STAFF PAPER

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World Standard Setters Meeting

Project	Conceptual Framework		
Paper topic	Profit or loss and other comprehensive income		
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Purpose of this paper

1. As part of the *Agenda Consultation 2011*, respondents told the IASB that there is a lack of clarity in IFRS on the roles of profit or loss, OCI and recycling. In response, section 8 of the IASB's Discussion Paper *A Review of the Conceptual Framework for Financial Reporting* (DP) discusses possible principles for the use of profit or loss, OCI and recycling. It describes the following preliminary views of the IASB:

   (a) the *Conceptual Framework* should require a profit or loss total or subtotal that also results, or could result, in some items of income or expense being recycled; and

   (b) the use of OCI should be limited to items of income or expense resulting from changes in current measures of assets and liabilities (remeasurements). However, not all such remeasurements would be eligible for recognition in OCI.

2. On the basis of these views, the DP discusses two alternative approaches for determining what items of income and expense should be recognised in OCI: a narrow approach and a broad approach. The narrow approach has two categories of item that would qualify for recognition in OCI, the broad approach has three.

3. In this paper we:

   (a) Describe and compare the broad approach and the narrow approach.

   (b) Ask you to apply the categories to real life examples.

(c) Ask which approach to recognising items in OCI you prefer (if any).

Approaches to OCI

4. Both the approaches to OCI in the DP start by grouping the types of remeasurements that are eligible to be presented in OCI into categories. These categories are a short-hand way to describe the characteristics that would make items of income and expense eligible to be recognised in OCI. These categories also dictate how recycling is dealt with.

5. The IASB did not seek to define or describe profit or loss or OCI using commonly cited attributes such as:

   (a) Realisation;

   (b) Recurrence (persistence);

   (c) Operating;

   (d) Measurement uncertainty;

   (e) Duration (ie long-term or short-term); or

   (f) Outside management control.

   Although these attributes provide insight into a possible distinction for individual types of items or entities, it was difficult to find a way to use one attribute in isolation (or several attributes together as a group) to distinguish items of income or expense.

6. Instead, the DP explores approaches to distinguishing the items included in OCI from the items included in profit or loss in a manner that supports the objective of financial reporting. Both the narrow approach and the broad approach start with the same broad principles, namely:

   (a) Profit or loss provides the primary source of information about an entity's performance in a period.

   (b) To support (a), OCI should only be used if it makes profit or loss more relevant ie enhances the predictive value of profit or loss or makes it more understandable.

7. Based on the broad principles above, the IASB determined that OCI should only be used for some (but not all) changes in current measures (remeasurements). Changes in cost-based measures and gains or losses resulting from initial recognition would not be presented in OCI because the IASB considers that the results of transactions, consumption and impairments of assets and fulfilment of liabilities should be recognised in profit or loss in the period in which they occur. Recognising these items in OCI would not generally enhance the predictive value or understandability of profit or loss as the primary source of information about the return the entity has made during the reporting period.

Narrow Approach to OCI

8. The narrow approach provides that to be eligible for recognition in OCI, an item of income or expense must fit one of two categories: bridging items or a mismatched remeasurements. These categories are described in the table below:

Category	**Definition**	**Recycling**	**Example**
Mismatched remeasurement	Represents the effects of a linked set of assets, liabilities or past or planned transactions so incompletely that it provides little relevant information about the return the entity has made on its economic resources in the period. IASB determines when linkage is sufficient to warrant recognition in OCI.	All When linked item(s) are recognised in profit or loss	Remeasurement of a hedging instrument in a cash flow hedge. Accumulated gain or loss recognised in OCI is recycled (reclassified to profit or loss) when the effect of the hedged item is recognised in profit or loss.
Bridging item	A disaggregated component of an item of income or expense Represents the difference between a measure used to determine profit or loss and a measure used in the statement of financial position. IASB determines when two different measures should be used in the primary financial statements. Profit or loss must reflect a meaningful, understandable and clearly describable measure	All Automatic result of measure recognised in profit or loss	Financial assets measured at fair value through OCI (under the proposals in the IFRS 9 2012 ED) Accumulated gain or loss recognised in OCI is recycled on disposal or impairment as a consequence of reflecting amortised cost in profit or loss.

9. The narrow approach is so called because it would significantly restrict the types of items that would be eligible to be presented in OCI. Although it would provide a clear framework for determining what should be presented in OCI, it gives the IASB little discretion when developing or amending IFRS to extend the use of OCI in the future.

