

Does OCI Presentation for Equity Financial Assets Matter?

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One significant change in International Financial Reporting Standard (IFRS) 9 Financial Instruments is how firms' equity financial assets (EFA) are presented. The default EFA presentation is at fair value through profit or loss (FVTPL); however, IFRS 9 allows irrevocable presentation of fair value through other comprehensive income (FVTOCI). Although FVTOCI is the most common presentation for EFA both before and after IFRS 9, there is a significant increase in the use of FVTPL post IFRS 9 via an improvement in disclosure clarity about presentation location. To assess the impact of EFA presentation, we recalculate profitability ratios assuming different presentation locations and find some evidence of significant differences for financial firms. We also provide descriptive evidence that EFA use and presentation behaviour vary between sectors and firm size quartiles. This study expands the literature on EFA accounting and provides a timely response to IFRS 9 post-implementation review by shedding some light on EFA use and presentation locations under IFRS 9.

In its effort to reduce financial instruments accounting complexity, the International Accounting Standards Board (IASB) issued International Financial Reporting Standard (IFRS) 9 *Financial Instruments*, which supersedes International Accounting Standard (IAS) 39 *Financial Instruments: Recognition and Measurement*. One significant change relates to the presentation of fair value gains or losses (FVGL) on financial assets that are equity investments in other entities (equity financial assets, hereafter EFA). Under IAS 39, the FVGL on EFA classified as at fair value through profit or loss (FVTPL) are presented in profit or loss, but the FVGL on available-for-sale (AFS) EFA are presented in other comprehensive income (OCI) (IAS 39, 55). IFRS 9 removes the AFS category for financial assets and uses profit or loss as the default presentation location for their FVGL on EFA. However, it allows not held-for-trading EFA to be presented at fair value through OCI (FVTOCI) (IFRS 9, 4.1.4 and 5.7.5).¹

The rationale for IFRS 9 allowing the FVTOCI presentation category for FVGL on EFA is that a separate presentation in OCI for some EFA would make it easier to identify the associated fair value changes and could provide decision-useful information to users (IFRS 9, BC5.23). However, prior literature suggests that managers tend to continue their previous accounting policies when a choice is allowed in new standards (Kvaal and Nobes 2012). Therefore, managers may continue to present the FVGL on EFA that are previously classified as AFS assets in OCI. Alternatively, managers may present the FVGL in OCI for more EFA to exploit the presentation choice given in IFRS 9. As judgement and discretion are involved in EFA presentation choice, the FVGL may signal different information about management moti-

vation depending on where it is presented. Managers may choose FVTOCI presentation for EFA if they want to reduce the variability in net profit, which is usually used in contracts (e.g., bonus and debt covenants). These choices may defeat the purpose for which the IASB allows the FVTOCI category. However, it is unclear how managers will exercise this choice. Further, the exercise of the choice may result in similar EFA being treated differently, thus compromising the comparability of accounting information for EFA.

The IASB is now reviewing the implementation of the classification and measurement requirements of IFRS 9. It issued a Request for Information (RFI) in September 2021, seeking constituents' feedback on how these requirements are working (IASB 2021). Driven by this standard-setting motivation, and in particular to gain insight into the RFI's Question 4, we examine how frequently the FVGL on EFA is presented in OCI and the impact of this presentation choice on financial statements.² We also provide descriptive evidence for whether firms' EFA presentation choice under IFRS 9 varies by sector, firm size or income volatility. There has also been a standard-setting debate on what items to present in OCI, and our paper informs this debate (Bradbury 2016; Hodgson and Russell 2014). Thus, we examine the following research questions:

RQ1. How frequently do firms choose the FVTOCI presentation for EFA?

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RQ2. What are the impacts of FVTOCI presentation choice for EFA on financial ratios?

RQ3. What are the characteristics of firms that choose the FVTOCI presentation for EFA?

Our sample comprises the S&P/Australian Securities Exchange (ASX) 300 index firms, and we examine a firm's EFA one year before and after IFRS 9 adoption in its annual reports both at firm and individual line item levels.³ We find that there is no significant change in the number of firms that have EFA from the prior year to the IFRS 9 adoption year. FVTOCI dominates EFA presentation choice in the adoption year, despite the fact that FVTPL is the default presentation for EFA in IFRS 9. Compared with the prior year, the percentage of firms choosing FVTOCI for FVGL on EFA remains largely stable. However, we find that the percentage of firms choosing only FVTPL presentation for EFA increased significantly in the adoption year, which is mainly due to a significant decrease in firms that have no EFA presentation choice disclosure. We find similar results when we consider the presentation at the EFA individual line item level.

These are encouraging indications that, first, as FVTOCI presentation choice remains stable, practitioners are choosing to present not-held-for-trading EFA in FVTOCI under IFRS 9, which is in accordance with the IASB's intention of allowing FVTOCI presentation. Second, the disclosure clarity of EFA presentation location has improved since the adoption of IFRS 9. We infer that the potential disruption of EFA presentation in IFRS 9 is minimal, which is a positive sign for preparers, users and the IASB.

In terms of the impacts of FVTOCI presentation choice for EFA on financial ratios in RQ2, we calculate profitability ratios assuming different presentation choices are used. With a non-parametric test, we do not find statistically significant differences for any of the ratios. However, there is some evidence that suggests ROE and EBIT margin are higher if all EFA use FVTPL rather than FVTOCI for financial firms, but not for non-financials. The profitability ratios are not statistically significantly different between as reported and using different presentation assumptions. Though further analysis is needed, financial firms report larger EFA values than non-financial firms and thus material changes are largely confined to this industry. Furthermore, it appears that firms do not (and in many cases cannot) choose between FVTOCI and FVTPL to maximise profit.

To understand the characteristics of firms that choose the FVTOCI presentation for EFA in RQ3, we find that the two sectors that have the greatest number of firms with EFA are financials and materials both before and after IFRS 9 adoption. EFA presentation choice varies by sector, with all firms in utilities, healthcare and communication services sectors presenting their EFA in FV-

TOCI only in both years. Using only FVTOCI presentation for EFA in financial firms decreases from the prior year to the IFRS 9 adoption year. Furthermore, firm size affects EFA presentation choice as larger firms are more likely to have EFA and are less likely to use FVTOCI. This may be because larger firms tend to have multiple EFA line items that use different presentation locations, and financial firms in the larger size quartiles are FVTPL users. We do not find a clear pattern in the choice of the FVTOCI presentation for EFA according to income volatility, which provides evidence that firms use FVTOCI presentation as allowed in IFRS 9 without reducing income volatility intentionally.

