IFRS

STAFF PAPER

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IASB® meeting

Project	**Primary Financial Statements**
Paper topic	Income and expenses from integral associates and joint ventures

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Purpose of the paper

1. In July 2019, the Board gave the staff permission to start the balloting process for the publication of the Exposure Draft. During the balloting process, the staff have identified an issue on which we would like the Board's input, namely how to classify, in the statement of profit or loss, income and expenses from investments in integral associates and joint ventures, other than the share of profit or loss from these investments.

Summary of staff recommendation

2. The staff recommend:

   (a) requiring entities to classify income and expenses from integral associates and joint ventures in the integral associates and joint ventures category of the statement of profit or loss; and

   (b) specifying that income and expenses from integral associates and joint ventures include, in addition to the share of profit or loss of integral associates and joint ventures;

      (i) impairment losses and reversals of impairment losses on integral associates and joint ventures; and

(ii) gains or losses on disposals of integral associates and joint ventures.

Board discussions about classification of income and expenses from associates and joint ventures

3. In January 2018, the Board tentatively decided to require entities to present in the statement(s) of financial performance the share of profit or loss of 'integral' associates and joint ventures separately from the share of profit or loss of 'non-integral' associates and joint ventures (January 2018 AP21B).

4. In January 2018, the Board also tentatively decided to:

   (a) use the Board's proposed definition of 'income and expenses from investments' as the basis for the split between integral and non-integral investments in associates or joint ventures, and include a non-exhaustive list of indicators that could be used in making this distinction.

   (b) propose the presentation in the statement(s) of financial performance of the share of profit or loss of integral associates or joint ventures as a line item above the 'income/expenses from investments' category and require a new subtotal above that line item. This subtotal was later described as operating profit (October 2018).

   (c) discuss the alternative approaches considered by the Board for presenting the share of profit or loss of integral associates and joint ventures, both within and outside the 'income and expenses from investments' category, and the Board's reasons for rejecting those approaches.

5. In September 2018, the Board developed proposals to help entities determine whether associates and joint ventures are integral or non-integral (September 2018 AP21D).

6. The Board's proposals for integral and non-integral associates and joint ventures relate to associates and joint ventures accounted for using the equity method only. Income and expenses from investments in associates and joint ventures not accounted for using the equity method would be classified in the investing category unless the

entity makes the investments in the course of their main business activities, in which case they would be classified in the operating category.

Drafting of the proposals

7. During drafting the staff have:

   (a) introduced the following categories to the statement of profit or loss to make the drafting easier and more understandable:

      (i) operating category;

      (ii) integral associates and joint ventures category;

      (iii) investing category; and

      (iv) financing category; and

   (b) proposed drafting that:

      (i) clarified that gains and losses on disposal or impairment of integral associates and joint ventures should be classified together with the share of profit or loss from integral associates and joint ventures, in the integral associates and joint ventures category; and

      (ii) described income and expenses classified in this category as income and expenses from integral associates and joint ventures.

Analysis

8. The Board did not specifically discuss classification of gains and losses from disposal or impairment of integral associates and joint ventures. However, during drafting, the staff concluded that it would be useful to clarify the proposed classification of these income and expenses. We thought that they should be classified together with the share of profit or loss from investments in integral associates and joint ventures because:

(a) this approach is consistent with the Board's general approach to classification, which is to include related income and expenses in the same category. For example, the Board is proposing to classify foreign exchange differences in the same category as income and expenses from the items that gave rise to them. Similarly, impairment of an asset would be classified in the same category as returns on the asset (so impairments of property, plant and equipment are classified in the operating category and impairments of assets that give rise to returns independently of other resources of the entity are classified in the same category as returns on those assets, usually in the investing category).

(b) some of the Board's reasons for classifying the share of profit or loss from integral associates and joint ventures outside the operating category also apply to income and expenses from impairment or disposal of these investments. Specifically, classifying income and expenses from investments in associates and joint ventures in the operating category would significantly disrupt users' analyses of operating margins. This is because the revenue line does not include revenue from associates and joint ventures.

9. However, during the balloting process, a Board member raised concerns about this approach. This Board member thinks the Board should classify only the share of profit or loss from integral associates and joint ventures outside the operating category—gains and losses from disposal or impairment of integral associates and joint ventures should be classified in the operating category. This is because, in this Board member's view:

(a) integral associates and joint ventures are a part of an entity's main business activities and therefore any income or expense relating to these investments should be classified as operating;

(b) the share of profit or loss from integral associates and joint ventures should not be classified as operating only because it includes expenses from financing and tax, which income and expenses classified in the operating category do not, and which users would want to analyse separately; and

(c) gains and losses from disposal or impairment of integral associates and joint ventures relate to items (shares) controlled by the entity.

