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STAFF PAPER

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Project	**Primary Financial Statements**		
Paper topic	Presentation of the share of the profit or loss of associates and joint ventures accounted for using the equity method		
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Purpose of paper

1. Paragraph 82(c) of IAS 1 *Presentation of Financial Statements* requires the separate presentation of the share of the profit or loss of associates and joint ventures accounted for using the equity method within profit or loss. The staff have observed significant diversity in practice in the presentation of this line item (see agenda paper 21A from the November 2016 Board meeting).

2. This paper explores whether we should require a specific location for presenting the share of the profit or loss of associates and joint ventures in the statement(s) of financial performance. Requiring a specific location for this line item may help in defining a comparable EBIT (Earnings before finance income/expenses and tax) subtotal (see agenda papers 21A and 21B for this meeting).

3. In this paper, we are only addressing the presentation of the share of the profit or loss of associates and joint ventures in the statement(s) of financial performance. We are not addressing the presentation of the entity's share in the investee's (ie associate or joint venture) other comprehensive income (OCI) —because paragraph 82A of IAS 1 and paragraph 3 of IAS 28 *Investments in Associates and Joint Ventures* require the entity to present its share in the investee's OCI as part of the entity's OCI. We are not addressing presentation issues in other primary financial statements either.

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Summary of staff recommendations

4. The staff recommend that:

   (a) the Board requires a specific location for presenting the share of the profit or loss of associates and joint ventures in the statement(s) of financial performance; and

   (b) the share of the profit or loss of associates and joint ventures be presented outside the EBIT subtotal after the entity's income tax expense (ie **Approach A** in this paper).

Structure of paper

5. The paper is structured as follows:

   (a) Current IFRS requirements (paragraphs 6–9);

   (b) What is the problem? (paragraphs 10–12);

   (c) Views from users (paragraphs 13–16);

   (d) Staff analysis (paragraphs 17–46); and

   (e) Staff recommendation (paragraphs 47–48).

Current IFRS requirements

6. Paragraph 82(c) of IAS 1 and paragraph 3 of IAS 28 require the presentation of the share of the profit or loss of associates and joint ventures accounted for using the equity method as a line item within the entity's profit or loss. However, IAS 1 and IAS 28 are silent about the exact location of that line item within profit or loss. Paragraph 24 of IFRS 11 *Joint Arrangements* is also silent about the location of the joint venturer's interest in a joint venture within profit or loss.

7. Paragraph 16 of IAS 28 requires an investment in an associate or a joint venture to be accounted for using the equity method. Paragraph 3 of IAS 28 states that the equity method is:

a method of accounting whereby the investment is initially recognised at cost and adjusted thereafter for the post-acquisition change in the investor's share of the investee's net assets. The investor's profit or loss includes its share of the investee's profit or loss and the investor's other comprehensive income includes its share of the investee's other comprehensive income.

8. The application of the equity method results in the inclusion in the statement of profit or loss of the entity's share of the *post-tax earnings* of the investee.

9. In the implementation guidance of IAS 1[1] the share in the *post-tax earnings* and post-non-controlling interests of the investee is presented in the entity's *pre-tax earnings.* This presentation is illustrated below:

Revenue
Cost of sales
Gross profit
...
Finance costs
Share of profit of associates
Profit before tax
Income tax expense
Profit for the year from continuing operations
Loss for the year from discontinued operations
Profit for the year

What is the problem?

10. Our review of a sample of 25 financial statements[2] evidenced the existence of diversity in practice in the presentation of the share of the profit or loss of associates and joint ventures. Entities presented this line item in different locations within profit or loss.

11. The most common locations that entities in our sample used (in descending order of frequency) are:

(a) below operating profit (when presented) but above profit before tax;

(b) above operating profit (when presented);

[1] We refer to IG6 in IAS 1 'XYZ Group – Statement of profit or loss and other comprehensive income for the year ended 31 December 20X7 (illustrating the presentation of profit or loss and other comprehensive income in one statement and the classification of expenses within profit or loss by function)'.

[2] This analysis was presented in paragraph 30 of Agenda Paper 21A of November 2016.

(c) below income tax, above profit (ie presented in the same way as profit or loss from discontinued operations); or

(d) above profit before tax with no operating profit presented (as shown in the Implementation Guidance of IAS 1).

