Framework that are of particular relevance here;

(a) The Framework explains that the qualitative characteristics of financial information are relevance, reliability, comparability and understandability. We need therefore to judge IAS 1 Revised against those characteristics. As IAS 1 deals with presentation, reliability will not generally be an issue. The one exception to this is if the standard requires an item to be split into two or more separate items for presentation purposes, because in that circumstance the standard could in effect require a reliable number to be split into two or more numbers, which may be unreliable. That is an issue only in the case of the amendment described in paragraph 2(f) above ('Amendment F').

(b) The Framework also defines the elements of financial statements (assets, liabilities, equity, income and expenses) and it states that a set of financial statements shall comprise the income statement, the balance sheet, a statement of changes in financial position and notes. However, it is vague as to whether, inter alia, there should be just one income statement, whether all income and expense items should be presented in the income statement, and whether the income statement can contain items that are neither income nor expense.

Thus, the focus of our discussion below is on the qualitative characteristics—and in the main on relevance, comparability and understandability.

Amendment A—Owner changes in equity are to be presented separately from non-owner changes

4 Under IAS 1 prior to IAS 1 Revised ('old IAS 1'), entities were allowed to present certain non-owner changes in equity in the same statement as owner changes in equity. IAS 1 Revised changes this. It requires entities to show owner changes in equity in a separate statement from non-owner changes.

5 This change appears to improve the comparability of the information, by ensuring that all entities will show owner changes together and separately from non-owner changes. The change also appears to improve the understandability of the information, by not allowing owner changes and non-owner changes to be shown together in a single statement. Non-owner changes in equity are a different economic phenomenon compared to changes in equity due to owner transactions, where the owners are acting in their capacity as owners, and the presentation adopted should highlight this difference.

6 One EFRAG member questioned whether there might be an inconsistency in the standard because the effects of changes in accounting policies are clearly not owner changes in equity and should therefore not be included in the statement of changes in equity. That EFRAG member however acknowledged the overall improvement resulting from the amendment and therefore agreed with the overall conclusion reached, that this amendment is in line with the framework.

Amendment B—All non-owner changes to be presented in one or two statements of comprehensive income

7 Old IAS 1 required the presentation of an income statement, including income and expense recognised in profit or loss. Other items of income and expense not recognised in profit or loss were presented either in the statement of recognised income and expense or in statement of changes in equity. Under IAS 1 Revised, all items of income and expense shall be presented either in one statement

(comprehensive income) or in two statements (an income statement and a statement of comprehensive income).

8 EFRAG believes that this in effect means that entities can either continue to present items of income and expense broadly (but not exactly) as most of them do now, or they can present them all in a single statement. It follows that the issue EFRAG needed to consider under this question was whether presenting all items of income and expense in a single statement is inconsistent in some way with the Framework or whether introducing this option creates an inconsistency. The relevance of presenting all non-owner changes in one statement and the understandability of total comprehensive income was discussed but most EFRAG members thought that, after an initial familiarisation, there would not be ongoing issue. They also noted that the single statement format maintains as a sub-total the "profit or loss" deemed important by many preparers and users

9 There was some discussion as to whether allowing entities a choice of preparing one or two statements was inconsistent with the comparability characteristic. As a general rule EFRAG is not in favour of options in standards because they affect comparability and one EFRAG member in particular thought this change could have an effect on comparability. In that member's view what is needed is greater standardisation of formats and of the items included in key line items, and the changes introduced by the Amendment do not achieve this; indeed, they introduce greater flexibility. However, that EFRAG member accepts that this concern is more about an opportunity being missed than the reporting format being changed in an unacceptable way. EFRAG therefore concluded this amended requirement was not inconsistent with the comparability characteristic.

Amendment C—Non-mandatory changes to the titles of the primary financial statements

10 Currently the primary financial statements are generally referred to using titles like 'income statement', 'balance sheet', 'cash flow statement', etc. However, IFRS does not prescribe the titles that entities should use, and some use different names. IAS 1 Revised gives new titles to the various primary financial statements, but again does not require the titles to be used. Although one EFRAG member thought this change might cause confusion (see also paragraph 9 above), most EFRAG members thought the effect on the financial statements of this change will be insignificant. Different entities may call their primary financial statements by different names, but they do that now already. Some may use the new titles and users may not be familiar with those new titles initially. However, they soon would be.

