STAFF PAPER

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Project	Primary Financial Statements	
Paper topic	Investments accounted for using the equity method	
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Objective of this paper

1. This paper continues the IASB's discussions on the proposals in the Exposure Draft *General Presentation and Disclosures* for entities with specified main business activities[1].

2. It is the second in a series of papers[2] on entities with specified main business activities and discusses:

   (a) the feedback on the proposal for entities with specified main business activities to classify income and expenses from associates and joint ventures accounted for using the equity method outside of the operating category; and

   (b) the consequences for entities with specified main business activities of the redeliberations on the classification of income and expenses from associates and joint ventures accounted for using the equity method under the general model.

[1] Entities that invest in the course of main business activities in assets that generate a return individually and largely independently of the other resources held by the entity (referred to as 'entities that invest in the course of main business activities') or provide financing to customers as a main business activity.

[2] The first paper in the series considered the feedback on the key concept of 'main business activities' that is related to both the investing category and the financing category (see Agenda Paper 21A of the March 2022 IASB Meeting).

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3. The staff do not make any recommendations or ask the IASB to make any decisions in this paper. The staff will bring back a future paper on the issues discussed in this paper on which the staff will ask the IASB to make decisions. In future papers the staff will also consider other issues related to entities with specified main business activities and whether any transition guidance is required.

Structure of the paper

4. This paper is structured as follows:
   - (a) background (paragraphs 5–19);
     - (i) proposals in the Exposure Draft (paragraph 5);
     - (ii) comment letter feedback on the proposals in the Exposure Draft (paragraphs 6–15);
     - (iii) summary of related tentative IASB decisions from its redeliberations to date (paragraphs 16–19);
   - (b) consistency in presentation of income and expenses from investments (paragraphs 20–26);
   - (c) implications for entities with specified main business activities if the IASB were to proceed with the proposal (paragraphs 27–53);
   - (d) Appendix A— Extract of the illustrative example of the statement of financial performance for an insurance entity;
   - (e) Appendix B— Extracts from the Exposure Draft; and
   - (f) Appendix C— Extracts from IFRS Accounting Standards.

Background

Proposals in the Exposure Draft

5. The Exposure Draft proposed that:

(a) income and expenses from investments made in the course of an entity's main business activities, including income and expenses from associates and joint ventures not accounted for using the equity method be classified in the operating category; and

(b) income and expenses from associates and joint ventures accounted for using the equity method be classified outside of the operating category by all entities regardless of their relationship to main business activities (paragraphs 47, 48, 53, B27, B32 and B38 of the Exposure Draft).

Comment letter feedback on the proposals in the Exposure Draft

6. Feedback on the proposals in the Exposure Draft for investments in associates and joint ventures held by entities with specified main business activities was generally focused on the distinction between integral and non-integral associates and joint ventures. This feedback is excluded from the comments below because the IASB has tentatively decided not to proceed with this proposal (see Agenda Paper 21A of the October 2021 IASB meeting).

Comments from users

7. Most users agreed with the proposal for entities to classify income and expenses from associates and joint ventures accounted for using the equity method outside of operating profit. The reasons given for supporting the proposal included:

(a) the potential effect of post-tax, post-financing measures, and the effect on any margin analysis, if income and expenses from associates and joint ventures accounted for using the equity method were included in operating profit; and

(b) requiring income and expenses from associates and joint ventures accounted for using the equity method to be classified in a specific location within the statement of profit or loss enhances comparability of the financial statements across different entities.

8. Of the users that commented, only one organisation representing users specifically commented on entities with specified main business activities. This organisation said that the only case where an exception to classifying income and expenses from

associates and joint ventures accounted for using the equity method in the operating category may be necessary is when the investments back insurance contracts.

Comments from industry bodies and entities in specific industries

9. Most respondents from the banking industry agreed with the proposal that income and expenses from associates and joint ventures accounted for using the equity method be classified outside of the operating category.

10. A few respondents from the real estate industry disagreed, in particular, with classifying income and expenses from joint ventures outside of the operating category. They explained that common legal structures used in some jurisdictions result in such investments being accounted for using the equity method, but these investments are actively managed as part of operations and, therefore, the proportionate share of profit and loss from the joint venture is an integral part of a real estate entity's operating profit.