12. In many cases, the entities that we reviewed did not explain why they decided to present the share of the profit or loss of associates and joint ventures in a particular location. However, the range of practices may reflect:

(a) how associates or joint ventures are managed in the business (ie whether the associate or joint venture is integral to the entity's operations—entities are more likely to present the results of an associate or a joint venture higher up the statement(s) of financial performance when the associate or joint venture is an integral part of the entity's operations); or

(b) presentation practices in different jurisdictions.

Views from users

13. This section summarises the views we heard from users of financial statements during our outreach activities. We have supplemented these views with our review of some investment research reports that allowed us to understand how analysts adjust information about associates and joint ventures for the purposes of their analysis.

14. Our research indicates that many users analyse and value the results of significant investments in associates and joint ventures separately from their valuation of an entity's day-to-day business operations (some analysts refer to the latter as the entity's "core" business operations). This is because they think that:

(a) the activities of associates or joint ventures are peripheral (ie not integral) to an entity's day-to-day business operations and are not the main source of an entity's "core" business operations;

(b) the results of associates and joint ventures are of a different "quality" from an entity's fully-consolidated results, because the entity is not able to exercise full control over the associate or joint venture (ie it exercises only

significant influence over an associate and joint control over a joint venture); and

(c) the results of associates and joint ventures are a blend of different amounts (ie core/non-core, financing and tax amounts of the investee) and users would normally exclude non-core, financing and tax amounts from their analysis and calculation of key metrics such as EBIT.

15. Users also commonly omit associates or joint ventures to avoid distorting the metrics included in their multiples and to have consistently defined multiples. For example in the calculation of "core" earnings multiples such as $\frac{\text{"}Core\ Enterprise\ Value\text{"}}{\text{"}Core\ EBIT\text{"}}$, users would exclude from:

(a) the numerator ("core enterprise value"), the estimated market value of investments in associates and joint ventures (as these investments are commonly considered non-core assets); and

(b) the denominator ("core EBIT"), the share of the profit or loss of associates and joint ventures (as these results are not pre-tax or pre-interest and combine core and non-core amounts).

16. However, our research also indicated that other users would incorporate the results of associates or joint ventures as part of their valuation of an entity's "core" business. This would be when those associates or joint ventures are integral to an entity's day-to-day business operations. For example, if a beverage company had an integral investment in its bottling company, some analysts would incorporate this investment into their valuation of an entity's "core" business operations.

Staff analysis

17. We have split our analysis into the following topics:

(a) If the Board requires a specific location for presenting the share of the profit or loss of associates and joint ventures, where could this be? (paragraphs 18–29)

(i) Approach A – should it be presented after the entity's income tax expense?

(ii) Approach B – should it be presented above the entity's profit before tax?

(b) Circumstances when the results of some investees are considered integral to an entity's business operations (paragraphs 30–43); and

(c) Should the Board propose creating an "investing" section within the statement(s) of financial performance to present the share of the profit or loss of associates and joint ventures? (paragraphs 44–46).

If the Board requires a specific location where could this be?

18. As noted in paragraphs 14–15 users commonly omit the entity's share of the profit or loss of associates and joint ventures from their calculation of key metrics and multiples and they analyse the entity's investment in associates and joint ventures separately. This seems to suggest that if the Board were to require the presentation of an EBIT subtotal in the statement(s) of financial performance[3], users would prefer the share of the profit or loss of associates and joint ventures to be presented *outside* the EBIT subtotal (ie below EBIT).

19. If the Board agrees that the share of the profit or loss of associates and joint ventures should be presented outside EBIT, the staff think that there are two approaches that the Board could consider:

    (a) Approach A – presentation after the entity's income tax expense; or

    (b) Approach B – presentation above the entity's profit before tax.

20. We observe that in both of the approaches mentioned above, the EBIT subtotal would perhaps have to be renamed as "Earnings *before* finance income/expenses, tax *and the share of results of associates and joint ventures*". This is to reflect that the share of the profit or loss of associates and joint ventures would not be included within the EBIT subtotal.

21. We provide an illustration of **Approach A** and **Approach B** below:

[3] Refer to Agenda Paper 21A (March 2017).

