STAFF PAPER

October 2021

IASB® meeting

Project	**Primary Financial Statements**
Paper topic	Associates and Joint Ventures

CONTACT(S) Aida Vatrenjak avatrenjak@ifrs.org

This Agenda Paper was initially prepared for the Board's September 2021 meeting as Agenda Paper 21F. However, it was not discussed at that meeting. This Agenda Paper is identical to Agenda Paper 21F for the September 2021 Board meeting.

Objective

1. This paper initiates the Board's redeliberations on the proposals set out in the Exposure Draft *General Presentation and Disclosures* relating to integral and non-integral associates and joint ventures. As discussed in the January 2021 Agenda Paper 21A *Plan for redeliberations*, the staff plan on a staged approach to the Board's redeliberations on this topic. This initial paper asks the Board for direction on how it wishes to proceed with key aspects of the proposals on the classification and presentation of income and expenses from integral and non-integral associates and joint ventures in the statement of profit or loss.

2. This paper discusses the proposals for entities other than those with specific main business activities, such as investing and the provision of financing to customers.

3. Future papers will discuss:

   (a) The classification of income and expenses from integral and non-integral associates and joint ventures for entities with specific main business activities.

   (b) Other aspects of the proposals relating to integral and non-integral associates and joint ventures, such as the proposals relating to presentation in the statement of cash flows.

Summary of staff recommendations

4. The staff recommend that the Board:

   (a) proceeds with the proposal to present income and expenses from equity-accounted associates and joint ventures outside of operating profit;

   (b) does not proceed with the proposal to require presentation of the subtotal 'operating profit or loss and income and expenses from integral associates and joint ventures';

   (c) does not proceed with the proposal to require income and expenses from integral associates and joint ventures to be identified and presented separately from non-integral associates and joint ventures; and

   (d) requires income and expenses from all equity-accounted associates and joint ventures to be classified in a merged investing, associates and joint ventures category.

Structure of the paper

5. This paper is structured as follows:

   (a) proposals in the Exposure Draft (paragraphs 7–11);

   (b) summary of feedback (paragraphs 12–29); and

   (c) staff analysis and questions for the Board (paragraphs 30–55).

6. This paper contains a condensed summary of feedback received on the Board's proposals relating to integral and non-integral associates and joint ventures. The December 2020 Agenda Paper 21D *Feedback summary—Subtotals and categories—integral and non-integral associates and joint ventures* contains more information about feedback from comment letters and outreach on this topic, including the fieldwork findings. The December 2020 Agenda Paper 21L *Feedback summary—Literature Review* includes a review of academic literature relating to this topic.

Proposals in the Exposure Draft

7. The Board proposed requiring entities to:

   (a) identify integral associates and joint ventures separately from non-integral associates and joint ventures;

   (b) classify income and expenses from integral associates and joint ventures in an 'integral associates and joint ventures' category, presented below operating profit;

   (c) present a subtotal for 'operating profit or loss and income and expenses from integral associates and joint ventures'; and

   (d) classify income and expenses from non-integral associates and joint ventures in the investing category.

8. In the Basis for Conclusions to the Exposure Draft, the Board notes that IAS 1 *Presentation of Financial Statements* requires presentation of the share of profit or loss of equity-accounted associates and joint ventures as a separate line item but does not specify its location. The Board has observed significant diversity in practice in the presentation of this information. For example, some entities present this line item as part of a measure labelled as operating profit, some present it just below operating profit and some present it after the tax line item. Users of financial statements expressed concerns that this diversity reduces comparability, particularly of the subtotals presented in the statement of profit or loss, making their analysis more difficult and time consuming.

9. The Board initially considered requiring presentation of this item in the investing category. However, stakeholder feedback suggests that some associates and joint ventures are integral to the reporting entity's main business activities and some are not. The Board concluded that the share of profit or loss from non-integral associates and joint ventures meets the proposed definition of income and expenses from investments and, therefore, should be classified in the investing category. The Board also concluded that the share of profit or loss from integral associates and joint ventures does not meet that definition and, therefore, should not be classified in the investing category.

10. The Board proposed classifying and presenting income and expenses from integral associates and joint ventures in a separate category, below operating profit. This proposal was based on feedback from users indicating that such income and expenses should be excluded from the operating category because:

    (a) the equity method combines income and expenses that normally would be analysed separately;

    (b) classifying those income and expenses in the operating category would significantly disrupt users' analyses of operating margins; and

    (c) the entity does not control the activities of associates and joint ventures, whereas the entity controls the other activities that give rise to income and expenses classified in the operating category.