11. Some respondents from the insurance industry disagreed with classifying income and expenses from associates and joint ventures accounted for using the equity method outside the operating category and expressed concerns about presentation mismatches arising when investments in associates and joint ventures accounted for using the equity method are held to cover insurance contract liabilities. One respondent from the insurance industry said that investments in associates and joint ventures are immaterial.

Comments from other stakeholders

12. One respondent, an accountancy body, suggested that the IASB require all entities to present income and expenses from associates and joint ventures accounted for using the equity method in a separate single line item classified in the investing category or a category between the operating category and the investing category.

13. One respondent, an accounting network, said that entities with specified main business activities, particularly those in the investment and insurance industries, should classify income and expenses from all associates and joint ventures in the operating category because in practice such entities do not differentiate between

investing in associates and joint ventures and other types of investments as part of their main business activities.

14. A few respondents, including an accounting network, said that they think it is counterintuitive that income and expenses from investments in associates and joint ventures accounted for using the equity method will never qualify for presentation in the operating category, but income and expenses from investments in equity instruments[3] over which an entity does not have joint control or significant influence are required to be classified in the operating category when the investments are in the course of main business activities.

15. A few accountancy bodies said that income and expenses from associates and joint ventures accounted for using the equity method should be classified in the operating category when the returns impact parties other than shareholders, such as insurance contract policyholders. One of these respondents suggested that in order to achieve the objective of IFRS 17 *Insurance Contracts* for insurers to present both 'investment revenue' and 'insurance finance expense' together as 'net finance result' (see Appendix A for the illustrative example of the statement of financial performance of an insurance entity), entities applying IFRS 17 should present income and expenses from associates and joint ventures accounted for using the equity method as a separate line item within the operating category either:

(a) within 'net financial result' between 'credit impairment losses' and 'insurance finance expenses'; or

(a) directly below net financial result with a subtotal of 'net financial result and income and expenses from associates and joint ventures accounted for using the equity method'.

[3] Equity instruments are either measured at fair value through profit or loss or fair value through other comprehensive income if the entity applies the election in paragraph 5.7.5 in IFRS 9 *Financial Instruments* (see paragraph 4.1.4 of IFRS 9).This election is an irrevocable election made on an instrument-by-instrument basis on initial recognition. Amounts presented in other comprehensive income are not subsequently transferred to profit or loss. Dividends received are recognised in profit or loss unless the dividend clearly represents a recovery of part of the cost of the investment (see paragraph B5.7.1 of IFRS 9).

Summary of related IASB tentative decisions from redeliberations to date

16. In October 2021 (see Agenda Paper 21A), the IASB tentatively decided to:

    (a) proceed with the proposal under the general model to require an entity to classify income and expenses from associates and joint ventures accounted for using the equity method outside the operating category;

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

    (c) not to proceed with the proposal to require an entity to identify and present income and expenses from integral associates and joint ventures separately from income and expenses from non-integral associates and joint ventures.

17. In December 2021 (see Agenda Paper 21B), the IASB tentatively decided to classify income and expenses from associates and joint ventures accounted for using the equity method in the investing category.

18. In February 2022 (see Agenda Paper 21A), the IASB tentatively decided to retain the line item for share of profit or loss from associates and joint ventures accounted for using the equity method.

19. In March 2022 (see Agenda Paper 21A), the IASB tentatively decided to clarify that:

    (a) the role of main business activities in the requirements of the [draft] IFRS Accounting Standard is limited to assessing whether an entity invests in the course of its main business activities or provides financing to customers as a main business activity. The assessment is performed at the reporting-entity level. Any changes in the outcome of the assessment should be applied prospectively with disclosure of the fact that there has been a change and information about the effect of the change that would allow users to perform trend analysis on operating profit.

    (b) investing in the course of main business activities or providing financing to customers as a main business activity is a matter of fact and not an assertion. An entity will need to use its judgement in assessing whether it invests in the course of its main business activities or provides financing to customers as a main business activity. The assessment should be based on observable evidence to the extent available.

(c) examples of observable evidence are:

(i) operating performance measures used in public communications; and

(ii) information about segments, if an entity applies IFRS 8 *Operating Segments*. Specifically:

1. a reportable segment that comprises a single business activity indicates that the business activity is a main business activity of the entity.
2. an operating segment that comprises a single business activity indicates the business activity could be a main business activity of the entity—if the performance of the operating segment is an important indicator of the operating performance of the entity.

