ICAEW REPRESENTATION
156/15

Profit or Loss versus OCI

ICAEW welcomes the opportunity to comment on the Getting a Better Framework Bulletin *Profit or Loss versus OCI* published by the European Financial Reporting Advisory Group (EFRAG) on 14 July 2015, a copy of which is available from this link.

This response of 18 November 2015 has been prepared on behalf of ICAEW by the Financial Reporting Faculty. Recognised internationally as a leading authority on financial reporting, the Faculty, through its Financial Reporting Committee, is responsible for formulating ICAEW policy on financial reporting issues and makes submissions to standard setters and other external bodies on behalf of ICAEW. The Faculty provides an extensive range of services to its members including providing practical assistance with common financial reporting problems.

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MAJOR POINTS

Introduction

1. We welcome the opportunity to comment on EFRAG's Getting a Better Framework Bulletin *Profit or Loss versus OCI*, which provides a helpful discussion of some of the key issues raised by the exposure draft (ED) *Conceptual Framework for Financial Reporting*, published in May 2015 by the International Accounting Standards Board (IASB). We have taken the Bulletin into account in preparing our response to the ED, which we are also sending to EFRAG at the same time as our response to its concurrent consultation document *IASB ED: Conceptual Framework for Financial Reporting*. The Bulletin raises questions not raised by the ED, and on some of these we do not yet have any views or we express only tentative ones.
2. We responded in 2013 (ICAEW Rep 130/13) to an earlier, related Bulletin in the Getting a Better Framework series, *The Role of the Business Model in Financial Reporting*. As we stated in our earlier response, business models already play a significant role in financial reporting, and we support this role. We raised some concerns, though, about the specific proposals in the 2013 Bulletin. Specifically, while in general we supported the idea that measurements of assets and liabilities should reflect the way in which they will give rise to future cash flows, we argued that this approach will not always produce the most useful information. We also noted that the implications for measurement of a business model approach were not entirely clear. The proposals in the 2015 Bulletin are more developed than those in the earlier Bulletin and its implications for measurement are clearer.
3. Ideally, we favour a single income statement, as we can see no convincing principle for distinguishing elements of other comprehensive income (OCI) from other income and expenses. However, we note that the IASB proposes to preserve the concept of OCI, with considerable support from constituents. Our comments on the Bulletin should be taken in this context.

Main concerns

4. Overall, we disagree with the emphasis placed on business models in the 2015 Bulletin. While we agree that business models do and should play an important role in financial reporting, we do not think that they are the key to solving all questions of measurement – in both the income statement and the statement of financial position – as the Bulletin implies. We also disagree, as explained below, with the Bulletin's proposals on different measurement bases, OCI and recycling.

RESPONSES ON SPECIFIC ISSUES

Q1: Different measurement bases

Do you agree that different measurement bases may be needed to provide relevant information in both the statement of financial position and in the statement of profit or loss? Do you agree that the first step in the process should be to identify the most relevant measurement basis for the statement of profit or loss? Do you agree that the choice of both measurement bases be driven by the business model?

5. We do not agree with the use of different measurement bases for the same item. In our view it is important, as a fundamental tenet of financial reporting, to keep the articulation between the statement of financial position and the income statement, and this implies that any item in the accounts should be measured on just one basis. Income and expenses arising from the chosen measurement basis may, nonetheless, be analysed into their component parts in the income statement and OCI where this provides useful information. Such an analysis might use different measurement bases, but other criteria may also be relevant. Any analysis of this sort should be stipulated as appropriate in the relevant standards.
6. We agree that the effect on profit or loss should be taken into account when the IASB decides on the measurement basis for an item. This will sometimes mean that the measurement in the statement of financial position in effect follows that in profit or loss. But sometimes things will be the other way round, and we do not believe that it would be sensible always to give priority

to profit or loss or always to give priority to the statement of financial position. It is the full articulation of an item across all statements that is important.

7. We agree that an item's role in the reporting entity's business model or models is an important consideration in deciding how it should be measured, but we do not think that the case has yet been made that it should be the overriding consideration.

Q2: Considering the business model

Do you agree with the descriptions of the various business models? Do you agree with the suggestions in the paper on how they would be portrayed in the profit or loss and financial position of entities? Are there other business models that it would be necessary to identify for financial reporting perspectives? If so what are they? What measurement bases would they require and why?

