STAFF PAPER

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Project	**Primary Financial Statements**
Paper topic	Feedback summary—Subtotals and categories—entities with particular main business activities

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Objective

1. The Exposure Draft *General Presentation and Disclosures* proposes requirements for the structure of the statement of profit or loss. It sets out specific requirements for entities with particular main business activities, such as providing financing to customers and investing. This paper analyses feedback from comment letters and outreach and fieldwork findings related to those specific requirements (Exposure Draft Questions 3 and 4).

Key messages

2. Most respondents agree with the proposals to classify in the operating category:
   (a) income and expenses from investments made in the course of an entity's main business activities; and
   (b) income and expenses from financing activities and income and expenses from cash and cash equivalents if an entity provides financing to customers as a main business activity.
3. However, many respondents said additional guidance would be needed to achieve consistent application and comparability, including guidance on the terms 'main business activities' and 'in the course of main business activities'.

4. Many respondents disagreed with the proposed accounting policy choice for entities that provide financing to customers as a main business activity. Some respondents suggest that, to improve comparability between entities, the accounting policy choice should be replaced with a practical expedient.

Structure of the paper

5. This paper is structured as follows:

   (a) Proposals in the Exposure Draft (paragraphs 7–8);

   (b) Comment letter and outreach feedback (paragraphs 9–36);

   (c) Fieldwork findings (paragraphs 37–49).

6. There are two appendices to this paper:

   (a) Appendix A includes the relevant questions from the Exposure Draft; and

   (b) Appendix B includes a diagram that summarises the proposals for the structure of the statement of profit or loss.

Proposals in the Exposure Draft

7. Agenda Paper 21B *Feedback summary—Subtotals and categories—general model* describes the 'general model' for the structure of the statement of profit or loss. In addition, the Board 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. The Board proposed that the operating category would include:

   (a) income and expenses from investments made in the course of an entity's main business activities (paragraph 48 of the Exposure Draft). For example, this proposal would apply to insurers and investment entities. An entity would assess on an asset-by-asset basis whether investments are made in the course of its main business activities.[1]

(b) (some) income and expenses from financing activities and income and expenses from cash and cash equivalents if the entity provides financing to customers as a main business activity (paragraph 51 of the Exposure Draft). For example, this proposal would apply to banks and entities that provide financing to customers purchasing their products. This requirement is formulated as an accounting policy choice (see paragraph 18).[2]

(c) income and expenses from cash and cash equivalents if the entity, in the course of its main business activities, invests in financial assets that generate a return individually and largely independently of other resources held by the entity (paragraph 52(a) of the Exposure Draft).[3]

(d) income and expenses on liabilities arising from issued investment contracts with participation features recognised applying IFRS 9 *Financial Instruments* (paragraph 52(b) of the Exposure Draft).[4]

(e) insurance finance income and expenses included in profit or loss (paragraph 52(c) of the Exposure Draft).[5]

8. Appendix B summarises these requirements and explains how they relate to the general model.

Comment letter and outreach feedback

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

(a) Question 3—income and expenses from investments made in the course of an entity's main business activities (paragraphs 10–16);

[1] Also see paragraphs B27 and BC58–BC61 of the Exposure Draft.

[2] Also see paragraphs B28–B29 and BC62–BC69 of the Exposure Draft.

[3] Also see paragraphs B30 and BC70–BC72 of the Exposure Draft.

[4] Also see paragraphs BC74–BC76 of the Exposure Draft.

[5] Also see paragraphs BC73 of the Exposure Draft.

(b) Question 4—an entity that provides financing to customers as a main business activity (paragraphs 17–27);

(c) Feedback that relates to both Questions 3 and 4 (paragraphs 28–34); and

(d) Other requirements for entities with particular main business activities (paragraphs 35–36).

Question 3—income and expenses from investments made in the course of an entity's main business activities

10. Most respondents, including many users, agreed with requiring an entity to classify in the operating category income and expenses from investments made in the course of the entity's main business activities. However, some respondents are concerned entities may apply the requirement inconsistently and opportunistically.

