STAFF PAPER

January 2018

IASB Meeting

Project	**Primary Financial Statements**
Paper topic	Presentation of the share of the profit or loss of ‘integral’ associates and joint ventures

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Purpose of the meeting

1. This Agenda Paper addresses the concerns raised and suggestions provided by some Board members about the presentation of the share of the profit or loss of ‘integral’ associates and joint ventures in the statement(s) of financial performance for non-financial entities.

2. This paper does not address the presentation of dividends received from associates and joint ventures in the statement of cash flows. We will consider this issue at a future meeting.

Structure of paper

3. The paper is structured as follows:

   (a) Summary of staff recommendations (paragraph 4);

   (b) Background (paragraphs 5–11);

   (c) Staff analysis (paragraphs 12–46); and

   (d) Appendix A — Illustrations of the separate presentation of the share of the profit or loss of ‘integral’ associates or joint ventures.

Summary of staff recommendations in this paper

4. The staff recommends to the Board that:

   (a) it should require entities to present the results of 'integral' associates and joint ventures separately from 'non-integral' associates and joint ventures;

   (b) the due process document should:

      (i) define the term 'integral associate or joint venture' with the meaning of 'an associate or joint venture whose activities are integrated into an entity's business activities and are thereby essential and fundamental in carrying out these activities';

      (ii) include a non-exhaustive list of indicators (based on paragraph 30) that could be used in applying the definition; and

      (iii) prohibit entities from changing the way the associate or joint venture is classified, unless the relationship between the reporting entity and the equity-accounted investment changes substantively.

   (c) the due process document should:

      (i) advocate the presentation of the share of profit or loss of 'integral' associates or joint ventures above the 'income/expenses from investments' category, but placed immediately after the entity's business activities by requiring a subtotal to be inserted above it (ie Approach B); and

      (ii) discuss at least all the three approaches (A–C) identified in paragraph 38 for the presentation of the share of the profit or loss of integral associates and joint ventures.

Background

Previous Board discussions

5. At the June 2017 Board meeting[1] the Board discussed the presentation of the share of the profit or loss of associates and joint ventures accounted for using the equity

[1] Refer to June 2017 Agenda Paper 21E.

method. Board members appeared to be more supportive of presenting the share of the profit or loss of associates and joint ventures above, rather than below EBIT (i.e. above finance income/expenses and tax). However, the Board did not decide on whether to require a single location for all associates/joint ventures.

6. At the September 2017 meeting the staff recommended introducing an investing category[2] (subsequently labelled at the November 2017 Board meeting as the ‘income/expenses from investments’ category), in the statement(s) of financial performance and presenting it above the EBIT subtotal. The staff did not provide recommendations for the presentation of the share of the profit or loss of associates and joint ventures at the September meeting. However, Board members expressed the following different views regarding the presentation of the share of the profit or loss of associates and joint ventures:

   (a) some thought that this share should be presented above the ‘income/expenses from investments’ category (i.e. as part of an entity’s business activities) if the investments were integral to the entity’s business activities; but if they were non-integral to the entity’s business activities they thought that those investments should be part of the ‘income/expenses from investments’ category; and

   (b) others thought this share should be presented in the ‘income/expenses from investments’ category irrespective of whether the associate or joint venture is integral to the entity’s business activities because analysts and other users typically assess the returns from associates and joint ventures separately from the returns from fully consolidated entities.

Staff recommendations at the November 2017 meeting

7. At the November 2017 meeting the Board tentatively decided to introduce an ‘income/expense from investments’ category in the statement(s) of financial performance[3]. Also at that meeting, the staff proposed requiring a single location

[2] Agenda Paper 21A for the September 2017 meeting covered, amongst other issues, proposals to introduce an investing category (refer to paragraphs 13–32).

[3] Refer to IASB Update from November 2017.

within the ‘income/expense from investments’ category for the share of profit or loss of *all* associates/joint ventures (irrespective of whether the associate/joint venture was considered integral to the business activities of the entity).

8. The Board did not reach a decision on the presentation of the share of the profit or loss of associates and joint ventures accounted for using the equity method. The Board therefore directed the staff to include in the project’s first due-process document a discussion of different possible approaches to presenting the share of the profit or loss of associates and joint ventures accounted for using the equity method. Those approaches could include:

   (a) presenting all associates and joint ventures accounted for using the equity method in the ‘income/expenses from investments’ category.

