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STAFF PAPER

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Project	**Primary Financial Statements**		
Paper topic	Feedback summary—Subtotals and categories—general model		
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Objective

1. This paper analyses feedback on the proposed 'general model'[1] for the structure of the statement of profit or loss, set out in the Exposure Draft *General Presentation and Disclosures* (Exposure Draft Questions 1,2,5 and 6). This paper discusses feedback from comment letters and outreach, as well as fieldwork findings related to this topic.

2. Feedback on the proposals for:

   (a) entities with particular main business activities, including providing financing to customers and investing, is analysed in Agenda Paper 21C *Feedback summary—Subtotals and categories —entities with particular main business activities* (Exposure Draft Questions 3 and 4); and

   (b) integral and non-integral associates and joint ventures, including presentation of a subtotal of operating profit and income and expenses from integral associates and joint ventures, is analysed in Agenda Paper 21D *Feedback summary—Subtotals and categories —integral and non-integral associates and joint ventures* (Exposure Draft Question 7).

[1] Paragraph 13 describes the 'general model'.

Key messages

3. Most respondents agree with the proposals to introduce defined subtotals and categories in the statement of profit or loss. They think the proposals have the potential to result in useful information and improve comparability between entities.

4. However, some respondents said additional guidance would be needed to achieve consistent application and comparability, including guidance on the definitions of the categories and the term 'main business activities'.

5. Many respondents expressed concerns about:

   (a) the proposed classification of foreign exchange differences and of fair value gains and losses on derivatives and hedging instruments—they question whether the benefits of such classification would outweigh the costs; and

   (b) the proposed labels for the categories in the statement of profit or loss—they say it is confusing that the labels are similar to the labels of the categories in the statement of cash flows, although the content of the categories is different.

6. Some respondents expressed concerns about:

   (a) defining the operating category as a residual category—mainly because they disagree with including in operating profit some income and expenses that are unusual, volatile or do not arise from an entity's main busines activities; and

   (b) the proposed classification of income and expenses from cash and cash equivalents and other investments held as part of treasury activities.

Structure of the paper

7. This paper is structured as follows:

   (a) Proposals in the Exposure Draft (paragraphs 8–14);

   (b) Comment letter and outreach feedback (paragraphs 15–79);

   (c) Fieldwork findings (paragraphs 80–94); and

   (d) Appendix A includes the relevant questions from the Exposure Draft.

Proposals in the Exposure Draft

8. The Exposure Draft proposed that an entity present the following new subtotals in the statement of profit or loss (paragraph 60 of the Exposure Draft):

   (a) operating profit or loss (operating profit);

   (b) operating profit or loss and income and expenses from integral associates and joint ventures (see Agenda Paper 21D); and

   (c) profit or loss before financing and income tax.

9. In applying these proposed new subtotals, an entity would present in the statement of profit or loss income and expenses classified in the following categories (paragraph 45 of the Exposure Draft):

   (a) operating;

   (b) integral associates and joint ventures (see Agenda Paper 21D);

   (c) investing; and

   (d) financing.

10. The investing category would include returns from investments, that is, income and expenses from assets that generate a return individually and largely independently of other resources held by an entity. The investing category would also include related incremental expenses (paragraph 47 of the Exposure Draft).[2]

11. The financing category would include (paragraph 49 of the Exposure Draft):[3]

    (a) income and expenses from cash and cash equivalents;

    (b) income and expenses on liabilities arising from financing activities; and

    (c) interest income and expenses on other liabilities, for example, the unwinding of discounts on pension liabilities and provisions.

12. The operating category includes income or expenses not classified in the other categories such as the investing category or the financing category. In other words, the

[2] Also see paragraphs B32–B33 and BC48–BC52 of the Exposure Draft.

[3] Also see paragraphs B34–B37 and BC33–BC47 of the Exposure Draft.

operating category would be the default category (paragraph 46 of the Exposure Draft).[4]

13. Figure 1 is a summary of a statement of profit or loss prepared by an entity applying the project proposals. The entity does not make investments in the course of its main business activities, nor does it provide financing to customers as a main business activity. In this paper, we refer to the model set out in Figure 1 as 'the general model'.

Figure 1—Structure of the statement of profit or loss applying the 'general model'

Revenue	X	Operating
Operating expenses	(X)	
Operating profit or loss	**X**	
Share of profit or loss of integral associates and joint ventures	X	Integral associates and joint ventures
Operating profit or loss and income and expenses from integral associates and joint ventures	**X**	
Share of profit or loss of non-integral associates and joint ventures	X	Investing
Income from investments	X	
Profit or loss before financing and income tax	**X**	
Interest revenue from cash and cash equivalents	X	Financing
Expenses from financing activities	(X)	
Unwinding of discount on pension liabilities and provisions	(X)	
Profit or loss before tax	**X**	

14. The Exposure Draft proposed specific requirements for entities with particular main business activities, to ensure that the operating category includes all income and expenses from their main business activities. These requirements and related feedback are discussed in Agenda Paper 21C.