Agreement

11. Some respondents who agreed said that the proposed requirements:

(a) are necessary to allow entities that invest in the course of their main business activities to present a meaningful operating profit subtotal;

(b) would be in line with current practice for entities in the financial services sector such as insurers and investment funds; and

(c) would enhance comparability between entities.

Concerns

12. Some respondents were concerned different entities may inconsistently identify 'investments made in the course of an entity's main business activities'. A few users said that entities may classify profitable investments in the operating category and loss-making investments in the investing category.

13. For instance, some respondents said it was unclear whether 'strategic investments' are 'investments made in the course of an entity's main business activities'. They said strategic investments include non-controlling shareholdings (that is, shareholdings that do not give the entity control, joint control or significant influence) in:

(a) suppliers or customers, including cross-shareholdings, which are held to strengthen business relationships; and

(b) businesses that the entity may intend to obtain control over in the future, for example venture capital investments or investments in start-up companies.

14. In addition, a few respondents said it was unclear:

(a) what ‘in the course of main business activities’ means and how it differs from ‘as a main business activity’. Some requested additional guidance and examples. A few respondents said ‘in the course of main business activities’ would be difficult to translate into their local language.

(b) whether ‘in the course of main business activities’ includes ‘ancillary activities’. For example, one standard-setter asked how an automotive manufacturer should classify rental income from leased dealerships that are accounted for as investment property.

(c) whether investments held to satisfy regulatory requirements would qualify as investments made in the course of an entity’s main busines activities—for example, investments held by insurers to meet minimum capital requirements.

15. A few preparers said splitting investments between those that are made in the course of main business activities and those that are not would be costly and the cost would exceed the benefits.

16. The Board proposed that income and expenses from associates and joint ventures accounted for using the equity method cannot be classified in the operating category as ‘investments made in the course of an entity’s main business activities’. A few respondents, mostly from the insurance, real estate and asset management industries, disagreed because in their view:

(a) investments in associates and joint ventures accounted for using the equity method should be treated consistently with other investments. They think it is counterintuitive that income and expenses from investments:

(i) over which the entity has control or has no significant influence can be classified in operating profit; but

(ii) investments that are ‘in between’—that is, investments over which the entity has joint control or significant influence—cannot be classified in the operating category.

(b) this proposal may result in a mismatch when expenses related to such investments are included in operating profit, for example in cases when investments in associates and joint ventures are held to cover insurance contract liabilities.

Question 4—an entity that provides financing to customers as a main business activity

17. Almost all respondents, including all users, agreed with requiring an entity that provides financing to customers as a main business activity to classify in the operating category income and expenses from financing activities and income and expenses from cash and cash equivalents. A few disagreed with this proposal and a few did not express a view.

18. Paragraph 51 of the Exposure Draft proposed an accounting policy choice:

> *If an entity provides financing to customers as a main business activity, it shall make an accounting policy choice to not classify in the financing category either […]:*
>
> *(a) income and expenses from financing activities, and from cash and cash equivalents, that relate to the provision of financing to customers; or*
>
> *(b) all income and expenses from financing activities and all income and expenses from cash and cash equivalents.*
>
> *Such income and expenses are instead classified in the operating category.*

19. Many respondents, including most regulators and accounting firms, disagreed with the proposed accounting policy choice. Some respondents, including many banks, explicitly agreed. Many respondents did not express a view or expressed general agreement with the proposal without commenting on the accounting policy choice. In the following paragraphs we describe the accounting policy set out in paragraph 51(a)

of the Exposure Draft as 'allocating financing expenses' and 51(b) as 'classifying all financing expenses in the operating category'.

Agreement

20. Some respondents said the proposals:

(a) are necessary to allow entities that provide financing to customers as a main business activity to present a net interest income subtotal and a meaningful operating profit subtotal; and

(b) would be in line with current practice for entities such as banks.

21. Some respondents, including some banks[6], explicitly agreed with the proposed accounting policy choice. They say it would be difficult for some entities, such as banks with investment or insurance activities, to identify the portion of financing expenses that relates to the provision of financing to customers. They think that the proposed accounting policy choice would reduce cost and complexity.

