IFRS

STAFF PAPER

September 2017

IASB® Meeting

Project	**Primary Financial Statements**
Paper topic	Structure of the statement(s) of financial performance—introduction of an investing category and additional subtotals

CONTACT(S) Michelle Fisher mfisher@ifrs.org +44 (0)20 7246 6918

This paper has been prepared for discussion at a public meeting of the International Accounting Standards Board (Board) and does not represent the views of the Board or any individual member of the Board. Comments on the application of IFRS® Standards do not purport to set out acceptable or unacceptable application of IFRS Standards. Technical decisions are made in public and reported in IASB® *Update*.

Purpose of this paper

1. This Agenda Paper seeks the Board's views on the staff's proposals to introduce an investing category and two additional subtotals—'profit before investing, financing and income tax' and 'profit before financing and income tax'—into the statement(s) of financial performance. The paper follows up the discussion at the June 2017 Board meeting by addressing the main concerns and suggestions raised by Board members about the staff proposal to introduce an EBIT (earnings before finance income/expenses and tax) subtotal.

2. This paper does not address financial institutions and other entities providing financial services. It also does not address investment entities or other entities that conduct significant investing activities. We would like the Board to focus on determining a suitable approach for a straightforward non-financial entity first. We will consider at a future meeting how this approach could be applied or adapted to more complex scenarios.

Summary of staff recommendations in this paper

3. The staff recommend:

   (a) in the statement(s) of financial performance, prioritising greater comparability and introducing subtotals that facilitate comparisons between entities, such as EBIT or similar subtotals as described in paragraph 3(d),

The International Accounting Standards Board is the independent standard-setting body of the IFRS Foundation, a not-for-profit corporation promoting the adoption of International Financial Reporting Standards. For more information visit www.ifrs.org.

over retaining flexibility and inclusion of a management performance measure (MPM) subtotal;

(b) introducing an investing category into the statement(s) of financial performance, and defining investing income/expense as income/expenses from assets and liabilities that:

   (i) yield a return for the entity; and

   (ii) do not result in significant synergies for the entity in combination with other resources of the entity.

(c) changing the term ‘investing activities’ in IAS 7 to ‘capital expenditure and investing activities’ to clarify that the way it is defined includes capital expenditure;

(d) introducing two subtotals into the statement(s) of financial performance (rather than a single EBIT subtotal as proposed in June 2017):

   (i) profit before investing, financing and income tax; and

   (ii) profit before financing and income tax.

(e) defining finance income/expenses as:

   (i) income/expenses related to the entity’s capital structure; and

   (ii) interest expenses[1] on liabilities outside capital structure (and any interest income on a net defined benefit asset or a net asset that arises when a liability outside capital structure qualifies for offset with an asset).

(f) defining capital structure as equity, assets and liabilities arising from financing activities, and cash and cash equivalents (a principles-based approach);

(g) requiring the following separate line items for finance income/expenses in the statement(s) of financial performance:

   (i) income related to capital structure;

   (ii) expenses related to capital structure;

[1] Interest refers to the unwinding of the discount/time value of money on these assets and liabilities. For simplicity the staff have ignored the possibility that there might be interest income on liabilities (or interest expense on a net asset), for example because of negative interest rates.

(iii) interest income on a net defined benefit asset or a net asset that arises when a liability outside capital structure qualifies for offset with an asset; and

(iv) interest expenses on liabilities outside capital structure.

The staff have explained how these recommendations differ from the June 2017 staff recommendations in appendix B.

Overview

4. The paper is structured as follows:

(a) background (paragraphs 5-7);

(b) should we prioritise greater comparability and subtotals that facilitate comparisons between entities, over retaining flexibility and inclusion of a MPM subtotal (paragraphs 8-12)?

(c) should we introduce an investing category into the statement(s) of financial performance (paragraphs 13-32)?

(d) should we align the investing categories in the statements of cash flows and financial performance (paragraphs 33-39)?

(e) is cash and cash equivalents too restrictive as a proxy for excess cash and temporary investments of excess cash that form part of capital structure (paragraphs 40-46)?

(f) is EBIT the right label for our subtotal (paragraphs 47-52)?

(g) Appendices

(i) A—illustrations of the staff recommendations in this paper:

Scenario 1—MPM provided as a subtotal

Scenario 2—MPM provided in a separate reconciliation

(ii) B—main differences between the staff recommendations at this meeting and the staff recommendations in June 2017

Background

Objective of introducing an EBIT subtotal

5. At the June 2017 Board meeting the staff explained that our objective in requiring an EBIT subtotal is:[2]

   (a) to provide a comparable measure of performance further up the statement(s) of financial performance than profit before tax; and

   (b) to facilitate comparisons of entities with different capital structures.

Staff recommendations in June 2017

6. In order to meet this objective, at the June 2017 Board meeting the staff recommended:

   (a) defining EBIT as profit before finance income/expenses and tax;

   (b) defining finance income/expenses as:

      (i) income/expenses related to the entity's capital structure; and

      (ii) interest on assets and liabilities not part of an entity's capital structure.

   (c) defining capital structure as equity, assets and liabilities arising from financing activities, and cash and cash equivalents (principles-based approach)—using 'cash and cash equivalents' as defined in IAS 7 *Statement of Cash Flows* as a proxy for excess cash and temporary investments of excess cash;

   (d) clarifying the current description of financing activities using similar wording to that proposed by the staff to the IFRS Interpretations Committee in March 2013;[3]

   (e) providing guidance that income/expenses related to capital structure includes:

---

[2] Paragraphs 7-11 of June 2017 Agenda Paper 21A.