Comment letter and outreach feedback

15. The analysis in this section is structured as follows:

    (a) Question 1—defining and requiring operating profit (paragraphs 16–18);

[4] Also see paragraphs BC53–BC57 of the Exposure Draft.

(b) Question 2—defining the operating category as a default category (paragraphs 19–25);

(c) Question 5—the investing category (paragraphs 26–40);

(d) Question 6—profit or loss before financing and income tax and the financing category (paragraphs 41–65);

(e) Classification of foreign exchange differences and of fair value gains and losses on derivatives and hedging instruments (paragraphs 66–74); and

(f) Alignment of categories between the statement of profit or loss and the statement of cash flows (paragraphs 75–79).

Question 1—Defining and requiring operating profit

16. Most respondents across all jurisdictions and stakeholder types (including all users) agreed that the Board should define operating profit and require all entities to present it as a subtotal in the statement of profit or loss.

17. Some respondents explained they agree with requiring entities to present operating profit because it is an important measure that provides useful information to users of financial statements (users). Some users explained they use operating profit in ratio analysis—for example in analysing operating margin—and as a starting point for forecasting in valuation models. A few respondents disagreed with requiring operating profit for entities such as banks (see paragraph 33 of Agenda Paper 21C).

18. Many respondents said the Board defining operating profit could improve comparability between entities. However, many of those respondents said further guidance would be needed to achieve comparability (see paragraph 23).

Question 2—Defining the operating category as a default category

19. Many respondents, including almost all users, agreed with the proposal to define the operating category as a default or residual category. Some respondents, mainly from Asia and North America, disagreed with defining the operating category as a default category.

Agreement

20. Many of the respondents who agreed with defining the operating category as a default category said it is a pragmatic approach because they think:

(a) a residual definition is simpler to apply for entities—in their view, it involves less judgement and is more likely to be consistently applied than a direct definition;

(b) it is easier for the Board to specify the income and expenses to be classified in the financing or investing categories than those in the operating category, because entities have various business activities;

(c) a residual definition is easy for users to understand; and

(d) one of the categories in the statement of profit or loss must be a residual category and they think the operating category is the most appropriate residual category.

21. Some of the respondents who agreed with defining the operating category as a residual category added that:

(a) they agreed that operating profit may include some unusual income and some expenses or income and expenses not arising from an entity's main business activities. Some of those respondents said that disclosure in the notes should give users sufficient information about such items.

(b) a residual definition would prevent entities excluding income or expenses from operating profit opportunistically, placing them in an 'other' or 'non-operating' category where they could be subject to less scrutiny by users.

Concerns

22. Some respondents are concerned that, applying the proposals, the operating category would include unusual income and expenses, volatile gains or losses and income and expenses not arising from an entity's main business activities:

(a) some of those respondents said the inclusion of such income and expenses would distort operating profit and undermine its usefulness as a predictive measure. In particular, some respondents said that in the insurance, asset management and real estate industry, users generally analyse fair value remeasurements of their investments separately from other operating income and expenses.

(b) some of those respondents said they would not object to including unusual, volatile or 'non-main' income and expenses in the operating category if such items could be separately presented within the category. However, they said the proposed ban on mixing nature and function in the statement of profit or loss (see Agenda Paper 21F) and proposed ban on columns for management performance measures (see Agenda Paper 21H) may prevent such separate presentation.

(c) some of those respondents expected that entities would start or continue using measures such as 'adjusted operating profit' that exclude unusual, volatile or 'non-main' income and expenses in internal and external reporting. They think that, as a result, the proposals would decrease the relevance of the statement of profit or loss.

23. Some of the respondents who agree with defining the operating category as a default category are concerned that, without further guidance from the Board, different entities are likely to apply the proposals inconsistently and operating profit would not be comparable between entities. These respondents suggested the Board should provide further guidance on:

(a) the definitions of the investing and financing categories (see paragraphs 35 and 52–55); and

(b) the terms 'main business activities' and 'in the course of main business activities' (see paragraphs 12– 14, 25 and 28–30 of Agenda Paper 21C).

24. Some of the respondents who agreed with defining the operating category as a default category said the Board should clarify the interaction (or perceived tension) between the residual definition and the concept of 'main business activities'. Some respondents are concerned the first sentence in paragraph 46 of the Exposure Draft could be read as requiring that the operating category *only* includes information about income and expenses from an entity's main business activities, which would contradict the residual definition. Paragraph 46 of the Exposure Draft states:

The operating category includes information about income and expenses from an entity's main business activities. An entity shall classify in the operating category all income and expenses included in profit or loss that are not classified in: (a) investing; (b) financing; (c) integral associates and joint ventures; (d) income tax; or (e) discontinued operations.