(d) the specified subtotals similar to gross profit in paragraph B78 of the Exposure Draft are examples of important indicators of operating performance for an entity that invests in the course of its main business activities or provides financing to customers as a main business activity.

Consistency in presentation of income and expenses from investments

20. A few respondents said that income and expenses from investments in associates and joint ventures accounted for using the equity method should be presented consistently with other investments held by entities that invest in the course of main business activities. In their view the outcome of presenting investments from associates and joint ventures accounted for using the equity method differently to other investments is counterintuitive (see paragraph 14).

21. The staff acknowledge that when looking at the proposals holistically some may see the outcome as counterintuitive. There are different outcomes for similar investments when an entity with associates and joint ventures accounted for using the equity method also invests in the course of its main business activities in:

(a) equity instruments accounted for in accordance with IFRS 9 *Financial Instruments*; and

(b) associates and joint ventures not accounted for using the equity method.

22. Applying the proposals in the Exposure Draft and the redeliberations to date, the entity would be required to classify:

(a) the income and expenses from the equity instruments and associates and joint ventures not accounted for using the equity method in the operating category because the investments are in the course of its main business activities; and

(b) the income and expenses from the associates and joint ventures accounted for using the equity method in the investing category.

23. Entities, such as investment funds, that invest in equity instruments and associates and joint ventures that are measured at fair value through profit or loss, manage these investments on a fair value basis. The income and expenses from these investments are an important indicator of operating performance of the entity and are included in a subtotal similar to gross profit in the operating category such as 'net income from financial assets at fair value through profit or loss'. Income and expenses from investments in associates and joint ventures accounted for using the equity method would not be included in this subtotal due to the different measurement basis.

24. The IASB tentatively decided to specify that income and expenses from investments in associates and joint ventures accounted for using the equity method are classified in the investing category due to:

(a) the uniqueness of the equity method; and

(b) the fact that many users of financial statements analyse the results of associates and joint ventures accounted for using the equity method separately (see paragraph BC82 of the Basis for Conclusions on the Exposure Draft and Agenda Paper 21B of the December 2021 IASB meeting) —feedback from users indicates that this may also be the case for entities with specified main business activities unless the investments in associates and joint ventures accounted for using the equity method back insurance contracts (see paragraph 8); and

(c) the approach being consistent with the IASB's key objectives for classifying income and expenses from investments in associates and joint ventures accounted for using the equity method (see Agenda Paper 21A of the October 2021 IASB meeting).

25. The IASB's key objectives for classifying income and expenses from investments in associates and joint ventures accounted for using the equity method are:

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

(b) to enhance the usefulness of the operating profit subtotal by classifying income and expenses from investments in associates and joint ventures accounted for using the equity method outside of operating profit (see Agenda Paper 21A of the October 2021 IASB meeting)—feedback from some respondents is supportive of this objective (see paragraphs 7, 9 and 12), while other respondents said that this objective is less relevant for some entities with specified main business activities because in practice such entities do not differentiate between investing in associates and joint ventures and other types of investments (see paragraph 13) .

26. In the next section of the paper, we consider the implications for entities in specific industries if the IASB were to proceed with the proposal for entities with specified main business activities to classify income and expenses from investments accounted for using the equity method outside of the operating category. The staff will consider in a future paper the classification of income and expenses from other investments in equity instruments, in particular, classification of dividends from investments in equity instruments accounted for at fair value through comprehensive income.

Implications for entities with specified main business activities if the IASB were to proceed with the proposal

27. In order to determine the population of entities with specified main business activities that are likely to be impacted by the proposal, the staff extracted the latest annual

figures[4] from S&P CapitalIQ for 9,493 entities applying IFRS Accounting Standards with industry classifications of real estate and financials. From the extracted data[5] 1,100 of the 2,413 (46%) entities with a real estate industry classification, 301 of the 699 (43%) of entities with an insurance industry classification and 1,745 of the 6,381 (27%) of non-insurance entities with a financial industry classification have investments in associates and joint ventures accounted for using the equity method.

28. It was not possible to do a more detailed analysis using the extracted data without manually analysing the financial statements of individual entities. As a result, in the analysis below the staff selected a small sample of entities in each industry classification for further analysis.

