OCI and relevance of performance measures: recent inquiry by IASB

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Agenda

• Introduction
• OCI in IFRSs
• Major concerns
• IASB’s current thinking
• Concluding remarks
Introduction
Development between BS v IS views

• BS focused
  – In early history
  – accounting is BS based

• From BS-IS focused
  – Since 1800s,
  – mainly because of
    – industrial revolution,
    – income tax legislation, and
    – measures against income manipulation in securities market,
  – accounting became more IS focused with core principles like
    – realization,
    – matching, and
    – conservatism
Development between BS v IS views

• IS-BS focused
  – From 1970s,
  – mainly because of
    – main developed countries became less manufacturing, and more financial service based,
    – Investors in capital market development became short sighted, and
    – influence of empirical and quantitative research from 1970s, and that of economic theory on accounting research, including economic definition of income.
  – As a result,
    – more assets and liabilities are required to be at fair value,
    – more assets are required to be written down because of impairment.
However, objective of financial reporting is not to provide information about *reporting entity’s value*, but to provide users with information useful for making decisions about providing resources to the entity.

<table>
<thead>
<tr>
<th>about resources and claims against the entity, and changes to them</th>
<th>to assess effective and efficient management of resources</th>
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</thead>
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Development between BS v IS views

• Impact of the global financial crisis from 2008: request to emphasize more on IS, and the concepts such as
  – Management stewardship,
  – Going concern,
  – Long term profitability,
  – Matching,
  – Reliability.
Controversy over key performance measures in IS

- All inclusive income or income from current operation
- Revenues and expenses, or gains and losses
- Ordinary or extraordinary incomes or expenses
- Profit or loss, or OCI

The key question is: what is the primary measure representing persistent, recurring earnings or profitability?
## OCI in IFRSs: old

<table>
<thead>
<tr>
<th>Recognised asset or liability</th>
<th>Remeasurement gains or losses in OCI</th>
<th>Recycle?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Property, plant &amp; equipment, intangible assets, exploration &amp; evaluation assets (IAS 16, 38, IFRS 4)</td>
<td>Revaluation gain or reversals</td>
<td>No</td>
</tr>
<tr>
<td>Net investment in foreign operations (and hedges) (IAS 21)</td>
<td>Exchange differences</td>
<td>Yes</td>
</tr>
<tr>
<td>Available for sale financial assets (IAS 39)</td>
<td>Changes in fair value</td>
<td>Yes</td>
</tr>
<tr>
<td>Cash-flow hedging instruments (IAS 39)</td>
<td>Effective portion of changes in fair value</td>
<td>Yes</td>
</tr>
</tbody>
</table>
## OCI in IFRSs: new

<table>
<thead>
<tr>
<th>Recognised asset or liability</th>
<th>Remeasurement gains or losses in OCI</th>
<th>Recycle ?</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009: Designated investments in equity instruments (IFRS 9)</td>
<td>Change in fair value</td>
<td>No</td>
</tr>
<tr>
<td>2010: Impact of own credit changes (IFRS 9)</td>
<td>Impact of own credit changes on FV of liability</td>
<td>No</td>
</tr>
<tr>
<td>2011: Pensions – net defined benefit assets or liabilities (IAS 19)</td>
<td>Re-measurement</td>
<td>No</td>
</tr>
<tr>
<td>2014: Financial assets measured at fair value through OCI (IFRS 9)</td>
<td>Changes in fair value other than impairment from credit loss</td>
<td>Yes</td>
</tr>
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</table>
## OCI in IFRSs: proposed

<table>
<thead>
<tr>
<th>Recognised asset or liability</th>
<th>Remeasurement gains or losses in OCI</th>
<th>Recycle?</th>
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</thead>
<tbody>
<tr>
<td>2017?: Insurance contracts</td>
<td>Impact of changes in discount rate on current value of insurance liability</td>
<td>Yes</td>
</tr>
</tbody>
</table>
International Financial Reporting Standards

Major Concerns

The views expressed in this presentation are those of the presenter, not necessarily those of the IASB or IFRS Foundation
Major concern

- Increasing use of OCI
- OCI becomes a garbage box to find answers for difficult issues
- No strong or consistent conceptual basis
Major questions asked in 2011 agenda consultation

- Respondents to IASB’s agenda consultation in 2011 strongly recommend put conceptual framework, particularly OCI, as priority project.