10. The staff do not recommend this approach because:

(a) it is inconsistent with the Board's general approach to classifying related income and expenses in the statement of profit or loss (see paragraph 8(a)).

(b) it would not respond to the views of users of financial statements who do not want to include any income and expenses relating to associates and joint ventures in the operating category because they would analyse returns on these investments separately.

(c) it would disrupt user's analysis of operating margins (see paragraph 8(b)).

(d) the classification of income and expenses in the statement of profit or loss was not developed based on a concept of control. Consistent with that, income and expenses from some other assets controlled by the entity are excluded from the operating profit category, for example income and expenses from investments in assets that give rise to returns independently of other resources of the entity.

11. Furthermore, the staff note that the Board did not conclude whether integral associates and joint ventures are a part of an entity's main business activities. In developing the proposals, the Board acknowledged that some stakeholders view them as such although investors have told the Board that they would generally analyse the results of such associates and joint ventures separately from the entity's main business activities.

Question 1
Does the Board agree with the staff recommendation to: (a) require entities to classify income and expenses from integral

associates and joint ventures in the integral associates and joint ventures category of the statement of profit or loss; and

(b) specify that income and expenses from integral associates and joint ventures include, in addition to the share of profit or loss of integral associates and joint ventures;

(i) impairment losses and reversals of impairment losses on integral associates and joint ventures; and

(ii) gains or losses on disposals of integral associates and joint ventures?

Drafting for integral associates and joint ventures

12. The appendix to this paper includes proposed drafting of the relevant sections of the Exposure Draft that has been prepared on the assumption that the Board agrees with the recommendation in this paper.

13. The Basis for Conclusions on this section also includes discussion of concerns raised by one Board member about the requirement to present income and expenses from integral associates and joint ventures separately from non-integral. This Board member is concerned that the proposed definition of and guidance on integral associates and joint ventures may not be sufficient to enable entities to achieve consistent classification, and that highlighting this concern will help ensure that the Board obtains feedback on this point (see Appendix—paragraph BC79).

Question 2

Do you have any significant comments or concerns on the proposed drafting included in the appendix?

Appendix—extracts from the draft Exposure Draft General Presentation and Disclosures

45 **An entity shall classify income and expenses included in profit or loss into the following categories:**

(a) operating (see paragraph xx);

(b) investing (see paragraphs xx–xx);

(c) financing (see paragraphs xx–xx);

(d) income tax (see paragraph xx);

(e) discontinued operations (see paragraph xx); and

(f) *integral associates and joint ventures* (see paragraph 53).

…

53 An entity shall classify in the integral associates and joint ventures category income and expenses from integral associates and joint ventures (see paragraph B37).

…

B37 Only associates and joint ventures accounted for using the equity method can meet the definition of integral associates and joint ventures. Applying IAS 28 *Investments in Associates and Joint Ventures* an entity may recognise income and expenses from integral associates and joint ventures in addition to the share of profit or loss accounted for using the equity method. Such income and expenses may include impairment losses or reversals, or gains or losses on disposals. Applying paragraph 53, income and expenses from integral associates and joint ventures include:

(a) the share of profit or loss of integral associates and joint ventures;

(b) impairment losses and reversals of impairment losses on integral associates and joint ventures; and

(c) gains or losses on disposals of integral associates and joint ventures.

Proposed amendments to IFRS 12 Disclosure of Interests in Other Entities

Defined terms

integral associates and joint ventures [IFRS 12 *Disclosure of Interests in Other Entities*]	Associates and joint ventures accounted for using the equity method that are integral to the main business activities of an entity and hence do not generate a return individually and largely independently of the other assets of the entity (see paragraphs 20A and 20D of IFRS 12).
non-integral associates and joint ventures [IFRS 12]	Associates and joint ventures accounted for using the equity method that are not integral to the main business activities of an entity and hence generate a return individually and largely independently of the other assets of the entity (see paragraphs 20A and 20D of IFRS 12).

Paragraphs 7(d) and 20A–20E are added. Paragraphs 7(a)–7(c) and 20 have not been amended but are included for ease of reference. New text is underlined.

Significant judgements and assumptions

7 **An entity shall disclose information about significant judgements and assumptions it has made (and changes to those judgements and assumptions) in determining:**

(a) that it has control of another entity, ie an investee as described in paragraphs 5 ~~and~~ –6 of IFRS 10 *Consolidated Financial Statements*;

(b) that it has joint control of an arrangement or significant influence over another entity; ~~and~~

(c) the type of joint arrangement (ie joint operation or joint venture) when the arrangement has been structured through a separate vehicle~~.~~; and

(d) <u>whether an associate or joint venture that is accounted for using the equity method is integral or non-integral to the entity's main business activities.</u>

...

