EFRAG

European Financial Reporting Advisory Group

24 July 2006

IAS 1 Amendments
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
UK

Dear Sir/Madam

Re: ED of Amendments to IAS 1 *Presentation of Financial Statements: A Revised Presentation*

On behalf of the European Financial Reporting Advisory Group (EFRAG), I am writing to comment on the Exposure Draft of Amendments to IAS 1 *Presentation of Financial Statements: A Revised Presentation*. This letter is submitted in EFRAG's capacity of contributing to the IASB's due process and does not necessarily indicate the conclusions that would be reached in its capacity of advising the European Commission on endorsement of the definitive IFRS on the issues.

Currently entities are required to present an income statement, and the items that are sometimes referred to as 'other comprehensive income items' are required to be presented either with changes in equity arising from transactions with equity holders in a statement of changes in equity or separately from changes in equity arising from transactions with equity holders in a statement of recognised income and expenses. Under the proposals in the Exposure Draft:

(a) changes in equity arising from transactions with equity holders are required always to be presented separately from other changes in equity;

(b) the income statement will no longer be a primary financial statement;

(c) the statement of recognised income and expenses will no longer show just other comprehensive income items; henceforth it will be the name given to a statement comprising the old income statement and the old statement of other recognised income and expenses;

(d) the new statement of recognised income and expenses will be a primary financial statement;

(e) entities will be required either to present the statement of recognised income and expenses as a single statement or as two separate statements (being the old income statement and the old statement of recognised income and expenses); and

(f) entities are free to call their accounting statements by whatever name they wish.

We support the proposal described in (a), which we think will improve the quality of financial reporting.

Some commentators might argue that the only change of significance resulting from proposals (b) to (f) is that henceforth entities will have a choice between presenting two performance statements—the old income statement and the old statement of recognised income and expenses—and a single performance statement that combines those two statements. If that were a fair characterisation of proposals (b) to (f), EFRAG would support them because we believe that the issue of whether entities should present one or two performance statements is a matter that warrants extensive debate and that, until that debate takes place, entities should be permitted a choice.

However, we do not believe that characterisation of the proposals is a fair one. In our view what is being proposed is more fundamental.

- the income statement will be downgraded because it will no longer be a primary financial statement;

- the option of continuing to present a separate income statement and statement of recognised income and expenses will be characterised as splitting the (new style) statement of recognised income and expenses in two.

We accept that this may be the outcome of the comprehensive debate that is due to take place as part of Segment B of this project, but we do not believe they are changes that should be made without having that debate. In other words, at this stage in the debate we believe that:

- the income statement should remain a primary financial statement; and

- the option to present a single performance statement should be characterised as involving the combination of the income statement and the (old style) statement of recognised income and expenses.

Of the other main proposals in the Exposure Draft:

- We support the proposed disclosure of the reclassification adjustments, subject to the comment we make below about disclosing taxation effects.

- We believe that any changes to titles of the primary financial statements are more appropriately considered in the context of discussions of Segment B. We see no need and no merit—but a number of disadvantages—in making the changes now.

- We do not agree with the proposal that the income tax relating to each component of other recognised income and expense should be disclosed. We question the usefulness of such information, bearing in mind that the figures would often be calculated using an effective tax rate which leads to an arbitrary allocation.

Our detailed comments are set out in the appendix to this letter.

If you would like further clarification of the points raised in this letter, please do not hesitate to contact either Svetlana Pereverzeva or me.

Yours sincerely

Stig Enevoldsen
EFRAG, Chairman

Questions 1 and 2 – A complete set of financial statements

The Exposure Draft proposes that the titles of the financial statements should be as follows:

(a) statement of financial position (previously 'balance sheet');

(b) statement of recognised income and expense;

(c) statement of changes in equity; and

(d) statement of cash flows (previously 'cash flow statement').

The Board does not propose to make the changes of nomenclature mandatory (see paragraph 31 of the draft Standard and paragraphs BC4 and BC5 of the Basis for Conclusions).

Question 1 – Do you agree with the proposed titles of the financial statements (bearing in mind that an entity is not required to use those titles in its financial statements)? If not, why?

For the reasons explained in our covering letter, we believe it is an oversimplification to characterise this proposal as involving nothing more than a change in the name of the various primary financial statements.

However, even if that were not the case, we do not agree with this proposal because we think there is no reason to change (ie no merit and no need) and a number of reasons not to.

