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Project	**Primary Financial Statements**		
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Purpose of this paper

1. The purpose of this paper is to address outstanding issues related to the project proposals for financial entities. These issues mostly concern the classification of income and expenses in the statement(s) of financial performance.
2. In this paper, by 'financial entities' we mean entities that:
   (a) provide financing to customers as a main business activity; and/or
   (b) invest in the course of their main business activities in assets that generate a return individually and largely independently of other entity resources.

Summary of staff recommendations

3. The staff recommend the Board:
   (a) require entities to include income from cash and cash equivalents in operating profit if, in the course of their main business activities, the entities invest in financial assets that generate a return individually and largely independently of other entity resources;
   (b) require entities to include in operating profit expenses related to liabilities arising from investment contracts with participation features they issue that are in the scope of IFRS 9 *Financial Instruments*;

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(c) clarify and illustrate the types of entities the Board had in mind when developing the requirements referring to ‘main business activities’, along the lines of paragraphs 63 and 64;

(d) specify that, when a business activity constitutes a separate reportable segment applying IFRS 8 *Operating Segments*, this indicates that the activity may be a main business activity; and

(e) clarify that income, expenses and dividend cash flows from associates and joint ventures not accounted for using the equity method shall be classified in the same way as income, expenses and dividend cash flows from other investments.

Structure of paper

4. This paper is structured as follows:

(a) Background (paragraphs 5–8)

(b) Issue 1—Income from cash and cash equivalents (paragraphs 9–25)

(c) Issue 2—Expenses from financing activities linked to operating activities (paragraphs 26–54)

(d) Issue 3— Main business activities (paragraph 55–66)

(e) Issue 4—Associates and joint ventures not accounted for using the equity method (paragraphs 67–71).

(f) Appendix A—Tentative Board decisions for subtotals and classification of income and expenses in the statement(s) of financial performance

(g) Appendix B—Tentative Board decisions for the classification of interest and dividends in the statement of cash flows

(h) Appendix C—Illustrations for investment contracts with participation features

Background

5. At its February 2019 meeting, the Board:

   (a) continued its discussion from the September 2018 Board meeting[1] about classification of income and expenses and subtotals in the statement(s) of financial performance for financial entities;[2] and

   (b) discussed the classification of interest and dividends received and paid in the statement of cash flows for financial entities.[3]

6. The Board's tentative decisions to date for the statement(s) of financial performance and the statement of cash flows are summarised in Appendices A and B, respectively.

7. At its February 2019 meeting, the Board discussed and tentatively agreed on the most important aspects of the approach for financial entities. However, Board members raised a number of issues at the September 2018 and February 2019 Board meetings that have not yet been addressed. This paper analyses those issues, as well as other outstanding issues identified by staff related to financial entities.

8. With this paper, we intend to conclude the Board discussions on financial entities—barring any sweep issues.

Issue 1—Income from cash and cash equivalents

What is the issue?

9. Applying the Board's February 2019 tentative decisions, most entities are required to present income from cash and cash equivalents below the 'profit before financing and income tax' subtotal. Only entities that provide financing to customers as a main business activity such as banks would include income from cash and cash equivalents in operating profit.

[1] See September 2018 Agenda Paper 21A, Agenda Paper 21B (illustrative examples) and September 2018 IASB *Update*.

[2] See February 2019 Agenda Paper 21A, illustrative examples and February 2019 IASB *Update*.

[3] See February 2019 Agenda Paper 21B illustrative examples and February 2019 IASB *Update*.

10. Therefore, entities that invest in the course of their main business activities but that do not provide financing to customers—for example most insurers—would be required to present income from cash and cash equivalents below the ‘profit before financing and income tax’ and ‘operating profit’ subtotals.

11. A few Board members suggested that for some entities, such as insurers, management of cash and cash equivalents is likely to be closely linked to the entity’s main investing activity. Consequently, they suggested income from cash and cash equivalents should be included in operating profit for such entities.

Why did the Board require presentation of income from cash and cash equivalents below profit before financing and income tax for non-financial entities?

12. For non-financial entities, the Board tentatively decided to require presentation of income from cash and cash equivalents below ‘profit before financing and income tax’ because:

    (a) the objective of the ‘profit before financing and income tax’ subtotal is to allow comparison of entities’ performance excluding the effect of the entities’ capital structure.

    (b) users commonly define capital structure as equity plus some subset of an entity’s liabilities minus excess cash and temporary investments of excess cash. This is because the way an entity manages excess cash is interrelated with its decisions on debt and equity financing. For example, excess cash that is not used in operations can be used to pay dividends, repay debt and buy back shares.

    (c) the Board tentatively decided not to define ‘excess cash and temporary investments of excess cash’ and instead decided to use ‘cash and cash equivalents’ as a proxy for excess cash and temporary investments of excess cash. In making this decision the Board noted that cash and cash equivalents are defined in IAS 7 *Statement of Cash Flows*, and hence using them as a proxy for excess cash would contribute to comparability .