   (b) presenting the share of profit or loss of ‘integral’ associates or joint ventures above the ‘income/expenses from investments’ category, thus presenting them immediately after the results of the main business activities of the entity; and presenting the share of profit or loss of non-integral associates or joint ventures in the ‘income/expenses from investments’ category; and

   (c) presenting the results of integral associates and joint ventures separately from those of non-integral associates and joint ventures, i.e. as distinct line items, but within the same category, i.e. the ‘income/expenses from investments’ category.

Views from ASAF members

9. At its December 2017 meeting, the Accounting Standards Advisory Forum (ASAF) discussed the staff proposal to include the share of profit or loss of associates and joint ventures in the ‘income/expenses from investments’ category[4].

10. ASAF members had mixed views on the presentation of the share of profit or loss of associates and joint ventures:

[4] The summary of this meeting is still in draft form and will be published in due course.

(a) some members said that the share of profit or loss of associates and joint ventures that are integral to an entity’s operations should be presented above ‘profit before investing, financing and income tax’ subtotal, whereas the share of profit or loss of non-integral associates and joint ventures should be presented as ‘income/expenses from investments’; and

(b) others said the share of all associates and joint ventures should be presented in a single location.

11. Some ASAF members said the Board should explore different approaches and propose guidance for distinguishing between integral and non-integral associates and joint ventures in a Discussion Paper.

Staff analysis

12. The staff have considered the presentation of the share of profit or loss of associates and joint ventures further and think that it may be possible for the Board to reach tentative decisions on this issue for inclusion in the first due process document.

13. We have structured our staff analysis as follows:

(a) Issue 1: Why would it be useful to present the share of profit or loss of ‘integral’ associates and joint ventures separately from ‘non-integral’ associates and joint ventures? (paragraphs 14–18)

(b) Issue 2: How should we describe or define ‘integral’ associates or joint ventures? (paragraphs 19–37)

(c) Issue 3: Which alternatives could be considered for the presentation of the share of profit or loss of ‘integral’ associates or joint ventures? (paragraphs 38–46)

Issue 1: Why would it be useful to present the share of profit or loss of ‘integral’ associates and joint ventures separately from ‘non-integral’ associates and joint ventures?

14. Our research has indicated that many users separate the results of investments in associates and joint ventures from the results of an entity’s controlled business activities when valuing an entity. This is because they think that:

    (a) the activities of associates or joint ventures are *always* peripheral (i.e. not integral) to an entity’s day-to-day business activities because they are not controlled by the entity. This means, for example, that the entity cannot direct the operations of the associate or joint venture nor can the entity extract dividends from the associate or joint venture at will.

    (b) the results of associates and joint ventures are of a different ‘quality’ because:

        (i) the results of associates and joint ventures are a blend of different amounts (i.e. business, investing, financing and tax amounts of the investee)—users would normally exclude investing, financing and tax amounts from their analysis and calculation of key metrics such as EBIT;

        (ii) associates and joint ventures make no contribution to revenue and so revenue-based margins that include the results of associates and joint ventures are distorted.

15. However, our research also indicated that some users incorporate the results of at least some associates or joint ventures into their valuation of an entity’s business activities. Whether the results of an associate of joint venture is included in the valuation appears to depend on how closely aligned or integral the associate or joint venture business is to the reporting entity’s business activities. Consequently, there seems to be a need in practice for users to be able to identify separately the results of integral and non-integral associates and joint ventures.

Staff recommendation

16. Separately presenting the results of integral associates and joint ventures would bring benefits for users as this will allow them to analyse these results separately from other

non-integral equity-accounted investments. Given this is already happening to some extent in practice, introducing a requirement in accounting standards to separate integral and non-integral associates and joint ventures would bring some order and consistency to how preparers provide this information.

17. However, introducing a requirement to separate the results of integral associates and joint ventures:

    (a) could be interpreted in different ways by different entities, potentially reducing comparability.

    (b) could result in preparers choosing to assign the share of profit or loss from associates and joint ventures between the two categories (i.e. ‘integral’ and ‘non-integral’) in an arbitrary, or even opportunistic, way.