Amendment D—A third statement of financial position if there have been restatements

11 Under old IAS 1, an entity presents two balance sheets, one showing the position at the end of the current reporting period and the other showing the position at the end of the prior period. IAS 1 Revised requires a third balance sheet—showing the position at the beginning of the prior period—to be shown when the entity has made a retrospective application of an accounting policy or a retrospective restatement or reclassification of items in its financial statements. The objective of this amendment is to enhance comparability.

12 EFRAG noted that the wording of this particular amendment could be interpreted to mean that a third statement of financial position is required even if the opening figures were not impacted by any adjustments; Yet the Board explains in its Basis for Conclusion (BC 32) that a third statement of financial position is required only

when it “has been affected by retrospective application or retrospective restatement, as defined in IAS 8 … or when reclassification has been made”. This lack of clarity is unhelpful. EFRAG also noted that some might interpret the revised standard’s references to the recycling of amounts between the two statements of income and expenses as “reclassification adjustments” as implying that the existence of such adjustments should give rise to the requirement for a third statement of financial position. However, EFRAG believes that the Board’s intention in both cases is clear. It therefore concluded that this amendment is consistent with the qualitative characteristics included in the Framework.

Amendment E—Disclosure of ‘reclassification adjustments’ (ie recycling)

13 IAS 1 Revised requires an entity to disclose reclassification adjustments relating to each component of other comprehensive income, either on the face of the statement or in the notes. (Currently IFRS allows/requires the recycling of certain income and expenses items. Thus, an item is sometimes recognised in equity or other comprehensive income initially, and is subsequently transferred from there to the income statement. That recognition in the income statement is referred to by the IASB as a ‘reclassification adjustment’.)

14 EFRAG believes that this amendment is consistent with the qualitative characteristics. By providing the disclosure, it enables users to understand the extent to which the line items represent income and expense of the year or the reclassification of prior years’ income and expense. This enhances the relevance, understandability and comparability of the financial statements.

Amendment F—Disclosure of income tax relating to each component of other comprehensive income

15 IAS 1 Revised also requires entities to disclose—either on the face of the primary financial statement or in the notes—the income tax relating to each component of other comprehensive income.

16 There is little doubt that, in theory at least, the tax effect of items of comprehensive income can be different from the tax effect of other items of income and expense and as such can be relevant information. However most EFRAG members question the relevance of the information in practice, because in their view estimating the tax effects would involve a significant amount of judgement, approximation and arbitrariness, at least partly because of the interdependence between the different items of other comprehensive income. This arbitrariness in particular could be a problem for comparability, relevance and even reliability. On the other hand, some EFRAG members do not believe that inappropriate estimations would be necessary and therefore do not share the concerns raised. In case that significant judgement and estimation would be necessary to do the tax allocation, these EFRAG members referred to the IFRS requirement to disclose such estimations as part of the notes to the financial statements. In these members view, such a disclosure ensures that the reader of the financial statements is appropriately informed.

Amendment G—Presentation of dividends and related per-share amounts on the face of the statement of changes in equity or in the notes.

17 Finally, old IAS 1 allowed entities a choice as to where to disclose the amount of dividends recognised as distributions to equity holders and the related amount per share: they could disclose the information on the face of the income statement, on the face of the statement of changes in equity or in the notes.

IAS 1 Revised narrows that choice to the face of the statement of changes in equity or the notes.

18 EFRAG noted that the required presentation on the face of the statement of changes in equity or in the notes was also allowed under the previously endorsed IAS 1. EFRAG believes that presenting dividends on the face of the equity statements is conceptually superior than showing them on the face of the income statement, as they represent equity and not necessarily only income distribution. Thus, EFRAG concluded that the revision would be consistent with the Framework.

Summary

19 EFRAG therefore concluded that the requirements of IAS 1 Revised consistent with the Framework, with the possible exception of Amendment F (disclosure of income tax relating to components of other comprehensive income).

Would the revised standard's implementation result in an improvement in accounting?