Staff analysis

13. In our view, cash and cash equivalents are not a reasonable proxy for excess cash and temporary investments of excess cash (see paragraph 12(c)) for some entities. This is because some entities have a significant balance of cash and cash equivalents that is not available to settle debt from financing activities because it is needed for operational purposes—for example:

    (a) insurers need to maintain a significant balance of cash and cash equivalents to be able to pay out insurance claims;

    (b) entities that invest in the course of their main business activities—such as insurers and investment funds—will often have significant cash and cash equivalents balances as a result of continuous rebalancing of their investment portfolios; and

    (c) open-ended investment funds need to maintain a balance of cash and cash equivalents to be able to buy back shares from investors who wish to redeem their shares.

14. Applying the Board's tentative decisions would result in presentation of an 'operating profit' subtotal that would not reflect such entities' result from operating activities, which would undermine the Board's objective of introducing the 'operating profit' subtotal.

15. Staff performed outreach with preparers from the insurance industry and two insurance analysts, who confirmed the view that for insurers, treating cash and cash equivalents as part of their capital structure may not be appropriate. The insurance analysts both said insurers' income from cash and cash equivalents should be presented together with their other investment returns in operating profit. They said insurers use cash to manage liquidity in their investment portfolios, and in their view the interest earned on cash holdings is similar to the interest earned on other investments.

16. Consequently, we recommend the Board amend its tentative decisions to ensure income from cash and cash equivalents is included in operating profit for entities of the types described in paragraph 13.

17. In addition, cash balances held by insurers and other investment companies are likely to be material.[4] Given the current low interest rates, income from cash and cash equivalents is likely to be limited, however this may change in the future.

18. Consequently, we have considered the following approaches to describe entities that shall include income from cash and cash equivalents in operating profit:

    (a) an approach based on how cash is used in the business (paragraphs 20–21); and

    (b) an approach based on the entity's main business activities (paragraphs 22–25).

19. We rejected introducing an exception only for insurers because:

    (a) such an exception would require us to define an 'insurer'; and

    (b) such an approach would not provide a solution for entities that are not insurers but nevertheless hold cash and cash equivalent balances that cannot be considered part of their capital structure.

Approach based on how cash is used in the business

20. We have identified the following principles we could use to identify the entities described in paragraph 13:

    (a) entities whose cash and cash equivalents are not available to settle debt from financing activities; and/or

    (b) entities whose cash and liquidity management and investment activities are closely linked.

21. However, we do not recommend pursuing an approach using either of these principles, because it would increase the complexity of the proposals by introducing new principles that would need to be defined and explained.

[4] Using CapitalIQ, we found that the largest 50 insurers (by total assets) applying IFRS Standards had an average cash and cash equivalents balance of £6 billion, compared to average total assets of £241 billion for the latest annual period available.

Approach based on the entity's main business activities

22. We think that, instead of using the approach described in paragraph 20, we may be able to capture the types of entities described in paragraph 13 using either of the following principles:

    (a) entities that, in the course of their main business activities, invest in *assets* that generate a return individually and largely independently of other entity resources; or

    (b) entities that, in the course of their main business activities, invest in *financial assets* that generate a return individually and largely independently of other entity resources.

23. We already use the principle in paragraph 22(a) in the project proposals to describe when income (expenses) from investments should be included in operating profit (see paragraph A11 of Appendix A). The principle in paragraph 22(b) is a variant on paragraph 22(a)—it is narrower because it only captures entities that invest in financial assets[5] (or a mix of financial and non-financial assets). We think using a principle used elsewhere in our proposals simplifies the overall model.

24. In our view, the main difference is that investment property companies would be captured by the principle in 22(a) but not in 22(b). We spoke with two real estate investors and they agreed with real estate investment companies presenting income from cash and cash equivalents below 'profit before financing and income tax'. In addition, we reviewed a number of financial statements and found that most real estate investment companies currently exclude income from cash and cash equivalents from operating profit. We think this is because such entities tend to invest in non-current assets and therefore cash is less likely to be interchangeable with their investments.

25. We recommend using the principle in paragraph 22(b), because it is most likely to capture those entities for whom cash and cash equivalents are not a reasonable proxy for excess cash and temporary investments of excess cash.

[5] As defined by paragraph 11 of IAS 32 *Financial Instruments: Presentation*.

Question 1
Does the Board agree with the staff recommendation to require entities to include income from cash and cash equivalents in operating profit if, in the course of their main business activities, the entities invest in *financial assets* that generate a return individually and largely independently of other entity resources?

Issue 2—Expenses from financing activities linked to operating activities

What is the issue?

26. Applying the February 2019 tentative Board decisions (see paragraphs A2–A4 of Appendix A), only entities that provide financing to customers as a main business activity would include expenses from financing activities in operating profit. In addition, all entities are required to present the unwinding of a discount on liabilities that do not arise from financing activities below 'profit before financing and income tax' (see paragraph A2(c) of Appendix A).