Entities in the banking industry

29. The feedback received did not indicate that the IASB should change the proposal in the Exposure Draft for entities in the banking industry (see paragraph 9). Limited outreach with stakeholders and analysis of the financial statements of 10 entities in the banking industry supported this feedback. In particular, the staff noted that:

    (a) of the 10 entities analysed seven entities presented an operating profit subtotal and classified income and expenses from associates and joint ventures accounted for using the equity method outside of operating profit;

    (b) the remaining three entities did not present an operating profit subtotal and either classified income and expenses from associates and joint ventures accounted for using the equity method within a non-interest income subtotal or directly above profit before tax;

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[4] The figures extracted were for the following line items in the Capital IQ standard template: ‘Sum of Equity Method Investments’ (statement of financial position figure), ‘Sum of Income / (Loss) from Affiliates’ (statement of profit or loss figure for investments accounted for using the equity method), ‘Sum of Total Assets’, ‘Sum of EBT Incl Unusual Items’ and ‘Sum of Net Income’.

[5] The number of entities considered to have investments in associates and joint ventures accounted for using the equity method in the extracted data had either (i) ‘Sum of Equity Method Investments’ (statement of financial position figure), (ii) ‘Sum of Income / (Loss) from Affiliates’ (statement of profit or loss figure for investments accounted for using the equity method) or both (i) and (ii).

(c) on average investments in associates and joint ventures were 1.45% of total assets with a range from 0.003% to 11.8% of total assets; and

(d) investments in associates and joint ventures accounted for using the equity method included investments in banking and financial services, renewable energy, infrastructure and private equity.

Entities in the real estate industry

30. Feedback received indicated some disagreement with the proposals from entities in the real estate industry, in particular, for investments in joint ventures accounted for using the equity method (see paragraph 10). Limited outreach with stakeholders indicated that:

(a) some of these concerns appear to stem from the view that proportionate consolidation is a more appropriate way to account for common legal structures used in some jurisdictions in the real estate industry; and

(b) for some entities, operations legally structured through joint ventures are a significant part of the entity's operations and managed in the same way as all other operations.

31. The staff analysed the financial statements of 10 entities in the real estate industry and based on this analysis noted that the disagreement with the proposals may not be representative of the real estate industry as a whole and the issues raised may be limited to some entities within the industry that use specific types of legal structures. In particular, the staff noted that:

(a) six of the entities classified income and expenses for associates and joint ventures accounted for using the equity method outside of operating profit, three included it within operating profit and one entity that did not present an operating profit subtotal presented it above profit before tax;

(b) on average investments in associates and joint ventures accounted for using the equity method were 8.81% of total assets with a range from 0.28% through to 21.69% of total assets; and

(c) investments were in both in associates and joint ventures and were not limited to real estate and property development, some entities also invested in other things such as financial and insurance services.

Entities in the insurance industry

32. Stakeholders, including users, accountancy bodies, accounting networks and entities in the insurance industry raised several issues about the proposal in the Exposure Draft for classifying income and expenses from associates and joint ventures accounted for using the equity method outside of operating profit (see paragraphs 8, 11, 13, and 15). In this section, we consider:

(a) the IASB's objectives when developing IFRS 17 (see paragraphs 33–35);

(b) exemptions from applying the equity method in IAS 28 *Investments in Associates and Joint Ventures* (see paragraphs 36–40);

(c) limited outreach with stakeholders (see paragraphs 41–43);

(d) analysis of financial statements of entities in the insurance industry (see paragraphs 44–45); and

(e) presentation mismatches (see paragraphs 46–53).

IASB's objectives when developing IFRS 17

33. IFRS 17 requires an entity to separately present:

(a) insurance service result, comprising insurance revenue and insurance service expenses; and

(b) insurance finance income or expense, comprising the change in the carrying amount of the group of insurance contracts arising from the effect of, and changes in, the time value of money and financial risk (see paragraphs 80, 87 and BC16 of IFRS 17).

34. Investments in assets are recognised and measured in accordance with other IFRS Accounting Standards. However, IFRS 17 requires an entity to disclose and explain the relationship between investment returns on its assets and insurance finance income or expenses to enable users of its financial statements to evaluate the sources of

finance income or expenses recognised in profit or loss and other comprehensive income (paragraph 110 of IFRS 17). The difference between investment returns and insurance finance income or expense, is referred to as 'net financial result' (see paragraph B78(d) of the Exposure Draft).