Broad Approach

10. The broad approach responds to concerns that the narrow approach results in some remeasurements being recognised in profit or loss that decrease its relevance, ie

(a) remeasurements that obscure information that is more useful; and

(b) reclassification adjustments (recycled amounts) that do not provide relevant information about the return the entity has made on its economic resources in the period of recycling.

11. The broad approach adds the additional category of transitory remeasurements to those that would be eligible for recognition in OCI. Therefore to be eligible for recognition in OCI under the broad approach an item of income or expense must be either a bridging item, a mismatched remeasurement or a transitory remeasurement.

12. Below is a description of transitory remeasurements.

Category	Definition	Recycling	Example
Transitory remeasurement	An item of income or expense that: • will be realised/settled over the long-term • is likely to reverse or significantly change • if separately recognised in OCI, in whole or in part, enhances the relevance and understandability of profit or loss	Some If the IASB determines that recycling provides relevant information	Remeasurement of a defined benefit pension liability/asset). Accumulated gain or loss recognised in OCI (reclassified to profit or loss) is not recycled. No operational and meaningful method of recycling can be determined.

13. The broad approach is so called because makes eligible to be recognised in OCI more items that would occur under the narrow approach. Potentially all items eligible to be recognised in OCI under current IFRS would be similarly eligible

under the broad approach. However the broad approach would give the IASB significant discretion when developing or amending IFRS.

The OCI Approaches compared

14. The OCI Approaches are described and compared below:

	Narrow Approach	**Broad Approach**
When can OCI be used?	Use of OCI is only where permitted or required by IFRS	Use of OCI is only where permitted or required by IFRS
What items of income or expense would be eligible?	Mismatched remeasurements Bridging items	Mismatched remeasurements Bridging items Transitory remeasurements
Recycling	Always Driven by the category and the reason why the item went into OCI	Sometimes Bridging and mismatched always (see Narrow Approach) Transitory remeasurements – only if it provides relevant information
Result	Limited items in OCI Less discretion for the IASB	More items in OCI (in line with current use) More discretion for the IASB

The OCI Approaches applied

15. Using the categories of bridging items, mismatched remeasurements and transitory remeasurements to aid your discussion, the following questions ask how you would present specific items of income and expense in the statement(s) of profit or loss and OCI. Please ignore current IFRS treatment and note that the categories can be applied in any order and that there is not a single right answer.

Question 1: Change in fair value of a strategic equity investment

Example: An entity has an equity investment. The investment is strategic ie there is no intention for the investee to sell or dispose of its shares in the investee as the investment is held to promote business between the two companies. The investee company pays regular dividends. The IASB has determined that fair value is the most relevant measurement for the purposes of the statement of financial position.

Using the categories of bridging items, mismatched remeasurements and transitory remasurements, please state how you would:

(a) recognise the changes in fair value of the equity investment in the statement(s) of profit or loss and OCI?

(b) recycle to profit or loss any amounts previously recognised in OCI (if at all).

Question 2: Change in fair value of a financial liability using the fair value option

Example: An entity has elected to use the fair value option for some of its issued fixed rate debt securities. The entity's debt securities are regularly bought and sold in its local corporate bond market and inputs needed to determine the amount of fair value attributable to the entity's own credit are considered to be observable.

Using the categories of bridging items, mismatched remeasurements and transitory remasurements, please explain how you would:

(a) recognise the changes in fair value attributable to the entity's own credit risk in the statement(s) of profit or loss and OCI?

(b) recycle to profit or loss any amounts previously recognised in OCI (if at all).

Question 3: Change in the measurement of a decommissioning liability

Example: An entity has recognised a liability (made a provision) to cover the estimated cost of decommissioning an item of equipment. The decommissioning is not expected to result in an outflow of cash for another 10 years. The equipment is measured at cost. The IASB has determined that the decommissioning liability should be remeasured to reflect the effect of:

- Changes in the estimated outflow of cash required to cover the decommissioning;
- Changes in the current market-based discount rates;
- Unwinding of the discount rate (ie the passage of time).

Using the categories of bridging items, mismatched remeasurements and transitory remasurements, please explain how you would:

(a) recognise each component of the remeasurement of the decommissioning liability in the statement(s) of profit or loss and OCI eg fully in Profit or loss, or all or a component in OCI?

(b) recycle to profit or loss any amounts previously recognised in OCI (if at all).

Which Approach?

Question 4: Which OCI Approach?

As described in paragraphs 7-16 above, the DP describes two approaches for determining what items are eligible for presentation in OCI. Do you support the narrow approach, the broad approach or neither? Why?

If you favour neither approach, which approach do you favour, and why?