27. Insurers do not generally provide financing to their customers. In addition, insurance finance expenses (income) would meet either the definition of 'expenses from financing activities' or 'unwinding of a discount on liabilities that do not arise from financing activities'. Consequently, applying the Board's tentative decisions unmodified, insurance finance expenses (income) would be presented below the 'profit before financing and income tax' subtotal.

28. The Board acknowledged that the presentation of insurance finance expenses (income) below operating profit would not result in useful information about contracts in the scope of IFRS 17 *Insurance Contracts*. Therefore, the Board tentatively decided to provide a specific exception—insurance finance expenses (income) shall always be included in operating profit (see paragraph A5 of Appendix A).

29. In this context, Board members have raised two issues:

(a) a few Board members suggested replacing the exception for insurance finance expenses (income) with a principle (see paragraphs 30–32).

(b) one Board member said that there are other situations in which the outcome described in paragraph 26 would not result in useful information—in particular for specific investment contracts (see paragraphs 33–39).

Replace the exception for insurance finance expenses (income) with a principle

30. Some Board members suggested replacing the exception for insurance finance expenses (income) with the following principle: 'expenses related to financing *from* customers should be included in operating profit'.

31. The Board's February 2019 tentative decisions include a principle (see paragraph A4 of Appendix A) that entities that provide financing *to* customers shall include in operating profit either:

(a) expenses from financing activities relating to the provision of financing to customers; or

(b) all expenses from financing activities.

32. This means that, applying the Board's tentative decisions to date, it is the activity on the asset side of an entity's statement of financial position that drives the presentation of the financing expenses related to its liabilities. For example, a bank will be required to include its interest expenses on customer deposits in operating profit applying the Board's tentative decisions because it uses those deposits to fund loans *to customers.* The fact that the interest expenses on deposits result from transactions *with customers* does not matter when applying the Board's tentative decisions to date. In other words, we currently do *not* have a principle that expenses for financing received *from* customers are always included in operating profit.

Investment contracts with participation features in scope of IFRS 9

33. One Board member said the outcome described in paragraph 26 would not result in useful information for investment contracts with participation features that are accounted for in accordance with IFRS 9, such as unit-linked investment contracts.

We use the term ‘participation features’ with the same meaning as in IFRS 17[6]—meaning a financial instrument for which the contractual terms specify that the payments to the investor vary with the returns on underlying items.

34. Some investment contracts with participation features are accounted for in accordance with IFRS 17—investment contracts with discretionary participation features issued by entities that also issue insurance contracts (see paragraph 3(c) of IFRS 17). Such contracts would be covered by the exception for insurance finance expenses (income) (see paragraph A5 of Appendix A).

35. However, the Board member said an issue arises when applying the Board’s February 2019 tentative decisions in cases where:

    (a) entities issue investment contracts with participation features that are in the scope of IFRS 9; and

    (b) the investors’ claim is recognised as a liability rather than equity from the perspective of the issuer in accordance with IAS 32.

36. Appendix C illustrates the outcome of the Board’s February 2019 tentative decisions for the contracts described in paragraph 35, distinguishing two cases:

    (a) Type I— the assets and liabilities related to the investment contracts are recognised in the consolidated statement of financial position of the entity that manages the assets (‘the management company’)—because the entity has control over the assets. For example, we have seen this in practice for unit-linked contracts issued by insurers.

    (b) Type II— the assets and liabilities related to the investment contracts are *not* recognised in the consolidated statement of financial position of the management company, but they are recognised in the statement of financial position of a separate entity that is not consolidated by the management company (‘the fund’).

[6] For example see paragraph BC228 of the Basis for Conclusions on IFRS 17.

37. The Board's February 2019 tentative decisions would apply to the income and expenses arising from investment contracts with participation features in the scope of IFRS 9 as follows:

    (a) income earned on the underlying assets of the investment contracts—this income is likely to be presented in operating profit applying paragraph A11 of Appendix A. The income is recognised by the management company in Type I cases and by the fund in Type II cases.

    (b) expense that represents the compensation owed to investors—this expense may meet the Board's tentative definition of 'expenses from financing activities' (see paragraph A3 of Appendix A). Assuming it does, it shall be presented below 'profit before financing and income tax' and below operating profit.

    (c) asset management fee—in Type II cases, the fund will pay a management fee to the management company, which the fund will present in operating profit as an expense.

38. The Board member said that in Type I cases, the presentation of the expense described in paragraph 37(b) below operating profit is unlikely to result in a faithful representation of the entity's performance. In addition, it does not correspond to current practice. Note that, if the investors' claim is classified as equity in accordance with IAS 32, no such expense recognised in the statement(s) of financial performance.

39. In particular, this is an issue if an insurer issues both investment contracts with discretionary participation features and investment contracts with non-discretionary participation features. In such cases, the expense that represents the compensation owed to investors would be presented inconsistently for the two types of contracts:

    (a) in operating profit for contracts with discretionary participation features in the scope of IFRS 17, applying the exception for insurance finance expenses (income) in paragraph A5 of Appendix A; and

    (b) below 'profit before financing and income tax' for contracts with non-discretionary participation features in the scope of IFRS 9.