    (c) would introduce a new requirement for entities that do not separate their associates and joint ventures in this way.

18. Overall, the staff view is that requiring entities to present the results of ‘integral’ associates and joint ventures separately from ‘non-integral’ associates and joint ventures would provide additional useful information to users of financial statements. In Issue 2 we discuss how ‘integral’ and ‘non-integral’ could be defined in a way that would minimise the issues described in paragraph 17.

Issue 1—Question to the Board
1. Does the Board agree with the staff recommendation in paragraph 18 that entities should present the results of ‘integral’ associates and joint ventures separately from ‘non-integral’ associates and joint ventures?

Issue 2: How should we describe or define ‘integral’ associates or joint ventures?

19. There are a number of different approaches that the Board could take to defining or describing ‘integral’ associates and joint ventures:

    (a) Approach 1—treat all joint ventures as ‘integral’ and all associates as ‘non-integral’ (see paragraphs 20–22);

(b) Approach 2—use our proposed definition of 'income/expenses from investments' to make the split between 'integral' and 'non-integral' associates and joint ventures (see paragraphs 23–27); and

(c) Approach 3—develop a definition of 'integral' (see paragraphs 28–37).

Approach 1— treat all joint ventures as 'integral' and all associates as 'non-integral

20. There is evidence that it is more common in practice for joint ventures to be seen as integral to an entity's business activities than associates (see paragraph 31). By definition, a reporting entity has joint control over its joint ventures but only exercises significant influence over its associates. If the business activities of an investment are integral to the activities of the reporting entity it is likely that the reporting entity will seek to exercise more power over the investee. Hence, it may be more likely that the investment will be structured to provide the entity with joint control rather than significant influence (ie a joint venture is more likely to be integral than an associate).

21. The Board could, therefore, require the results from joint ventures to be designated as 'integral' to the investor's business activities, whereas the results from associates would be designated as 'non-integral'.

22. Because this approach relies on the existing distinction between associates and joint ventures it would be easy for preparers to apply. However, we do not think that this approach will provide the most useful split between the different types of equity-accounted investments. We are aware of some associates that preparers and users consider to be 'integral' to the reporting entity's business activities—for example, when the associate is a critical supplier to the entity (eg an aircraft manufacturer having an investment in a company manufacturing the wings of its aircraft, or a beverage company having an investment in its bottling company).

Approach 2— Use our proposed definition of 'income/expenses from investments'

23. The Board could use our proposed definition of 'income/expenses from investments' as the basis for the split between 'integral' and 'non-integral' investments.

24. At the November 2017 meeting[5] the Board tentatively decided to define 'income/expenses from investments' as:

> income/expenses from assets that generate a return for the entity individually and largely independently from other resources held by the entity.

25. In other words, if a preparer decides that the results from an associate or joint venture do not meet this definition, they would be required to exclude those results from the 'income/expenses from investments' category and present them above that category.

26. The advantages of this approach are:

    (a) we would not have to define 'integral' in the context of associates and joint ventures, which would be a new definition in accounting standards.

    (b) it would lead to consistency of application across all potential items in the 'income/expenses from investments' category, rather than making equity-accounted investments a special case.

27. The disadvantages are:

    (a) if preparers are permitted to split income and expenses from equity-accounted investments between categories, they may argue that they should have that level of flexibility in relation to other items in the income/expenses from investments category, which is not our intention because at the November 2017 meeting the Board agreed on providing guidance on which items meet the definition of 'income/expenses from investments'; and

    (b) some might argue that all associates and joint ventures 'generate a return (ie dividends) for the entity individually and largely independently from other resources held by the entity'. If this view is taken, all associates and joint ventures would be treated as 'non-integral'.

[5] Refer to IASB Update from November 2017.

Approach 3— develop a definition of 'integral'

28. Approach 3 would require the Board to develop a definition of 'integral'.

29. In our review of investment reports, we observed that the terms 'integral' or 'non-integral' are sometimes used by analysts to distinguish between activities that are close to or part of an entity's day-to-day business activities and activities that are considered more peripheral[6]. However, those terms are not defined.