[3] From Agenda Paper 7, paragraph 84 for the March 2013 IFRS Interpretations Committee meeting.

(i) all income and expenses on items of capital structure that solely arise from financing activities; and

(ii) income and expenses related to the funding aspect—for example, including the interest—of items of capital structure that do not solely arise from financing activities, for example trade payables on extended credit terms.

(f) requiring the separate presentation below EBIT of the components of finance income/expenses:

(i) income related to capital structure;

(ii) expenses related to capital structure;

(iii) interest income on assets outside capital structure; and

(iv) interest expenses on liabilities outside capital structure.

Board discussion

7. The Board did not take any decisions at the June 2017 Board meeting. The staff think that the Board was generally supportive of the direction of the staff recommendations in paragraph 6. However the staff has identified the following main concerns and suggestions raised by Board members (some of these points are expanded upon in the later sections of this paper):

(a) the need to explore the presentation of an investing category in the statement(s) of financial performance, either before or after EBIT.

(b) concern that cash and cash equivalents is too restrictive as a proxy for excess cash and temporary investments of excess cash that form part of an entity's capital structure.

(c) concerns that the staff proposal could result in significant changes in presentation for some companies, in particular presenting interest on assets outside capital structure in finance income/expenses, which could have unintended consequences.

(d) general support for including the share of profit or loss of associates and joint ventures above EBIT, rather than below EBIT.

(e) concern that EBIT might not be the right label for the subtotal unless we are excluding purely interest and tax, and that using 'earnings' rather than 'profit' may be confusing.

(f) concern that if we put too much below EBIT there would be too many restrictions on the MPM subtotal, meaning it might not be possible for a company to present management's view of performance.

(g) some suggestions to show the MPM in a separate reconciliation or in a separate management performance statement, rather than as a subtotal in the statement(s) of financial performance. Reasons included:

(i) then the MPM would not be restricted to amounts included in EBIT; and

(ii) to avoid concerns about 'elevating' the MPM to an IFRS measure in the statement(s) of financial performance.

Should we prioritise comparable subtotals over a MPM subtotal?

What is the problem?

8. At the June 2017 Board meeting it was difficult for the Board to make concurrent decisions about the following staff proposals:

(a) the proposal to introduce an EBIT subtotal to help to address the need for greater comparability between entities; and

(b) the proposal to introduce a MPM, above EBIT, to help to address the conflicting need to retain flexibility for preparers to present their view of performance.

9. In particular, it was difficult for the Board to decide what should be in finance income/expenses, and therefore presented below the EBIT subtotal, in isolation from decisions about appropriate constraints on the MPM, for the following reasons:

(a) it might be possible for both the EBIT and MPM subtotals to coexist. However, the more we exclude from EBIT (ie the more income and expenses required to be presented below EBIT), the more restrictions there would be on what can be included in a MPM subtotal that is presented

above EBIT. If we want the MPM to represent management's view of performance, we would want to limit the income/expenses excluded from EBIT to the greatest extent possible to accommodate a wide range of MPMs. For example, if EBIT is defined to exclude the share of profit or loss of associates and joint ventures, then this item would also be required to be excluded from the MPM subtotal. However, in some cases management might want to include the share of profit or loss of associates and joint ventures in the MPM, for example if it considers associates or joint ventures to be integral to the entity's operations.

(b) if we limit the income/expenses excluded from EBIT to try to accommodate a wide range of different MPM subtotals (ie limit what is included in the 'I' in EBIT), EBIT would become close to the profit before tax subtotal. This is contrary to our objective in paragraph 5(a) and may mean there is little point in requiring both an EBIT and a profit before tax subtotal to be presented.

Staff analysis

10. The staff think it would be difficult to incorporate both an EBIT and a MPM subtotal in the statement(s) of financial performance without compromising the usefulness of one of the subtotals for some companies. Therefore we suggest prioritising one of these subtotals and focusing on developing our proposals for this subtotal first. The staff think greater comparability and introducing subtotals that facilitate comparisons between entities, such as EBIT or similar subtotals as described in paragraph 3(d), is more important than retaining flexibility and introducing a MPM subtotal for the following reasons:

(a) during our outreach there was significant support for introducing a comparable EBIT subtotal and enhancing comparability in the statement(s) of financial performance, particularly among users of financial statements. There was far less support for introducing a MPM subtotal and several concerns were raised about including 'non-IFRS/non-GAAP measures' in the statement(s) of financial performance.

(b) at their June/July 2017 meetings, ASAF, CMAC and GPF members were also generally more supportive of our proposals to introduce an EBIT subtotal, than the MPM subtotal, and had more concerns about the MPM subtotal (a summary of these meetings is provided in the appendix to Agenda Paper 21). The staff think that this view was shared by Board members at the June 2017 Board meeting.

(c) some Board members preferred showing the MPM in a separate reconciliation or statement, rather than as a subtotal in the statement(s) of financial performance.