Staff analysis

40. We have considered the following approaches to address the issues described in paragraphs 29–39:

    (a) Approach A—introduce a principle that expenses related to financing *from* customers should be included in operating profit (paragraphs 41–45); and

    (b) Approach B—introduce an exception, specifically targeting investment contracts with participation features in the scope of IFRS 9 (paragraphs 46–50).

Approach A—Introduce a principle for financing from customers

41. Applying Approach A, we would introduce a principle that ‘expenses related to financing *from* customers should be included in operating profit’. If we assume that both insurance finance expenses (income) and the expense representing investor compensation for investment contracts with participation features could be considered ‘expenses related to financing from customers’, Approach A would result in both types of expenses being included in operating profit.

42. Approach A would affect a broader population of contracts than contracts in the scope of IFRS 17 and investment contracts with participation features in the scope of IFRS 9. We think that ‘expenses related to financing from customers’ would include interest expenses recognised in accordance with paragraphs 60–65 of IFRS 15 *Revenue from Contracts with Customers* on contracts that include a significant financing component.

43. Therefore, such a principle would also affect entities applying the general model[7]—for example entities in the construction sector that receive advance payments from customers. The Board’s tentative decisions to date result in all interest expenses and unwinding of discounts (including interest expenses arising from contracts with a significant financing component applying IFRS 15) being presented below ‘profit before financing and income tax’ for entities applying the general model. This would no longer be the case if the principle described in paragraph 41 is introduced.

[7] By ‘general model’ we mean the Board’s tentative requirements for entities that do not meet the definition of financial entities in paragraph 2.

44. We have identified the following advantages of Approach A:

    (a) it provides a single principle that could replace the exception for insurance finance expenses (income), as well as address the issue for investment contracts with participation features.

    (b) it achieves a symmetrical treatment for interest income and interest expense recognised for contracts with a significant finance component accounted for in accordance with IFRS 15. Any interest income recognised when a customer pays in arrears would be included in operating profit because it meets neither the definition of 'expenses from financing activities' (see paragraph A3 of Appendix A) or 'income (expenses) from investments' (see paragraph A9 of Appendix A).

45. We have identified the following disadvantages of Approach A:

    (a) the Board's tentative decisions so far have resulted in items that arguably have both operating and financing characteristics being presented below 'profit before financing and income tax'—for example, the unwinding of a discount on pensions, provisions and interest expense on trade payables. In other words, the Board has so far taken a broad view on which items should be presented below 'profit before financing and income tax'. Requiring entities to include expenses related to financing from customers in operating profit would arguably be inconsistent with that approach.

    (b) it is ambiguous whether all insurance finance income (expenses) could be considered 'expenses related to *financing* from customers', because it is unclear whether all types of insurance contracts involve 'financing activities' as defined in paragraph A3 of Appendix A. If the Board wants to capture all insurance finance expenses (income) with this principle, it would need to clarify that all insurance finance expenses (income) arise from financing activities.

    (c) a 'customer' is defined in IFRS 15 as 'a party that has contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities in exchange for consideration'. We think there may be cases

where it may not be clear whether a party providing financing meets this definition, in particular for contracts in the scope of IFRS 9.

Approach B—Exception for investment contracts with participation features

46. Applying Approach B, we would introduce the following principle:

    'An entity is required to include in operating profit expenses related to liabilities arising from investment contracts with participation features it issues that are in the scope of IFRS 9.'

47. The rationale for Approach B is that, for investment contracts with participation features there is a direct link between the investment returns and the expense representing the compensation owed to investors. Therefore the margin between the investment returns and the expense is an important indicator of operating performance of the entity—at least for Type I cases described in paragraph 36(a). Consequently, the expense should be included in operating profit.

48. We expect that only entities that invest in assets that generate a return individually and largely independently of other entity resources issue investment contracts with participation features. Consequently, we do not expect Approach B will affect entities applying the general model.

49. The advantages of Approach B are that, unlike Approach A:

    (a) it is a targeted approach that is specifically aimed at the contracts for which we know the Board's current tentative decisions would be problematic;

    (b) it does not disrupt the Board's model for the statement(s) of financial performance for non-financial entities;

    (c) it uses the concepts of 'investment contracts' and 'participation features', which are used in IFRS 17; and

    (d) the underlying rationale (ie including the expense in operating profit will result in the presentation in operating profit of a meaningful margin between investment income and directly related expenses) is consistent with the rationale the Board used earlier when developing the principle for entities that provide financing to customers (see paragraph 63(a)).

50. The disadvantage of Approach B is that it adds another exception to the model and does not replace the exception for insurance finance expenses (income)—this makes the model appear more complex.

Application to Type II cases (Approach A and B)

51. Both approaches may capture some Type II cases described in paragraph 36(b), ie cases where the assets and liabilities are *not* recognised in the consolidated statement of financial position of the entities managing the investments. For the entities holding the assets ('the fund' in the example in Appendix C), operating profit would then be close to zero. However, the investors in the fund—who are the primary users of the fund's financial statements—are likely to view the profit before any compensation to investors as an indicator of the operating performance of the fund.