30. We further observed that some analysts employ different factors to assess the relationship between an entity and its non-consolidated, equity-accounted investments. For example, some factors used in this assessment are[7]:

    (a) significance of the amount of investment in the associate or joint venture;

    (b) the existence of integrated lines of business with the associate or joint venture;

    (c) whether the associate or joint venture is a critical supplier or customer;

    (d) whether the entity shares a name or a brand with the associate or joint venture;

    (e) position of the other owners in the joint venture (whether strategic or financial investment) or associate; or

    (f) common sources of capital and lending relationships.

31. From our review of some financial statements we could not find conclusive evidence of the entities' reasons for considering associates or joint ventures 'integral' to their business activities. We found out more about the reasons why some *joint ventures* are considered integral to an entity's business activities in our review of the comments received from respondents on the Exposure Draft ED 9 *Joint Arrangements*[8]. Some respondents mentioned that joint ventures are integral when they:

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[6] Other terms used by analysts are 'core/non-core' or operating/non-operating'.

[7] We are referring to some of the factors included in a report issued by Standard & Poor's Rating Services, Ratings Direct®, McGraw Hill Financial, November 19, 2013.

[8] Refer to paragraph 72 of [Agenda Paper 10B] of April 2008.

(a) represent a significant percentage of the entity's turnover and operating results; and/or

(b) are run as an extension of the group's activities. That is, when the joint venture's activities are operated in the same manner as the entity's subsidiaries (i.e. an entity's regional directors provide the same oversight and advice to subsidiaries and joint ventures; or the computer systems of subsidiaries and joint ventures are aligned with those of the group); and/or

(c) are used to run complex and larger projects (we understand that this type of joint venture is common in the construction and energy sectors).

32. In the Oxford Dictionary 'integral' is defined as 'necessary to make a whole complete; essential or fundamental'[9]. The staff believe that this definition could be used as a basis for identifying integral associates and joint ventures. This could be done by defining the term 'integral associate or joint venture' with the meaning of 'an associate or joint venture whose activities are:

(a) integrated into an entity's business activities; and thereby

(b) essential and fundamental to carrying out those activities'.

33. To support this, and help entities to apply the definition consistently, the Board could also describe a non-exhaustive list of indicators that an entity could use to assess whether its investments in associates or joint ventures are 'integral' to its business activities. Those indicators could be based on the list of factors in paragraph 30.

34. Preparers would be expected to use judgement in applying the definition, using the indicators for guidance. The staff also suggest that entities should be prohibited from changing the way an associate or joint venture is classified unless the relationship between the reporting entity and the equity-accounted investment changes substantively.

35. The advantages of this approach are:

[9] We consulted the online version of the Oxford Dictionary.

(a) it provides more guidance on when associates or joint ventures should be treated as integral than Approach 2 which may promote consistent application and, hence, improve comparability; and

(b) it appears to reflect the way some users differentiate between integral and non-integral associates and joint ventures.

36. The main disadvantages of this approach are:

(a) it introduces a new defined term that preparers will need to consider. This increases complexity and may be more costly to implement than Approach 1 or Approach 2; and

(b) preparers will have to use judgement in identifying which of its associates or joint ventures are integral based on the definition of 'integral' and so classification may differ between entities.

Staff recommendation

37. The staff recommend Approach 3 because:

(a) unlike Approach 1, it allows preparers to treat associates as 'integral' which is consistent with the way some users view some investments in associates;

(b) it provides more guidance on which equity-accounted investments should be treated as 'integral' than Approach 2. Additional guidance is likely to promote consistent application and, hence, improve comparability. We do not think the guidance on 'integral associates or joint ventures' would result in an outcome that is inconsistent with the definition of 'income/expenses from investments'; and

(c) prohibiting entities from changing the way the associate or joint venture is classified, unless the relationship between the reporting entity and the equity-accounted investment changes substantively, would prevent entities from opportunistically reclassifying associates or joint ventures as 'integral'.

Issue 2—Questions to the Board
1. Does the Board agree that the due process document should:
(a) define an 'integral associate or joint venture' as an associate or joint venture whose activities are integrated into an entity's business activities and are thereby essential and fundamental in carrying out these activities'?
(b) include a non-exhaustive list of indicators (based on paragraph 30) that could be used in applying the definition?
(c) prohibit entities from changing the way the associate or joint venture is classified, unless the relationship between the reporting entity and the equity-accounted investment changes substantively?