Approach A (after income tax)	
Statement of Financial Performance	
	2016
	(in millions)
Revenue	11,292
Cost of goods sold	(2,815)
SG&A expense	(3,679)
Management performance measure	4,798
Litigation charges	(100)
Goodwill impairment	(364)
Fair value change in investment property	12
Dividend income	200
Earnings before finance income/expenses, tax and share of results of associates and joint ventures	4,546
Finance income	203
Finance expense	(116)
Profit before tax and share of results of associates and JVs	4,633
Income tax expense	(815)
Profit before share of results of associates and JVs	3,818
Share of profit of associates and JVs	1,000
Profit for the year from continuing operations	4,818
Loss from discontinued operations	(30)
Profit for the year	4,788

Approach B (above profit before tax)	
Statement of Financial Performance	
	2016
	(in millions)
Revenue	11,292
Cost of goods sold	(2,815)
SG&A expense	(3,679)
Management performance measure	4,798
Litigation charges	(100)
Goodwill impairment	(364)
Fair value change in investment property	12
Dividend income	200
Earnings before finance income/expenses, tax and share of results of associates and joint ventures	4,546
Finance income	203
Finance expense	(116)
Share of profit of associates and JVs	1,000
Profit before tax	5,633
Income tax expense	(815)
Profit for the year from continuing operations	4,818
Loss from discontinued operations	(30)
Profit for the year	4,788

Approach A – presentation after the entity's income tax expense

22. Under this approach, the share of the profit or loss of associates and joint ventures is considered a post-tax amount that would be presented *after* an entity's income tax expense.

23. The rationale for this approach is that the equity method requires that the entity's profit or loss includes its share of the investee's profit or loss. The presentation after the entity's income tax expense would be consistent with the fact that the investee's profits are a post-tax amount.

24. However, a possible argument against this approach is that the share of the profit or loss of associates and joint ventures is only post the taxes paid by the investee and ignores any additional taxes paid by the entity in relation to that investment. This would raise the question whether the nature of the share of the profit or loss of

associates and joint ventures is truly a post-tax amount from the entity's perspective. This gives rise to Approach B, discussed below.

Approach B – presentation above the entity's profit before tax

25. Under this approach, the share of the profit or loss of associates and joint ventures is considered a pre-tax amount that would be presented above the entity's *profit before tax* subtotal.

26. The rationale for this approach is that some jurisdictions could impose additional taxes on the entity in relation to the associates and joint ventures. For example, payment of tax on dividends from the investee (ie an associate or a joint venture). Because there could be a tax on the dividends received some might consider the total amount of the share of the profit or loss of associates and joint ventures to be a pre-tax amount.

27. The main disadvantage of this approach is that not all jurisdictions impose additional taxes on the entity in relation to the associates and joint ventures and this approach may not be justifiable in those jurisdictions.

Staff view

28. We do not support Approach B (presentation above the entity's profit before tax). We are not convinced that taxing the dividends received from the investee would justify a presentation of the *total* share of the results as a pre-tax amount. Moreover, we observe that Approach B would not always be an ideal approach for all jurisdictions because jurisdictions may have different tax rules.

29. We think that Approach A (presentation after the entity's income tax expense) might be a better approach for presenting the entity's share in the profit or loss of associates and joint ventures.

Circumstances when the results of some investees are considered integral to an entity's operations

30. Our analysis indicated that the nature of the activities of some investees can affect how an entity presents those results. Some are considered to be an integral part of an entity's operating activities and hence are included in operating profit (when

presented). Others are considered to be "passive investments" and hence are presented below operating profit.

31. From our review of some financial statements we could not find conclusive evidence of the entity's reasons for considering associates or joint ventures integral to its operating activities. Nevertheless, we found that when the activities of the associates or joint ventures are similar to or are integrated with an entity's main line of business (for example in the case of a construction company running a concession through an associate or joint venture), the results from those investees tend to be disclosed within the entity's operating/recurring profit (when these subtotals are presented) in the statement(s) of financial performance.