52. We could include an exception for Type II cases in the requirements, but this would increase the complexity of the model. In addition, we note that such entities would be able to include additional, more useful, subtotals higher up in the statement(s) of financial performance applying paragraph 85 of IAS 1 *Presentation of Financial Statements*.

53. Type II cases where the investors' claim is classified as a liability in accordance with IAS 32 represent only a limited subset of all investment contracts. The staff are researching how common such Type II cases are.

Staff recommendation

54. We recommend Approach B, because of the reasons described in paragraph 49.

Question 2

Does the Board agree with the staff recommendation to require entities to include in operating profit expenses related to liabilities arising from investment contracts with participation features they issue that are in the scope of IFRS 9?

Issue 3—Main business activities

What is the issue?

55. Applying the Board's tentative decisions, an entity will need to assess whether it meets the following two criteria in order to determine how to classify its income and expenses in the statement(s) of financial performance and how to classify its cash flows in the statements of cash flows:

    (a) does the entity provide financing to customers *as a main business activity* (see paragraph A4 of Appendix A); and

    (b) does the entity invest *in the course of its main business activities* in assets that generate a return individually and largely independently of other entity resources (see paragraph A11 of Appendix A)?

56. A few Board members have said that:

    (a) the assessment in paragraph 55 is likely to involve significant judgement; and

    (b) the Board should consider whether further guidance should be developed to help entities assess what are their 'main business activities'.

57. In the September 2018 and February 2019 Agenda Papers, the staff proposed using the concept of 'business activities' because it is used in the *Conceptual Framework for Financial Reporting* (*Conceptual Framework*).[8] Paragraphs BC0.29–BC0.31 of the Basis for Conclusions on the *Conceptual Framework* explain that the Board concluded that the nature of an entity's business activities can affect the relevance of

[8] See paragraph 33(b) of September 2018 Agenda Paper 21A.

some types of financial information and that the Board may need to consider that factor when developing or revising Standards—in particular it needs to be considered in the context of:

(a) the selection of the unit of account;

(b) the selection of a measurement basis; and

(c) classification of assets, liabilities, equity, income or expenses (see paragraph 7.7 of the *Conceptual Framework*)—it is in this context we are using 'business activities' for the purpose of our proposals.

58. However, the *Conceptual Framework* does not define 'business activities'. Paragraph BC0.32 says:

> 'The concept of business activities is discussed in the 2018 *Conceptual Framework* to assist the Board in developing Standards. ***In a particular Standard, the concept of business activities can be further explained and developed***. The discussion of business model in IFRS 9 *Financial Instruments* is one example of how the Board has applied the concept of business activities.' [emphasis added]

59. In the light of the comments raised by Board members (see paragraph 56) and the discussion in the Basis for Conclusions on the *Conceptual Framework* (see paragraph 58), we considered whether further guidance should be developed to help entities assess what are their 'main business activities'.

Staff analysis—should the Board develop further guidance on 'main business activities'?

60. We first considered whether the Board should attempt to provide a principle-based definition of an entity's 'main business activities'. However, we think such an approach would be similar to the Board trying to define an entity's 'ordinary activities', which the Board has found to be challenging in the past.

61. Secondly, we considered whether we should provide quantitative guidance on what is a 'main business activity', for example by specifying that if a business activity contributes more than x% to an entity's total revenue, profit or total assets, it is a main

business activity. However, we did not explore such an approach further because it would be rule-based rather than principle-based—the Board would probably need to choose an arbitrary number as a percentage threshold.

62. Instead of developing a definition, we recommend the Board help entities assess whether they meet the criteria in paragraph 55 by clarifying and illustrating the types of entities the Board had in mind when developing the requirements.

63. For the first criterion—an entity provides financing to customers as a main business activity (see paragraph 55(a))—we recommend the Board clarify that:

    (a) the principle is meant to capture entities for which the margin between their interest income and the related interest expense (the net interest income) is an important indicator of operating performance;[9] and

    (b) examples of entities the Board had in mind when developing the requirement include, but are not limited to, banks and entities that have captive finance activities (such as car manufacturers).

64. For the second criterion—an entity that in the course of its main business activities invests in assets that generate a return individually and largely independently of other entity resources (see paragraph 55(b))—we recommend the Board clarify that:

    (a) the principle is meant to capture entities for which investment returns are an important indicator of operating performance;[10] and

    (b) examples of entities the Board had in mind when developing the requirement include, but are not limited to, investment entities as defined by IFRS 10 *Consolidated Financial Statements*, investment property companies and insurers.

65. In addition, we recommend the Board specify that, when a business activity constitutes a separate reportable segment applying IFRS 8, this is an indicator that it may be a main business activity.

[9] See paragraph 19 of February 2019 Agenda Paper 21A.

[10] See paragraph 20 of February 2019 Agenda Paper 21A.

66. However, we do not propose a separate reportable segment should be a criterion that is required to be met for a business activity to be a main business activity. This is because not all entities identify segments on the basis of products or services provided—for example some entities identify geographical segments.