Issue 3: Which alternatives could be considered for the presentation of the share of profit or loss of 'integral' associates or joint ventures?

38. As we noted in paragraph 8 of this paper, the Board tentatively agreed to include different alternatives for the presentation of the share of the profit or loss of associates and joint ventures in the project's first due process document. We think the Board is of the view that the results from non-integral equity-accounted investments will always be presented in the 'income/expenses from investments' category, so the only question here is where the results from 'integral' associates and joint ventures should be presented. There are at least three alternatives for the presentation of the share of profit or loss of 'integral' associates or joint ventures:

    (a) Approach A: above the 'income/expenses from investments' category, as part of an entity's business activities.

    (b) Approach B: above the 'income/expenses from investments' category, but placed immediately after the entity's business activities by requiring a subtotal to be inserted above it.

    (c) Approach C: separately presenting the results from 'integral' and 'non-integral' associates and joint ventures within the 'income/expenses from investments' category, i.e. so there are separate line items for each but the total returns on equity-accounted investments are all included in this category.

39. An illustration of all three approaches is presented in Appendix A of this paper.

40. Approach A has the following advantages:

(a) it might better reflect the way in which an entity conducts its business activities; and

(b) some entities already present the results of some equity-accounted investees in their operating results so for these entities it would not represent a change in practice.

41. A potential disadvantage of Approach A is that it mixes the reporting of income and expenses from assets and liabilities that are controlled by the reporting entity with those that are not. It is also inconsistent with the feedback from most investors that they would like the results of all associates and joint ventures to be excluded from business activities. It may be worth bearing in mind that a similar consideration (ie preventing an entity from recognising assets and liabilities for which an entity does not have rights or obligations) was a factor in the Board's decision to remove the proportionate consolidation model and require the equity method for joint ventures during the development of IFRS 11 *Joint Arrangements*[10].

42. Requiring an entity to present the share of the profit or loss of integral associates and joint ventures above the 'income/expenses from investments' category and immediately after, but not within, the entity's business activities by requiring a subtotal to be given above it (Approach B) has the following advantages:

(a) it maintains a segregation of returns from controlled assets and liabilities within business activities from returns from non-controlled investments, while at the same time indicating the more central (i.e. integrated) nature of these particular associates and joint ventures;

[10] Refer to paragraph BC 11 in IFRS 11.

(b) it leads to the presentation of what is effectively an operating profit from controlled entities subtotal, which users may find helpful and which is already presented by many entities on a voluntary basis; and

(c) although it introduces another potential subtotal to the statement(s) of financial performance (i.e. as subtotals could be required both above and below the item, as shown in Appendix B), each of these subtotals may be helpful to different users as it gives both a subtotal of results from consolidated businesses only and another that adds in integral associates and joint ventures.

43. A disadvantage of Approach B is that it increases the number of subtotals to be given in the statement(s) of financial performance, which may add complexity to the statement(s) of financial performance and confuse users. It may also be difficult to decide on the labelling of the subtotal that represents business profit from consolidated activities.

44. Approach C, separating the results from 'integral' and 'non-integral' associates and joint ventures within the 'income/expenses from investments' category, has the following advantages:

(a) it would be consistent with the way most users treat the share of profit or loss of associates and joint ventures for purposes of their analysis (ie it is usually analysed separately from an entity's business activities);

(b) it should make it easier for users to locate and assess the share of profit or loss of associates and joint ventures (they will be presented in a single location); and

(c) it reflects the view of some users that providing greater uniformity in the presentation of the share of profit or loss of associates and joint ventures is more important than a split between integral/non-integral.

45. A potential disadvantage of Approach C is that this approach would not deliver the additional subtotals (similar to the ones described in Approach B) which users might find helpful. It also fails to reflect the very wide range of ways equity-accounted investments are used by entities and therefore the underlying economic distinction

between different types of equity-accounted investment, which means that some of the income and expenses are more appropriately classified as business activities.