This study responds to the IASB's post-implementation review of IFRS 9 in its work plan with particular emphasis on EFA presentation choice (IASB 2020) and speaks to standard setters on how the alternative EFA presentation option is implemented by firms. First, as IFRS 9 is newly effective, our paper is among the first to show firms' EFA use and materiality by discussing EFA presentation choices under IFRS 9. Second, this study offers practical contributions to managers, auditors and investors by shedding some light on EFA presentation location requirements in IFRS 9. We emphasise differences across sectors, with the particular importance of EFA in financial firms. As Australian accounting standards adopt IFRS 'word for word' (Thomson 2009; Wang 2019), the results of this study are likely generalisable to other IFRS jurisdictions.

Background and Related Literature

EFA standard setting

IAS 39, issued in 1999, is the first comprehensive standard dealing with the recognition, derecognition and measurement of financial instruments and hedge accounting (Deloitte 2021a). The standard went through multiple revisions after it was issued. In this study, we focus on the 2009 version of IAS 39 that was in force before the IASB issued IFRS 9.

IAS 39 classifies financial assets into four categories: (1) a financial asset at FVTPL; (2) held-to-maturity investments; (3) loans and receivables; and (4) AFS financial assets (IAS 39, 9). EFA are classified as FVTPL or AFS assets according to the manner of use and management choice (IASB 2009a). All EFA, except for those whose fair value cannot be reliably measured, must be measured at fair value at each balance date (IAS 39, 46).⁴ The FVGL on EFA that are classified as FVTPL must be presented in profit or loss. FVGL on AFS must be taken to OCI with the cumulative FVGL reclassified to profit or loss once the assets are derecognised (IAS 39, 55). Although the classification and measurement of EFA in IAS 39 have been widely applied for many years, it is

criticised for being too rule-based and complex, and creating opportunities for subjective application by managers (Fang et al. 2022; Barth et al. 2017; Dong and Zhang 2018; IASB 2021).

IFRS 9 requires fair value measurement for all EFA, with presentation in profit or loss being the default presentation basis for FVGL on EFA (IFRS 9, 4.1.4). However, firms may irrevocably choose to use FVTOCI at initial recognition when the EFA is ‘neither held for trading nor contingent consideration recognised by an acquirer in a business combination to which IFRS 3 applies’ (IFRS 9, 5.7.5). Once FVTOCI presentation is selected, EFA gains and losses from fair value changes are recognised in OCI, and the cumulative FVGL previously recognised in OCI are not reclassified to profit or loss on derecognition.

EFA and OCI presentation research

Examining the implementation of the local equivalent of IFRS 9, Fang et al. (2022) find a decrease in EFA use immediately before its adoption in China. They suggest that firms respond to the risk of fair value fluctuations increasing earnings volatility by decreasing their EFA holdings (Fang et al. 2022).

Prior research also examines whether firms’ AFS assets’ use is opportunistic (Dong and Zhang 2018; Barth et al. 2017; Guo et al. 2019). Dong and Zhang (2018) find that US banks selectively trade their AFS assets for earnings management purposes, and this behaviour is not due to a lack of fair value measurement reliability (Dong and Zhang 2018). Barth et al. (2017) find consistent evidence that US banks manipulate earnings by realising gains and losses on AFS assets. Furthermore, banks’ earnings management behaviour is not eliminated by including gains and losses on AFS assets in OCI (Barth et al. 2017). Guo et al. (2019) use one Chinese company as a case study to provide a closer look at accounting treatments for EFA under the Chinese accounting standard that converges with IAS 39. They find that the company strategically classified its equity investments as AFS assets and presented FVGL in OCI to reduce the volatility of net profit. Besides, by increasing the holding percentage of the equity investments, the company reclassified its EFA to long-term equity investments, to which equity accounting IAS 28 *Investments in Associates and Joint Ventures* applies, for the purpose of smoothing earnings.⁵

OCI, which is a repository of items that are not included in net income, is perceived as a ‘dumping ground’ for controversial items that are frequently complex and ambiguous (Rees and Shane 2012; Detzen 2016). A stream of literature discusses the usefulness of OCI in decision making (Mechelli and Cimini 2014; Wang et al. 2019; Kabir and Laswad 2011). Mechelli and

Cimini (2014) find that total OCI is value relevant in a sample of listed European entities. In contrast, Kabir and Laswad (2011) do not find incremental value relevance of OCI in New Zealand listed companies though OCI is able to predict one-year-ahead cash flows from operating activities.

One argument for excluding unrealised gains or losses from profit or loss and presenting them in OCI is that incorporating these in profit or loss would induce volatility in profit (Bradbury 2016; Black 2016). Since EFA presentation location affects firms’ net income or OCI, it is possible that firms use EFA presentation choice as a tool to reduce income volatility or to smooth earnings. This study explores firms’ sector, firm size, and income volatility as three main factors in understanding firms’ EFA presentation choice behaviour.

Research Design

Sample and data

Our initial sample comprised all firms in the S&P/ASX 300 index on 22 March 2021. S&P/ASX 300 firms account for about 85% of the market capitalisation of ASX firms. The index includes firms from all 11 Global Industry Classification Standard (GICS) sectors and covers large-cap, mid-cap and small-cap firms, allowing us to examine whether the exercise of the presentation choice varies by sector and firm size.

We excluded from the initial sample 25 investment entities (e.g., exchange traded or managed funds), six firms that apply US Generally Accepted Accounting Principles (US GAAP), one insurance firm that is exempt from adopting IFRS 9 till 2022, and 14 newly listed firms with annual reports available from 2019. This selection process yielded a sample of 254 firms. Panel A in Table 1 describes the sample selection process.

IFRS 9 is effective on or after 1 January 2018, with earlier application permitted.⁶ Panel B in Table 1 displays the distribution of firms’ IFRS 9 adoption by year, and we note that firms without EFA may still adopt IFRS 9 early for other financial instruments. The majority of firms with EFA applied IFRS 9 in 2019. This is the effective year for firms whose balance dates are other than 31 December. Since 30 June is the most common balance date for Australian firms, IFRS 9 became effective in 2019 for most of the sample firms.