Question 3
Does the Board agree with the staff recommendation to: (a) clarify and illustrate the types of entities the Board had in mind when developing the requirements referring to 'main business activities'—along the lines of paragraphs 63 and 64; and (b) specify that, when a business activity constitutes a separate reportable segment applying IFRS 8, this indicates that the activity may be a main business activity.

Issue 4—Associates and joint ventures not accounted for using the equity method

What is the issue?

67. The Board has tentatively decided that all entities shall:

    (a) exclude from operating profit the share of profit or loss of associates and joint ventures accounted for using the equity method (see paragraphs A11(a) and A12 of Appendix A); and

    (b) classify cash flows from dividends received from associates and joint ventures accounted for using the equity method as investing cash flows (see paragraph B1(b) of Appendix B).

68. During outreach, stakeholders have suggested the Board should clarify the classification of income and expenses and cash flows related to investments in associates and joint ventures that are not accounted for using the equity method.

69. An entity is required to account for investments in associates and joint ventures using the equity method except:

    (a) when the entity is a parent that is exempt from preparing consolidated financial statements by the scope exception in paragraph 4(a) of IFRS 10 (see paragraph 17 of IAS 28 *Investments in Associates and Joint Ventures*).

    (b) when the entity meets all the criteria in paragraph 17(a)–(c) of IAS 28.

    (c) when the entity is a venture capital, mutual fund, unit trust or similar entities. In that case it can elect to measure investments in associates and joint ventures at fair value through profit or loss in accordance with IFRS 9 (see paragraphs 18–19 of IAS 28).

    (d) when the entity classifies an investment as held for sale. In that case it applies IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* to the investment (see paragraphs 20–21 of IAS 28).

    (e) in its separate financial statements (see paragraph 10 of IAS 27 *Separate Financial Statements*).

Staff analysis

70. We propose to clarify that income, expenses and dividend cash flows from associates and joint ventures not accounted for using the equity method shall be classified in the same way as income, expenses and dividend cash flows from other investments (eg financial instruments accounted for in accordance with IFRS 9 and investment properties accounted for in accordance with IAS 40 *Investment Property*).

71. This means that, in contrast to paragraph 67:

    (a) some financial entities will be required to include in operating profit fair value gains or losses related to associates and joint ventures measured at fair value through profit or loss, applying paragraph A11 of Appendix A. Other entities will present such fair value gains or losses as income (expenses) from investments.

(b) some financial entities will be required to classify dividends from associates or joint ventures as cash flows from operating activities, if the related income is included in operating profit in the statement(s) of financial performance (applying paragraph B3 of Appendix B). Other entities will present such cash flows as cash flows from investing activities.

Question 4
Does the Board agree with the staff recommendation to clarify that income, expenses and dividend cash flows from associates and joint ventures not accounted for using the equity method shall be classified in the same way as income, expenses and dividend cash flows from other investments?

Appendix A—Tentative Board decisions for subtotals and classification of income and expenses in the statement(s) of financial performance

This summary reflects the tentative Board decisions to date as well as the staff proposals in this paper (the latter are underlined).

A1. An entity, except as specified in paragraph A4(b), shall present the following (sub)totals:

(a) operating profit;

(b) operating profit and the share of integral associates and joint ventures;

(c) profit before financing and income tax; and

(d) profit or loss.

Profit before financing and income tax

A2. An entity shall present between the 'profit or loss' and 'profit before financing and income tax' (sub)totals:

(a) income from cash and cash equivalents;

(b) expenses (income) from financing activities (see paragraph A3);

(c) unwinding of a discount on liabilities not arising from financing activities (eg net interest on net defined benefit liabilities and unwinding of a discount on provisions); and

(d) income tax expenses.

A3. 'Financing activities' in paragraph A2(b) involve:

(a) the receipt or use of a resource from a provider of finance (or provision of credit).

(b) the expectation that the resource will be returned to the provider of finance.

(c) the expectation that the provider of finance will be appropriately compensated through the payment of a finance charge. The finance charge is dependent on both the amount of the credit and its duration.

A4. As an exception to paragraph A2(a) and A2(b), an entity that provides financing to customers as a main business activity shall include in operating profit:

(a) expenses from financing activities and income from cash and cash equivalents relating to the provision of financing to customers; or

(b) all expenses from financing activities and income from cash and cash equivalents—in this case, an entity shall not present a 'profit before financing and tax' subtotal.

A5. As an exception to paragraph A2(b) or A2(c), an entity shall include insurance finance income or expenses as defined in IFRS 17 *Insurance Contracts* in operating profit.

A6. As an exception to paragraph A2(a), an entity that invests in financial assets that generate a return individually and largely independently of entity resources shall include income from cash and cash equivalents in operating profit.

A7. As an exception to paragraph A2(b), an entity shall include in operating profit expenses related to liabilities arising from investment contracts with participation features it issues that are in the scope of IFRS 9 *Financial Instruments.*

Operating profit and share of profit or loss of integral associates and joint ventures

A8. An entity shall include income and expenses from investments between the 'operating profit and share of profit or loss of integral associates and joint ventures' subtotal and the 'profit before financing and tax' subtotal.

