Ontario Securities Commission Staff Notice 52-711
Income Statement Presentation

The purpose of this Staff Accounting Communique (the "Communique") is to communicate staff's views with respect to generally accepted accounting principles as applied to certain income statement presentation issues. In particular, this Communique addresses the presentation of items on a net of tax basis, the presentation of subtotals such as operating income on the face of the income statement and the disclosure of earnings per share.

During 1989 and 1990, a number of changes were made to the CICA Handbook that affected existing accounting practice with respect to Discontinued Operations (section 3475), Extraordinary Items(section 3480) and Capital Assets (section 3060). Sections 3475 and 3480 state that discontinued operations and extraordinary items must be disclosed on a net of tax basis.

The definition of an extraordinary item was narrowed and a clear distinction was made between extraordinary items and unusual items. The nature of items that can be classified as extraordinary and, for that reason presented net of tax is limited to infrequently occurring events that do not typify normal business activities and that do not depend primarily on decisions or determinations by management or owners (e.g. a loss incurred as a result of an earthquake). Unusual items are those resulting from transactions or events that have some but not all of the characteristics of extraordinary items. Section 1520 requires disclosure of such unusual items resulting from transactions or events that are not expected to occur frequently over several years or that do not typify normal business activities of the entity. Some examples of unusual items are inventory write-downs, plant relocation expenses, restructuring costs, provisions for plant closing which are not discontinued operations, gains from the sale of capital assets and gains on the settlement of claims. These unusual items may occur infrequently or they may not be "normal" or "typical", however, they may be part of the activities of the normal business cycle, which for many industries extends beyond the standard 12-month annual reporting period ("Normal Business Activities").

The significant requirement in section 3060 that is of relevance to this Communique is that intangible capital assets must be amortized over their useful lives.

Since the implementation of these CICA Handbook sections, it has come to staff's attention that some issuers have adopted accounting practices that staff does not view as in accordance with generally accepted accounting principles. Certain issuers have adopted an income statement presentation that excludes the amortization of intangible assets (e.g. circulation and subscription rights) from operating income. Amortization expense, net of tax, is presented in an area of the income statement that is normally limited to the presentation of discontinued operations and extraordinary items. Other issuers have presented unusual items in a manner similar to discontinued operations and extraordinary items. In some cases earnings per share is disclosed on the face of the income statement before the effects of the amortization of intangible assets or unusual items.

In staff's view, presenting any items other than extraordinary items and discontinued operations on a net of tax basis on the face of the income statement is contrary to generally accepted accounting principles. The fact that the CICA Handbook requires net of tax presentation only in respect of these two items in staff's view is intended to restrict the use of net of tax presentation to these two items alone. Footnote 3 to section 3470 of the CICA Handbook states that "The net-of-tax method distorts results by mixing the tax effect with other items in the income statement and in the balanced sheet. In the view of the Research Committee, it should not be used." Income statement items such as amortization expense and unusual items should be disclosed on a gross basis and should not be sequestered from other income statement items in a manner that suggests they are similar to extraordinary items and discontinued operations. Presenting items that result from Normal Business Activities as if they are extraordinary implies that these items are non-recurring, do not typify normal business activities and are beyond the control of the issuer's management when that is not the case. For that reason, in staff's view such presentation is potentially misleading.

Nonetheless, examples of net of tax presentation of items other than discontinued operations and extraordinary items continue to be filed on the public record. Staff has been made aware of issuers with income statement presentation that currently conforms to generally accepted accounting principles that are now considering the adoption of net of tax presentation for operating expense items such as amortization because financial statements prepared on this basis have been filed by other issuers. To prevent any misapprehension as to the unacceptability of this presentation, it is considered necessary to provide guidance on this issue and to formally advise issuers that in the view of staff, only discontinued operations and extraordinary items should be presented on a net of tax basis on the face of the income statement.

With respect to the presentation of subtotals such as operating income, operating profit or income from continuing operations on the income statement, staff notes that there is no specific CICA Handbook recommendation that requires the use of such subtotals nor is there any authoritative guidance that sets out what items must be included. Staff recognizes that there are difficult allocation issues with respect to some income statement items and this Communique does not address these allocation issues. The development of a comprehensive income statement standard is beyond the scope of this Communique.

However, in staff's view the exclusion of items that are directly related to Normal Business Activities from an income statement subtotal that is clearly intended to be representative of such activities is misleading and limits the comparability of financial information. This is particularly true when issuers in the same industry adopt different interpretations of operating income. To ensure comparability and to address the existing practice problem, those issuers that choose to highlight an income statement subtotal such as operating income should include all items in that subtotal that are reasonably considered to be representative of Normal Business Activities. This includes write-downs of working capital items such as inventory and accounts receivable, as well as depreciation and amortization of capital assets that generate operating revenue, among other items. For example, amortization of publishing rights and circulation must be included in the operating income subtotal of a company with significant publishing operations. If highlighting a particular income statement item is desired, it can be achieved by presenting the item as a separate line item on the face of the income statement or in the notes to the financial statements on a before tax basis.

With respect to earnings per share, staff's view is that the accounting standards in section 3500 of the CICA Handbook are quite clear in requiring basic earnings per share figures be shown for income before discontinued operations and extraordinary items and net income for the period. Generally accepted accounting principles do not contemplate the presentation of earnings per share before the deduction of unusual items or operating items such as amortization expense. Issuers should not disclose earnings per share before the deduction of unusual or operating items on the face of the income statement.

If information on the net income impact of certain items is considered desirable, this information, including the tax effect, may be disclosed in the notes to the financial statements. This disclosure would be similar to the disclosure permitted for a change in accounting policy. The disclosure may include the per share effects, disclosure of earnings per share information in summary financial statements or financial high-lights must include the earnings per share information required by section 3500 of the CICA Handbook. All references to supplementary earnings per share should be referenced to an appropriate note to the financial statements or other information that enables the reader to identify the specific items included or excluded from the supplementary earnings per share information.

The staff view on these issues has been previously communicated to reporting issuers and their advisers in staff comment letters and in the Office of the Chief Accountant's financial statement review reports. However, as a result of practice by some issuers, it is considered necessary to communicate the staff view in a more formal manner in this Communique in order to clarify that financial statements which do not comply with these recommendations will be considered by staff to be inappropriate for purposes of meeting the financial statement requirements under the *Ontario Securities Act* and Regulation.