35. Applying the proposals in the Exposure Draft, 'insurance service result' and 'net financial result' are examples of subtotals similar to gross profit. A subtotal is similar to gross profit when it represents the difference between a type of revenue and directly related expenses incurred in generating that revenue (see paragraph B78 of the Exposure Draft). These subtotals that are similar to gross profit are important indicators of operating performance of entities with specified main business activities that are included in the operating category (see paragraph 19(d)).

Exemptions from applying the equity method

36. Applying the proposals in the Exposure Draft, an entity is required to classify income and expenses from associates and joint ventures not accounted for using the equity method in the operating category when the investment is in the course of its main business activities (see paragraph B32(a)(vii) of the Exposure Draft).

37. IAS 28 permits some entities to elect to account for investments in associates and joint ventures at fair value through profit or loss in accordance with IFRS 9. This election can be applied when an investment in an associate or a joint venture is held by, or is held indirectly through, an entity that is a venture capital organisation, or a mutual fund, unit trust and similar entities including investment-linked insurance funds. The election is applied separately for each associate or joint venture at initial recognition of the associate or joint venture (see paragraph 18 of IAS 28).

38. The election can also be applied to a portion of an investment in an associate[6] held indirectly through a venture capital organisation, or a mutual fund, unit trust and similar entities including investment-linked insurance funds regardless of whether the venture capital organisation, or a mutual fund, unit trust and similar entities including investment-linked insurance funds, has significant influence over that portion of the investment in the associate. The remaining portion of the investment is accounted for

[6] The election cannot be applied to a portion of an investment in a joint venture (see paragraph 19 of IAS 28).

using the equity method (see paragraph 19 of IAS 28). Applying the proposals in the Exposure Draft, an entity that applies this election would be required to classify income and expenses from:

(a) the portion of the investment in the associate measured at fair value through profit or loss in the operating category when the investment in that portion is an investment in the course of main business activities; and

(b) the remaining portion in the investing category because it is accounted for using the equity method regardless of its relationship to main business activities.

39. IAS 28 does not define venture capital organisation, mutual fund, unit trust and similar entities including investment-linked insurance funds. An example of an investment-linked insurance fund[7] was added to IAS 28 when IFRS 17 was issued to prevent measurement mismatches arising when investments in associates and joint ventures underlie insurance contracts with direct participation features (see Agenda Paper 2B of the November 2015 IASB meeting). These amendments to IAS 28 can be applied on initial recognition or when an entity adopts IFRS 17 (see paragraphs 18 and 45F of IAS 28).

40. The staff note that the IASB is currently not planning to consider the scope of entities that can apply the election to measure investments in associates and joint ventures at fair value through profit or loss in the equity method project (see Agenda Paper 13 of the April 2022 IASB meeting).

Limited outreach with stakeholders

41. Limited outreach with stakeholders, including preparers in the insurance industry and accounting networks, indicated that there are three key types of investments in associates and joint ventures in the insurance industry:

(a) investments in associates and joint ventures that are directly or indirectly linked to insurance contracts;

[7] An example of an investment-linked insurance fund is a fund held by an entity as the underlying items for a group of insurance contracts with direct participation features. For the purposes of this election, insurance contracts include investment contracts with discretionary participation features (see paragraph 18 of IAS 28).

(b) investments in associates and joint ventures held to meet solvency requirements; and

(c) investments in associates and joint ventures held to undertake insurance activities in some jurisdictions, particularly in Asia.

42. These stakeholders explained that investments in associates and joint ventures and portions of investments in associates (see paragraph 38) that are directly linked to insurance contracts where policyholders bear the investment risk (some of the investments in associates and joint ventures in (a) of paragraph 41) are generally measured at fair value through profit or loss, otherwise they are accounted for using the equity method. They explained that:

(a) all investments in (a) and (b) of paragraph 41 would generally be considered to be part of 'investment return' and comprise 'net financial result';

(b) an investment in an associate or joint venture can be held for dual purposes, for example:

(i) a portion of an investment in an associate or joint venture accounted for using the equity method may be indirectly linked to insurance contracts and the remaining portion of the investment may be held to meet solvency requirements; and

(ii) a portion of an investment in an associate that is directly linked to insurance contracts may be accounted for at fair value through profit or loss and the remaining portion which is indirectly linked to insurance contracts or held for solvency purposes may be accounted for using the equity method;

(c) the purpose for holding the investment in the associate or joint venture accounted for using the equity method may change over the life of the investment, so entities do not generally distinguish between investments that are indirectly linked to insurance contracts and those that are held for solvency requirements; and

(d) investments in paragraph (c) of paragraph 41 are similar to associates and joint ventures used to undertake business activities in other industries. These associates and joint ventures do not back insurance contracts and are not held for solvency requirements.