We hand-collected EFA data from the sample firms’ annual reports, which we downloaded from firms’ websites or the ASX website, in the IFRS 9 adoption year and the previous year for comparison (508 firm years in total). We read each firm’s financial statements to confirm if the firm had EFA. For these firms, we collected the nature of the EFA, what securities the firm invests in, the number of EFA line items, where in the statement

Table 1 Sample**Panel A: Sample selection process**

	No. of firms
Total number of firms	300
Less: Funds	-25
US GAAP users	-6
Exempt from adopting IFRS 9	-1
Newly listed with annual report available from 2019	-14
Total firms to check for EFA (full sample)	254
Firms with EFA in adoption year	111

Panel B: Sample by IFRS 9 adoption year

IFRS 9 adoption year	2014	2015	2016	2017	2018	2019	Total
Firms in full sample	4	10	7	8	39	186	254
Firms with EFA	3	6	3	2	13	84	111

of profit or loss and OCI the firm presents the FVGL on EFA, the value of EFA both at the firm and individual line item levels, and the effect of EFA on profit or loss and OCI. Other firm financial data were collected from the Eikon database.

Research method

If a firm only presents the FVGL on EFA in profit or loss (OCI), then we classify it as an only FVTPL (only FVTOCI) user. Some firms have multiple EFA line items and classify some EFA as FVTPL and other EFA as FVTOCI (classified as both FVTOCI and FVTPL users). Last, if a firm does not disclose where it presents the FVGL, it is classified as a no FVTOCI/FVTPL disclosure user. To provide any insight into the change in the choice of FVTOCI presentation between before and after IFRS 9 adoption, we report results in grouping term any FVTOCI (FVTPL) users who are the only FVTOCI (only FVTPL) users plus the both users category at firm level analysis.

We report EFA statistics for both undeflated and deflated values at the firm and line item levels and for each presentation category separately for the adoption and pre-adoption years. We use total assets and market capitalisation as deflators. Deflated values allow us to evaluate the quantitative materiality of EFA. We also report the statistics for financial and non-financial firms separately.

For RQ2, we focus on the impact of OCI presentation choice for EFA on firms' profitability ratios because investors are interested in firm profit performance, and analysts' forecast and managerial compensation are linked to profitability (Efendi et al. 2007; Yu 2010; Farouk and Hassan 2014; Bishop et al. 2005). We consider two measures of profitability: return on equity (ROE) and earnings before interest and tax (EBIT) margin (Stent et al. 2010).⁷ ROE is net income scaled by to-

tal common equity, and EBIT margin is EBIT scaled by total revenue.

We calculate the profitability ratios using three sets of numbers. First, we calculate the ratios using the reported numbers ('Reported ratios'). Second, we assume that all firms categorise their EFA as FVTPL and recalculate the ratios ('All FVTPL ratios'). Third, we assume that all firms categorise their EFA as FVTOCI and recalculate the ratios ('All FVTOCI ratios'). We report differences using the non-parametric Wilcoxon test and student *t*-test for robustness between the sets of ratios.

For RQ3, we explore whether FVTOCI presentation choice varies by sector, firm size and income volatility. We first report how many firms have EFA and how many firms are in each presentation category in each sector. We then repeat this analysis by dividing the full sample firms (254 firms) into quartiles according to their total assets. To explore whether firms' EFA presentation choice is related to income volatility, we use the standard deviation of ROE as our income volatility proxy. We divide the full sample into quartiles according to the standard deviation of ROE, calculated over a five-year window up to and including the IFRS 9 adoption year (Jayaraman 2008; Hunt et al. 2000).

Results

The use of EFA: Frequency and magnitudes

Table 2 reports the frequency of different EFA presentation categories at the firm and line item levels. One hundred and eleven (43.7%) firms have EFA at their IFRS 9 adoption year-end, which is not significantly different from the prior year. We also find that only FVTOCI is most widely used during both the adoption and pre-adoption year (47.7% and 50.5%, respectively), followed by only FVTPL (38.7% in the adoption year and 25.7% in the pre-adoption year) and both FVTOCI

Table 2 The use of EFA presentation at firm and line item level**Panel A: Use of EFA presentation at firm level**

	IFRS 9 adoption year		Pre-adoption year		Chi-square
	No.	%	No.	%	
Only FVTOCI users	53	47.7	55	50.5	0.047
Only FVTPL users	43	38.7	28	25.7	3.682*
Both FVTOCI and FVTPL users	12	10.8	10	9.2	0.190
No FVTOCI/FVTPL disclosure users	3	2.8	16	14.6	14.993***
Any FVTOCI users	65		65		0.026
Any FVTPL users	55		38		4.861**
Firms with EFA	111	43.7	109	42.9	0.032

Panel B: Use of EFA presentation at line item level

	IFRS 9 adoption year		Pre-adoption year		Chi-square
	No.	%	No.	%	
FVTOCI EFA items	94	47.7	103	53.9	1.619
FVTPL EFA items	100	50.8	67	35.1	9.990***
No FVTOCI/FVTPL disclosure EFA items	3	1.5	21	11.0	14.888***
EFA items	197	100	191	100	
Average EFA items per firm	1.77		1.75		

Any FVTOCI (FVTPL) users are only FVTOCI (FVTPL) users plus both FVTOCI and FVTPL users. % for different categories indicates the percentage of firms (items) in that category to the total firms (items) with EFA. % for firms with EFA indicates the percentage of firms with EFA in the full sample. Chi-square tests are reported on the change in the number of different EFA presentation users before and in the IFRS 9 adoption year. Chi-square test is performed for each of the categories and the other categories are grouped together as a different category. *, ** and *** represent statistical significance at the 10%, 5% and 1% levels, respectively.

and FVTPL methods (10.8% in the adoption year and 9.2% in the pre-adoption year). Forty-six (86.8%) of the 53 firms that are only FVTOCI users in the IFRS 9 adoption year are also only FVTOCI users in the previous year.