11. The staff do not think that prioritising comparability and introducing a comparable EBIT, or similar, subtotal over introducing the MPM subtotal means that we should abandon our proposals for the MPM altogether. Based on our outreach and research, the staff think that in many cases entities would exclude finance income/expenses (and investing income/expenses) from the MPM. For example, entities commonly present an adjusted operating profit measure which excludes only non-recurring operating items. Such a measure would not be expected to include amounts that are excluded from our EBIT subtotal (illustrated in Appendix A, Scenario 1). Nevertheless, if after developing our proposals for EBIT, or similar, subtotal we find the outcome is too restrictive for some companies to present a MPM subtotal we could:

(a) consider other options for presenting the MPM if it doesn't 'fit' as a subtotal in the statement(s) of financial performance with the EBIT, or similar, subtotal. For example the MPM might be disclosed:

(i) in a separate reconciliation presented with the statement(s) of financial performance (see Appendix A, Scenario 2);

(ii) in the notes, for example in a separate note, or as part of the operating segment note—also prepared using a management approach; or

(iii) using a columnar approach in the statement(s) of financial performance, showing the components of the MPM in a separate column.

(i)-(iii) would ensure the measure is still subject to a high level of transparency and discipline through its inclusion in the financial statements.

(b) or encourage/require the separate presentation of line items showing management's view of infrequent or unusual items (including separate presentations of infrequent or unusual finance income/expenses) rather than requiring a MPM subtotal. One might argue that the separate presentation of infrequent or unusual items is already required by the requirements for additional line items in the statement(s) of financial performance in paragraphs 85- 86 of IAS 1, but more specific requirements might ensure more consistent application. Such presentation would help investors assess the persistence or sustainability of an entity's financial performance, which appears to be a key reason why investors find management's view of performance helpful.

12. If the Board agrees with the staff recommendation to prioritise greater comparability in the statement(s) of financial performance and introducing subtotals that facilitate comparisons between entities over including a MPM subtotal, then the staff would bring their proposals for the MPM to a future meeting after we have made tentative decisions about these comparable subtotals.

Question 1

For the statement(s) of financial performance, the staff recommend:

(a) prioritising greater comparability and introducing subtotals that facilitate comparisons between entities, such as EBIT or similar subtotals as described in paragraph 3(d);

over

(b) retaining flexibility and including a management performance measure (MPM) subtotal.

Do you agree?

Should we introduce an investing category into the statement(s) of financial performance?

What is the problem?

13. At the June 2017 Board meeting some Board members expressed the following concerns about the staff recommendations in paragraph 6:

(a) presenting interest on assets outside capital structure in finance income/expenses would be a significant change in presentation for some companies. This could have unintended consequences, for example:

  (i) it appears to require the interest on financial assets measured at fair value through profit or loss to be separated from other fair value changes, and to be measured using the effective interest method—currently this is permitted but not required;

  (ii) it would create an artificial distinction between interest and dividends/fair value changes on investments; and

  (iii) it would mean entities could have a completely different presentation and EBIT subtotal, depending on whether they invest in equity or debt instruments, which might be an odd outcome.

(b) using cash and cash equivalents as a proxy for excess cash and temporary investments of excess cash that form part of an entity's capital structure is too restrictive. However some Board members noted that it would be difficult to include a wider view of which assets should be considered part of capital structure without involving management judgement or requiring the Board to distinguish between different investments based on their characteristics, for example identifying criteria for strategic investments (explained further in paragraph 43).

14. Some Board members noted that one way of helping to address the concerns in paragraph 13 would be to consider an investing category in the statement(s) of financial performance.

Staff analysis

Advantages and disadvantages

15. The staff think the following are the advantages of including an investing category in the statement(s) of financial performance:

(a) it would improve information for investors by providing:

  (i) additional structure to the statement(s) of financial performance; and

(ii) clearer information about investing income and expenses.

(b) it would enable investors to more easily make adjustments to the EBIT, or similar, subtotal to exclude investing income/expenses if they wish to. This would lessen the importance of trying to accommodate the following in our proposals (and hence avoid the difficulties associated with them described in paragraph 13):

(i) incorporating a wider view of excess cash and temporary investments of excess cash in capital structure (however the staff considers this in more detail in paragraphs 40-46); and

(ii) separately presenting interest on assets outside capital structure in finance income/expenses, below EBIT.

This is because most assets that might otherwise be considered part of capital structure and/or on which interest is recognised would likely be investing in nature.

(c) it might provide a suitable location for the share of profit or loss of associates and joint ventures (see paragraphs 26-28).

(d) it might provide greater consistency between the structure of the statement(s) of financial performance and the statement of cash flows. This is because the statement(s) of financial performance would essentially be split into three categories like the statement of cash flows (ie, financing, investing and operating).

16. The staff think the following are the disadvantages of including an investing category in the statement(s) of financial performance:

(a) it might imply a false sense of cohesiveness with the investing category in the statement of cash flows, unless we use the IAS 7 definition of investing activities to determine what goes in the investing category in the statement(s) of financial performance. Furthermore, if we use a different definition of investing in the statement(s) of financial performance than the definition of ‘investing activities’ in IAS 7, this could cause confusion.

(b) it might add further constraints on the MPM, if the MPM is included as a subtotal in the statement(s) of financial performance. This is because any income/expenses that are required to be presented in the investing category

could not be included in the MPM, assuming the MPM subtotal is required to be presented above the investing category.

(c) it would not fully address the concerns in paragraph 13(b) about cash and cash equivalents being too restrictive as a proxy for excess cash and temporary investments of excess cash, unless an entity provided sufficient disaggregation to allow users to identify which income/expenses relate to investments that an entity manages as part of capital structure.

