Other Comprehensive Income: A New Concept in India

The concept of "Other Comprehensive Income (OCI)" is not new in the international accounting frameworks such as in International Financial Reporting Standards (IFRS) and US GAAP. However, in India, under existing Accounting Standards notified under Companies (Accounting Standards) Rules, 2006 (CASR, 2006), there is no concept of OCI. Indian Accounting Standards (Ind ASs) converged with IFRS contain the requirements relating to OCI which will be a new concept in India. Internationally, OCI is a hot topic of debate. Questions like the necessity of OCI are being raised and discussed at various international accounting forums. There are other issues related to OCI which are also being discussed at international fora. The article introduces the concept of OCI and other aspects relating to OCI in Ind AS.

Why OCI?

To understand the concept of OCI, it is imperative to know the need for OCI. The *Framework for the Presentation and Preparation of Financial Statements* (Framework) issued by the Institute of Chartered Accountants of India (ICAI) defines 'Income' as:

> **"*Income* is increase in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity participants."**

CA. Sanjeev Maheshwari

(The author is a member of the Institute. He can be reached at casanjeevmaheshwari@gmail.com)

From the above definition, it is understood that any increase in economic benefits due to enhancements of assets or decreases of liabilities other than those relating to contributions from equity participants is income. Let us understand the above definition by an example. In case a fixed asset is revalued, there is an increase in economic benefit due to enhancement of the asset. Therefore, the increase in the value of fixed asset due to revaluation meets the definition of income. However, such an increase is not recognised in the statement of profit and loss. Under the existing accounting standards notified under CASR, 2006, such an increase is credited to revaluation reserve

To make the requirements of accounting standards consistent with the definition of 'income' contained in the Framework and to avoid the impact of gains or losses on account of fluctuations in the fair value of fixed asset on the profit or loss, the need for OCI arises.

as per the requirements of Accounting Standard (AS) 10, *Accounting for Fixed Assets*. The treatment prescribed in AS 10 is, however, not consistent with the definition of 'income' given in the Framework. The reserve is a part of equity and only transactions with equity participants should be directly recognised in equity as per the said definition. To make the requirements of accounting standards consistent with the definition of 'income' contained in the Framework and to avoid the impact of gains or losses on account of fluctuations in the fair value of fixed asset on the profit or loss, the need for OCI arises. Accordingly, such gains and losses are recognised in OCI component of the statement of profit and loss; the conventional profit or loss being the other component (see Ind AS 1, *Presentation of Financial Statements*). The corresponding debit/credit of such items is the appropriate component of equity, such as, Revaluation Reserve. OCI, thus, brings into accounts the economist's perspective of income. The objective of any business is maximisation of wealth to its shareholders. One argument in favour of OCI is that profit or loss focuses on the accountant's concept of income whereas OCI fills the gap for the wealth creation objective which is evident from the above definition of income. Thus, the economist's concept of income is the sum of the accountant's concept of income, namely, profit or loss and the OCI. In Ind AS, this sum is termed as 'Total Comprehensive Income' which meets the definition of the term 'income' in the Framework.

Which items to be recognised in OCI?

While, from the perspective of the definition of the term 'income' in the Framework, OCI bridges the gap by recognising certain items in OCI, it gives rise to various other issues which have vexed the standard-setters including the IASB over the years. The most significant and important issue is which items should be recognised in profit or loss and which items should be recognised in OCI. The IASB has come under considerable criticism as it has been felt by various stakeholders that OCI has been considered as a dumping ground for items which are considered controversial and with regard to which there is inability to reach an acceptable solution by the standard-setter.

In an attempt to address this issue, in July 2013, the IASB issued a Discussion Paper on 'A Review of the Conceptual Framework for Financial Reporting' which, inter alia, discusses the purpose of the statement of profit or loss and OCI. The IASB at its meetings in June and July 2014 deliberated on the proposals in the Discussion Paper and the comments received on those proposals and arrived at the following tentative decisions:

(i) The Conceptual Framework should require profit or loss as a subtotal as at present.

(ii) The Conceptual Framework should describe profit or loss as the primary source of information about an entity's performance for the period, but emphasise that it is not the only source of such information. For example, items included in OCI also provide information about an entity's performance.

(iii) The Conceptual Framework should describe the dual objectives for profit or loss depicting the return that an entity has made on its economic resources during the period, and providing information that is helpful in assessing prospects for future cash flows.

(iv) The Conceptual Framework should include a rebuttable presumption that all items of income and expense should be included in profit or loss unless the IASB concludes in a particular standard that including an item of income or expense–or a component of such an item - in OCI would enhance the relevance of profit or loss as the primary source of information about an entity's performance for the period. This presumption cannot be rebutted for items of income and expense that arise when cost-based measures are used for assets and liabilities. The Conceptual Framework should also propose that the presumption for including items of income and expense in profit or loss can only be rebutted for changes in current measures of assets and liabilities, and only if including those changes-or components of those changes - in OCI enhances the relevance of profit or loss as the primary source of information about an entity's performance for the period. It should be emphasised that including items of income and expense resulting from changes

in current measures of assets and liabilities-or components of those changes-in OCI is an application of the classification, aggregation and disaggregation principle for presentation and disclosure, designed to provide effective communication of financial information and to make that information more understandable.