11. The proposed subtotal was intended to balance the need for:

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

    (b) exclusion of those income and expenses from the operating category.

Summary of feedback

Key messages

12. Almost all respondents provided feedback on the topic. Respondents expressed diverse opinions across various aspects of the proposals in the Exposure Draft. Many respondents did not express an overall view, commenting instead on specific aspects of the proposals. However, of those that expressed an overall view, more disagreed with the proposals than agreed. Most respondents highlighted concerns with the proposals. These respondents included respondents that agreed with the proposals, respondents that disagreed and respondents that did not express an overall view. Their concerns relate to:

    (a) the proposal to identify integral associates and joint ventures separately from non-integral associates and joint ventures (paragraphs 15–18);

(b) the proposed definitions of integral and non-integral associates and joint ventures (paragraphs 19–23); and

(c) the separate presentation of amounts relating to these investments in the primary financial statements (paragraphs 24–28).

13. Overall, there is not much support among stakeholders for the proposals. In terms of support by stakeholder type, there is relatively wider support for the proposals among accounting bodies, accounting firms, regulators and standard setting bodies. Both preparers and users generally disagreed with the proposals. However, most users agreed with one aspect of the proposals, the exclusion from operating profit of the share of profit or loss from equity-accounted associates and joint ventures.

14. Feedback from fieldwork participants identified many practical difficulties with the proposed requirements.[1]

Separate identification of 'integral' and 'non-integral' associates and joint ventures

15. Some respondents said that they agree with the Board's proposal to identify integral associates and joint ventures separately from non-integral associates and joint ventures. They said that this could enable users to understand whether the activities undertaken by the associates and joint ventures relate to the main business activities of the reporting entity.

16. Some respondents, including many users, said the separate identification of integral and non-integral associates and joint ventures would not provide useful information. Of these respondents, many suggested that existing disclosure requirements in IFRS 12 *Disclosure of Interest in Other Entities* are sufficient to provide users with the information they need, while some users said that improving those disclosures would be more useful than separate identification of integral and non-integral associates and joint ventures.

[1] For more information about the fieldwork findings, see paragraphs 36–49 of the December 2020 Agenda Paper 21D *Feedback summary—Subtotals and categories—integral and non-integral associates and joint ventures*.

17. Some respondents, including some users, said that any proposed classification would require arbitrary judgements that would not capture the sometimes complex relationships between an entity and its associates and joint ventures.

18. Many respondents did not specifically comment on the proposal to require separate identification of integral and non-integral associates and joint ventures, but disagreed with specific aspects of the proposed classification (see paragraphs 21–23 of this paper).

Definitions of integral and non-integral associates and joint ventures

19. The Exposure Draft defined 'integral associates and joint ventures' as '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'. In addition, paragraph 20D of the proposed amendment to IFRS 12 gives 'significant interdependence' as the only indicator of whether the associate or joint venture is integral to the main business activities of the reporting entity.

20. A few respondents agreed with the proposed definition and guidance. They did not provide specific reasons for their agreement, but they expressed no concerns.

21. Most respondents, including some of those who agreed with the proposals to identify separately integral associates and joint ventures, have concerns over the definition of, or indicator for, integral associates and joint ventures. For example, some respondents pointed out that the definition consists of two separate parts, which may lead to different conclusions depending on whether the associate or joint venture is regarded as 'integral to the main business activities of an entity' or regarded as 'not generating a return individually and largely independently of the other assets of the entity'.

22. Some respondents disagreed with the indicator of integral associates and joint ventures included in paragraph 20D of the proposed amendment to IFRS 12. In their view:

    (a) the term 'significant interdependence' is not well-defined.

    (b) the indicator does not always accurately capture what management would consider to be integral associates and joint ventures. For example, one respondent (a preparer representative group) said that many entities and users of financial statements believe that actively exercising significant influence (or joint control) over other companies indicates that those associates (or joint ventures) are integral to an entity's main business activities, and that the actual circumstances of reporting entities cannot be understood solely in terms of significant interdependency.

23. Many respondents asked for more guidance and/or more examples to help identify integral and non-integral associates and joint ventures. Some respondents commented that the classification would require management to exercise significant judgement and could leave room for opportunistic classification. The resulting classification may also not be consistent across different entities, raising doubts about the usefulness of the information provided. Such judgements could be complex and result in additional costs for preparers. Respondents also said it may be difficult to judge whether returns arise individually and largely independently, especially for conglomerates that engage in many different business activities.