32. We found out more about the reasons why some joint ventures are considered integral to an entity's business operations in our review of the comments received from respondents on the Exposure Draft ED 9 *Joint Arrangements*[4]. Some respondents mentioned that joint ventures are integral when they:

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

    (b) are run as an extension of the group's activities. This is, when the joint venture's activities are operated in the same manner as the entity's subsidiaries (ie 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); or

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

33. The fact that the activities from some joint ventures might be closer to the entity's core operating activities raises the question about whether an entity should be *allowed* or *required* to present its share of the profit or loss of certain investments within EBIT.

34. In paragraph 29 we propose to present the share of the profit or loss of associates and joint ventures after the entity's income tax expense (we show it as "Approach A").

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

We think that this approach could be adapted to either *allow* ("Approach A1") or *require* ("Approach A2") an entity to present the results of some investees considered integral to its business operations within EBIT (Note, if the Board prefers Approach B this could also be adapted in a similar way). In both of these approaches the EBIT subtotal would perhaps have to be renamed as "Earnings before finance income/expenses, tax and share of results of *non-integral* associates and joint ventures". This is to reflect that the share of the profit or loss of *non-integral* associates and joint ventures would not be included within the EBIT subtotal.

35. We provide below an illustration of what approaches A1 and A2 would look like. In this illustration, we are assuming that an entity has different investments in associates and joint ventures and one of its joint ventures is integral to its business operations. We also provide a discussion of those two approaches after this illustration.

Presentation after income tax. An entity would be allowed/required to present its share of the results of some associates or JVs higher up in profit or loss

Statement of Financial Performance

	2016
	(in millions)
Revenue	11,292
Cost of goods sold	(2,815)
SG&A expense	(3,679)
Share of profit of integral Joint Venture 'A'	500
Management performance measure	5,298
Litigation charges	(100)
Goodwill impairment	(364)
Fair value change in investment property	12
Dividend income	200
Earnings before finance income/expenses, tax and share of results of non-integral associates and joint ventures	5,046
Finance income	203
Finance expense	(116)
Profit before tax and share of results of non-integral associates and JVs	5,133
Income tax expense	(815)
Profit before share of results of non-integral associates and JVs	4,318
Share of profit of non-integral associates and JVs (excluding the share in JV 'A')	500
Profit for the year from continuing operations	4,818
Loss from discontinued operations	(30)
Profit for the year	4,788

Approach A1: Allow *the presentation of the share of the profit or loss of integral associates and joint ventures within EBIT*

36. Under this approach, management would determine which of its investments in associates or joint ventures is integral to its business operations. Management could choose to present its share of the results of those investees within EBIT.

37. Some advantages of this approach are:

    (a) it would provide management with greater flexibility in reporting the share of its investees' results;

    (b) many entities already present the results of some investees within EBIT, so Approach A1 would avoid them needing to change that practice; and

    (c) reflecting the results of integral associates or joint ventures as part of an entity's core operations might provide meaningful information to users about how close the activities of an investee are to an entity's operations.

38. Some disadvantages of this approach are:

    (a) allowing a choice of presentation would not be consistent with the objective of introducing a comparable EBIT subtotal and would not eliminate the existing diversity in practice in the presentation of the share of the profit or loss of associates or joint ventures (see paragraphs 10-11); and

    (b) management might have different views on when associates/joint ventures are considered integral to the entity's operations and might selectively choose to show the results of profitable investments above EBIT and the unprofitable ones below EBIT to inflate the management performance measure (if presented).

Approach A2: Require *the presentation of the share of the profit or loss of integral associates or joint ventures within EBIT*

39. Under this approach, management would be *required* to present within EBIT those investments in associates or joint ventures that are integral to its business operations. The Board could prescribe some factors that an entity should use to assess whether

some of its investments in associates or joint ventures are integral to an its operations. For example, some factors that an entity could use in its assessment could be[5]:

(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 to the entity;

(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

(f) common sources of capital and lending relationships.

40. An advantage of this approach is that management would identify associates or joint ventures that are integral to an entity's business operations based on criteria prescribed by the Board and so there would be more consistency between entities in when associates or joint ventures are classified as integral.

41. Nevertheless, this approach has the following disadvantages:

(a) management would still use its judgement in identifying which of its associates or joint ventures are integral based on the criteria developed by the Board and so classification may still differ between entities. In addition, if the Board provides a list of factors that an entity could use to identify integral associates or joint ventures, it would be difficult to ensure that this list is complete and that this list would be assessed in a consistent way by all entities.