Concerns—accounting policy choice

22. Many respondents disagreed with the proposed accounting policy choice:

(a) many respondents said allowing an accounting policy choice would undermine the comparability of operating profit and make the statement of profit or loss more complex for users to understand.

(b) some respondents said allowing some entities to classify all expenses from financing in the operating category would result in a loss of useful information for users. For example, a few respondents said it would not be appropriate for a manufacturer that provides financing to customers to apply such a policy.

(c) a few respondents said that most entities that provide financing to customers as a main business activity should be able to make the allocation on a reasonable basis, without undue cost or effort. A few respondents said they expect:

[6] Some banks explicitly agreed with the accounting policy choice, one bank disagreed, some banks expressed general agreement with the proposal without commenting on the accounting policy choice, other banks did not express a view.

(i) such an allocation is likely to be made for internal reporting purposes; and

(ii) the provision of financing to customers is often isolated in a separate subsidiary, which should make it easier to identify the related financing expenses.

23. Respondents suggested the following alternative approaches:

(a) some respondents suggested requiring entities to allocate financing expenses (paragraph 51(a) of the Exposure Draft), unless such an allocation would be arbitrary or would involve undue cost or effort. In the latter case:

(i) some respondents suggest that all financing expenses should be classified in the operating category (paragraph 51(b) of the Exposure Draft);

(ii) a few other respondents suggest that all financing expenses should be classified in the financing category; and

(iii) a few other respondents suggest that all financing expenses should be classified either in the operating or the financing category, depending on the predominant activity of the entity.

(b) a few respondents suggested requiring all entities, except specific entities, to allocate financing expenses. They suggest that entities whose *only* main business activity is providing financing to customers should be allowed to classify all financing expenses in the operating category.

(c) a few respondents suggested requiring entities to allocate financing expenses, without any exemptions.

(d) a few respondents suggested retaining the two accounting policy options but requiring that an entity’s policy should be based on how the income and expenses are allocated in internal management reporting.

24. A few respondents said the Board’s approach to introducing accounting policy choices and practical expedients in different proposals appeared inconsistent and suggested the Board should develop principles to help it develop such requirements more consistently.

Other concerns and alternative approaches

25. Some respondents said it is unclear when 'providing financing to customers' constitutes a main business activity—in particular for entities that provide financing to customers to enable those customers to purchase the entity's products. For example, one preparer from the telecom industry said it was common to offer financing to customers purchasing a handset, but they were unsure whether this constituted a main business activity. Some respondents are concerned that, without further guidance, entities may apply the proposals inconsistently.

26. A few respondents suggested the Board should provide additional guidance on how to allocate financing expenses between the provision of financing to customers and other business activities. A few respondents also suggested entities should be required to disclose how they have made the allocation.

27. Some respondents, including many banks, suggested that when an entity classifies all financing expenses in the operating category, it should also classify interest on liabilities not arising from financing activities (such as the unwinding of a discount on provisions) in the operating category, because:

    (a) otherwise, such interest would be the only remaining item in the financing category, which would clutter the statement of profit or loss;

    (b) such classification would be consistent with current practice and with regulatory reporting templates; and

    (c) they think such interest relates to the entity's operating activities.

Feedback that relates to both Questions 3 and 4

Further guidance on 'main business activities'

28. Many respondents said the Board should provide further guidance to help an entity identify its main business activities, because this assessment plays an important role in the determination of operating profit. Without further guidance, they are concerned entities would apply the proposals inconsistently, which would undermine the comparability of the operating profit subtotal.

29. A few respondents suggested additional indicators that could help an entity identify a main business activity—for example, they suggested an activity is likely to be a main business activity if:

    (a) the income or expenses from the activity are reviewed by the chief operating decision maker in assessing the entity's operating performance;

    (b) the income or expenses from the activity are considered in determining key management personnel compensation; or

    (c) the activity is included in the entity's business purpose as described in its articles of association (or similar documents).

30. Some respondents suggested the Board should clarify:

    (a) the relationship between 'main business activities' and similar concepts in other Standards, such as 'ordinary activities' (used in the definition of revenue in IFRS 15 *Revenue from Contracts with Customers*) and 'principal revenue-producing activities' (used in the definition of cash flows from operating activities).