Separate presentation of amounts relating to integral and non-integral associates and joint ventures in the primary financial statements

24. The Board proposed to require an entity to present in the primary financial statements amounts relating to integral associates and joint ventures separately from those relating to non-integral associates and joint ventures. The Board also proposed creating a new subtotal 'operating profit or loss and income and expenses from integral associates and joint ventures' in the statement of financial performance.

25. Respondent's views were mixed: some agreed with the proposals and some did not.

26. Respondents who agreed with the proposals said that there is currently diversity in practice in how entities present income and expenses from associates and joint ventures. Some entities include such income and expenses within operating profit while others do not. These respondents expect comparability of financial statements across different entities to be enhanced by the proposal to require income and expenses from equity-accounted associates and joint ventures to be presented in specific locations within the statement of financial performance. A few respondents said that presenting separately income and expenses from integral associates and joint

ventures helps to convey management’s view on how closely related the investment is to the main business activities of the reporting entity, and how management see its businesses. They said that a separate category and subtotal could also help users identify the results of such investments by presenting them closer to operating profit.

27. Respondents who disagreed with the proposals include those who did not support separately defining integral and non-integral associates and joint ventures and a few respondents who supported a separate definition but said that the information should be disclosed in the notes to financial statements, rather than be presented in the primary financial statements.

28. Most users commented that the new subtotal in the statement of financial performance is not useful because the new subtotal includes both pre-tax and post-tax amounts, as well as the effects of financing for the associates and joint ventures (but not the effects of financing for the rest of the entity). Those users said they would not use the subtotal in their analysis and that, in their view, the subtotal adds clutter to the statement of financial performance. However, these users supported the exclusion of all equity-accounted associates and joint ventures from operating profit, again because of the potential effect of these post-tax, post-financing measures, and the effect on any margin analysis, which would arise if equity-accounted associates and joint ventures were included in operating profit.

Alternative approaches

29. Many respondents who disagreed with the proposals suggested alternative approaches to the classification and presentation of income and expenses from equity-accounted associates and joint ventures. These suggestions are discussed in the staff analysis section of this paper (paragraphs 30–55).

Staff analysis

30. The staff note that when developing the proposals in the Exposure Draft on classifying and presenting income and expenses from equity-accounted associates and joint ventures, the Board’s key objectives were to:

(a) reduce diversity in practice and enhance comparability, by specifying where to present income and expenses from equity-accounted associates and joint ventures in the statement of profit or loss; and

(b) enhance the usefulness of the operating profit subtotal, by excluding income and expenses from equity-accounted associates and joint ventures from operating profit.

31. In the staff view, feedback from respondents does not indicate a need to change those objectives. However, it indicates that the Board should consider other approaches to meeting those objectives. Therefore, the staff have considered how the Board could proceed on this topic, so as to both meet the Board's objectives and respond to the stakeholder feedback received.

32. The remainder of this paper discusses:

(a) a recommended approach (paragraphs 33–45); and

(b) other approaches considered but not recommended (paragraphs 46–55).

Recommended approach

33. Taking into account the feedback received, the staff recommend the following approach:

(a) retain the proposal to present income and expenses from equity-accounted associates and joint ventures outside of operating profit. Feedback from users indicates strong support for this approach.

(b) do not retain the proposal to require presentation of the subtotal 'operating profit or loss and income and expenses from integral associates and joint ventures'. This suggestion is based on respondents' feedback, including from most users of financial statements, that such a subtotal would not provide useful information.

(c) do not retain the proposal to require income and expenses from integral associates and joint ventures to be identified and presented separately from non-integral associates and joint ventures, for the following reasons:

(i) respondents' feedback, including from many users, indicates that the separate identification of amounts relating to integral and non-integral associates and joint ventures would not provide useful information.

(ii) respondents' concerns about the proposed definitions of integral and non-integral would be difficult to resolve, and there seems little point in attempting to do so if users think that the resulting information would not be useful.

(iii) if the proposed subtotal is not retained (as suggested above), requiring income and expenses relating to integral associates and joint ventures to be identified and presented separately from non-integral associates and joint ventures seems unnecessary. Instead, consistent with the presentation of other line items, entities would apply the disaggregation principles when determining whether (and, if so, how) to disaggregate income and expenses from equity-accounted associates and joint ventures.