43. In practice, some stakeholders view the scope of entities that are exempt from applying the equity method and can elect to measure investments in associates and joint ventures at fair value through profit or loss narrowly and others more broadly. The staff also understand that even when the election is available, some entities may choose not to apply it due to:

(a) the practical difficulties in calculating fair value for some investments in associates and joint ventures; and

(b) reluctance by some entities to recognise fair value gains and losses from investments in associates and joint ventures in profit or loss.

Analysis of financial statements of entities in the insurance industry

44. As the effective date for IFRS 17 is annual reporting periods beginning on or after 1 January 2023, it is not possible to determine from financial statements currently available in the marketplace:

(a) which associates and joint ventures are directly or indirectly linked to insurance contracts or held as part of solvency requirements and will be included in net financial result and which associates and joint ventures are used for insurance or other business activities;

(b) if investments in associates and joint ventures are linked to insurance contracts what type of insurance contracts they are linked to; and

(c) whether entities will change the measurement method for some or all of their investments in associates and joint ventures currently accounted for using the equity method to fair value when they adopt IFRS 17.

45. The staff analysed the financial statements of 30 entities in the insurance industry and noted that:

(a) assets that back insurance contracts where the risk is borne by policyholders are generally measured at fair value through profit or loss, however, it was not always clear from the information disclosed whether such assets include investments in associates and joint ventures and, if so, what the amount of these assets were as a percentage of total assets;

(b) on average investments in associates and joint ventures accounted for using the equity method were approximately 1.9% of total assets. However, in the line item for investments in associates and joint ventures accounted for using the equity method in the statement of financial position:

(i) some entities included all associates and joint ventures accounted for using the equity method; and

(ii) others only included associates and joint ventures accounted for using the equity method that undertake insurance and other financial services. These entities included investments in associates and joint ventures accounted for using the equity method held for investment purposes in invested assets, with some of these entities disclosing the amount included in invested assets in the notes. For example, for one entity, associates and joint ventures accounted for using the equity method that undertake insurance and other financial services were 0.34% of total assets and associates and joint ventures accounted for using the equity method held as part of invested assets were 1.23% of total assets;

(c) a few entities presented a separate line item in the statement of profit or loss that only included the share of profit or loss from investments in associates and joint ventures accounted for using the equity method that undertake insurance and other financial services. Some of these entities disclosed the share of profit or loss from investments in associates and joint ventures accounted for using the equity method included in investment income and others did not;

(d) a few entities only disclosed the share of profit or loss for material investments in associates and joint ventures accounted for using the equity method; and

(e) investments in associates and joint ventures accounted for using the equity method included investments in insurance, banking and financial services, real estate, IT software, renewable energy, infrastructure and private equity.

Presentation mismatches

46. Based on the feedback and research above the staff acknowledge that the proposals in the Exposure Draft may result in presentation mismatches for entities in the insurance industry. For example, these presentation mismatches would arise, when:

    (a) an entity judges that it cannot apply the election to account for investments in associates and joint ventures at fair value through profit or loss; or

    (b) an entity chooses not to apply the election on initial recognition of an investment in an associate or joint venture, or when it adopts IFRS 17 (see paragraphs 36–39).

47. In general, if presentation mismatches were to arise, it would be possible for an entity to:

    (a) applying paragraph 42 of the Exposure Draft, present an additional subtotal which adds together operating profit and income and expenses from investments in associates and joint ventures accounted for using the equity method; and

    (b) applying the guidance on management performance measures, disclose a subtotal, such as net financial result and income and expenses from investments in associates and joint ventures accounted for using the equity method, in the notes.