Alternative approaches

25. Some respondents suggested alternative approaches to address the concerns discussed in paragraph 22:

(a) some respondents suggested the Board should define operating profit directly, for example as 'income and expenses from an entity's main business activities'. Some of these respondents added that their suggestions would involve the creation of an 'other' or 'non-operating' category for income or expenses that do not fit in the operating category or the other specified categories. A few respondents suggested the Board should provide a principles-based definition of an entity's main business activities. A few respondents suggested entities should have flexibility to identify their own main business activities, reflecting management's view on the entity's business model.

(b) a few respondents said the Board should allow or require the presentation in the statement of profit or loss of:

    (i) a subtotal within the operating category for operating profit before unusual and 'non-main' income or expenses;

    (ii) a separate line item within the operating category that groups unusual or 'non-main' income or expenses; or

    (iii) a separate column for unusual and volatile items.

(c) some respondents suggested that income and expenses related to investment and divestment decisions, such as gains or losses on disposals, should be classified in the investing category (further discussed in paragraph 39).

Question 5—the investing category

26. Most respondents, including most users, agree with requiring an entity to present a separate investing category in the statement of profit or loss. Some respondents disagree with requiring such a category (paragraphs 30–32).

27. Many respondents agreed with the proposal for the investing category to include ‘income and expenses from investments’, defined as ‘income and expenses from assets that generate a return individually and largely independently of other resources held by an entity’. However, some respondents said the definition is insufficiently robust (paragraphs 33–36).

28. A few respondents expressed concerns about including incremental expenses in the investing category (paragraphs 37–38).

29. A few respondents suggested an alternative approach (paragraphs 39–40).

A separate investing category

30. Some respondents explained they agreed with requiring an investing category because it could provide useful information. A few users explained that an investing category, separate from the operating category, would be useful because:

    (a) they analyse and value entities’ investments separately. A separate category would facilitate users’ modelling of future operating margins because the operating category would exclude income and expenses from investments that do not contribute to revenue.

    (b) the investing category may draw users’ attention to any speculative activities that are unrelated to an entity’s main business activities.

31. A few other respondents said they agreed with requiring an investing category because it would enhance comparability between entities. They said that some entities currently include income and expenses from investments in operating profit (or a similar subtotal), whereas others exclude them.

32. Many of the respondents who disagreed with requiring an investing category suggested the Board should merge the investing and financing categories to address classification issues between those two categories (see paragraphs 48–49). A few

respondents explained they disagreed with requiring an investing category because they expect such a category would include few items for many entities and may clutter the statement of profit or loss.

Income and expenses from investments

33. Few respondents explained why they agreed with the proposed definition of income and expenses from investments. One accounting firm said they agreed with a principles-based definition because it would be difficult for the Board to provide a list of classes of assets that are considered investments.

34. Many respondents expressed concerns about the lack of alignment between the investing category in the statement of profit or loss and cash flows from investing activities (further discussed in paragraphs 75–79).

35. Some respondents said the definition of 'income and expenses from investments' is unclear and may be inconsistently and opportunistically applied in practice. For example, a few respondents:

(a) said it was unclear whether income and expenses from assets or disposal groups that qualify as 'held for sale' but not as 'discontinued operations'[5] would be classified in the investing category. Some respondents argue that such income and expenses meet the definition of the investing category because, by definition, 'held for sale' items will be recovered principally through a sale transaction rather than through continuing use in combination with other resources of the entity.

(b) said it was unclear how the definition relates to the definition of a 'cash-generating unit' in IAS 36 *Impairment of Assets*.

(c) provided examples of specific assets for which they said it is unclear whether related income and expenses could be classified in the investing category—for example loans to employees and biological assets.

36. Some respondents (mainly preparers) said income and expenses from financial assets used in an entity's treasury management activities should not be classified in the

[5] Applying IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*.

investing category because they are related to an entity’s financing activities (further discussed in paragraph 49(b)).

Incremental expenses

37. Some respondents explicitly expressed their support for classifying in the investing category only incremental expenses, rather than directly related expenses, incurred in generating income and expenses from investments. They think it would be difficult for entities to allocate all directly related expenses to the investing category.