(v) The Conceptual Framework should specify that where the measurement of an item in balance sheet differs from the measurement of the related item in profit or loss, the difference would be reported in OCI.

Under IFRS, the following items are presently recognised in OCI:

(i) Fair value changes on revaluation of property, plant and equipment and intangible assets as per IAS 16, *Property, Plant and Equipment* and IAS 38, *Intangible Assets*.

(ii) Remeasurements of employee defined benefit plans, e.g., actuarial gains and losses, as per IAS 19, *Employee Benefits*.

(iii) Gains and losses arising from translating the financial statements of a foreign operation as per IAS 21, *Effects of Changes in Foreign Exchange Rates*.

(iv) Gains and losses from investments in equity instruments designated at fair value through other comprehensive income as per IFRS 9, *Financial Instruments*.

(v) Gains and losses of financial assets having specified payment of principal and interest held to collect contractual cash flows and to sell as per IFRS 9, *Financial Instruments*.

(vi) The effective portion of gains and losses on hedging instruments in a cash flow hedge and the gains and losses on hedging instruments that hedge investments in equity instruments measured at fair value through other comprehensive income as per IFRS 9, *Financial Instruments*.

The reason for the carve out in Ind AS 103 is that at the time of business combination the assets and liabilities acquired and the purchase consideration are all valued at fair value and, accordingly, it is felt that the resulting gain should not be recognised in profit or loss but should be recognised in equity either by routing it through OCI or directly in equity.

(vii) For particular liabilities, designated at fair value through profit or loss, the amount of the change in fair value attributable to changes in the liability's credit risk as per IFRS 9, *Financial Instruments*.

(viii) Changes in the value of the time value of options when separating the intrinsic value and time value of an option contract and designating as the hedging instrument only the changes in the intrinsic value as per IFRS 9, *Financial Instruments*.

(ix) Changes in the value of the forward elements of forward contracts when separating the forward element and spot element of a forward contract and designating as a hedging instrument only the changes in the spot element, and changes in the value of the foreign currency basis spread of a financial instrument when excluding it from the designation of that financial instrument as the hedging instrument as per IFRS 9, *Financial Instruments*.

Under Ind AS, apart from the items listed above, Ind AS 103, *Business Combinations* requires that if there exists a clear evidence of the underlying reasons for classifying the business combination as a bargain purchase, the gain is recognised in OCI and with a corresponding recognition as 'capital reserve'. In case, no clear evidence exists of underlying reasons for classifying a business combination as a bargain purchase, the excess is recognised directly in capital reserve as a component of equity. IFRS 3 does not make such distinctions and requires recognition of the bargain purchase gain in profit or loss. The reason for the carve out in Ind AS 103 is that at the time of business combination the assets and liabilities acquired and the purchase consideration are all valued at fair value and, accordingly, it is felt that the resulting gain should not be recognised in profit or loss but should be recognised in equity either by routing it through OCI or directly in equity as stated above. It may also be noted that where there is no clear evidence of underlying reasons for classifying business combinations as a bargain purchase, the gain directly recognised in capital reserve does not meet the definition of 'income' as has been the objective of introducing the concept of OCI.

Reclassification/Recycling of items of OCI

Another issue which has been much debated at the international *fora* is that while at initial recognition, the items recognised in OCI are generally unrealised

gains or unrealised losses, whether on realisation, the resulting gain or loss on such items should be recognised in profit or loss or the same should remain in OCI. Under Ind AS, while certain items are re-classified or re-cycled into profit or loss on realisation, there are certain other items which remain in OCI even on realisation. Such adjustments in OCI are termed as 're-classification adjustments', which are defined in Ind AS 1, *Presentation of Financial Statements, as follows*:

> ***"Reclassification adjustments are amounts reclassified to profit or loss in the current period that were recognised in other comprehensive income in the current or previous periods".***

Of the nine items recognised in OCI as mentioned in an earlier paragraph, the relevant Ind AS prohibit the recycling of such items into profit or loss in the following cases:

(i) Fair value changes on revaluation of property, plant and equipment and intangible assets as per Ind AS 16, *Property, Plant and Equipment* and Ind AS 38, Intangible Assets.

(ii) Re-measurements of employee defined benefit plans as per Ind AS 19, *Employee Benefits*.

(iii) Gains and losses from investments in equity instruments designated at fair value through other comprehensive income as per Ind AS 109, *Financial Instruments*.

(iv) For financial liabilities designated at fair value through profit or loss, the amount of the change in fair value attributable to changes in the entity's own credit risk as per Ind AS 109, *Financial Instruments*.

Under Ind AS 103, it has not been specified whether the bargain purchase gain recognised in OCI should be re-classified in profit or loss or not. It is presumed that this would continue in OCI. Apart from the items listed above, the other items recognised in OCI get re-classified in profit or loss on realisation thereof.