34. The recommendation in paragraph 33(c) would, in effect, combine the two proposed required line items for the share of profit or loss from associates and joint ventures (paragraphs 65(a)(iii) and (iv) of the Exposure Draft) into a single line item, as is currently required under paragraph 82(c) of IAS 1. That suggestion also would have a similar effect on other proposals in the Exposure Draft for the separate identification of amounts relating to integral and non-integral associates and joint ventures, which will be discussed further at a future meeting, as noted in paragraph 3(b) of this paper (Also, more broadly, the proposals in the Exposure Draft on the presentation of required line items in the primary financial statements will be discussed at a future meeting).

35. If the Board agrees with approach set out in paragraph 33, the remaining question is where income and expenses from associates and joint ventures should be presented in the statement of profit or loss. The staff considered two options, based on suggestions from some respondents:

(a) Option 1: require entities to classify income and expenses from equity-accounted associates and joint ventures in an 'associates and joint ventures' category, which is presented below the operating category and above the investing category (discussed further in paragraphs 36–37).

(b) Option 2: merge the associates and joint ventures category with the investing category, that is, require entities to classify income and expenses from equity-accounted associates and joint ventures in a merged investing, associates and joint ventures category (discussed further in paragraphs 38–41).

36. Option 1 would, in effect, extend the proposed classification and presentation of income and expenses from integral associates and joint ventures to all equity-accounted associates and joint ventures. Classifying income and expenses from equity-accounted associates and joint ventures in a separate 'associates and joint ventures' category would reflect that those income and expense items do not fit neatly into the other categories—they do not belong in the financing category, but classification in either operating or investing does not seem appropriate either, because:

(a) users' feedback indicates that income and expenses from equity-accounted associates and joint ventures should be presented outside operating profit; and

(b) if the separate identification of integral and non-integral associates and joint ventures is not retained (as suggested), income and expenses from associates and joint ventures could include a combination of income and expenses, some of which may not meet the definition of income and expenses from investments.[2]

37. Hence, presenting the 'associates and joint ventures' category between the operating category and the investing category would reflect that this category could comprise a combination of income and expenses from operating and investing.

38. Option 2 would simplify the structure of the statement of profit or loss. If entities are not required to present an 'operating profit or loss and income and expenses from integral associates and joint ventures' subtotal, or present income and expenses from integral associates and joint ventures separately from non-integral associates and joint

[2] The Board will discuss the precise definition of income and expenses from investments at a future meeting. At this stage, the staff do not expect that any future refinements of that definition would impact on the matters discussed in this paper.

ventures (as is recommended in paragraph 33), it could be argued that there is little benefit in retaining a separate ‘associates and joint ventures’ category.

39. For example, some entities might have few other line items in the investing category and/or have a relatively small amount of income and expenses from associates and joint ventures. In such cases, it could be argued that requiring income and expenses from equity-accounted associates and joint ventures to be presented in a separate ‘associates and joint ventures’ category might result in the structure of the statement of profit or loss being more complex than necessary.

40. Also, it can be argued that it makes little practical difference whether income and expenses from equity-accounted associates and joint ventures are required to be presented in a separate ‘associates and joint ventures’ category or in a category merged with the investing category. The only difference is that, if presented in a separate category, income and expenses from associates and joint ventures would be a line item presented before line items for income and expenses from investments. If there is a single merged category, the entity itself would determine the order of presentation of line items in that category. As there will be few line items in that category, we do not expect this potential difference in the ordering of line items within the category to have an effect on the usefulness of the presentation.

41. If the Board agrees with Option 2, we think the label used for the merged category should reflect its new composition, that is, investing, associates and joint ventures. Such a label might also assist with addressing concerns raised by many respondents about the proposed labels for the categories in the statement of profit or loss, which many found confusing because the labels are similar to the labels of the categories in the statement of cash flows, although the content of the categories is different. The latter point will be discussed further at a future meeting, together with definition of income and expenses from investments.

42. Because we think that the benefit of simplicity outweighs any benefits of two separate categories, we recommend Option 2—that is, merge the investing category with the associates and joint ventures category, and require entities to classify income and expenses from equity-accounted associates and joint ventures in the merged investing, associates and joint ventures category.

43. It should be noted that both Options 1 and 2 make it possible for an entity to present an additional subtotal, which adds together operating profit and income and expenses from equity-accounted associates and joint ventures, if the entity concludes doing so would provide useful information for understanding its performance, applying paragraphs 42 and 43 of the Exposure Draft.

44. In the staff view, the approach recommended in paragraphs 33 and 42 would:

(a) meet the Board's objectives of:

(i) enhancing comparability and resolving diversity in practice, by specifying where to present income and expenses from equity-accounted associates and joint ventures; and

(ii) enhancing the usefulness of the operating profit subtotal, by excluding income and expenses from equity-accounted associates and joint ventures from operating profit;

(b) respond to stakeholder feedback, including from most users, about the proposed separate identification of integral and non-integral associates and joint ventures and the proposed subtotal; and

(c) avoid the need to distinguish between integral and non-integral associates and joint ventures, thereby resolving stakeholders' concerns about the proposed definitions.