We make two inferences based on our results. First, the consistent use of FVTOCI suggests that firms choose the FVTOCI presentation for not-held-for-trading EFA, which were classified as AFS securities under IAS 39, without violating the IASB's purpose of allowing the FVTOCI category in IFRS 9. Second, the FVTPL users increase significantly from the prior year to the adoption year. This is mainly because of the decrease in the percentage of firms that do not disclose where they present the FVGL on EFA (16 (14.6%) during the pre-adoption year versus three (2.8%) during the adoption year). This suggests that IFRS 9 has improved firm disclosures about their EFA presentation location.⁸

As shown in Panel B of Table 2, a total of 197 EFA line items are reported in the 111 firms' annual reports, with an average of 1.77 EFA line items per firm. Sixty firms report only one EFA line item (data not in the table). The use of different presentation locations is relatively even in the adoption year, with 94 (47.7%) using FVTOCI presentation and 100 (50.8%) using FVTPL. Again, we find a significant increase in the EFA line items using the FVTPL presentation and a decrease in non-disclosures

in the adoption year.⁹ Thus, the results at the line item level support our inferences from the firm-level analysis.

Table 3, Panel A shows the descriptive statistics for EFA magnitudes at the firm level. The average EFA value is \$1,933.6 million (\$1,730.5 million) in the adoption year (pre-adoption year). However, the median value is only \$44.3 million (\$40.0 million in the pre-adoption year). The large difference between mean and median is due to a large value of EFA in financial firms, whereas EFA value in non-financial firms is often much smaller. Considering differences in EFA use between financial and non-financial firms, we provide separate descriptive statistics of EFA values in financial and non-financial firms. The average EFA value in financial firms is \$5,615.2 million, whereas it is \$92.8 million in non-financial firms in the IFRS 9 adoption year.

We also report descriptive statistics for EFA value, deflated by total assets and market capitalisation in each category, respectively. The mean (median) EFA to total assets is 12.5% (0.9%) in the IFRS 9 adoption year. The mean (median) EFA to market capitalisation is 30.0% (1.1%). Judged by a quantitative materiality threshold of 5% of total assets, EFA are not material for 71.2% of firms. However, EFA are material for 59.5% of financial firms. For example, the median EFA to total assets is 8.3% for financial firms but only 0.5% for non-financial firms in the IFRS 9 adoption year. There are no significant differences for any EFA value between the IFRS 9

Table 3 Descriptive statistics of EFA magnitudes at firm and line item level**Panel A: Descriptive statistics of EFA magnitudes at firm-level**

	Adoption year						Pre-adoption year			
	Obs	Mean	Median	S.D.	Min.	Max.	Mean	Median	t-test	z-score
All firms with EFA										
EFA value	111	1933.6	44.3	9596.7	0.0	75792.0	1730.5	40.0	1.430	0.053
EFA/Total assets	111	12.5%	0.9%	27.1%	0.0%	100.0%	12.7%	1.3%	0.123	−0.503
EFA/Market capitalisation	111	30.0%	1.1%	116.6%	0.0%	1127.1%	19.9%	1.1%	1.496	0.223
Financial firms with EFA										
EFA value	37	5615.2	916.1	16136.6	0.2	75792.0	5060.7	728.5	1.462	−0.199
EFA/Total assets	37	32.8%	8.3%	39.5%	0.0%	100.0%	33.2%	8.7%	0.466	0.055
EFA/Market capitalisation	37	83.1%	23.0%	192.3%	0.0%	1127.1%	53.2%	8.3%	1.581	−0.872
Non-financial firms with EFA										
EFA value	74	92.8	19.9	243.2	0.0	1547.8	88.2	19.8	0.510	−0.110
EFA/Total assets	74	2.4%	0.5%	4.9%	0.0%	26.1%	2.6%	0.6%	0.689	0.593
EFA/Market capitalisation	74	3.5%	0.7%	10.2%	0.0%	62.1%	3.9%	0.6%	1.352	0.244
Only FVTOCI users										
EFA value	53	366.6	24.3	1152.6	0.0	6409.6	370.5	37.9	0.018	0.713
EFA/Total assets	53	12.8%	0.7%	30.1%	0.0%	98.1%	13.6%	1.2%	0.153	0.698
EFA/Market capitalisation	53	14.1%	0.8%	33.8%	0.0%	116.5%	14.6%	1.0%	0.080	0.476
Only FVTPL users										
EFA value	43	561.0	60.0	1509.2	0.1	9599.0	370.9	66.7	0.762	−0.329
EFA/Total assets	43	14.0%	1.7%	26.9%	0.0%	100.0%	19.1%	3.3%	0.719	−1.247
EFA/Market capitalisation	43	19.4%	2.6%	40.8%	0.0%	149.0%	21.2%	3.5%	0.102	−0.353
Both FVTOCI and FVTPL users										
EFA value	12	14253.8	934.0	26836.4	4.9	75792.0	15520.6	1285.3	0.109	−0.330
EFA/Total assets	12	9.5%	2.6%	15.7%	0.0%	52.1%	9.1%	2.6%	0.058	−0.264
EFA/Market capitalisation	12	145.8%	21.2%	328.1%	0.0%	1127.1%	75.6%	16.8%	0.647	0.330
No FVTOCI/FVTPL disclosure users										
EFA value	3	12.0	2.7	17.6	0.9	32.3	166.1	7.1		
EFA/Total assets	3	0.1%	0.0%	0.2%	0.0%	0.3%	0.8%	0.1%		
EFA/Market capitalisation	3	0.1%	0.0%	0.2%	0.0%	0.4%	1.1%	0.4%		
Any FVTOCI users										
EFA value	65	2930.4	40.5	12423.7	0.0	75792.0	2701.3	51.8	0.108	0.484
EFA/Total assets	65	12.2%	0.8%	27.9%	0.0%	98.1%	12.9%	1.4%	0.160	0.836
EFA/Market capitalisation	65	38.4%	1.0%	148.6%	0.0%	1127.1%	24.0%	1.1%	0.697	0.286
Any FVTPL users										
EFA value	55	3548.5	118.1	13455.6	0.1	75792.0	4357.7	134.5	0.263	0.633
EFA/Total assets	55	13.0%	2.0%	24.8%	0.0%	100.0%	16.5%	3.2%	0.616	1.305
EFA/Market capitalisation	55	47.0%	3.0%	161.2%	0.0%	1127.1%	34.9%	3.5%	0.451	0.422