38. A few respondents were concerned that the requirement to classify incremental expenses in the investing category would be inconsistently applied in practice. Many of those respondents said that there is diversity in practice in how entities identify incremental expenses and similar concepts applying existing Standards. A few respondents asked the Board to clarify:

   (a) whether incremental financing expenses for investments, for example on loans that finance a specific investment, would be classified in the investing category;

   (b) at which level expenses need to be ‘incremental’ to qualify for inclusion in the investing category—for example at the level of an individual investment or at the portfolio level; and

   (c) whether legal and advisory fees incurred in purchasing an investment are incremental, considering that often (part of) these fees would still be due even when the transaction does not go ahead.

Alternative approaches

39. As described in paragraph 25(c), a few respondents, mostly from France and Brazil, suggested that income and expenses related to investment and divestment decisions should be classified in the investing category. For example, such income and expenses could include:

   (a) gains or losses on disposal of assets, such as property plant and equipment;

   (b) gains or losses on loss of control of subsidiaries (other than discontinued operations); and

(c) gains or losses on gaining control of subsidiaries, such as gains on a bargain purchase or gains or losses on remeasurements in a step acquisition.

40. In these respondents' view:

(a) such income and expenses meet the definition of the investing category because they are generated independently from an entity's other resources—in particular assets or disposal groups that qualify as 'held for sale' but not as 'discontinued operations' (see paragraph 35(a));

(b) the proposed classification would align better with cash flows from investing activities, which includes cash flows arising from obtaining or losing control of subsidiaries or other businesses and cash flows from sales of long-term assets.

(c) including such items in operating profit reduces comparability of the subtotal between entities relying on organic and those relying on external growth; and

(d) users generally adjust for such income and expenses or analyse them separately when analysing an entity's performance.

Question 6—profit or loss before financing and income tax and the financing category

41. Most respondents, including most users, agreed with requiring entities (except for some specified entities) to present a profit or loss before financing and income tax subtotal in the statement of profit or loss. A few respondents disagreed with requiring the subtotal (paragraphs 43–44).

42. Many respondents provided comments on the proposed content of the financing category:

(a) income and expenses from cash and cash equivalents (paragraphs 45–50);

(b) income and expenses on liabilities arising from financing activities (paragraphs 51–55);

(c) interest income and expenses on liabilities not arising from financing activities (paragraphs 56–61); and

(d) interest on trade payables and trade receivables (paragraphs 62–63).

Profit before financing and income tax subtotal

43. Some respondents explained they agreed with requiring entities to present a profit or loss before financing and income tax subtotal because such a subtotal:

(a) would provide useful information, allowing users to analyse an entity's performance independently of how that entity is financed. A few academics added that distinguishing between an entity's operating and financing activities in valuing an entity is supported by corporate finance theory.

(b) would be similar to an EBIT subtotal, which is commonly presented.

44. Many of the respondents who disagreed with requiring the subtotal suggested the Board should merge the investing and financing categories, because in their view:

(a) merging the investing and financing categories would address classification issues between those two categories (see paragraphs 48–49); and

(b) considering that entities would be required to present operating profit, the profit before financing and income tax subtotal would not provide much additional information and may clutter the statement of profit or loss, especially when the investing category includes few items.

Income and expenses from cash and cash equivalents

45. Many respondents, including some users, agree with the proposal to classify income and expenses from cash and cash equivalents in the financing category; some respondents disagree and many respondents, including many users, did not express a view.

46. A few respondents explained they agree with the proposal to classify income and expenses from cash and cash equivalents in the financing category because they agree with the Board's rationale that:

(a) users typically consider excess cash and temporary investments of excess cash as part of an entity's financing;

(b) cash and cash equivalents represent a reasonable proxy for excess cash and the temporary investments of excess cash for many entities;

(c) 'cash and cash equivalents' is an existing defined term; and

(d) requiring entities to split cash and cash equivalents between amounts used for operational purposes and excess cash would impose undue cost or effort.

47. A few other respondents said they acknowledge different views exist on how to classify income and expenses from cash and cash equivalents, and they accept the Board's proposal as a reasonable compromise. They welcome that such income and expenses would be classified in a consistent location across entities, which would enable users to reclassify income and expenses from cash and cash equivalents to other categories if they wish to do so.

48. Some respondents expressed concerns about the proposal to include income and expenses from cash and cash equivalents in the financing category:

(a) some of those respondents (mainly preparers) think that cash and cash equivalents are too narrow as a proxy for excess cash and temporary investments of excess cash. They are concerned the proposals would not allow entities to present a 'cost of net debt' subtotal that accurately reflects their treasury activities.

(b) some other respondents think that income and expenses from cash and cash equivalents do not belong in the financing category because:

(i) income and expenses from cash and cash equivalents meet the definition of income and expenses from investments;

(ii) income and expenses from cash and cash equivalents do not arise from 'financing activities' as defined by the Board;

(iii) the financing category would be simpler to understand if it only included income and expenses from liabilities, not assets; and

(iv) such classification would be inconsistent with the statement of cash flows, where all interest received, including interest on cash and cash equivalents, would be classified as cash flows from investing activities.