A9. 'Income and expenses from investments' are 'income and expenses from assets that generate a return individually and largely independently of other entity resources'. 'Income and expenses from investments' include the share of profit or loss of non-integral associates and joint ventures and income and expenses from all associates and joint ventures not accounted for using the equity method.

A10. The Board has tentatively decided to provide a list of some items that would typically be treated as 'investing' and a list of some items that would typically not be treated as 'investing'.

A11. As an exception to paragraph A8, an entity that in the course of its main business activities invests in assets that generate a return individually and largely independently of other entity resources shall include in operating profit, income (expenses) from investments made in the course of its main business activities. However, the share of profit or loss of non-integral associates and joint ventures accounted for using the equity method is always excluded from operating profit.

Operating profit

A12. An entity shall include between the 'operating profit' and 'operating profit and share of profit or loss of integral associates and joint ventures' subtotal, the share of profit or loss of integral associates and joint ventures accounted for using the equity method. The share of profit or loss of integral associates and joint ventures is always excluded from operating profit.

A13. An entity shall include all other income and expenses that are not covered by paragraphs A2–A12 in operating profit. In other words, operating profit is defined as a residual.

Appendix B—Tentative Board decisions for the classification of interest and dividends in the statement of cash flows

This summary reflects the tentative Board decisions to date as well as the staff proposals in this paper (the latter are underlined).

B1. All entities (including financial entities) shall:

(a) classify cash flows from dividends paid as financing cash flows.

(b) separately present the investing cash flows of 'integral' and 'non-integral' associates and joint ventures accounted for using the equity method within the 'investing activities' section of the statement of cash flows. The split between 'integral' and 'non-integral' associates and joint ventures should be the same for the statement of cash flows as for the statement(s) of financial performance.

B2. Non-financial entities shall classify:

(a) cash flows arising from interest incurred on financing activities as financing cash flows;

(b) cash flows arising from interest paid that is capitalised as part of the cost of an asset as financing cash flows; and

(c) cash flows arising from interest and dividends received (including from associates and joint ventures not accounted for using the equity method) as investing cash flows—the Board tentatively decided to amend the definition of 'investing activities' in IAS 7 *Statement of Cash Flows* accordingly.

B3. The Board tentatively decided financial entities (entities that provide financing to customers as a main business activity and/or invest in the course of their main business activities in assets that generate a return individually and largely independently of other resources) shall classify cash flows from dividends received, interest paid and interest received each in a single section of the statement of cash flows. Financial entities shall determine the section in which to classify these cash flows as follows:

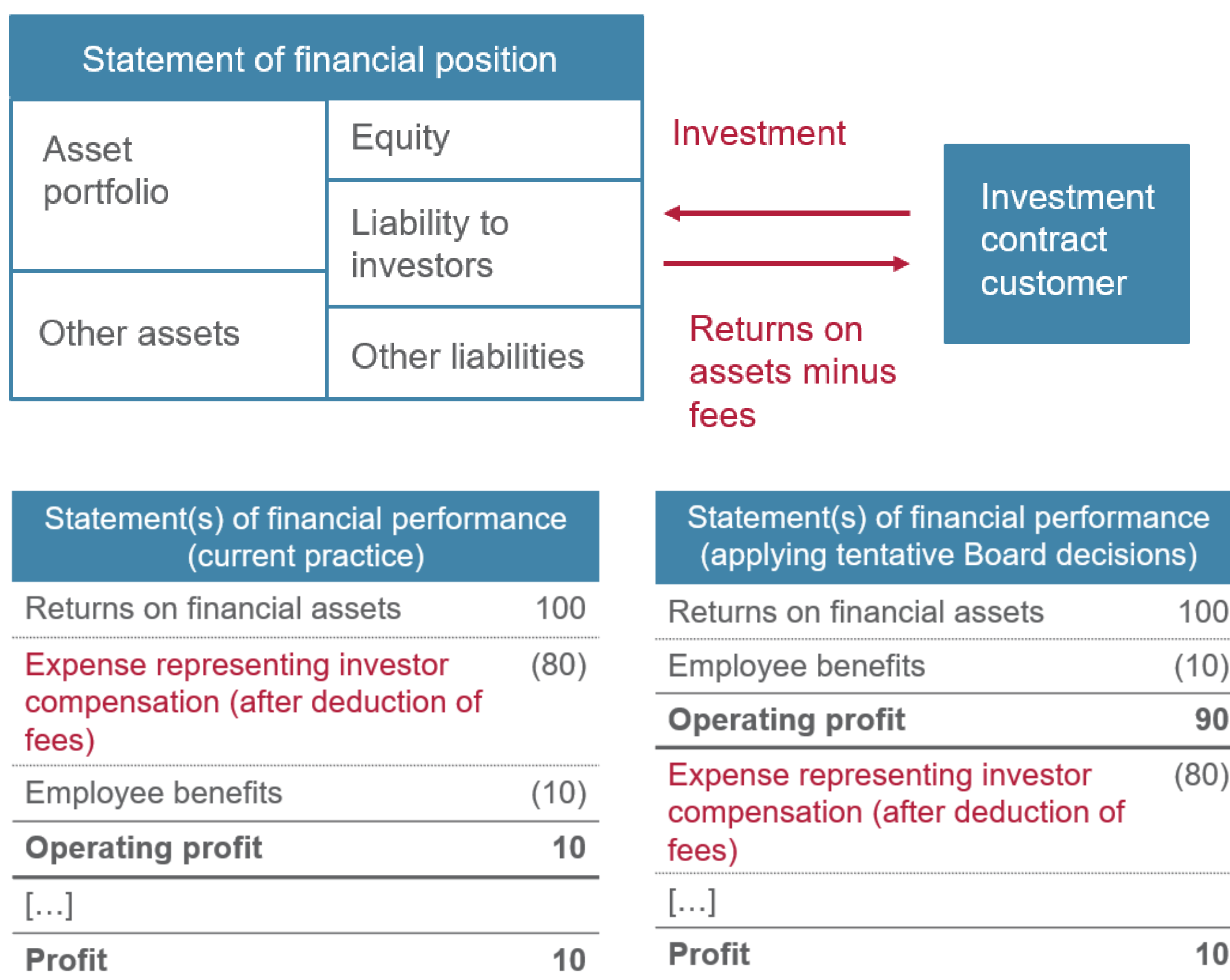
(a) if the entity presents related income (expenses) in a single section of the statement(s) of financial performance, the entity shall present related cash flows in that section; or