Panel B: Descriptive statistics of EFA magnitudes at line item level

EFA line items										
EFA item value	197	1089.5	21.3	4878.0	0.0	55894.0	985.6	20.9	0.209	0.131
EFA item/Total assets	197	7.1%	0.4%	20.6%	0.0%	100.0%	7.3%	0.4%	0.092	0.378
EFA item/Market capitalisation	197	16.9%	0.7%	71.8%	0.0%	831.2%	11.4%	0.5%	0.946	−0.413
EFA line items in financial firms										
EFA item value	88	2360.9	140.7	7113.8	0.0	55894.0	2065.9	137.5	0.275	−0.364
EFA item/Total assets	88	13.8%	0.9%	0.3%	0.0%	100.0%	13.6%	0.7%	0.055	−0.311
EFA item/Market capitalisation	88	35.0%	1.9%	104.6%	0.0%	831.2%	21.6%	1.5%	1.053	−1.051
EFA line items in non-financial firms										
EFA item value	109	63.0	8.0	189.7	0.0	1529.3	62.5	10.3	0.020	0.437
EFA item/Total assets	109	1.6%	0.3%	0.0%	0.0%	26.1%	1.9%	0.3%	0.414	0.935
EFA item/Market capitalisation	109	2.3%	0.4%	8.0%	0.0%	57.6%	2.8%	0.4%	0.349	0.425
FVTOCI EFA line items										
EFA item value	94	715.6	19.4	2752.4	0.0	22309.0	505.5	19.9	0.600	0.231
EFA item/Total assets	94	7.5%	0.4%	23.0%	0.0%	98.1%	7.5%	0.3%	0.001	0.225
EFA item/Market capitalisation	94	12.9%	0.4%	47.5%	0.0%	395.2%	8.5%	0.4%	0.794	−0.343
FVTPL EFA line items										
EFA item value	100	1473.4	41.8	6298.8	0.0	55894.0	1992.9	69.7	0.452	0.674
EFA item/Total assets	100	6.9%	0.5%	18.5%	0.0%	100.0%	9.0%	0.9%	0.660	1.228
EFA item/Market capitalisation	100	21.2%	0.8%	89.8%	0.0%	831.2%	19.2%	1.4%	0.169	0.594

(Continued)

Table 3 (Continued)**Panel A: Descriptive statistics of EFA magnitudes at firm-level**

	Adoption year						Pre-adoption year		t-test	z-score
	Obs	Mean	Median	S.D.	Min.	Max.	Mean	Median		
No FVTOCI/FVTPL disclosure EFA line items										
EFA item value	3	12.0	2.7	17.6	0.9	32.3	126.6	7.1		
EFA item/Total assets	3	0.1%	0.0%	0.2%	0.0%	0.3%	0.6%	0.0%		
EFA item/Market capitalisation	3	0.1%	0.0%	0.2%	0.0%	0.4%	0.9%	0.2%		

EFA value and EFA line item value are presented in AUD millions. Univariate *t*-test and non-parametric Wilcoxon test examine the EFA value differences between IFRS 9 adoption year and the prior year. The z-score column reports the z-score in Wilcoxon test. *, ** and *** represent two-tailed statistical significance at the 10%, 5% and 1% levels, respectively. No statistical test is performed when the number of observations is less than five.

adoption year and the prior year using univariate tests. This suggests that firms do not change their EFA holding levels in response to IFRS 9.

Panel B of Table 3 provides descriptive statistics of EFA at line item level. The largest EFA line item is 'Financial assets measured at FVTPL-equity securities and listed managed investment schemes' at \$55,894 million, and the smallest EFA line item is 'Non-current Listed Securities-Other' at \$0.007 million. Since the magnitudes are at the line item level, the magnitudes of the statistics are smaller in Panel B than in Panel A.

The effect of EFA on financial ratios

Table 4 displays the impact of OCI presentation on firms' profitability ratios in the adoption year. The sample in Panel A is 111 firms that have EFA. Using the reported figures ('Reported ratios' columns), the mean ROE is 12.5%, and the mean EBIT margin is 10.3%. When we recalculate ratios assuming that all EFA are presented at FVTPL ('All FVTPL ratios'), the mean ROE and EBIT margin is 12.7% and 15.1%, respectively. On the other hand, when assuming that all EFA are presented at FVTOCI ('All FVTOCI ratios'), the average ROE is 12.3% and the EBIT margin is 9.4%.

We report differences between the sets of ratios using the non-parametric Wilcoxon test and student *t*-test for robustness. The differences in mean ROE under these scenarios are not significant at conventional levels. We observe similar results for EBIT margin; however, the difference in mean EBIT margin between 'All FVTPL ratios' and 'All FVTOCI ratios' is marginally significant with the *t*-test. In addition, in untabulated analysis of firms with material EFA, we find no significant difference in ROE between FVTPL and FVTOCI presentations.¹⁰ The difference in EBIT margin between these presentation alternatives approaches only marginal significance ($p = 0.11$).

Figure 1 illustrates the magnitude of change in ratios in the 111 firms that have EFA in the IFRS 9 adoption year. More than 90% of firms' profitability ratios' changes are within 5% when presenting FVGL for EFA at different locations. However, some firms' ratios experience large changes when different EFA presentation locations are chosen. For example, one non-financial firm's ROE changes from 15.5% as reported to -13.4% in 'All FVTPL ratios'. The ROE of another non-financial firm changes from 35.2% ('Reported ratios') to 54.8% ('All FVTPL ratios'). Most financial firms are only FVTPL users that may experience a large change in ROE if FVTOCI presentation is selected. For example, one company's ROE was 15.1% as reported but -4.8% in 'All FVTOCI ratios'. Almost all large EBIT margin changes happen in financial firms.

Next, we report results for any FVTOCI users (Panel B), financial firms (Panel C) and non-financial firms (Panel D) in Table 4. For simplicity, we only report the mean and median ROE and EBIT margin for these subsamples. Similar to the results in Panel A, there are no significant differences for any of the ratios in the subsamples. However, there is some evidence that shows the mean ROE (EBIT margin) of financial firms significantly changes from 13.4% (54.3%) under the 'All FVTPL' scenario to 12.0% (36.7%) under the 'All FVTOCI' scenario. These results suggest that the presentation choice affects profitability significantly for financial firms only. However, there is no difference between what is reported ('Reported ratios') and either 'All FVTPL ratios' or 'All FVTOCI ratios' for financial firms. We infer that presentation choice is not solely driven by an intention to influence the profitability ratios.