49. Some respondents suggested the following alternative approaches to address the concerns in paragraph 48(a):

(a) merging the investing and financing categories and allowing an entity to include additional, entity-specific subtotals instead of profit before financing and income tax; or

(b) requiring an entity to classify income and expenses on a broader set of liquid assets in the financing category, including:

   (i) liquid financial instruments (other than cash equivalents) that are temporary investments of excess cash, including invested cash that will be used in planned future capital expenditure.

   (ii) assets that are held to secure specific liabilities, such as assets entities are legally required to hold to fund environmental liabilities. They argue that classifying returns on such assets in the financing category would be similar to the treatment of interest income on plan assets for defined benefit obligations.

50. Respondents who think that income and expenses from cash and cash equivalents do not belong in the financing category (paragraph 48(b)) suggested requiring an entity to classify income and expenses on cash and cash equivalents in the investing category.

Income and expenses on liabilities arising from financing activities

51. Many respondents agreed with classifying income and expenses on liabilities arising from financing activities in the financing category; many did not express a view.

52. A few respondents said some aspects of the proposed definition of 'financing activities' were not clear. The Board proposed to define financing activities as (paragraph 50 of the Exposure Draft):

> *Activities involving the receipt or use of a resource from a provider of finance with the expectation that:*
>
> *(a) the resource will be returned to the provider of finance; and*
>
> *(b) the provider of finance will be compensated through the payment of a finance charge that is dependent on both the amount of the credit and its duration.*

53. A few respondents said it was unclear whether, to meet the first part of the definition (paragraph 50(a) of the Exposure Draft), the resource had to be returned in the same form as it was received. For example, they said it was unclear whether the definition would capture finance expenses on trade payables and advance payments received from customers (contracts with a significant financing component in scope of IFRS 15 *Revenue from Contracts with Customers*) in which cash is exchanged for goods or services.

54. A few respondents said it was unclear whether, to meet the second part of the definition (paragraph 50(b) of the Exposure Draft), the compensation to the finance provider should depend *solely* on the amount of credit and its duration. They said that for some liabilities compensation also depends on other factors such as the performance of the entity. A few respondents questioned whether the definition intended to capture only activities involving instruments that meet the 'solely payments of principal and interest' (SPPI) criterion described in IFRS 9 *Financial Instruments*.

55. A few respondents said it was unclear whether the proposed definition would capture:

(a) negative interest, both on assets and liabilities;

(b) income and expenses from perpetual debt and interest-free loans;

(c) interest income and expenses and penalties on assets and liabilities arising from uncertain tax positions;

(d) remeasurements of contingent consideration;

(e) income and expenses related to liabilities with characteristics of equity;

(f) expenses related to supply chain financing; and

(g) costs related to equity transactions that are recognised in profit or loss.[6]

[6] That is, costs related to equity transactions that are not eligible to be deducted from equity applying paragraphs 35 and 37 of IAS 32 *Financial Instruments: Presentation*, such as costs attributable to listing existing shares (rather than new shares).

Interest on liabilities not arising from financing activities

56. Many respondents agree with classifying interest income and expenses on liabilities not arising from financing activities (for example, the unwinding of discounts on pension liabilities and provisions) in the financing category; some disagree and many did not express a view.

57. A few respondents explained they agree because:

    (a) many users of financial statements treat such income and expenses as if they were income or expenses from financing activities in their analysis—for example in valuation models based on 'enterprise value'; and

    (b) an entity could make a funding decision to borrow money to transfer, fund or settle these liabilities.

58. A few other respondents acknowledge that arguments exist for classifying interest on liabilities not arising from financing activities in the operating or financing category. They accept the proposed approach to support comparability.

59. A few respondents said interest on liabilities not arising from financing activities should be classified in the operating category rather than the financing category A few explained that they hold this view because:

    (a) the financing category should only include income and expenses on liabilities arising from financing activities;

    (b) there is not always a market to transfer or settle such liabilities;

    (c) the counterparty is not a lending institution; and

    (d) some entities manage their pension cost as a whole, without distinguishing between the interest and service cost.

60. A few respondents made other suggestions:

    (a) a few agreed entities should classify net interest on net defined benefit liabilities in the financing category but suggested unwinding of a discount on other provisions, such as decommissioning liabilities, should be classified in the operating category. For example, a few preparers in the extractive industry said they view all income and expenses from decommissioning liabilities as a part of their operating activities.

(b) a few said entities should be required to make an accounting policy choice based on management's view on the function of the liability in the business.