(d) it would make the structure of the statement of financial performance less flexible, which might add complexity when catering for different entities in different industries. Furthermore, many non-financial entities may have little investing income/expenses and so an investing category/subtotal may add unnecessary clutter (although it could be excluded if not material).

Step 1: What is our objective of having an investing category

17. The staff think that the first step in considering whether we should have an investing category in the statement(s) of financial performance is determining our objective, ie what is our reason for introducing this category. The staff think our objective is:

(a) to help to mitigate the concerns raised by Board members in paragraph 13 (this was the main reason that some Board members suggested considering an investing category); and

(b) to provide more transparent and comparable information across entities about the returns on an entity's investments. Such separate information is helpful for investors because they often measure an entity's investments separately from the entity's operations when valuing the entity's business (explained in more detail in paragraph 21 of June 2017 Agenda Paper 21A and paragraphs A2-A4 of the appendix to that paper).

18. We do not think our objective should be greater cohesiveness with the statement of cash flows. We have received feedback that cohesiveness between the statement(s) of financial performance and statement of cash flows is important. However, we think that the statements serve different purposes (as explained in paragraph 37). Therefore, we think we should only introduce an investing category into the statement(s) of

financial performance if we have a good reason for doing so, ie on the basis of its own merits.

Step 2: How do we define or describe what goes in the investing category?

19. The staff think if we include an investing category in the statement(s) of financial performance the Board will need to consider whether to:

    (a) allow management's view of what is investing income/expenses; or

    (b) specify which income/expenses should be in the investing category; or

    (c) develop principles over what income/expenses should be classified as investing, and if so:

        (i) whether these principles be based on the principles in IAS 7 to be consistent with the investing category in the statement of cash flows; or

        (ii) whether we should develop different principles for the statement(s) of financial performance.

20. Management view of investing: this approach would provide flexibility to management in reporting performance. However, the staff do not think that we should allow management's view of investing income/expenses without any guiding principles because:

    (a) it would be unlikely to improve comparability between entities;

    (b) it may not provide sufficient transparency to address the problems in paragraph 13; and

    (c) it would be inconsistent with the staff proposal in June 2017 to have a principles-based approach to determining capital structure and finance income/expenses (see June 2017 Agenda Paper 21A), which is carried over in the recommendation for this meeting (see paragraph 3(e)-(f)).

21. Specifying which income/expenses are investing: this approach might help to improve comparability between entities. However, the staff do not think that the Board should prescribe a list of income and expenses that should be classified as investing income/expenses because:

(a) it may be difficult to ensure that the list is complete and would be applied consistently by entities;

(b) it would be inconsistent with having a principles-based approach to describing finance income/expenses; and

(c) it is unlikely that a single list could be applied across different business models and industries and so it would be more likely to provide uniformity than comparability—ie it could make unlike things look alike. For example, we might prescribe that income/expenses on investment property is investing income/expenses for a straightforward manufacturing entity. However, such income/expenses may not be investing in nature for property companies. Although our intention is to focus on determining a suitable approach for a straightforward entity first (emphasised in paragraph 2), we do not want an approach that is so restrictive it is not adaptable to different business models and industries.

22. Principle based on IAS 7 definition of investing activities: Paragraph 6 of IAS 7 defines investing activities as '…the acquisition and disposal of long-term assets and other investments not included in cash equivalents'. An advantage of using the IAS 7 definition is that entities are familiar with the definition and it would achieve alignment between the statement(s) of financial performance and the statement of cash flows. Furthermore, if we use a different description for the investing category in the statement(s) of financial performance it could lead to confusion. However, the staff observe that the definition of 'investing activities' in IAS 7 would not meet our objective in paragraph 17 for the following reasons:

(a) it would appear to only capture income/expenses related to the acquisition and disposal of assets, rather than the returns from holding or using those assets; and

(b) it covers a broad range of assets, for example it includes cash flows to acquire and sell assets that support an entity's operating activities, such as property, plant and equipment and intangible assets. The staff think a narrower definition of investing income/expense would provide more useful information for investors who analyse the results of operations separately from other activities. For example, the staff do not think we would want to

include depreciation of property, plant and equipment in the investing category in the statement(s) of financial performance.

23. What other principles could we use to meet our objective in paragraph 17(b)? In the Board's previous Financial Statement Presentation project, the Board considered the creation of an investing category in the primary financial statements. In the 2010 Staff Draft of an Exposure Draft of IFRS *X Financial Statement Presentation* (2010 FSP Staff Draft) an investing activity was defined as an activity related to an asset or a liability that:

    (a) yields a return for the entity—for example, interest, dividends, royalties, equity income, gains or losses; and

    (b) does not result in significant synergies for the entity by combining that asset or liability with other resources of the entity.[4]

24. The 2010 FSP Staff Draft also provided examples of investing activities and related items that might be classified in the investing category, these included:[5]

    (a) dividends received on equity investments;

    (b) interest earned on debt investments;

    (c) distributions of non-financial investments such as rents, royalties, fees and commissions; and

    (d) investments in associates or joint ventures.