One argument against reclassification is that reclassification from OCI in profit or loss amounts to recognition of the same income twice. The proponents of this belief, *e.g.,* Accounting Standards Board of Japan (ASBJ) argue that profit or loss should be an all-inclusive measure and, thus, all items included in OCI should be subsequently recycled to profit or loss, because of the following reasons.

- The accumulated total profit or loss and the accumulated total cash flows over all accounting periods since the inception of the entity would be the same when all other comprehensive income items are recycled. On the other hand, if any other comprehensive income item is not recycled, some of the cash flows would never be reflected in profit or loss, which would change the fundamental characteristic of profit or loss and impair the usefulness of profit or loss as an overall measure of performance.
- Recycling of other comprehensive income is necessary from the viewpoint of stewardship. From the viewpoint of stewardship, profit or loss should be all-inclusive and, therefore, even the effects of non-recurring transactions or events should be included in profit or loss because they may affect the assessment of the capability of management.

In view of the above, it may be interesting to note that the ASBJ decided to make 'deletions or modifications' to the Standards issued by the IASB to eliminate all of the non-recycling requirements and to require the recycling of all items included in other comprehensive income in principle, except for revaluation surplus under the revaluation model on property, plant and equipment and intangible assets, considering that it appears to have aspects different from other non-recycling items in that there is a conceptual debate as to whether revaluation surplus is based on the concept of physical capital maintenance.

As far as the ICAI is concerned, no carve-outs to the treatment of items in OCI have been made in Ind AS. The argument of ASBJ that the revaluation of fixed assets is based on physical concept of capital is debatable. The revaluation gains and losses represent unrealised gains and losses due to market fluctuations that represent the economist's perspective of income and expenses. Even on sale, any balance left in revaluation surplus is an unrealised gain and hence should not be recycled to profit or loss. With regard to the re-measurements of defined benefit liabilities (assets) which ASBJ

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decided to be allocated and reclassified from OCI to profit or loss over the remaining working lives of employees as it feels that recycling on the basis of actual payment to individual employees would make the financial statements more relevant. However, it is felt that as the defined benefit liability (asset) is determined for all the employees covered in the plan, it is almost impossible to identify the movement in liability (asset) for each employee. Using a proxy for recycling based on actual payments to individual employees will make the financial statements not only less relevant but also less reliable. It may be noted that such a recycling provision was there in IAS 19 before 2013 and was scrapped in the revised standard after due consideration on its relevance and reliability. Further, the decision of ASBJ to permit recycling of gains and losses on equity instruments recognised in OCI brings into existence the IAS 39 category of "Available for Sale" and the issues related to it which would defeat the very reason for removing that category in IFRS 9 (Ind AS 109). Also, the requirement of ASBJ to test such equity instruments for impairment on the basis of incurred loss model once again defeats the very purpose of introducing Expected Loss Model of Impairment in IFRS 9 (Ind AS 109). Similarly, recycling of changes in fair value of a liability due to own credit risk to profit or loss would defeat the very purpose of requiring such changes to OCI. In view of these reasons, the ICAI has decided to go along with the requirements of IFRS issued by IASB.

The Conceptual Framework project of the IASB has decided tentatively that the Framework should include a rebuttable presumption that all items of income and expense included in OCI should be recycled to profit or loss. In which situation, the presumption is to be rebutted as to be left to the Standard-setter, namely, the IASB.

Presentation of OCI items

The nature of items to be classified or not to be classified into profit or loss in OCI has necessitated that the Ind AS 1, *Presentation of Financial Statements*, requires that under the OCI section, line items for amounts of OCI in the period are presented, classified by nature (including share of the OCI of associates and joint ventures accounted for using the equity method) and grouped into those that, in accordance with other Ind ASs:

(a) will not be reclassified subsequently to profit or loss; and

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(b) will be reclassified subsequently to profit or loss when specific conditions are met.

An entity is required to disclose the amount of income tax relating to each item of OCI, including reclassification adjustments either in the statement of profit and loss or in the notes. Therefore, the presentation of items of OCI may be either:

(i) net of related tax effects; or

(ii) before related tax effects with one amount shown for the aggregate amount of income tax relating to those items.

Where an entity elects alternative (ii) above, the total tax pertaining to items of OCI is required to be allocated between the items that might be reclassified subsequently to the profit or loss section and those that will not be reclassified subsequently to profit or loss section. Ind AS 1 further requires the reclassification adjustments relating to components of other comprehensive income to be disclosed separately. It may be noted that where a standard specifies "disclose", it means disclosure in the notes and where a standard specifies "present", it means presentation on the face of the financial statements, *viz.*, balance sheet, statement of profit and loss, statement of cash flows and statement of changes in equity. Ind AS 1 provides an option to present reclassification adjustments either in the statement of profit or loss or in the notes. If the entity presents reclassification adjustments in the notes, the items of OCI presented in the statement of profit and loss will be after any related reclassification adjustments.

Conclusion

For the time being, we can gather that the concept of OCI is going to remain. The Conceptual Framework being developed by IASB may reduce controversies related to which items should be recognised in OCI and which of those should be recycled. However, since this aspect will be addressed in the individual standards, there may be occasions when all concerned may not agree with the final outcome. ■