61. A few respondents said it was unclear where an entity should classify the effect of changes in discount rates on liabilities not arising from financing activities when this effect is recognised in profit or loss.

Interest on trade payables and trade receivables

62. Applying the proposals in the Exposure Draft:

(a) interest revenue from trade receivables would be classified in the operating category (paragraph B33(a) of the Exposure Draft) because it would not meet the definition of 'income or expenses from investments'; whereas

(b) interest expenses on trade payables would be classified in the financing category (paragraph B35(c) of the Exposure Draft) because it would meet the definition of income and expenses from financing activities.

63. Some respondents said the proposed classification for interest on trade receivables and trade payables is inconsistent, considering that both are related to an entity's working capital management. Some of those respondents suggested alternative approaches:

(a) a few agree with the classification of interest expenses on trade payables but suggest interest income on trade receivables should be classified in the investing category (and meets the definition of that category) unless the provision of financing to customers is a main business activity.

(b) one standard-setting body agrees with the classification of interest expenses on trade payables but suggests interest income on trade receivables should also be classified in the financing category to avoid accounting mismatches.

(c) a few agree with the classification of interest income on trade receivables but suggest interest expenses on trade payables should also be classified in the operating category. They said income and expenses related to working capital management should be included in operating profit because they are part of an entity's main business activities.

Other comments related to the financing category

64. Some respondents suggested the Board should clarify whether incremental expenses related to financing activities should be classified in the financing category—similar to the requirement proposed for the investing category (see paragraph 10). Some of those respondents said such expenses should be included in the financing category, but one preparer said such expenses should not be included. For example, incremental expenses could include transaction costs not included in the initial measurement of the instrument (see paragraph 5.1.1 of IFRS 9 *Financial Instruments*).

65. A few respondents commented on the proposal to require entities to present a separate line item for 'income or expenses from financing activities' in the statement of profit or loss (paragraph 65(a)(ii) of the Exposure Draft):

    (a) a few respondents suggested the Board should also require entities to present as a separate line item the other components of the financing category—that is, income and expenses from cash and cash equivalents and interest income and expenses on liabilities not arising from financing activities; and

    (b) one respondent questioned whether the proposed line item for 'income or expenses from financing activities' conflicted with the ban on offsetting income and expenses in paragraph 29 of the Exposure Draft (a requirement carried over from IAS 1).

Classification of foreign exchange differences and of fair value gains and losses on derivatives and hedging instruments

66. The Board proposes that an entity shall classify foreign exchange differences included in profit or loss in the same category of the statement of profit or loss as the income and expenses from the items that gave rise to the foreign exchange differences.

67. The Board's proposals for the classification of gains and losses from derivatives and hedging instruments can be summarised as follows (paragraphs 56–59 of the Exposure Draft):[7]

[7] Also see paragraphs B39–B43 and BC90–BC102 of the Exposure Draft.

<table>
<tr><th colspan="2"></th><th colspan="2">Gains and losses on:</th></tr>
<tr><th colspan="2"></th><th>Derivatives</th><th>Non-derivative financial instruments</th></tr>
<tr><td rowspan="2">Used for risk management</td><td>Designated as a hedging instrument</td><td colspan="2">Classify in the category affected by the risk the entity manages, except when it would involve grossing up gains and losses—then classify in the investing category.</td></tr>
<tr><td>Not designated as a hedging instrument</td><td>Apply the presentation requirements for derivatives designated as hedging instruments except if such classification would involve undue cost or effort—then classify in the investing category.</td><td rowspan="2">Apply requirements for classification in paragraphs 45–55 of the Exposure Draft.</td></tr>
<tr><td colspan="2">Not used for risk management</td><td>Classify in the investing category, except when used in the course of a main business activity—then classify in the operating category.</td></tr>
</table>

68. Some respondents provided specific feedback on these proposals.

Classification of foreign exchange differences

69. Many respondents disagreed with the proposed classification:

(a) most of them said they disagreed because they think the proposals would:

(i) be complex and costly to apply; and

(ii) fail to reflect many entities' practice of managing foreign exchange risk on a net basis across the entity's different activities. Some are concerned that allocating foreign exchange differences to different categories applying the proposals would make operating profit appear volatile, even when foreign exchange risk is eliminated at the level of profit or loss. They said the resulting classification would be arbitrary and would not provide useful information.

(b) some of these respondents suggested all foreign exchange differences should be classified in a single category, with a few suggesting the financing category.

70. A few respondents from various stakeholder groups agreed with the proposed classification, stating the proposals were conceptually sound, although a few of them also pointed to practical challenges.

71. Other respondents who commented on this topic said the proposals would be challenging to apply and a few made additional suggestions including:

(a) additional time for implementation; and

(b) more examples and guidance, for example relating to the classification of foreign exchange differences on intercompany transactions.