25. Informal feedback on the definition in the 2010 FSP Staff Draft was generally positive. However some felt that the application of the definition would not enhance comparability. In line with this we received some feedback that we should consider including guidance on identifying investments that may or may not have synergies with the other resources/operations of the entity. Some respondents were also unclear whether the examples of investing activities provided in the 2010 FSP Staff Draft would always be investing activities, for example investments in associates or joint ventures.

---

[4] Based on paragraph 81 of the 2010 FSP Staff Draft.

[5] paragraph 82 of the 2010 FSP Staff Draft

Share of the profit or loss of associates and joint ventures

26. At the June 2017 Board meeting the staff recommended presenting the share of the profit or loss of associates and joint ventures accounted for using the equity method below EBIT, directly below the income tax expense, for the following reasons:

    (a) it would better reflect the nature of the share of the profit or loss recognised through the application of the equity method (ie that the entity recognises a share in the *post-tax* results of the investee); and

    (b) it would be consistent with how most users treat the share of the profit or loss of associates and joint ventures for purposes of their analysis (ie treating them as non-core items, excluded from EBIT).

27. The staff also proposed that the same location should be required regardless of whether the associate or joint venture is considered integral to an entity's operations for the following reasons:

    (a) to remove diversity in practice in presentation; and

    (b) for consistency with our objective of greater comparability/a comparable EBIT subtotal.

28. At the June 2017 Board meeting, 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 (ie above finance income/expenses and tax). The staff think that if we introduce an investing category, this might provide the most suitable location, assuming we require a single location for all associates/joint ventures. However, depending on how we define investing income/expenses, the Board will need to consider whether the share of profit or loss of some associates and joint ventures should be presented outside the investing category in any cases. For example, an entity might argue that it has associates/joint ventures that are integral to its business and result in significant synergies in combination with the entity's other resources (paragraph 23(b)). We do not suggest that the Board should take a specific decision on whether to require a single location for all associates/joint ventures at this meeting, but we suggest to bear this issue in mind when considering an investing category.

Staff recommendation

29. The staff support introducing an investing category in the statement(s) of financial performance for the reasons in paragraph 15. We also suggest we develop principles to determine what to include in this category, together with illustrative examples to support the principles. We think this would result in relatively comparable information for users, whilst recognising that it is not possible to prescribe which income and expenses should be classified as investing for all different entities with different business models. It would also be consistent with applying a principles based approach to describing finance income/expenses. The staff think this investing category should be before EBIT, rather than after EBIT, because the category will include income/expenses that are not financing, interest or tax. Nevertheless, we could also require a second subtotal before the investing category. The staff has considered this and whether EBIT is the appropriate name for our subtotal in paragraphs 47-52.

30. The staff think that the way we define or describe the investing category should be consistent with our objective for adding this category to the statement(s) of financial performance as described in paragraph 17. The staff suggest using the definition in the 2010 FSP Staff Draft (paragraph 23), and accompanying examples (including those in paragraph 24), because this definition focuses on identifying returns on investments that are separate from an entity's operations and would be expected to capture those assets that are not cash or cash equivalents, but that an entity might consider to be part of capital structure. However, we may wish to develop some supporting guidance to ensure the definition is interpreted consistently by entities.

Question 2a

The staff recommend that we should:

(a) introduce an investing category into the statement(s) of financial performance to provide separate information about the returns on an entity's investments.

(b) define investing income/expenses as income/expenses from assets and liabilities that:

(i) yield a return for the entity; and

(ii) do not result in significant synergies for the entity in combination with other resources of the entity.

Do you agree?

31. Consistent with having an investing category and to respond to the concerns in paragraph 13(a), the staff also suggest that finance income/expenses should be defined more narrowly than the June 2017 staff proposal (meaning that the 'I' in EBIT would be defined more narrowly). The staff suggest that interest on assets outside capital structure should be excluded from finance income/expenses, except for interest on a net asset that arises because either a defined benefit plan has a funding surplus or a liability outside capital structure qualifies for offset with an asset. The staff think that where an entity presents a single net asset or liability for an obligation outside capital structure (rather than a separate gross funding asset and gross liability), it would not make sense to present the interest income/expense on the gross asset or gross liability in different locations (eg in investing versus in financing). We think offset, once achieved, sufficiently indicates that the funding asset is part of a financing arrangement and so the interest income on any net asset should also be in finance income/expenses.

32. Nevertheless, we do not think we can extend this case to interest income on funding assets that do not qualify for offset with the related liability because it would involve significant judgement as to whether the asset solely relates to financing the liability. The staff note that this means that finance income/expenses would not include interest on an asset established to fund a liability outside capital structure unless the funding asset and liability qualify for offset. For example, for a fund established to fund some or all of the costs of decommissioning plant and equipment, paragraph 7 of IFRIC 5 *Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds* notes that offset is only appropriate if the entity is not liable to pay decommissioning costs in the event that the fund fails to pay.

Question 2b

The staff recommend that we should define finance income/expenses more narrowly than the June 2017 staff proposal to consist of, and presented as the following four line items:

(a) income related to the entity's capital structure;
(b) expenses related to the entity's capital structure;
(c) interest income on a net defined benefit asset or a net asset that arises when a liability outside capital structure qualifies for offset with an asset; and
(d) interest expenses on liabilities outside capital structure.

Do you agree?

Should we align the investing categories in the statements of cash flows and financial performance?

What is the problem?

33. If we introduce an investing category into the statement(s) of financial performance, stakeholders might assume that it corresponds to the investing category in the statement of cash flows. If we use a different definition of investing in the statement(s) of financial performance than in the statement of cash flows this could lead to confusion.

