ICAEW representation

ICAEW REP 42/06

PRESENTATION OF FINANCIAL STATEMENTS

Memorandum of comment submitted in July 2006 by the Institute of Chartered Accountants in England and Wales, in response to the Exposure Draft of Proposed Amendments to IAS 1 Presentation of Financial Statements: A Revised Presentation, published for comment by the International Accounting Standards Board on 16 April 2006.

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INTRODUCTION

1. The Institute of Chartered Accountants in England and Wales welcomes the opportunity to comment on the International Accounting Standards Board's Exposure Draft of Proposed Amendments to IAS 1 Presentation of Financial Statements: A Revised Presentation, published on 16 April 2006. We have reviewed the proposals and set out below our major points and our responses to the specific questions raised in the exposure draft.

WHO WE ARE

2. The Institute of Chartered Accountants in England and Wales (the 'Institute') is the largest accountancy body in Europe, with more than 127,000 members. Three thousand new members qualify each year. The prestigious qualifications offered by the Institute are recognised around the world and allow members to call themselves Chartered Accountants and to use the designatory letters ACA or FCA.

3. The Institute operates under a Royal Charter, working in the public interest. It is regulated by the Department of Trade and Industry through the Financial Reporting Council. Its primary objectives are to educate and train Chartered Accountants, to maintain high standards for professional conduct among members, to provide services to its members and students, and to advance the theory and practice of accountancy.

MAJOR ISSUES

Overall response

4. On balance we do not believe that the Board should have issued an exposure draft with a limited range of proposals at this stage in the project. Most of the key issues arising from this project have been deferred until Phase B, most notably those issues relating to recognition and measurement which need to be resolved before issues of presentation can be addressed. We believe that it is essential to allow constituents to participate in a better-informed debate about a complete package of proposals. The fact that Phase A has produced such a modest package of changes is indicative of the danger of carrying out projects in phases: it invariably leads to all the difficult questions being left until the end, when it would be better (and ultimately probably easier) to present a full package of measures argued on a principled and fully-articulated basis.

5. We also question the wisdom of converging on SFAS 130, which is itself under review. This seems contrary to the stated intention of both Boards as to how they will converge. In addition, the level of convergence is somewhat limited. Moreover, the ED introduces another option – one or two statements of recognised income and expense – when it is acknowledged that options are generally unhelpful and should be avoided where possible.

6. Having said that, we recognise that the changes promoted in the overall project represent a major step for some countries. In the UK, the issues

surrounding this project have been debated over many years and are generally well understood; we recognise that this is not the case in many other jurisdictions, in the light of which it may be easier to take smaller, incremental steps. In one respect in particular the ED would bring IFRS into line with better UK accounting: we strongly support the proposal to present changes in equity arising from transactions with owners in their capacity as owners separately from other changes in equity. This proposal could and should be implemented straight away.

SPECIFIC QUESTIONS

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?*

7. While it is for the IASB to determine what terms it wishes to use in its own standards, allowing different terms to be used in financial statements is unhelpful and will lead to less consistent usage in practice. We very much agree with the 'alternative view' set out in paragraphs AV8 - AV11, which supports retaining the current terms and points out that 'statement of financial position' is generally taken to mean something other than a traditional balance sheet. We also question why this standard has been singled out to be brought into line with the terminology in the Framework, whilst others remain out of line.

8. Even the terms chosen by the Board are open to question. Firstly, although they match the Framework, the Board's review of the Framework may lead to changes in terminology, which will in turn lead to inconvenient changes to the relevant standard(s). Secondly, each of the terms contains definitional problems. For example:

   - Why is 'recognised' not included in the title of the Statement of changes in equity?

   - Is the term 'recognised' not redundant since by definition the statements can only deal with those items that are recognised?

- The Framework defines expenses as expenses and losses (vs income = revenue + gains), which is a tautology and confusing to readers.

Overall, we believe it would be better to use terms that are familiar, but otherwise it would be better to establish terms that are easy for people to use as labels.