8. The descriptions of the 'price change' and 'transformation' business models seem reasonable and match our own thinking as put forward in *Business Models in Accounting: The Theory of the Firm and Financial Reporting* (2010). We are not sure about the 'long-term investment' and 'liability driven' business models, as explained in the next two paragraphs.
9. As regards the long-term investment model, in the case of investment properties we doubt whether rental income is necessarily more important to the reporting entity than the potential gain on eventual resale. Partly for this reason, we think there is a strong case for the fair value reporting model currently allowed by IAS 40, *Investment Property*, under which changes in the value of properties are reported in profit or loss. The Bulletin also mentions dividends and 'income from letting others use the asset' as examples of income within this business model. Does this imply that holding equities always comes within this business model? Or only sometimes? And if so, when? On the face of it, lessor accounting ('income from letting others use the asset') would come within this business model, but this point is not discussed in the Bulletin.
10. The only other type of business identified as operating this business model is banks. We are not sure which activities of banks EFRAG has in mind here. Banks' normal lending activities would presumably come within the transformation business model and available for sale assets within the price change model. Perhaps EFRAG has in mind fair value through OCI assets for the long-term investment model. It would be helpful to have more information on this.
11. As regards the liability driven business model, this appears to be aimed primarily at insurers, but its implications for them are not spelt out, so it is difficult to form a view. We would be concerned about building this into a separate model for insurers without a full justification.
12. We set out our views on OCI and recycling below. Beyond this, we do not have any comments at this stage on the Bulletin's proposals for how the different models should be dealt with in profit or loss or the statement of financial position. Nor have we identified any other types of business models for which distinctive approaches to measurement would be required. However, as we do not regard the business model as the overriding criterion in this respect, we do not believe that it is necessary to have identified all relevant types of business models.

Q3: OCI items

What are your views on the proposal to include differences resulting from applying different measurement bases and incomplete transactions in OCI?

13. We believe that OCI should be restricted to items that neither help to measure the current year's performance nor help to estimate future performance. These are, of course, vague concepts, as are any other concepts proposed in this area. However, we think that the list might typically include only:
    - gains on the revaluation of property, plant and equipment (PPE);
    - gains on the sale of PPE, except where they are in substance corrections of accumulated depreciation;

- foreign currency translation adjustments on foreign subsidiaries;
- actuarial gains and losses on a defined benefit pension scheme; and
- fair value gains and losses on effective hedges.

This is, of course, similar to the list under current IFRS practice, except that it includes gains on the sale of certain types of PPE. This category might typically be land and buildings that have risen in value, partly because they are not consumed or not wholly consumed by the entity. We believe, however, that more work is needed on these concepts.

14. The list also overlaps to some extent (eg, fair value gains and losses on effective hedges), but not completely (eg, gains on the sale of certain types of PPE), with the Bulletin's proposals. Although we do not regard the business model as the overriding consideration, we might argue, for example, that as making gains on the sale of PPE is not part of a firm's business model, including them (even when realised) in profit or loss does not help measure the firm's performance in the period or provide the most useful basis for estimating future income or cash flows.

Q4: Recycling

What are your views on the proposal to recycle amounts included in OCI as a result of applying different measurement bases under long-term investment business models?

15. In general, we do not agree with recycling; this is not only for reasons of principle, but also because recycling introduces complexity and is confusing for users. Of the items identified above that we believe should be recognised in OCI, in our view only fair value gains and losses on effective hedges should be recycled to profit or loss. This is because they would be recycled at the point that they become relevant to measuring performance for the period. There is no time at which the other items we have identified would be relevant to measuring performance for the period or to predicting future performance. We therefore disagree with the Bulletin's proposals on this subject.

Q5: Current value measurements in the statement of financial position

For the purpose of the statement of the financial position (not the statement of profit or loss), would you be in favour of greater use of current value measurements than required today? What are the reasons for your views?

16. We are broadly happy with the present level of current value measurements under IFRS. We do not see that materially more useful information would be produced by either significantly reducing or significantly increasing the present level of such information. Debates will no doubt continue on how best to measure particular items, and there may well be changes for some items as a result of this, but we would not support a determined move in either direction.

Q6: Changes in interest rates

Do you think the discount rate should be updated, and if so, should the effect of the changes be included in OCI or in profit or loss? What are the reasons for your views?

17. In general, we think that where interest rates are used to determine current amounts, they should be updated each accounting period. Whether the resulting changes should be reported in profit or loss or OCI should be determined in accordance with the principles we have suggested above. They do represent real economic phenomena, so should not be ignored.