    (b) the level at which 'main business activities' are assessed in a group. They questioned whether the assessment should be made from the perspective of the reporting entity—that is, the group—or the individual subsidiaries. Some of those respondents said the Board should clarify whether differences in classification can arise between consolidated and separate financial statements due to different activities being identified as main business activities.

    (c) how an entity should identify and present changes in its main business activities. Some respondents said it was unclear whether comparative figures would need to be restated to reflect changes in main business activities.

    (d) how an entity's main business activities relate to its operating segments. For example:

        (i) paragraph B31 of the Exposure Draft proposed that: 'If, applying IFRS 8 *Operating Segments*, an entity reports a segment that constitutes a single business activity, that may indicate that that business activity is a main business activity.' A few respondents suggested the Board should clarify that an *operating* segment can represent a main business activity, even if it does not meet the criteria in IFRS 8 to be a *reportable* segment.

(ii) one user and one standard-setter suggested 'non-main' business activities should be presented as a separate reconciling column in segment reporting. The standard-setter also suggested the Board should consider requiring disclosure of operating profit by segment.

Disclosure requirements

31. A few respondents said that the following disclosure requirements—which the Exposure Draft proposes to carry over from IAS 1 *Presentation of Financial Statements*—would provide sufficient information about how an entity has identified its main business activities:

(a) the requirement for an entity to describe its main busines activities (paragraph 138 of IAS 1, paragraph 99 of the Exposure Draft); and

(b) the requirement to disclose information about significant judgements (paragraph 122 of IAS 1, proposed to be moved to paragraph 27E of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*).

32. However, some other respondents suggested strengthening the proposed disclosure requirements by:

(a) giving the requirement to describe the entity's main business activities more prominence in the Standard—it is currently at the end of the Standard in the 'other disclosures' section.

(b) introducing a specific disclosure requirement for judgements made in identifying an entity's main business activities. One accounting firm suggested clarifying that the requirement to disclose information about significant judgements described in paragraph 31(b) includes significant judgements made in applying presentation and disclosure requirements. They said this requirement is read by some as only relating to judgements made in applying recognition and measurement requirements.

Presentation of subtotals

33. A few respondents said that, applying the requirements for entities with particular main business activities, some entities may classify almost all income and expenses in the operating category. For example, for entities such as banks, operating profit could be almost equal to profit before tax. They questioned whether operating profit would provide additional useful information in such cases. Some of those respondents suggested an entity should not be required to present operating profit in such cases.

34. A few respondents also asked the Board to clarify how entities should apply the proposals when operating profit and profit before financing and income tax are (almost) equal.

Other requirements for entities with particular main business activities

35. Few respondents provided comments on the proposed requirements for entities to classify in the operating category (paragraph 52 of the Exposure Draft):

    (a) income and expenses from cash and cash equivalents if the entity, in the course of its main business activities, invests in financial assets that generate a return individually and largely independently of other resources held by the entity;

    (b) income and expenses on liabilities arising from issued investment contracts with participation features recognised applying IFRS 9; and

    (c) insurance finance income and expenses included in profit or loss.

36. Most of the respondents who commented on these proposals agreed with them. A few respondents suggested the Board should clarify whether the requirements in paragraphs 35(b) and 35(c) apply even when issuing investment contracts or insurance contracts is not the entity’s main business activity.

Fieldwork findings

37. The following section discusses the fieldwork findings related to categories and subtotals in the statement of profit or loss for entities with particular main business

activities, including providing financing to customers and investing. The findings are organised by the following categories corresponding to the objectives of the fieldwork:

(a) observations on how the requirements were interpreted;

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

(c) systems changes that may be required to apply the requirements.

38. The methodology of the fieldwork is described in Agenda Paper 21A *Feedback summary—Overview*.

Observations on how the requirements were interpreted

39. Most participants were able to identify and include in the operating category income and expenses from:

(a) the provision of financing to customers when providing financing to customers was a main business activity; and

(b) investments made in the course of the participants' main business activities.