Firm characteristics and EFA presentation location

In this section, we explore whether EFA presentation location differs according to firm characteristics. Figure 2

Table 4 The impact of OCI presentation on financial ratios

Panel A: Firms with EFA

	Reported ratios		All FVTPL ratios		All FVTOCI ratios	
	ROE(%)	EBIT margin(%)	ROE(%)	EBIT margin(%)	ROE(%)	EBIT margin(%)
Mean	12.5	10.3	12.7	15.1	12.3	9.4
Median	10.2	20.5	10.4	20.4	9.3	19.7
S.D.	15.0	133.5	15.6	144.4	15.3	133.3
Min.	-31.0	-1186.5	-32.4	-1231.4	-31.0	-1186.5
Max.	98.2	119.7	98.2	364.3	98.2	119.7
	z-score		t-test			
Reported versus FVTPL	0.120	0.027	0.431	1.468		
Reported versus FVTOCI	-0.313	-0.268	1.214	0.802		
FVTPL versus FVTOCI	-0.429	-0.285	0.988	1.660*		

Panel B: Any FVTOCI users

	Reported ratios		All FVTPL ratios		All FVTOCI ratios	
	ROE(%)	EBIT margin(%)	ROE(%)	EBIT margin(%)	ROE(%)	EBIT margin(%)
Mean	11.4	4.2	11.7	12.3	11.4	4.1
Median	11.4	16.5	10.4	16.5	9.5	16.5
	z-score		t-test			
Reported versus FVTPL	-0.179	-0.030	0.438	1.475		
Reported versus FVTOCI	0.007	0.023	1.417	1.079		
FVTPL versus FVTOCI	0.191	0.042	0.486	1.482		

Panel C: Financial firms with EFA

	Reported ratios		All FVTPL ratios		All FVTOCI ratios	
	ROE(%)	EBIT margin(%)	ROE(%)	EBIT margin(%)	ROE(%)	EBIT margin(%)
Mean	12.5	38.9	13.4	54.3	12.0	36.7
Median	8.6	41.2	10.5	42.1	8.2	39.6
	z-score		t-test			
Reported versus FVTPL	0.638	0.184	1.658	1.620		
Reported versus FVTOCI	-0.411	-0.270	0.814	0.623		
FVTPL versus FVTOCI	-0.984	-0.422	1.743*	1.752*		

Panel D: Non-financial firms with EFA

	Reported ratios		All FVTPL ratios		All FVTOCI ratios	
	ROE(%)	EBIT margin(%)	ROE(%)	EBIT margin(%)	ROE(%)	EBIT margin(%)
Mean	12.5	-4.0	12.3	-4.5	12.4	-4.3
Median	10.3	14.5	10.3	14.5	9.9	13.9
	z-score		t-test			
Reported versus FVTPL	-0.236	-0.054	0.441	0.826		
Reported versus FVTOCI	-0.138	-0.150	1.255	1.602		
FVTPL versus FVTOCI	0.090	-0.094	0.132	0.326		

The z-score column reports the z-score in non-parametric Wilcoxon test. The t-test column reports the results in Univariate t-test. *, ** and *** represent two-tailed tests of statistical significance at the 10%, 5% and 1% levels, respectively.

shows EFA use by presentation locations by GICS sectors during both the adoption and pre-adoption years. Differences exist between sectors in EFA use frequency and presentation choice. The financials and materials sectors have the greatest number of firms with EFA. Untabulated results also show that these sectors have the highest percentage of firms with EFA (financials = 84.1%; materials = 57.1%). In contrast, utilities and healthcare have the least number of firms with EFA. All utilities, healthcare and communication services firms

present their EFA at FVTOCI. Only 25.0% of real estate firms with EFA are FVTOCI users (either only FVTOCI users or both users) with no change from pre-adoption year to IFRS 9 adoption year. There are declines for FVTOCI users on adoption of IFRS 9 in the financial and information technology sectors, from 52.8% to 46.0% and 75.0% to 33.3%, respectively. The proportion of both FVTOCI and FVTPL users in the financial sector remains consistent after adoption, at approximately 20%. The percentage of financial firms that are only

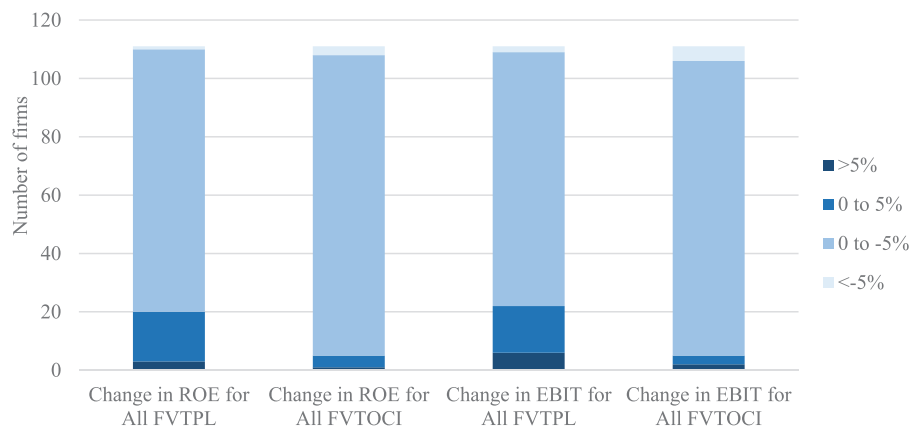


Figure 1 Presentation location and magnitude of change in ratios in firms with EFA in IFRS 9 adoption year [Colour figure can be viewed at [wileyonlinelibrary.com](#)]