Classification of gains and losses from derivatives and hedging instruments

72. In relation to the proposed classification of gains or losses on derivatives not in designated hedging relationships to categories according to the risks they manage:

(a) a few respondents agreed with the proposed approach saying it would appropriately reflect the results of an entity's operating, investing and financing activities;

(b) some disagreed, saying that the proposals would require additional processes and controls, and would lead to inconsistent application;

(c) a few were also concerned that the proposals would be creating a new type of hedge accounting which would be confusing and a few asked for more guidance on determining when derivatives are used for risk management; and

(d) entities in financial industry said they expect they would, applying the proposals, classify all gains and losses from derivatives in the operating category and were not generally concerned by the proposals.

73. Some respondents expressed concerns about the proposed designation of the investing category as the default classification category when classification according to risk management would cause undue cost, derivatives are not used for risk management purposes, or are hedging offsetting risks in different categories, saying that:

(a) the proposal may lead to entities presenting an investing category for no reason other than to classify gains and losses from derivatives, potentially even for entities in the financial industry;

(b) requiring derivatives that hedge net positions to be classified in the investing category would result in accounting mismatches and not provide a faithful representation of entities' risk management activities; and

(c) other categories, for example the operating category, are more appropriate for classification in such circumstances.

74. In relation to the proposed classification of gains or losses on hedging instruments in designated hedging relationships, a few respondents said the classification of hedge ineffectiveness was unclear.

Alignment of categories between the statement of profit or loss and the statement of cash flows

Proposals in the Exposure Draft

75. The Board developed its proposals for the categories in the statement of profit or loss without trying to align classifications across the primary financial statements. Consequently, income and expenses classified in the operating, investing and financing categories in the statement of profit or loss do not necessarily correspond with the cash flows from operating, investing and financing activities in the statement of cash flows.

76. In particular, the Board has intentionally defined the investing categories in the two statements with different objectives:

(a) in the statement of profit or loss, the investing category aims to capture results of 'stand-alone' investments that users typically analyse separately; whereas

(b) in the statement of cash flows, the investing category aims to capture cash flows from investments in long-term assets that will generate future returns.

77. For example, cash flows from property, plant and equipment are included in cash flows from investing activities, but income and expenses from those assets would be included in the operating category in the statement of profit or loss.

Feedback

78. Many respondents say that different classifications between the statement of cash flows and the statement of profit or loss would reduce the understandability of the

statements, particularly because both statements use the same terms—operating, investing and financing.

79. Some respondents:

(a) agreed the categories in the statement of profit or loss and the statement of cash flows have different objectives. They suggested the Board should use different labels for the categories in the two statements to avoid confusion.

(b) asked the Board to do more work generally on alignment of the two statements, but some also acknowledged such work might be better undertaken as a part of a separate project to undertake a comprehensive review of IAS 7 *Statement of Cash Flows*.

(c) said the Board should at least avoid introducing new inconsistencies between the statement of profit or loss and the statement of cash flows. These respondents gave examples of items for which the proposals on the classification of interest and dividends in the statement of cash flows introduce inconsistencies with the statement of profit or loss:

(i) the classification of interest and dividend cash flows for entities with particular main business activities[8];

(ii) dividends received from integral joint ventures and associates;

(iii) interest received on cash and cash equivalents;

(iv) interest paid that is capitalised as part of the cost of an item of property, plant and equipment; and

(v) interest received from customers applying IFRS 15 *Revenue from Contracts with Customers*.

[8] See paragraphs 34B–34C of the proposed amendments to IAS 7 in the Exposure Draft, which apply to entities that provide financing to customers as a main business activity or in the course of its main business activities invest in assets that generate a return individually and largely independently of the entity's other resources.

Fieldwork findings

80. The following section discusses the fieldwork findings related to categories and subtotals in the statement of profit or loss. The findings are organised into the following sections corresponding to the objectives of the fieldwork:

    (a) observations on how the requirements were applied (paragraphs 82– 85);

    (b) aspects of the Exposure Draft that participants identified as being unclear (paragraphs 86–88); and

    (c) extent of process or systems changes that may be required (paragraphs 89–94).

81. The methodology of the fieldwork is described in Agenda Paper 21A.

Observations on how the requirements were applied

82. All participants that provided a recast statement of profit or loss presented all of the categories proposed in the Exposure Draft that were relevant to the participant.

83. Nearly all participants that provided a recast statement of profit or loss presented all of the subtotals required by the Exposure Draft that were relevant to the participant.

84. However, one participant did not present a profit before financing and income tax subtotal. The participant did not have income or expenses that would be classified in investing category nor any integral associates or joint ventures and therefore their operating profit was equal to profit before financing and income tax.