(b) if the entity presents related income (expenses) in more than one section of the statement(s) of financial performance, the entity shall make an accounting policy choice regarding the section of the statement of cash flows in which to present related cash flows.

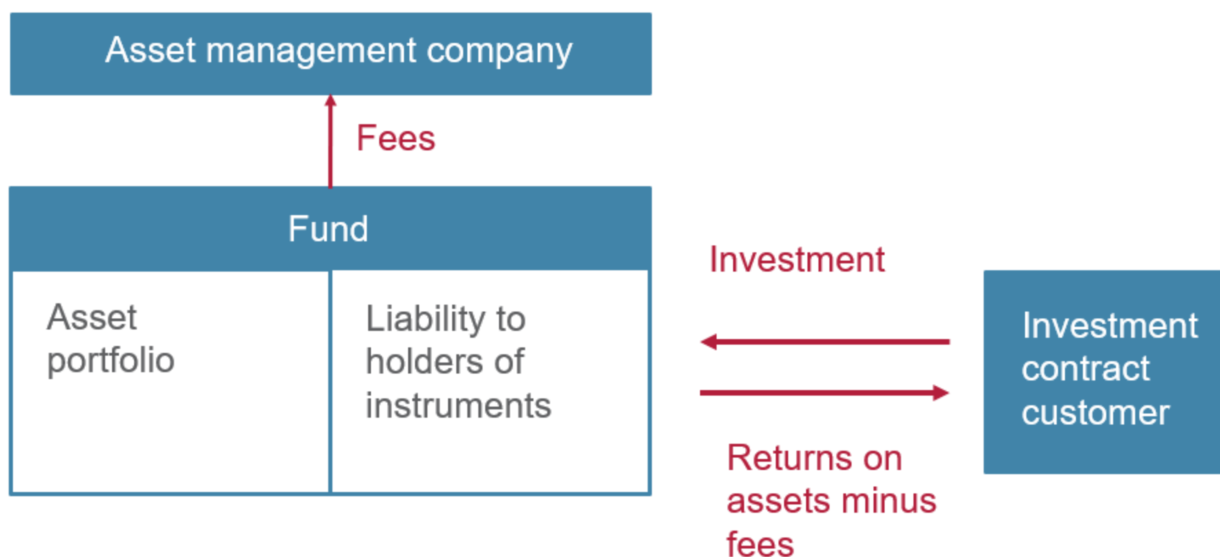
Appendix C—Illustrations for investment contracts with participation features

C1. In these examples, the investors' claim is recognised as a liability rather than equity from the perspective of the issuer of the contracts. Consequently, we have based the example for Type II on paragraph IE 32 of the illustrative examples accompanying IAS 32 *Financial Instruments: Presentation* for 'entities whose share capital is not equity as defined in IAS 32'.

Type I—Assets and liabilities recognised in the consolidated statement of financial position of the entity managing the assets



Type II—Assets and liabilities not recognised in the consolidated statement of financial position of the entity managing the assets



Statement(s) of financial performance for fund (see IAS 32 example 7)	
Returns on financial assets	100
Management fees	(20)
Operating profit	**80**
Distributions to investors in fund	(80)
Change in net assets attributable to investors in fund	**0**

Statement(s) of financial performance for management company	
Management fees	20
Employee benefits	(10)
Profit	**10**

(In this case current practice and the outcome applying the Board's tentative decisions to date are aligned)