Amendments A, D, E and G

20 EFRAG then considered whether the revisions to IAS 1 will result in an improvement in the financial information provided. In EFRAG's view, some of the revisions (separate presentation of owner and non-owner changes in equity (Amendment A); presentation of a third balance sheet when there has been a restatement (Amendment D); separate disclosure of reclassification adjustments (Amendment E) and a reduction in the choice as to where to present the disclosure of dividends recognised as distribution to equity holders and related per share information (Amendment G) clearly improve the comparability of the information provided in the financial statements because they result in the information being presented in a more unified manner. EFRAG believes that eliminating options is not necessarily always an improvement and does not in all cases improve comparability, because different economic phenomena and transactions might indeed require different accounting. However, EFRAG believes that presenting information in a unified place in the cases addressed by the revisions will improve the presentation of financial information and will therefore be helpful to readers of the financial statements.

21 Amendments A and E also improve the understandability of the information provided, by separating out owner changes in equity from non-owner changes and by providing more information about the effect of recycling.

Amendment B—All non-owner changes to be presented in one or two statements of comprehensive income

22 EFRAG considered the arguments brought forward by the IASB in relation to the inclusion of the option to show non-owner changes to equity in one or two statements. While different EFRAG members had different views on the IASB's arguments—and as a result had different views on whether Amendment B improved financial reporting—EFRAG concluded that the amendment would not impair quality of the financial statements. Users of financial statements would still be able to draw exactly the same information and therefore conclusions as under old IAS 1.

Amendment C—Non-mandatory changes to the titles of the primary financial statements

23 As already explained in paragraph 10, with one possible exception, EFRAG members believe the effect on the financial statements of this change will not be significant. It will result neither in an improvement nor in a deterioration in the quality of the information provided.

Amendment F—Disclosure of income tax relating to each component of other comprehensive income

24 EFRAG also assessed whether the disclosure of income tax relating to each component of other comprehensive income would improve accounting. As already pointed out, EFRAG supports the theoretical background and the general merit of disclosing such information, but is concerned that the practical difficulties involved in many cases means that the information will often be arbitrary and, as a result, lacking relevance and reliability. EFRAG therefore concluded that although the disclosure would sometimes result in an improvement in the information provided, sometimes it would not.

25 EFRAG then considered whether the requirement might actually reduce the quality of the information provided. It believes that, as a matter of principle, if an entity provides some disclosures that it did not previously provide, but the information in that new disclosure is neither relevant nor reliable, the effect could be to reduce the overall usefulness of the information provided. For that reason some EFRAG members concluded that Amendment F could reduce the usefulness of the information provided. However, other EFRAG members thought that it would not reduce the usefulness and pointed out that, in view of the disclosure requirements for significant estimates and judgements applied by management, the user of the financial statements would not be misinformed.

Does the accounting that results from the application of the revised standard meet the criteria for EU endorsement?

26 As already mentioned, EFRAG has previously concluded that old IAS 1 meets the endorsement criteria. Furthermore, as explained above, with one exception EFRAG believes that the various amendments included in IAS 1 Revised are consistent with the Framework. Finally, EFRAG's view is that Amendments A, D, E and G improve the financial information provided, and only Amendment F has the potential to make the information worse.

27 As already explained, most EFRAG members were concerned about the comparability, relevance and even reliability of the information resulting from Amendment F (disclosure of income tax relating to each component of other comprehensive income). As a result some members believe it would result in deterioration in the quality of the information provided. All EFRAG members were troubled by the introduction of tax allocation in relation to items included in other comprehensive income at this point in time, when it seemed that the IASB's current thinking in the second phase of the project would result in no tax allocations. Nevertheless, EFRAG members were unanimous in the view that this issue was not sufficient in itself to justify recommending non-endorsement of the IAS 1 Revisions.

28 Some EFRAG members were concerned that, as the amendments represent only the first stage in a multi-phased project on presentation, preparers and users were being expected to deal with a series of changes in what is a fundamental

aspect of financial reporting. They thought this might not allow preparers, users and other stakeholders to digest and apply the amendments. This could potentially result in confusion and loss of comparability with historic data. They also noted that other, more substantial changes, were planned, and expressed concern about making a series of small amendments now when a series of bigger ones seemed likely to come along in a few years time.

29 This also led some members to express concerns about the cost implications to preparers and users (by way of persistent system changes) and whether the benefits outweighed those costs.

30 Other EFRAG members were of the view that, although recurring amendments to existing standards are not desirable, it would be rare that the problems created by recurring amendments would prevent endorsement, particularly when, as in this case, the amendments and the revised literature seems to meet the endorsement criteria.

31 Therefore, after considering the various arguments, EFRAG concluded that, on balance, IAS 1 Revised satisfies the criteria for EU endorsement.