45. Also, in the staff view, other approaches (discussed in paragraphs 46–55 of this paper) would not provide a better alternative.

Other approaches considered but not recommended

46. The staff considered the following alternative approaches suggested by respondents but does not recommend pursuing any of these approaches:

(a) retain the proposal to separately identify integral and non-integral equity-accounted associates and joint ventures, but introduce a rebuttable presumption that joint ventures are integral and associates are non-integral (paragraphs 47–49);

(b) require amounts relating to associates to be presented separately from amounts relating to joint ventures, instead of distinguishing between integral and non-integral associates and joint ventures (paragraphs 50–53); and

(c) allow management to decide where and how income and expenses from associates and joint ventures should be presented (paragraphs 54–55).

Rebuttable presumption that joint ventures are integral and associates are non-integral

47. Some respondents commented that the Board should consider introducing a rebuttable presumption for classifying integral and non-integral associates and joint ventures. A few of these respondents specifically suggested having a rebuttable presumption that joint ventures are integral and that associates are non-integral.

48. In the staff view, a rebuttable presumption is likely to help resolve some of the difficulties with distinguishing between integral and non-integral, by making that distinction easier to apply in practice. However, it would not fully resolve those difficulties. For example, it would be necessary to provide guidance on when an entity should or must rebut the presumption.

49. Moreover, given that feedback from many users indicates that the proposed requirement to separately identify integral and non-integral associates and joint ventures would not provide useful information, there seems to be little benefit in retaining that proposal.

Separate associates and joint ventures, instead of integral and non-integral

50. A few respondents commented that the Board should consider requiring amounts relating to associates be presented separately from amounts relating to joint ventures, instead of creating a new classification of integral and non-integral.

51. A requirement to present amounts relating to associates separately from amounts relating to joint ventures would be more straightforward than the proposed requirement to present separately amounts relating to integral and non-integral associates and joint ventures, both for the Board when setting such a requirement and for preparers to apply in practice. This is because any such requirement would be

based on existing requirements in IFRS Standards when accounting for investments in associates and joint ventures.

52. However, given that many users did not support the proposed requirement to present separately amounts relating to integral and non-integral associates and joint ventures, it is unclear how the suggested alternative requirement to present separately amounts relating to associates and joint ventures would be helpful. For example, the reasons why users support presenting income and expenses from equity-accounted investments outside of operating profit (see paragraph 10) apply to both associates and joint ventures. Also, many users said that the existing disclosures about associates and joint ventures required by IFRS 12, or improvements to those disclosures, would be more useful than the separate presentation of income and expenses from associates and joint ventures.

53. In the staff view, given the feedback from users, there would be little (if any) benefit in replacing the proposed requirement to present separately amounts relating to integral and non-integral associates and joint ventures with an alternative requirement to present separately amounts relating to associates and joint ventures. Instead, as noted in paragraph 33(c)(iii), the staff think that the disaggregation principles should be applied when entities are determining whether (and, if so, how) to disaggregate income and expenses from equity-accounted associates and joint ventures.

Management choice on presentation

54. A few respondents suggested allowing management to decide where and how income and expenses relating to associates and joint ventures should be presented. However, this approach would not be consistent with the Board's objectives (as discussed in paragraph 30).

55. Also, specifying requirements in an IFRS Standard for where and how income and expenses relating to associates and joint ventures should be presented in the statement of profit or loss would not prevent management from providing additional information about this item, if thought useful.

Questions for the Board

Questions for the Board
Q1 Does the Board agree with the recommended approach set out in paragraph 33 and 42? More specifically, does the Board agree that it should: (a) proceed with the proposal to present income and expenses from equity-accounted associates and joint ventures outside of operating profit; (b) not proceed with the proposal to require presentation of the subtotal ‘operating profit or loss and income and expenses from integral associates and joint ventures’; (c) not proceed with the proposal to require income and expenses from integral associates and joint ventures to be identified and presented separately from non-integral associates and joint ventures; and (d) require income and expenses from equity-accounted associates and joint ventures to be classified in a merged investing, associates and joint ventures category? Q2 If the Board disagrees with the recommended approach (or aspects of it), does the Board wish to explore further any of the other approaches discussed in paragraphs 46–55?