- We believe the changes will cause confusion. One effect will be that entities will call the identical statement by different names (assuming some of them choose to use the newly introduced names). This will give the impression that there has been change and there are differences when that might not be the case. Also, as the title 'statement of recognised income and expense' is used in the current IAS 1 with a meaning that is different from the one in the draft ED. Another effect will be that, where there has been change, the labels given to the statements will not change, thus obscuring that fact.
- We foresee significant problems in translating the new terms into other languages.
- We also do not accept the argument that the titles are better than the existing ones. For example, the ED argues that 'statement of financial position' "better reflects the function of the statement and is consistent with the Framework", yet the financial position of an entity encompasses more than merely information presented in the balance sheet (it would include other aspects such as, for example, liquidity and solvency).
- As explained in our covering letter, we do not believe that the 'income statement' should cease to be a primary financial statement without proper debate (i.e. the full set of primary financial statements should include an 'income statement' and a statement that reflects other non-owner changes in equity).

We therefore believe that no changes to the titles of the primary financial statements at this time. Instead, the issue should be considered in the context of the debate on Segment B.

If notwithstanding the arguments above, the Board decides to proceed with the proposal, we believe that the use of these titles should not be mandatory.

The Exposure Draft introduces a requirement to present a statement of financial position as at the beginning of the earliest period presented in the financial statements. Therefore, in addition to notes, an entity would be required to present three statements of financial position, and two of each of the other statements that form part of a complete set of financial statements (see paragraphs 31 and 39 of the draft Standard and paragraphs BC6–BC9 of the Basis for Conclusions).

Question 2 – Do you agree that a statement of financial position as at the beginning of the period should be part of a complete set of financial statements, and that an entity presenting comparative information should therefore be required to present three statements of financial position in its financial statements? If not, why?

We believe that presenting a statement of financial position at the beginning of the earliest presented period will necessarily result in additional cost for the preparer. We furthermore question the usefulness of this requirement in most cases and consider the current disclosures of any changes to the prior period statement of financial position to be sufficient. Furthermore, we believe that to a certain extent presentation of this excessive information will be detrimental to the overall quality of the financial statements. This is especially true when a company needs to present two years of comparative information; this would result in the presentation of four statements of financial position which will not enhance the understandability or help for any analysis of the financial statements.

We, however, understand that it might be convenient for the users to have an entire statement of financial position (ie three statement of financial position) where a restatement of a former period was necessary for example when a retrospective application of amendments to accounting standards is done.

Considering these arguments and the significant concerns as outlined above we strongly urge the Board to request the presentation of the opening statement of financial position only in case of changes to the balances presented in previous set of financial statements.

Questions 3–5 – Reporting owner changes in equity and recognised income and expenses

The Exposure Draft proposes to require entities to present all changes in equity arising from transactions with owners in their capacity as owners (ie 'owner changes in equity') separately from other changes in equity (ie 'non-owner changes in equity' or 'recognised income and expense'). Non-owner changes in equity would be presented in either (a) a single statement of recognised income and expense, or (b) two statements: a statement displaying components of profit or loss and a second statement beginning with profit or loss and displaying components of other recognised income and expense (see paragraphs 81 and 82 of the draft Standard and paragraphs BC11–BC20 of the Basis for Conclusions).

Question 3 – Do you agree that non-owner changes in equity should be referred to as 'recognised income and expense' (bearing in mind that an entity is not required to use the term in its financial statements)? If not, why?

Is the terminology used in the Standard important if entities are permitted to use other terms in their financial statements? If so, what term would you propose instead of 'recognised income and expense'?

While we do not object to the proposed term as such (especially taking into consideration that it is implicitly used in the current IAS 1), we oppose the implications the use of this term might have. As fully explained in our answer to Question 5 and in our cover letter, we object to effective suppression of the current 'income statement', and therefore, introduction of the 'statement of recognised income and expense' as the only primary financial statement with an option of splitting it into two. On a point of detail, we question whether the word 'recognised' is really needed.

Also, we would like to draw the Board's attention to the fact that there is potentially an inconsistency between the definition of the total recognised income and expense (page 17 of the ED) and the example of statement of changes in equity (page 96 of the ED).

Total recognised income and expense is defined as "the change in equity of an entity during a period from transaction and other events, other than those resulting from contributions by and distributions to equity holders in their capacity as equity holders". That could imply that results of changes in accounting policy (and effect of correction of errors) should be part of the total recognised income and expense (as it is not "a contributions by and distributions to equity holders in their capacity as equity holders"). However, the cumulative impact of changes in accounting policy is shown as a restatement of opening equity in the example of a statement of changes in equity shown on page 96 of the ED.

In summary, the current definition of total recognised income and expense in IAS 1 could be construed as encompassing restatement due to changes in accounting policies. We recommend that the Board should clarify the position and definition of the total recognised income and expense to avoid any misunderstanding.