Interests in joint arrangements and associates

20 An entity shall disclose information that enables users of its financial statements to evaluate:

(a) the nature, extent and financial effects of its interests in joint arrangements and associates, including the nature and effects of its contractual relationship with the other investors with joint control of, or significant influence over, joint arrangements and associates (paragraphs 21 and 22); and

(b) the nature of, and changes in, the risks associated with its interests in joint ventures and associates (paragraph 23).

20A An entity shall classify its associates and joint ventures accounted for using the equity method as either integral associates and joint ventures or as non-integral associates and joint ventures on initial recognition.

20B An entity shall change the classification of an associate or joint venture as integral or non-integral if and only if the relationship between the reporting entity and the associate or joint venture changes.

20C When an integral or non-integral associate or joint venture is reclassified in the period, an entity shall disclose how the entity's relationship with the associate or joint venture has changed and the amount reclassified.

20D When assessing whether an associate or joint venture accounted for using the equity method is integral or non-integral to an entity's main business activities, the entity shall consider all facts and circumstances. A significant interdependency between an entity and an associate or joint venture would indicate that the associate or joint venture is integral to the main business activities of the entity. Examples of a significant interdependency between an entity and an associate or joint venture include:

(a) having integrated lines of business with the associate or joint venture;

(b) sharing a name or brand with the associate or joint venture so that externally it may appear as one business in relation to the activities of the associate or joint venture (although the reporting entity may have other, separate businesses); and

(c) having a supplier or customer relationship with the associate or joint venture that the entity would have difficulty replacing without significant business disruption.

20E When applying paragraph 20 to associates and joint ventures accounted for using the equity method an entity shall disclose the information required separately for integral associates and joint ventures and non-integral associates and joint ventures.

Basis for Conclusions

Classification of income and expenses from associates and joint ventures accounted for using the equity method

BC77 As discussed in paragraph BCxx, the Board has observed significant diversity in practice in the presentation of an entity's share of the profit or loss of associates or joint ventures accounted for using the equity method. Consequently, the Board considered specifying where in the statement of profit or loss an entity should present its share of the profit or loss of associates or joint ventures accounted for using the equity method.

BC78 The Board considered requiring entities to present their share of the profit or loss of associates or joint ventures in a single location in the statement of profit or loss—the investing category. However, stakeholder feedback suggests different associates and joint ventures may have important differences in characteristics in that:

(a) the activities of some associates and joint ventures are integral to the reporting entity's main business activities. Feedback suggests this characteristic is common in joint ventures.

(b) the activities of some associates and joint ventures are not integral to the reporting entity's main business activities, that is they have little or no effect on those activities

BC79 Consequently, the Board proposes to require entities to classify their associates and joint ventures as either integral or non-integral associates and joint ventures and present separately the share of profit or loss of these different types of associates and joint ventures. To achieve this the Board proposes to amend IFRS 12 to define integral and non-integral associates and joint ventures and to provide indicators to help entities apply those definitions, as well as requirements for when a change in classification may be appropriate (see paragraphs BCxx–BCxx). A Board member stated that, due to the importance of the consistent classification of income and expenses, it was important that a clear distinction could be drawn between integral and non-integral associates and joint ventures. This Board member questioned whether the proposed definitions would achieve this clarity of distinction.

BC80 The Board concluded that the share of profit or loss of non-integral associates and joint ventures meets the definition of income or expenses from investments and therefore proposes to classify it in the investing category.

BC81 In contrast, the Board concluded that it would be inappropriate to classify the share of profit or loss of integral associates and joint ventures in the investing category because such income and expenses are not independent from income and expenses classified in the operating category. In other words, they do not meet the definition of income or expenses from investments.

BC82 The Board considered whether to require entities to classify the share of profit or loss of integral associates and joint ventures in the operating category. Such an approach would respond to the views of some stakeholders that entities may invest in integral associates and joint ventures in the course of their main business activities. However, it rejected this approach because many users of financial statements analyse the results of investments in associates and joint ventures accounted for using the equity method separately from the results of an entity's operating activities. Users explain that this is because:

(a) the equity method of accounting combines income and expenses that users would normally analyse separately, including financing expenses and income taxes.

(b) classifying the share of profit or loss of associates and joint ventures in the operating category would significantly disrupt users' analyses of operating margins. This is because the revenue line does not include revenue from associates and joint ventures.

(c) the entity does not control the activities of associates and joint ventures as it does the other activities giving rise to income and expenses classified in the operating category and only exercises joint control over the activities of joint ventures.

BC83 Instead of classifying the share of profit or loss of integral associates and joint ventures in the operating category, the Board proposes to create a separate category for income and expenses from integral associates and joint ventures and require entities to:

(a) classify income and expenses from integral associates and joint ventures in this proposed category; and

(b) present an operating profit or loss and income and expenses from integral associates and joint ventures subtotal.