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?*

9. Disclosing the opening balance sheet will be of little value to users of the accounts except where there is a restatement that affects years prior to the comparative year. However, given that the notes would have to be expanded, preparers could face considerable costs. The proposal does not therefore meet acceptable cost-benefit criteria. As well as strongly disputing the assertion that there would be no cost in producing this information, we further believe that in any case it runs the risk of further cluttering up current statements with very old historical data when financial statements are becoming longer and more complex. It does not seem unduly onerous for users to look at the previous year's accounts if they want the opening balance sheet for the corresponding year. We suggest that it would be preferable to meet the need for an opening balance sheet where there have been restatements by extending the requirements in IAS 8 *Accounting policies, changes in accounting estimates and errors* as appropriate.

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'?

10. We are content for non-owner changes in equity to be referred to as 'recognised income and expense', subject to our overall comments about terminology in paragraph 7 above.

***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?*

11. Notwithstanding our overall preference that the whole of Phase A should have been deferred and included in a complete package, we strongly support the proposal to present changes in equity arising from transactions with owners in their capacity as owners separately from other changes in equity. This proposal could and should be implemented straight away in that it is the only proposal in the ED that is based on a properly-articulated principle, derived from the Framework, which is widely accepted.

***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?

12. We agree that, for the present, entities should be permitted to present components of recognised income and expense in either a single statement or two statements. We are nevertheless concerned at the proposals. Although ostensibly there will be flexibility in presentation, we fear that this flexibility may be short-lived and that the Board intends an eventual move to a mandatory single income statement (as evidenced, for example, by paragraph BC13). At present our members have very different (and opposing) views on whether one or two (or more) statements should be required. We find it impossible to debate the question as to the number of statements, however, until the proposed basis on which gains and losses are presented is finalised in Phase B – the Board is thus asking the wrong question at the wrong time.

13. If the Board is convinced that it is right *in principle* to require only one statement of recognised income and expense to be presented, it should have proposed that for comment in the ED (rather than implying it via statements in

the Basis for Conclusions). As it is, the proposals appear premature because the Board seems to prefer a single statement before it has addressed key issues, which centre on the need for clear and robust guidance as to how, on a principled basis, specific items should be dealt with within the statement(s): what should comprise the components of the statement(s); where different gains and losses should be presented; what level of flexibility is available; whether recycling is permitted or required and so on.

14. Questions about presentation can only be resolved when these more fundamental issues have been resolved. The Board certainly needs to have more evidence of users' needs before pronouncing on any particular presentation. We believe that, for Phase A (if it is to become a standard), the primary consideration should be to achieve equal prominence for gains and losses included or not included in profit or loss, rather than to agonise about whether a single statement is preferable to two statements.

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?*

15. We agree with the requirement to disclose reclassification adjustments relating to each component of other recognised income and expense, and to allow such disclosure to be in the notes. Indeed, we see it as vital to retain the flexibility about where the information should be presented in order to avoid clutter on the face of the statements.

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?*

16. Mixing of pre- and post-tax items in one statement is potentially confusing; the issue of tax will need to be properly addressed in Phase B.

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?*

17. Although the IASB maintains that it is not proposing to change IAS 33 *Earnings per share*, we believe that the phrasing of this question may constitute a de facto change to IAS 33. This is because we are aware that some interpret Paragraph 73 as precluding presentation of alternative EPS figures on the face of the income statement, whereas others believe that that the paragraph is not restrictive: ie, disclosure can be either on the face of the statement or in the notes. The wording of this question would indicate that the IASB believes that IAS 33 should be interpreted as being restrictive as to presentation on the face of the statement.

18. In any case, given the IASB's view that users should not focus on one performance metric, but should look at a complete set of information given, the IASB's strong focus on a single EPS figure gives a rather different message. It would be better to allow different per-share figures to suit the entity concerned (for example, where net asset value per share is more relevant) and merely require proper disclosure of the basis of preparation.

AMENDMENTS TO OTHER PRONOUNCEMENTS

19. We have reviewed the section on Amendments to other pronouncements in the ED and have the following comments:

- IFRS 1 paragraph 39(b) is amended by the ED to require an old GAAP/IFRS reconciliation of total recognised income and expense rather than profit or loss. We believe that both should be required: ie, a reconciliation of profit or loss should also be required, as is shown in the amended example in IFRS 1 IG63.

- IAS 12 paragraphs 77 and 77A (and the preceding heading) refer to 'profit or loss on ordinary activities'. As the concept of extraordinary vs ordinary activities is not one recognised by IAS 1, it would be better to amend it simply to 'profit or loss'.

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