85. A few participants said that the current presentation of their statement of profit or loss was designed to align with the structure of their segment disclosures. These participants said that the changes to the presentation of the statement of profit or loss for categories and subtotals would result in a misalignment with the segment disclosures.

Aspects of the Exposure Draft participants identified as unclear

86. Responses to the questionnaire indicated that all participants were clear on the classification of income and expenses into the operating, investing and financing categories.

87. However, some participants identified specific income and expenses classified in the operating category that they believed would provide better information if classified in another category. For example, one entity incurred expenses for the availability of an unused credit line. It concluded that the expenses for the unused credit line did not meet the definition of financing activities because there was no liability at the period end. This participant said classifying expenses for the unused credit line in the financing category would provide better information for users than classifying them in the operating category.

88. Paragraph 57(c)(ii) of the Exposure Draft proposes that entity should classify gains and losses on designated hedging instruments in the investing category in particular cases to avoid the grossing up of gains and losses. Some participants said this proposal was unclear—they did not understand when it would apply, or why grossing up should be avoided.

Extent of process or systems changes that may be required

89. Nearly all participants said that changes to general ledgers would be required to classify income and expenses into the categories proposed in the Exposure Draft. In some cases, these changes would require the separation of single general ledger items into multiple items. For example, many participants said that interest revenues are included in a single general ledger account. Classifying interest revenue on cash and cash equivalents in the financing category and classifying interest revenue from investments in financial instruments in the investing category would require the creation of new general ledger accounts, changes to the mapping of the accounts to the different categories, and changes to recurring journal entries to record transactions in the appropriate categories.

90. Potential systems and process changes required to apply the proposals for classifying foreign exchange differences and gains or losses and derivatives varied significantly between participants.

91. Some participants said that information was not available in current systems to classify foreign exchange differences and gains and losses on derivatives in the categories proposed in the Exposure Draft. For example, many of the participants that

did not have the available information on the underlying sources of foreign exchange differences and gains and losses on derivatives said this was because they managed these items on a net basis in a central treasury function.

92. Some participants said that significant changes to systems and processes would be required to apply the proposals for foreign exchange differences and gains and losses on derivatives. For example, one participant said that the changes would delay their ability to implement the proposals by at least a year.

93. In contrast, some participants said that no changes to systems or processes would be required to classify foreign exchange differences and gains and losses on derivatives in the categories proposed in the Exposure Draft because their existing systems already track the underlying sources.

94. A few participants said that changes in planning and budgeting systems might be necessary because the proposed operating profit subtotal is different from their current operating profit which is used in those systems.

Question for the Board

Does the Board have any comments or questions on the feedback discussed in this paper? Specifically:

(a) Is there any feedback or fieldwork evidence that is unclear?

(b) Are there any points, or fieldwork evidence, you think the Board did not consider in developing the Exposure Draft but should consider in the re-deliberations?

(c) Are there any points, or fieldwork evidence, you would like staff to research further for the re-deliberations?

Appendix A—Relevant questions in the Exposure Draft

Question 1—operating profit or loss
Paragraph 60(a) of the Exposure Draft proposes that all entities present in the statement of profit or loss a subtotal for operating profit or loss. Paragraph BC53 of the Basis for Conclusions describes the Board's reasons for this proposal. Do you agree with the proposal? Why or why not? If not, what alternative approach would you suggest and why?

Question 2—the operating category
Paragraph 46 of the Exposure Draft proposes that entities classify in the operating category all income and expenses not classified in the other categories, such as the investing category or the financing category. Paragraphs BC54–BC57 of the Basis for Conclusions describe the Board's reasons for this proposal. Do you agree with this proposal? Why or why not? If not, what alternative approach would you suggest and why?

Question 5—the investing category
Paragraphs 47–48 of the Exposure Draft propose that an entity classifies in the investing category income and expenses (including related incremental expenses) from assets that generate a return individually and largely independently of other resources held by the entity, unless they are investments made in the course of the entity's main business activities. Paragraphs BC48–BC52 of the Basis for Conclusions describe the Board's reasons for the proposal. Do you agree with the proposal? Why or why not? If not, what alternative approach would you suggest and why?

Question 6—profit or loss before financing and income tax and the financing category
(a) Paragraphs 60(c) and 64 of the Exposure Draft propose that all entities, except for some specified entities (see paragraph 64 of the Exposure Draft), present a profit or loss before financing and income tax subtotal in the statement of profit or loss. (b) Paragraph 49 of the Exposure Draft proposes which income and expenses an entity classifies in the financing category. Paragraphs BC33–BC45 of the Basis for Conclusions describe the Board's reasons for the proposals. Do you agree with the proposals? Why or why not? If not, what alternative approach would you suggest and why?