Staff analysis

Alternatives to consider

34. If we use a definition of ‘investing’ for the statement(s) of financial performance that is unrelated to the definition of ‘investing activities’ in IAS 7, as is recommended by the staff in paragraph 30, the staff suggest we could consider the following alternatives to avoid confusion:

   (a) making corresponding changes to the definition of investing activities in IAS 7; or

   (b) using different terms in the statement(s) of financial performance and the statement of cash flows to make it clearer that these categories are different. For example we could either use a different term than ‘investing’ in the statement(s) of financial performance or we could change the term ‘investing activities’ in IAS 7.

Should we make corresponding changes to the IAS 7 definition?

35. Paragraph 6 of IAS 7 defines investing activities as ‘…the acquisition and disposal of long-term assets and other investments not included in cash equivalents.’ Paragraph 16 of IAS 7 provides the following explanation of the purpose of the investing category in the statement of cash flows:

> The separate disclosure of cash flows arising from investing activities is important because the cash flows represent the extent to which expenditures have been made for resources intended to generate future income and cash flows. Only expenditures that

result in a recognised asset in the statement of financial position are eligible for classification as investing activities.

36. The objective of providing information about cash flows from investing activities in IAS 7 appears to be to identify investments made in—ie the acquisitions and sales of—assets that are generally long-term in nature, including long-term assets that support an entity's operations, and investments such as debt or equity instruments. The objective does not appear to include identifying the returns from those assets. For example:

    (a) the investing category in the statement of cash flows includes cash flows from the acquisition and disposal of property, plant and equipment. However we do not think it would include cash returns from using those assets, for example cash received from customers.

    (b) paragraph 33 of IAS 7 permits cash inflows from interest and dividends received to be classified as either operating or investing cash flows. However, based on a strict reading of the definition of investing activities in IAS 7, the staff do not think these appear to be investing activities without the clarification provided in paragraph 33 of IAS 7. At a future Board meeting we will bring our proposals about the possibility of eliminating the options for the classification of interest and dividends in the statement of cash flows.

37. The staff think that the current objective in IAS 7 for having an investing category (identifying investments made in long-term assets that will generate future returns) is fundamentally different from our objective for considering an investing category in the statement(s) of financial performance (identifying returns from investments that are not part of an entity's operations). We think that this difference arises to some extent due to the different purposes of the statement(s) of financial performance and statement of cash flows. Therefore, the staff think we should use a different term in the statement(s) of financial performance than in the statement of cash flows rather than try to align the investing categories across the statements (alternative (b) in paragraph 34).

38. We will be considering whether to make targeted improvements to the statement of cash flows at a future meeting. For example, we could consider reporting cash flows to acquire property, plant and equipment within operating activities, rather than

investing activities, if we think this provides clearer information to investors about the split between an entity's operating activities versus non-operating activities. However, assuming we do not make significant changes to the purpose of the investing category in the statement of cash flows, the staff think we should use different terms in the statement(s) of financial performance and the statement of cash flows.

Should we use different terms?

39. The staff think the term 'investing income/expenses' is appropriate in the statement(s) of financial performance if we use the definition in the 2010 FSP Staff Draft—ie income/expenses from assets and liabilities that yield a return for the entity and do not result in significant synergies for the entity in combination with other resources of the entity (see paragraph 23). Possible alternatives that the staff considered but rejected were 'non-operating' or 'non-core' income/expenses. Therefore, the staff suggest changing the term 'investing activities' in IAS 7 to clarify that it includes capital expenditure, but retaining the existing definition of 'investing activities' as follows (changes to paragraph 6 of IAS 7 shown in underline):[6]

> ***Capital expenditure and*** ***investing activities*** are the acquisition and disposal of long-term assets and other investments not included in cash equivalents.

Question 3

The staff recommend changing the term 'investing activities' in IAS 7 to 'capital expenditure and investing activities' to clarify that the way it is defined includes capital expenditure.

Do you agree?

[6] The staff observe that the proposed labels might imply that the investing category in the statement(s) of financial performance (ie investing income/expense) is a subset of the investing category in the statement of cash flows (capital expenditure and investing cash flows), which might not be the case. For example, IAS 7 allows investing cash flows such as cash inflows from interest and dividends received to be classified as either operating or investing cash flows, whereas the staff think that interest and dividend income would meet the proposed definition of investing income/expense. However, as noted in paragraph 36(b), we will consider removing the option in the statement of cash flows at a future meeting.

Is cash and cash equivalents too restrictive as a proxy for cash and temporary investments of excess cash that form part of capital structure?

What is the problem?

40. Capital structure is often viewed as including excess cash and temporary investments of excess cash—we will refer to both together as ‘excess cash’ in the rest of this paper. This is because the way an entity manages excess cash is interrelated with its decisions on capital structure, ie excess cash is ‘negative’ capital structure. At the June 2017 Board meeting, we recommended using ‘cash and cash equivalents’ as defined in IAS 7 as a proxy for an excess cash notion. IAS 7 defines cash equivalents as short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value. We received feedback that this might be too restrictive, for example sometimes excess cash is held in longer term investments.

41. Some CMAC and GPF members observed that some longer-term assets are held for the purposes of settling liabilities. For example, one GPF member commented that when they issue loans, they invest a specific amount of cash in financial assets, that are not cash equivalents, as a liquidity reserve. In this member’s view, the income and expenses related to these financial assets should be presented as finance income and expenses.