(b) whilst classification might be more consistent than under Approach A1, having two locations for associates and joint ventures would not eliminate the existing diversity in practice in the presentation of the share of the profit

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[5] Some of these factors are based on actual factors that some analysts use to assess investments in joint ventures (we found them in one of the investment reports we analysed).

or loss of associates and joint ventures; it would also not be consistent with the objective of introducing a comparable EBIT subtotal.

Staff view

42. We do not think that either approach (ie Approach A1 or Approach A2) would be consistent with:

    (a) our objective of introducing a comparable EBIT subtotal; and

    (b) the needs of most users.

43. Therefore, we think that the Board should not support the presentation of an entity's share of the profit or loss of associates and joint ventures within EBIT. We note this would mean that the share of the profit or loss of integral associates and joint ventures could not be included in the Management Performance Measure (see Agenda Paper 21C).

Should the Board propose creating an "investing" section within the statement(s) of financial performance to present the share of the profit or loss of associates and joint ventures?

44. In the Board's previous Financial Statement Presentation project (FSP), the Board considered the creation of an investing category in the primary financial statements to include an asset or a liability that "(a) yields a return for the entity and (b) does not result in significant synergies for the entity"(refer to paragraph 81 of the Financial Statement Presentation Staff Draft). In the statement(s) of financial performance the "investing" category included the return from "investing" long-term assets such as investments in associates or joint ventures; the return (ie dividends received) on other unconsolidated equity investments; and gains or losses from the sale or disposal of investment property. The investing category was presented before debt and equity (ie the "financing" category) in the statement(s) of financial performance.

45. We observe that the resulting "business" total (operating activities + investing activities) may be similar to having an EBIT subtotal because of the separation of activities that create value for the entity (ie operating and investing activities) versus the activities that fund or finance those business activities (ie its financing activities).

46. However, the staff does not propose creating a separate investing category to present an entity's share of the profit or loss of associates and joint ventures. This is mainly because introducing an investing category would require the creation of an "operating" category to differentiate "operating" from "investing" activities. The staff are proposing to introduce an EBIT subtotal rather than an operating profit because defining an operating profit subtotal that is applicable to entities in all industries is quite challenging (ie previous attempts to define this notion have failed as there is no consensus about what 'operating' really means)[6]. Consequently, we do not recommend the Board to create an investing category in the statement(s) of financial performance. We illustrate the presentation of an investing category below:

Illustration of the creation of an investing category	
Statement of Financial Performance	
	2016
	(in millions)
Operating	
Revenue	11,292
Cost of goods sold	(2,815)
SG&A expense	(3,679)
Management performance measure	4,798
Litigation charges	(100)
Goodwill impairment	(364)
Total operating profit	**4,334**
Investing activities	
Fair value change in investment property	12
Dividend income	200
Share of profit of associates and JVs	1,000
Total investing profit	1,212
TOTAL BUSINESS PROFIT	5,546
Finance income	203
Finance expense	(116)
Profit before tax	5,633
Income tax expense	(815)
Profit for the year from continuing operations	4,818
Loss from discontinued operations	(30)
Profit for the year	4,788

[6] Refer to paragraphs 26-29 of Agenda Paper 21B of March 2017.

Staff recommendation

47. We think that Approach A (presentation after income tax expense) would best reflect the nature of the results recognised by the entity through the application of the equity method (ie that the entity recognises a share in the *post-tax* results of the investee). Approach A would also be consistent with the way most users treat the results of associates and joint ventures for purposes of their analysis (ie treating them as non-core items, excluded from EBIT).

48. We note, however, that Approach A might not be entirely consistent with the way some entities view the results of some of their investees. Some entities present their share of the profit or loss of some associates and joint ventures above operating profit to indicate that those results are more integral to the entities' operations than others. However, we think that the Board should not allow or require the presentation of an entity's share of the profit or loss of associates and joint ventures within EBIT as this would cause diversity in practice and would not be consistent with our objective of introducing a comparable EBIT subtotal.

Question to the Board

Does the Board agree with our recommendation in paragraphs 47–48 of this paper to present the share of the profit or loss of associates and joint ventures outside EBIT and below income tax expense?