- Major questions aske include:
  1. How should financial performance be defined?
  2. How should profit or loss and OCI be defined?
  3. What items should be in OCI?
  4. Should OCI be recycled?
  5. Should OCI be the only decision by IASB or not?
International Financial Reporting Standards

IASB’s current thinking

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OCI in IASB’s Conceptual Framework

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<td>Objective</td>
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<td>Qualitative characteristics</td>
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<td>Elements</td>
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<td>Measurement</td>
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<td>Measurement</td>
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<tr>
<td>Recognition</td>
<td>Recognition</td>
<td>Derecognition</td>
<td>Recognition</td>
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<td>Presentation &amp; disclosure</td>
<td>Presentation &amp; disclosure</td>
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<td>Reporting entity</td>
<td>Reporting entity</td>
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IASB plans to publish revised CF in early 2017

OCI
1. How should financial performance be defined?

- Performance is not only reflected by profit or loss, or comprehensive income, but also reflected by other measures in 3 basic financial statements.

- Income statement
  - All items of income and expense provide some information about performance;
  - Make best use of subtotals or totals to make information more useful;
  - Present as one or two statements.
2. How should profit or loss and OCI be defined?

<table>
<thead>
<tr>
<th>Profit or loss</th>
<th>OCI</th>
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<tbody>
<tr>
<td>- Realised</td>
<td>- Unrealised</td>
</tr>
<tr>
<td>- Recurring (persistent)</td>
<td>- Non-recurring</td>
</tr>
<tr>
<td>- Operating</td>
<td>- Non-operating</td>
</tr>
<tr>
<td>- Measurement certainty</td>
<td>- Measurement uncertainty</td>
</tr>
<tr>
<td>- Short-term</td>
<td>- Long-term</td>
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<tr>
<td>- Under management control</td>
<td>- Outside management control</td>
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**IASB’s view:** No one generally accepted way to distinguish profit or loss and OCI
3. What items should be in OCI?

• Items in profit or loss communicate the primary picture of the return an entity has made on its resources
  – A common starting point for analysis

• OCI could be used if doing so would enhance relevance of profit or loss, and performance measures.
4. Should OCI be recycled?

• OCI should be recycled when doing so would enhance the relevance or faithful representation of the information provided in P&L for that period

• The key is the scope of OCI: narrow or broad?

• Narrow use of OCI
  – OCI contains only some re-measurements of current value in two categories:
    – ‘Bridging items’: arises where same asset/liability is represented in BS and IS using two different measurements: debt investments measured at fair value through OCI.
    – ‘Mismatched re-measurements’: arises when offsetting impact of linked transactions or other events is not yet recognised: cash flow hedging and foreign exchange translation.

  – OCI always recycle
4. Should OCI be recycled?

• Broad use of OCI
  – OCI contains only some re-measurements of current value in **three** categories:
    – Bridging items
    – Mismatched re-measurements
    – **Transitory re-measurements**
  – Recycling
    – All bridging items and mismatched re-measurements
    – Some transitory re-measurements
      – **if** results in more relevant information

• IASB decided to take narrow view, that is, OCI will be rare.
5. Should OCI be the only decision by IASB or not?

• Yes.
IASB’s other efforts on performance measures

- IASB and FASB once had a joint project Financial Statement Presentation.
- The two boards originally proposed a drastic change to the content and structure of three basic financial statements, including how to improve performance related information users want.
- However, the project was suspended in 2010 because of strong resistance from all over the world.
IASB’s other efforts on performance measures

- IASB is now having two research projects related to performance measures:
  - Primary financial statements
  - Principles of disclosure

- In addition to its views in CF projects, IASB has tentatively decided:
  - IASB should consider how to improve the structure and content of performance statement, including line item subtotals
  - IFRS should provide additional guidance on the depiction of non-recurring, unusual or infrequently occurring items in performance statement
IASB’s other efforts on performance measures

- IASB should not prohibit the disclosure of alternative performance measures (APMs), and should
  - refine the definition of APMs
  - develop qualitative constraints on the use of APMs
- Presentation of EBIT and EBITDA in P&L complies with IFRS, provided that the statement is presented ‘by nature’ and such subtotals are in accordance with the related requirements in IAS 1.
Concluding remarks
Concluding remarks

• Relative importance of BS and IS has been evolving in the past 100 years.

• At the same time, there has been endless debate over what is the primary performance measure in IS representing persistent, recurring earnings or profitability.

• The major controversy in the past 10 years is around distinction between profit or loss, and OCI.
Concluding remarks

• Trying to find solid conceptual basis for OCI is one of the major efforts IASB is now devoting in its CF project.

• It is important, but hard to find generally accepted solution.

• A better approach might be to provide more guidance on different performance measures in performance statement, rather than focus only on OCI.

• Such guidance should be principle based, and should not be too descriptive.
Concluding remarks

• We should also look beyond traditional financial statements structure and think how to enhance relevance of financial reporting under modern IT and communication environment.
Thank you