Staff analysis

42. The staff have identified the following alternatives that we might consider if we think cash and cash equivalents is too restrictive:
    (a) widen the definition of capital structure to cover other liquid investments, ie other investments that are readily convertible to a known amount of cash;[7]
    (b) identify characteristics or indicators that should be applied by entities in determining whether an investment should form part of capital structure; or
    (c) allow management judgement about which assets should be part of capital structure.

[7] Based on the explanation of short-term highly liquid investments in paragraph 7 of IAS 7.

43. The staff do not think we should try to identify characteristics or indicators (paragraph 42(b)). The Board has tried to distinguish different types of investments in the past based on characteristics and based on intent, but has not been successful. For example, when developing IFRS 9 *Financial Instruments* the Board considered distinguishing between different investments based on characteristics—for example developing a principle to identify equity investments whose fair value changes should be presented in profit or loss (or other comprehensive income), including a distinction based on whether an investment in equity instruments represented a 'strategic investment'. However, the Board decided that it would be difficult, and perhaps impossible, to develop a clear and robust principle that would identify investments that are different enough to justify a different presentation requirement. The Board considered whether a list of indicators could be used to support the principle, but decided that such a list would inevitably be rule-based and could not be comprehensive enough to address all possible situations and factors. Moreover, the Board noted that such an approach would create complexity in application without necessarily increasing the usefulness of information to users of financial statements.[8]

44. The staff does not think we should allow management judgement in determining what constitutes excess cash (paragraph 42(c)) because this would conflict with our objective of having a comparable EBIT, or similar, subtotal.

45. We understand that for some entities ‘cash and cash equivalents’ might provide an artificially narrow view of excess cash. However, the staff think if we introduce an investing category, we should retain cash and cash equivalents as a proxy for excess cash for the following reasons:

    (a) the investing category will provide greater transparency about income and expenses from investments that are not cash equivalents that an entity might consider to be part of capital structure. This would enable investors to more easily make adjustments to include other amounts in ‘income/expenses related to capital structure’ if they want to do so (although the staff acknowledge that there may not be sufficient disaggregation in the investing category to identify exactly which investments an entity manages

[8] See paragraph BC5.25(c) of the Basis for Conclusions accompanying IFRS 9.

as part of capital structure, although this could be required to be disclosed in the notes).

(b) it would be difficult to bring other assets into capital structure for the reasons explained in paragraphs 43-44. To illustrate, if an entity has assets that it could either use to settle liabilities that form part of capital structure or hold as investments, the staff think it would be:

   (i) difficult for the Board to set criteria on when these should form part of capital structure that could be applied consistently by entities (paragraph 43); and

   (ii) would require significant judgement and result in a lack of comparability between entities if we allow management to determine whether these form part of capital structure (paragraph 44).

   Nevertheless, as observed in paragraph 45(a), provided that income/expenses on such assets are sufficiently disaggregated in a breakdown of investing income/expenses in the notes, the information will be available to enable investors to make adjustments to income/expenses relating to capital structure if they wish to do so.

46. If the Board does not support introducing an investing category, the staff has some sympathy for widening cash and cash equivalents to include other liquid investments (see paragraph 42(a)). This may also avoid the need to have a separate line item for 'interest on assets outside capital structure' (paragraph 6(f)(iii)) and the associated difficulties with that line item (explained in paragraph 13(a)), because more of these assets would be part of capital structure.

Question 4

The staff recommend that we should retain cash and cash equivalents as a proxy for cash and temporary investments of excess cash in our definition of capital structure. Do you agree?

Is EBIT the right label for our subtotal?

What is the problem?

47. At the June 2017 Board meeting the staff proposed to define EBIT as earnings before finance income/expenses and tax. There are a number of problems with using EBIT as the label for our subtotal:

    (a) the statement(s) of financial performance use the term 'profit' rather than 'earnings'. Introducing the notion of 'earnings' might be confusing.

    (b) based on the staff proposal to define finance income/expenses, the 'I' in EBIT would include income/expenses other than interest—it would include all income/expenses related to capital structure, for example foreign exchange gains and losses.

    (c) one ASAF member observed that the 'T' in EBIT would be income taxes, not all taxes.

Staff analysis

48. EBIT is a performance measure that is widely recognised and used in practice, and which is commonly understood to be profit plus interest (or more broadly, finance income/expenses) and income tax. EBIT is commonly reported by companies and used by investors in ratio analysis, multiples analysis, and as an input in a Discounted Cash Flows (DCF) model.

49. There are benefits from using a well-known term. Furthermore, if we use a different term instead of EBIT this could cause confusion if we are essentially describing the same measure. However, the label 'EBIT' is not consistent with IFRS terminology. Furthermore, in practice, there is some diversity in how EBIT is determined by different stakeholders, for example in the classification of items as finance income/expenses such as net interest on net defined benefit liabilities. Using a different label would be more consistent with IFRS terminology and might prove safer, because it would avoid investors that are familiar with EBIT making incorrect assumptions about what an IFRS-defined EBIT subtotal consists of.