BC84 The Board proposes that, in addition to the share of profit or loss of integral associates and joint ventures, the integral associates and joint ventures category should include other income and expenses from integral associates and joint ventures, including:

(a) impairment losses and reversals of impairment losses on integral associates and joint ventures; and

(b) gains or losses on disposals of integral associates and joint ventures.

BC85 A Board member thought the Board should classify only the share of profit or loss from integral associates and joint ventures outside the operating category; and that other income and expenses from integral associates and joint ventures, including gains or losses on impairment and disposal, should be classified in the operating category. They support this approach because, in their view:

(a) integral associates and joint ventures are a part of an entity's main business activities and therefore any income or expense relating to these investments should be classified as operating;

(b) the share of profit or loss from integral associates and joint ventures should not be classified as operating only because it includes expenses from financing and tax, which income and expenses classified in the operating category do not, and which users would want to analyse separately; and

(c) gains and losses from disposal or impairment of integral associates and joint ventures relate to items (shares) controlled by the entity.

BC86 However, the Board proposes to classify income and expenses from integral associates and joint ventures in the integral associates and joint ventures category because:

(a) this is consistent with the Board's general approach to classifying related income and expenses in the statement of profit or loss.

(b) this would respond to the views of users of financial statements who do not want to include any income and expenses relating to associates and joint ventures in the operating category because they would analyse returns on these investments separately.

(c) this would not disrupt user's analysis of operating margins.

(d) the classification of income and expenses in the statement of profit or loss was not developed based on a concept of control. Consistent with that, income and expenses from some other assets controlled by the entity are excluded from the operating profit category, for example income and expenses from investments in assets that give rise to returns independently of other resources of the entity.

BC86 The Board noted that some users of financial statements have said that, for reasons similar to those described in paragraph BC82, they would not use the proposed subtotal of operating profit or loss and income and expenses from integral associates and joint ventures. The Board however concluded that the proposed presentation and the subtotal requirement balance the needs for:

(a) an operating profit or loss that excludes any income or expenses from financing, investing and income taxes and provides a comparable basis for calculating operating margins; and

(b) separate presentation of the income and expenses from the associates and joint ventures that are integral to the reporting entity's main business activities.

BC87 Some stakeholders have asked the Board to require entities to disaggregate the share of profit or loss of integral associates and joint ventures between different categories of profit or loss. The Board, however, concluded that such a proposal would go beyond the scope of this project as this would involve reconsidering the basis of presenting investment in associates and joint ventures as set out in IFRS 10 *Consolidated financial Statements*, IFRS 11 *Joint Arrangements* and IFRS 12.

BC88 Consistent with its proposal to require entities to present the share of profit or loss of integral associates and joint ventures separately from the share of profit or loss of non-integral associates and joint ventures, the Board also proposes to:

(a) amend IAS 7 to require that cash flows from investments in integral associates and joint ventures are presented separately from cash flows from investments in non-integral associates and joint ventures (see paragraphs BCxx).

(b) amend IFRS 12 to, in addition to requirements relating to the definition of integral and non-integral associates and joint ventures (see paragraph BC79), require separate disclosures about integral and non-integral associates and joint ventures. See paragraphs BC224–BC228 for discussion about proposed amendments to IFRS 12.

…

IFRS 12 Disclosure of Interests in Other Entities

BC224 As discussed in paragraph BC79, the Board proposes to require entities to classify their investments in associates and joint ventures accounted for using the equity method as either integral to an entity's main business activities or non-integral to those activities.

BC225 To achieve this, the Board proposes to amend IFRS 12 to introduce a definition of integral and non-integral associates and joint ventures. The proposed definition is based on the proposed definition of income and expenses from investments. The purpose of this approach is for income and expenses from associates and joint ventures to be classified in the investing category only when they would meet the definition of income and expenses from investments. This approach is also easier and more understandable than developing a new definition for integral and non-integral associates and joint ventures.

BC226 The Board further proposes introducing a set of indicators to help entities determine which associates and joint ventures are integral to an entity's main business activities. Given the wide range of possible business relationships between an entity and its associate or joint venture, the Board concluded that that is not possible to develop an exhaustive list of criteria that could encompass all possible business scenarios and has instead proposed a list of indicators.

BC227 The Board also proposes amending IFRS 12 to require separate disclosures about integral and non-integral associates and joint ventures.

BC228 To help users of financial statements understand the judgements made by an entity, the Board further proposes requiring entities to disclose significant judgements and assumptions it made to assess whether associates and joint ventures accounted for using the equity method are integral or not, and disclosure requirements relating to any changes in classification.