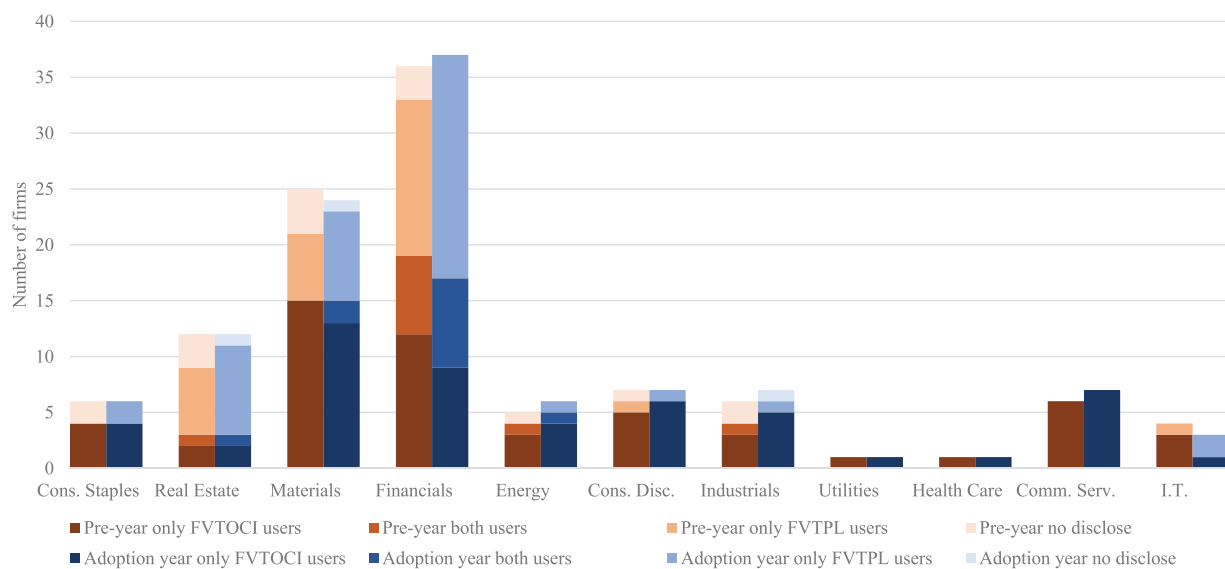


Figure 2 EFA use and presentation location by GICS sectors in IFRS 9 adoption and pre-adoption years [Colour figure can be viewed at [wileyonlinelibrary.com](#)]

FVTPL users increases from 38.9% in the pre-adoption year to 54.1% after IFRS 9 is adopted. More than 60% of firms in the consumer staples, energy, consumer discretionary and industrials sectors choose FVTOCI presentation for their EFA.

We next explore whether EFA presentation location varies by firm size. Figure 3 shows firms' EFA presentation choice in IFRS 9 adoption year by firm size quartiles, as proxied by total assets.¹¹ We find that the largest and large quartiles of firms have more EFA, consistent with larger firms having more cash flows for investing in EFA. However, only 33.3% of firms with EFA use only FVTOCI presentation in the largest firm size quartile, compared to a relatively more even split with other presentation locations in the other size quartiles. The largest quartile of firms has multiple EFA items requir-

ing different presentation locations that 25.6% are both FVTOCI and FVTPL users.

We examine the effect of profit dispersion using ROE volatility. Since we require five years of ROE, including the IFRS 9 adoption year, we lose 22 firms from the full sample due to a lack of sufficient data. Hence, we end up with 232 firms, of which 104 (44.8%) have EFA. We consider volatility relative to the broader sample to allow us to benchmark if firms with EFA are more or less volatile. Figure 4 shows firms' EFA presentation location in different ROE volatility quartiles.¹² Of firms with EFA in the lowest ROE volatility quartile, 56.7% are FVTOCI users, and the percentage in low, high and highest quartiles is 57.7%, 65.5% and 52.6%, respectively. No clear relation between income volatility and EFA presentation choice is visible; however, as income volatility

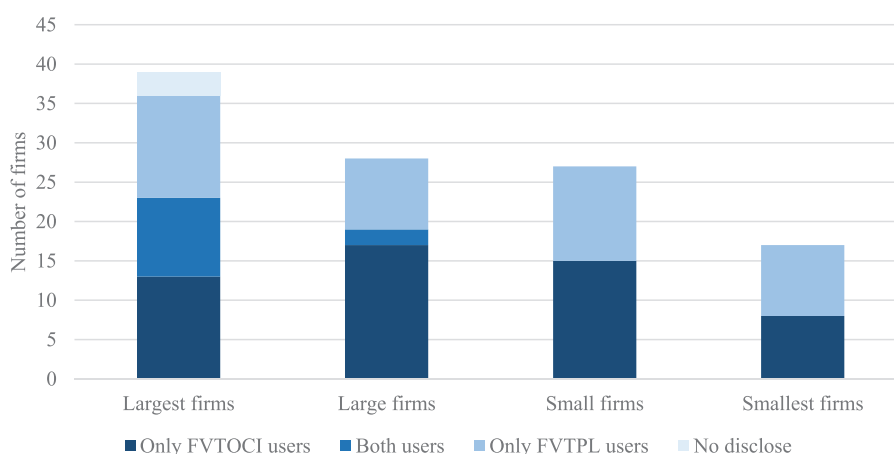


Figure 3 EFA presentation location by total assets quartiles [Colour figure can be viewed at [wileyonlinelibrary.com](https://onlinelibrary.wiley.com/doi/10.1111/auar.12385)]

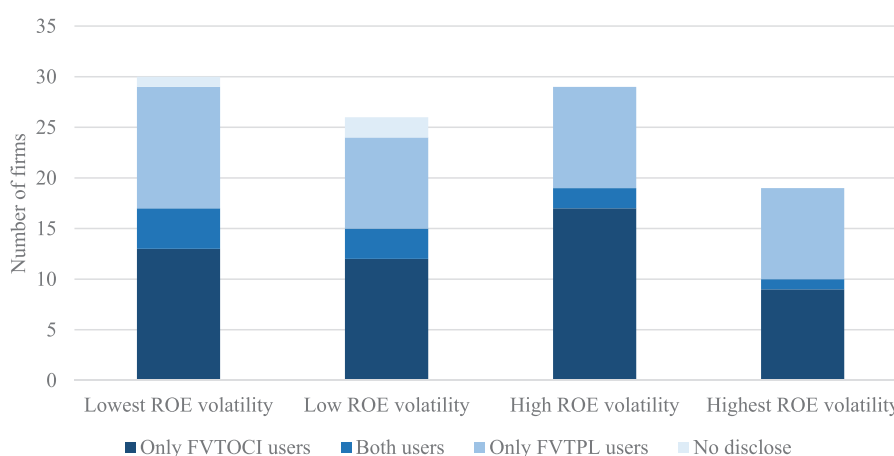


Figure 4 EFA presentation location by ROE volatility quartiles [Colour figure can be viewed at [wileyonlinelibrary.com](https://onlinelibrary.wiley.com/doi/10.1111/auar.12385)]

may also be driven by firm size and industry (Jayaraman 2008; Gao and Zhang 2015), further analysis may be warranted.