50. The staff suggest that instead of using EBIT, it may be more accurate and helpful to call our subtotal 'profit before financing and income tax'. In addition, if we decide to include an investing category above finance income/expenses and income tax we could introduce a second subtotal; 'profit before investing, financing and income tax'. This presentation is shown in appendix A. We think both subtotals would be consistent with our objective of introducing an EBIT subtotal in paragraph 5 as follows:

    (a) both subtotals would provide a comparable measure of performance further up the statement(s) of financial performance than profit before tax; and

    (b) the line items presented to support these two subtotals will enable investors to make their own adjustments to the subtotals to make comparisons of entities with different capital structures. For example, users will be provided with separate information about the following:

        (i) income/expenses related to capital structure (see paragraph 3(g) of the staff recommendation);

        (ii) interest on liabilities outside capital structure (paragraph 3(g)); and

        (iii) income/expenses on an entity's investments (paragraph 3(b)).

51. The staff observe that if we define investing and finance income/expenses, we would in effect be creating an operating category. For many entities their 'profit before investing, financing and income tax' subtotal might be equivalent to their operating profit, if determined. Nevertheless the staff do not suggest we call this subtotal an operating profit subtotal for the following reasons:

    (a) it would result in us defining operating profit as a residual or default category, ie equal to the subtotal of all income/expense recognised in profit or loss that do not meet our definition of investing or finance income/expenses. We received some feedback in the Financial Statement Presentation project that operating profit is an important subtotal which should be defined positively, rather than measured as a default amount that captures income/expenses that are difficult to classify. For example, there could be items that do not meet the staff's proposed definitions of investing or finance income/expenses that some entities and some users might not

consider to be part of operating profit, for example expenses of defending a hostile takeover bid and/or charitable donation expenses.

(b) we have had difficulties in the past in trying to define operating profit because stakeholders have different views about what income/expenses should be included in operating profit. At the September 2016 World Standards-setters meeting, participants debated the characteristics of operating profit but they did not reach a consensus.

52. Nevertheless, we are aware that there is some support for us to define and include an operating profit subtotal in the statement(s) of financial performance. If we produce a Discussion Paper as our first due process document, we can seek feedback on whether the Board should consider a residual approach to defining operating profit.

Question 5

The staff recommend that we should introduce two subtotals into the statement(s) of financial performance (rather than a single EBIT subtotal):

(a) profit before investing, financing and income tax; and

(b) profit before financing and income tax.

Do you agree?

Appendix A—Illustrations of the staff recommendations in this paper

A1. This Appendix shows:

(a) Scenario 1: Management performance measure provided as a subtotal because it fits into the statement(s) of financial performance; and

(b) Scenario 2: Management performance measure provided in a separate reconciliation because it does not fit into the statement(s) of financial performance as a subtotal, because it includes some finance income.

Scenario 1—Management performance measure fits into the statement(s) of financial performance (provided as MPM subtotal)

Statement(s) of financial performance (by function)

Revenue	10,000
Cost of goods sold	(4,000)
Gross profit	6,000
SG&A	(2,000)
Management performance measure	4,000
Restructuring expenses	(1,000)
Profit before investing, financing and income tax	3,000
Share of profit of associate/joint venture	250
Other investing income[9]	50
Profit before financing and income tax (essentially an EBIT subtotal)	3,300
Income related to capital structure	200
Expenses related to capital structure	(1,000)
Interest income on a net defined benefit asset or a net asset that arises when a liability outside capital structure qualifies for offset with an asset	50
Interest expenses on liabilities outside capital structure	(450)
Net finance income (expense)	(1,200)
Profit before tax	2,100
Income tax expense	(600)
Profit or loss	**1,500**

[9] For example, this line item might include interest on loans receivable and fair value gain and losses on a passive investment in shares of another company. This information might be disaggregated in the notes or presented as separate line items.

Scenario 2—Management performance measure does not fit into statement of financial performance (provided as separate reconciliation)

Statement(s) of financial performance (by function)

Revenue	10,000
Cost of goods sold	(4,000)
Gross profit	6,000
SG&A	(2,000)
Restructuring expenses	(1,000)
Profit before investing, financing and income tax	3,000
Share of profit of associate/joint venture	250
Other investing income	50
Profit before financing and income tax	3,300
Income related to capital structure	200
Expenses related to capital structure	(1,000)
Interest income on a net defined benefit asset or a net asset that arises when a liability outside capital structure qualifies for offset with an asset	50
Interest expenses on liabilities outside capital structure	(450)
Net finance income (expense)	(1,200)
Profit before tax	2,100
Income tax expense	(600)
Profit or loss	**1,500**

Management performance measure reconciliation (for example, provided below statement of financial performance)

Management performance measure	4,050
Share of profit of associate/joint venture	250
Other investing income	50
Restructuring expenses	(1,000)
Net interest income on net defined benefit asset (part of finance income/expenses)	(50)
Profit before financing and tax	**3,300**

Appendix B—main differences between the staff recommendations at this meeting and the staff recommendations for the EBIT subtotal in June 2017

B1. Introducing an investing category into the statement(s) of financial performance, which enables us to introduce the following two subtotals into the statement(s) of financial performance (rather than a single EBIT subtotal):

(a) profit before investing, financing and income tax; and

(b) profit before financing and income tax.

B2. Defining finance income/expenses more narrowly;

(a) to include only ‘interest income on a net defined benefit asset or a net asset that arises when a liability outside capital structure qualifies for offset with an asset’;

(b) rather than ‘interest income on all assets outside capital structure’.