40. Most banks made an accounting policy choice to classify all income and expenses from financing in the operating category. These banks said the policy choice was made because it was consistent with their current practices and because they believed it provided better information to users.

41. Two banks made an accounting policy choice to classify only income and expenses from the provision of financing to customers in the operating category. For these banks finance income and expenses judged not to relate to the provision of financing to customers were those from instruments held for regulatory capital purposes.

42. One participant obtained financing *from* customers by holding customer deposits but did not provide financing *to* customers. This participant said that the expenses on its customer deposits were a part of its main business activities and classifying them in the operating category would provide better information to users. However, because the participant did not provide financing to customers, the Exposure Draft did not permit classifying the expenses from financing activities in the operating category.

43. One participant identified two main business activities, manufacturing products and providing financing to customers. This participant exercised the accounting policy choice to split expenses from financing and classify only those related to provision of finance to customers in the operating category. However, this participant concluded it did not have any expenses from the provision of financing to customers. Therefore, in the operating category it presented income from financing as a separate line item with no corresponding financing expenses.

Aspects of the Exposure Draft participants identified as unclear

44. Some participants said that significant judgements were required in determining whether financing was a main business activity or investments were made in the course of an entity's main business activities.

45. Participants that said significant judgement was required in determining whether financing was a main business activity often provided extended credit terms on sales to customers resulting in material interest revenues. For example, one participant in the real estate industry provided mortgages to some customers as part of its sales of properties. The participant found it difficult to assess whether they provided financing to customers as a main business activity—customer financing is directly related to their main business activity of selling properties, but they did not consider the result of customer financing activities to be an important indicator of their operating performance. The participant judged that the activity was part of its main business activities and therefore classified a portion of its financing costs to the operating category based on its weighted average cost of capital.

46. Participants that said significant judgement was required in determining whether investments were made in the course of a main business activity often made investments in customers or suppliers. For example, many banks that provided loans to customers also invested in the equity shares of some of their customers and therefore judged that the customer relationship meant that the investment was made in the course of the main business activity. Similarly, one participant with manufacturing as a main business activity had a material equity investment in an entity with which it had both supplier and customer relationships. This manufacturer said that it was

difficult to judge whether these relationships meant that the investment was made in the course of its main business activity.

47. Some participants said that they were unclear on whether different main business activities could be identified in the consolidated financial statements and the subsidiary financial statements. For example, some participants were unclear whether having a subsidiary with a main business activity of providing financing to customers meant that providing financing to customers was required to be a main business activity in the consolidated financial statements.

48. Some participants raised concerns that having different main business activities in the consolidated financial statements than the subsidiary financial statements may cause practical difficulties. For example, one participant was required to present financial statements for both the consolidated group and for the non-consolidated parent company. The non-consolidated parent company was a holding company and would therefore have a different main business activity from the consolidated group. This participant said that the different main business activities would make it difficult to:

(a) continue its current practice of presenting the group and parent statements of profit and loss in a single statement;

(b) consolidate the parent and subsidiary accounts without additional processes and systems changes; and

(c) explain the differences between the main business activities to investors and regulators.

Extent of process or systems changes that may be required

49. Some participants that said they would have different main business activities in the group financial statements than in the subsidiary financial statements said that systems and process changes would be required to reclassify income and expenses on consolidation.

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 3—the operating category: income and expenses from investments made in the course of an entity's main business activities
Paragraph 48 of the Exposure Draft proposes that an entity classifies in the operating category income and expenses from investments made in the course of the entity's main business activities. Paragraphs BC58–BC61 of the Basis for Conclusions describe 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 4—the operating category: an entity that provides financing to customers as a main business activity
Paragraph 51 of the Exposure Draft proposes that an entity that provides financing to customers as a main business activity classify in the operating category either: • income and expenses from financing activities, and from cash and cash equivalents, that relate to the provision of financing to customers; or • all income and expenses from financing activities and all income and expenses from cash and cash equivalents. Paragraphs BC62–BC69 of the Basis for Conclusions describe the Board's reasons for the proposals. Do you agree with the proposal? Why or why not? If not, what alternative approach would you suggest and why?

Appendix B—summary of the proposals for the structure of the statement of profit or loss