Summary and Conclusions

With growing criticism from various stakeholders about the complexity and difficulty in applying the classification and reclassification rules (Crump 2012), the IASB issued IFRS 9 to supersede IAS 39 with a date effective on or after 1 January 2018. One major change is how EFA are classified, measured and presented. First, only two presentation options for FVGL on EFA, which are FVTPL or FVTOCI (IFRS 9, 5.7.5), are provided in IFRS 9 instead of allowing the cost option in IAS 39 (IAS 39, 46, Deloitte 2021b). Second, the default EFA presentation in IFRS 9 is FVTPL, which is different from AFS assets in IAS 39 to which the OCI presentation is applied. Third, once the FVTOCI choice

is made in IFRS 9, it is irrevocable without reclassifying the cumulative gains or losses from equity to profit or loss when the EFA is derecognised. The IASB has launched a post-implementation review of IFRS 9, investigating, among others, the implementation of these changes in accounting for EFA and the impact thereof (IASB 2021). Our study provides early evidence of how firms respond to the presentation choice allowed for EFA, and hence, is relevant to the IASB and its constituents.

Our first question examines firms' EFA presentation implementation. We observe that OCI is the dominant presentation location for the FVGL on EFA during both the adoption year and the pre-adoption year. The percentage of firms using the OCI presentation remains stable, suggesting that firms follow IFRS 9 to present EFA at FVTOCI. While firms choosing to present the FVGL in profit or loss increased significantly during the adoption year, this is mainly due to the decrease in firms not disclosing the presentation location.

To understand the impact of EFA presentation choice, RQ2 examines the impact on financial ratios, and we find that EFA is not a material asset for most non-financial firms. However, as expected, it is a material asset for financial firms. Consistent with the materiality of EFA for financial firms, some evidence shows that the presentation location has a significant impact on their profitability ratios. However, for most firms, the impact of the presentation choice on profitability is statistically insignificant. These results suggest that firms do not (and cannot) use the choice to influence profitability.

For RQ3, EFA use and presentation vary across sectors and firm size quartiles. Financial and material are the two sectors that have the greatest number of firms with EFA. Only FVTOCI users in the financial industry have a large decrease in the adoption year, which suggests that financial firms follow IFRS 9 to use the default FVTPL presentation for their EFA. Large firms are more likely to have high EFA values and multiple EFA line items. Finally, we do not find a clear pattern between EFA presentation and income volatility.

This study contributes to Question 4 of the IASB's RFI post-implementation review of IFRS 9 (IASB 2021). Question 4 (a) asks 'Is the option to present fair value changes on investments in equity instruments in OCI working as the Board intended?'. Based on our sample, we infer that firms appropriately present their EFA in FVTOCI as allowed in IFRS 9. This comes from the stability of OCI presentation of FVGL on EFA under both IAS 39 and IFRS 9. In addition, there is no clear relation between firms' income volatility and choice of FVTOCI, suggesting that the choice is not driven by any motivation to influence income volatility. Taken together, the potential disruption of EFA presentation in IFRS 9 is immaterial for the majority of firms. Question 4(b) asks, 'For what equity instruments do entities elect to present fair value changes in OCI?'. Based on our observations from reading firms' EFA disclosures, we find that firms disclose where the FVGL of EFA goes to (FVTOCI or FVTPL) and what the investments are (e.g., listed or unlisted equities) in EFA item names. However, there is insufficient disclosure of the reasons for EFA presentation choice. As the disclosures are required in standards, we suggest the IASB provides more examples of improving firms' EFA disclosures to IFRS enforcement agents (e.g., audit committees, independent auditors and stock market regulators) to ensure that the requirements are complied with. Last, Question 4(c) is, 'Are there any unexpected effects arising from the option to present fair value changes on investments in equity instruments in OCI?'. We find that the presentation location of the FVGL on EFA does not impact profitability significantly; however, there is evidence that it can impact the profitability of some financial firms.

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Conflict of Interest

There are no material conflicts of interest.

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Data Availability Statement

The data that support the findings of this study are freely available from company annual reports at <http://www.asx.com.au>.

Notes

- 1 FVTOCI is a presentation choice rather than a classification or measurement choice for FVGL on EFA (IFRS 9, 5.7.5).
- 2 RFI Question 4 is '(a) Is the option to present fair value changes on investments in equity instruments in OCI working as the Board intended? Why or why not? (b) For what equity instruments do entities elect to present fair value changes in OCI? (c) Are there any unexpected effects arising from the option to present fair value changes on investments in equity instruments in OCI? How significant are these effects?'
- 3 Australia applies Australian Accounting Standards Board (AASB) 9, which incorporates IFRS 9 word for word. We just use the term IFRS 9 for consistency and convenience.
- 4 Under IAS 39, EFA that cannot be measured with reliability are measured at cost at each balance date.
- 5 Bradbury et al. (2022) suggest that fair value may be more useful than the equity method of accounting, but that is perhaps only the case if it is available and verifiable.
- 6 IASB provided a temporary exemption from applying IFRS 9 for entities whose predominant activities are issuing insurance contracts until 2021 (Deloitte 2016).
- 7 We choose ROE rather than return on assets (ROA) since ROE is more consistent with the investor decision-making objective of financial reporting.
- 8 Another explanation, that amounts going through FVTPL in the pre-adoption year are not material to disclose separately, seems

- less likely as the newly disclosed gains or losses from EFA in the adoption year are not past conventional materiality thresholds.
- 9 We note that no disclosure firms could have multiple EFA line items for which they do not disclose where FVGL were presented. Thus, 16 no disclosure firms have 21 no disclosure EFA line items in the pre-adoption year.
 - 10 In this analysis, we use a materiality threshold of 5% of total assets for EFA.
 - 11 Using market capitalisation as the proxy for firm size gives similar results.
 - 12 When dividing the full sample into quartiles according to firms' ROA and EBIT margin volatility, the results remain qualitatively similar, that is, that there is no clear relation between income volatility and EFA presentation location.

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