Staff recommendation

46. The staff view is that the question about which alternatives could be considered for the presentation of the share of profit or loss of 'integral' associates or joint ventures is finely balanced, as reflected in the varied views we have received so far in our outreach and meetings with stakeholders about the presentation of equity-accounted returns. The staff therefore recommends that all three approaches should be included in a due process document, in order to understand constituents' views of the respective merits of each. Nevertheless, if the Board wishes to propose only one approach, the staff recommends Approach B, as it gives at least as much information as Approach A while segregating returns from non-controlled entities from revenue and expenses from controlled entities.

Issue 3—Questions to the Board

1. Does the Board agree with our recommendation in paragraph 46 to advocate in a due process document the presentation of the share of profit or loss of 'integral' associates or joint ventures above the 'income/expenses from investments' category, but placed immediately after the entity's business activities by requiring a subtotal to be inserted above it (ie Approach B)?

2. Does the Board agree we should nevertheless discuss at least all the three approaches (A–C) identified in paragraph 38 for the presentation of the share of the profit or loss of integral associates and joint ventures?

3. Is there any other approach that the Board might wish to explore?

Appendix A – Illustrations of the separate presentation of the share of the profit or loss of 'integral' associates or joint ventures

A1. We illustrate in the following page the presentation of the share of the profit or loss of 'integral' and 'non-integral' associates and joint ventures under the approaches discussed in paragraph 38 of this paper.

(a) Approach A: above the 'income/expenses from investments' category, as part of an entity's business activities.

(b) Approach B: above the 'income/expenses from investments' category, but placed immediately after the entity's business activities by requiring a subtotal to be inserted above it.

(c) Approach C: separating the results from 'integral' and 'non-integral' associates and joint ventures within the 'income/expenses from investments' category, i.e. so there are separate line items for each but the total returns on equity-accounted investments are all included in this category.

Illustrations of the separate presentation of the share of the profit or loss of 'integral' associates or joint ventures

Approach A Statement of Financial Performance	
	2017
Revenue	
Cost of products sold	X
SG&A expense	X
Service cost	X
Share of profit of associates and JVs ***integral to operations***	X
Profit before investments, financing and income tax	X
Income/expenses from investments	
Share of profit of ***other*** associates and JVs	X
Fair value changes in the value of investment property	X
Dividends received on equity investments	X
Interest income on long-term debt investments	X
Gain on the disposal of real estate investment	X
Rental income	X
Profit before financing and income tax	X
Interest income from cash and cash equivalents calculated using the effective interest method	X
Other income from cash and cash equivalents and financing activities	X
Expenses from financing activities	X
Other finance income	X
Other finance expense	X
Profit before tax	X
Income tax expense	X
Profit for the year from continuing operations	X
Loss from discontinued operations	X
Profit for the year	X

Approach B Statement of Financial Performance	
	2017
Revenue	X
Cost of products sold	X
SG&A expense	X
Service cost	X
Operating profit from consolidated entities	X
Share of profit of associates and JVs ***integral to operations***	X
Profit before investments, financing and income tax	X
Income/expenses from investments	
Share of profit of ***other*** associates and JVs	X
Fair value changes in the value of investment property	X
Dividends received on equity investments	X
Interest income on long-term debt investments	X
Gain on the disposal of real estate investment	X
Rental income	X
Profit before financing and income tax	X
Interest income from cash and cash equivalents calculated using the effective interest method	X
Other income from cash and cash equivalents and financing activities	X
Expenses from financing activities	X
Other finance income	X
Other finance expense	X
Profit before tax	X
Income tax expense	X
Profit for the year from continuing operations	X
Loss from discontinued operations	X
Profit for the year	X

Approach C Statement of Financial Performance	
	2017
Revenue	
Cost of products sold	X
SG&A expense	X
Service cost	X
Profit before investments, financing and income tax	X
Income/expenses from investments	
Share of profit of associates and JVs ***integral to operations***	X
Share of profit of ***other*** associates and JVs	X
Fair value changes in the value of investment property	X
Dividends received on equity investments	X
Interest income on long-term debt investments	X
Gain on the disposal of real estate investment	X
Rental income	X
Profit before financing and income tax	X
Interest income from cash and cash equivalents calculated using the effective interest method	X
Other income from cash and cash equivalents and financing activities	X
Expenses from financing activities	X
Other finance income	X
Other finance expense	X
Profit before tax	X
Income tax expense	X
Profit for the year from continuing operations	X
Loss from discontinued operations	X
Profit for the year	X