Question 4 – Do you agree that all non-owner changes in equity (ie components of recognised income and expense) should be presented separately from owner changes in equity? If not, why?

We agree with this proposal and concur that it is important to segregate changes in net assets that arise from transactions with owners in their capacity as owners from other changes in equity. We particularly welcome the decision of the Board to make the statement of changes in equity a primary financial statement (rather than allowing changes in equity that result from transactions with equity holders to be shown in the notes to the financial statements).

We note however that the term 'owners' is not currently defined and in particular the proposed disclosure of transactions between parent company equity holders and minority interests proposed in the recent Business Combination ED was criticised by most commentators. We therefore believe that this aspect is worthy of further consideration.

Question 5 – Do you agree that entities should be permitted to present components of recognised income and expense either in a single statement or in two statements?

If so, why is it important to present two statements rather than a single statement?

If you do not agree, why? What presentation would you propose for components of recognised income and expense that are not included in profit or loss?

We do not agree with the implication in the Exposure Draft that the option to present two statements involves splitting the single statement in two; in our view the correct way to view things at this stage of the project is to characterise the presentation of a single statement as combining the two statements.

Under existing IFRS the primary financial statements required to be provided include an income statement and a statement of changes in equity (comprising what we will call, for the purposes of this discussion 'other recognised income and expenses' and 'changes in equity resulting from transactions with equity holders'). In our view, unless and until there has been a comprehensive debate on whether the income statement should continue to be a primary financial statement (a debate that is due to take place as part of Segment B of the project), it is not appropriate to change the income statement's status. That means that the proposals in the ED should be characterised as allowing entities to choose between:

(a) presenting an income statement and a separate statement showing 'other recognised income and expenses'; and

(b) combining those two statements in a single statement of total income and expenses.

While at first glance this issue might appear to be a matter of semantics, we do not think it is; what the ED is proposing represents a fundamental change of concept which requires a thorough debate as part of Segment B.

In reply to your specific question in relation to optionality, we believe that the issue of whether components of recognised income and expense should be presented in one or two statements warrants an extensive debate. It is closely linked to the matters of grouping, segregating, ordering and subtotalling the components of recognised income and expense all of which will more property be considered as part of Segment B. We therefore agree with allowing the options until the conclusions of the Segment B work are finalised.

Questions 6 and 7 – Other recognised income and expense—reclassification adjustments and related tax effects

The Exposure Draft requires the disclosure of reclassification adjustments relating to each component of other recognised income and expense (see paragraphs 92–96 of the draft Standard and paragraphs BC21–BC23 of the Basis for Conclusions).

Question 6 – Do you agree with this proposal? If not, why?

We agree with the Board's view that separate presentation of reclassification adjustments is essential to inform users clearly of those amounts that are included as income and expenses in two different periods – as income or expenses in statement of other recognised income and expense in previous periods and as income or expenses in profit and loss in the current period. We, therefore support the requirement to disclose reclassification adjustments relating to each component of other recognised income and expense.

It is our understanding that the issue of reclassification adjustments (commonly referred to as "recycling") should be addressed as part of Segment B.

The Exposure Draft requires the disclosure of income tax relating to each component of other recognised income and expense (see paragraph 90 of the draft Standard and paragraphs BC24 and BC25 of the Basis for Conclusions).

Question 7 – Do you agree with this proposal? If not, why?

We do not support this proposal.

We do not agree with the Board's assessment that the information to provide disclosure of income tax relating to each component of other recognised income and expense is readily available and believe it will be subject to arbitrary allocation only and therefore, we believe that often preparers might simply apply an effective tax rate to these items to satisfy this requirement. We do not believe that users will benefit from such an arbitrary allocation.

Furthermore, we do not believe that there is a rationale to treat tax effects on other recognised income and expense differently from the tax effects of profit and loss which are not presented for each individual component. Additionally, the presentation and segregation of such items and their tax effect when presenting one statement of total recognised income and expense is arbitrary and particularly difficult in practice.

Question 8 – Presentation of per-share measures

The Exposure Draft does not propose changes to IAS 33 *Earnings per Share*. Therefore, earnings per share will be the only per-share measure presented on the face of the statement of recognised income and expense. If an entity presents any other per-share measure, that information is required to be calculated in accordance with IAS 33 and presented in the notes (see paragraph BC26 of the Basis for Conclusions).

Question 8 – Do you agree that earnings per share should be the only per-share measure that is required or permitted to be presented on the face of the statement of recognised income and expense? If not, which other per-share measures should be required or permitted to be presented on the face of a statement and why?

We agree that earnings per share should be the only per-share measure that is required or permitted to be presented on the face of the statement of recognised income and expense and therefore no changes to IAS 33 should be made as part of this project.