48. However, these two approaches do not fully address the concerns raised because:

    (a) an additional subtotal of 'operating profit and income and expenses from associates and joint ventures accounted for using the equity method' does not allow entities to include income and expenses from associates and joint ventures in net financial result as the IASB intended when it developed IFRS 17 (see paragraphs 33–35); and

    (b) 'net financial result' is a specified subtotal similar to gross profit that is not a management performance measure (see paragraph B78 of the Exposure Draft) —it seems counterintuitive for an entity to use the guidance on management performance measures in order to correct net financial result so that this subtotal can be presented as intended by the IASB when developing IFRS 17.

49. In order to address the concerns, the IASB could consider exploring whether to develop an exception from the general principle that would permit some entities to classify income and expenses from investments in associates and joint ventures accounted for using the equity method in the operating category when the return from the investment is included in a subtotal similar to gross profit. However, it would not be appropriate to apply such an exception to associates and joint ventures that perform insurance and other business activities because income and expenses from these investments in associates and joint ventures are not considered to be part of net financial result and, therefore, should be classified outside the operating category to ensure consistency with all other entities (see paragraph 42).

50. If the IASB were to develop an exception there is a risk that the scope can be interpreted to capture a larger population than the IASB intended, thus undermining the IASB's objective for requiring income and expenses from associates and joint ventures accounted for using the equity method to be classified outside operating profit (see paragraph 25).

51. The staff also acknowledge that the election in paragraph 18 of IAS 28 to measure associates and joint ventures at fair value through profit or loss in accordance with IFRS 9 is only available on initial recognition of the associate and joint venture and on transition to IFRS 17 (paragraph 45F of IAS 28). Broadening the scope of entities that can apply the election would be one way to reduce the presentation mismatch. However, broadening the scope of entities that can apply the election is not something which the IASB is considering in the equity method project and is beyond the scope of this project (see paragraph 40).

52. Regardless of the whether the IASB were to consider expanding the scope of entities that can apply the election, the staff will consider in a future paper whether the IASB should permit entities that did not apply the election on initial recognition of an associate or joint venture recognised prior to applying the [draft] IFRS Accounting Standard to apply paragraph 18 of IAS 28 on transition to the [draft] IFRS Accounting Standard.

53. The staff acknowledge that the IASB would be in a better position to assess the effect of the proposal on entities in the insurance industry once financial statements applying IFRS 17 are available in the marketplace. However, the staff do not think that the

IASB should delay making a decision on this proposal until a full set of financial statements applying IFRS 17 becomes available for annual reporting periods beginning on or after 1 January 2023 as it would substantially delay the project.

Question for the IASB
Q1 Does the IASB have any questions or comments? In particular, do you think staff need to perform any additional research or outreach before asking the IASB to make decisions on this topic?

Appendix A—Extract of the illustrative example of the statement of financial performance for an insurance entity

A1. An extract of the illustrative example for an insurance entity in paragraph IE9 of the Exposure Draft is reproduced below.

BB Group—Statement of financial performance for the year ended 31 December 20X2

	(in currency units)	
	20X2	**20X1**
Insurance revenue	138,200	133,800
Insurance service expenses	(107,000)	(106,000)
Insurance service result	31,200	27,800
Interest revenue calculated using the effective interest method	21,500	22,000
Other investment revenue	95,500	81,000
Credit impairment losses	(9,000)	(11,000)
Insurance finance expenses	(85,900)	(84,000)
Net financial result	22,100	8,000
Other expenses[(a)]	(3,100)	(4,600)
Operating profit	50,200	31,200
Share of profit or loss of integral associates and joint ventures	(3,200)	1,500
Operating profit and income and expenses from integral associates and joint ventures	47,000	32,700
Share of profit or loss of non-integral associates and joint ventures	(2,200)	3,300
Profit before financing and income tax / Profit before tax	44,800	36,000
Income tax expense	(11,200)	(9,000)
PROFIT FOR THE YEAR	33,600	27,000

(a) Paragraph 28 of [draft] IFRS X requires the composition of 'other expenses' to be analysed in the notes. However, such a note is not included in the examples.

Appendix B—Extracts from the Exposure Draft

B1. The paragraphs from the Exposure Draft are reproduced below.

47 The objective of the investing category is to communicate information about returns from investments that are generated individually and largely independently of other resources held by an entity. Except as required by paragraph 48, an entity shall classify in the investing category:

(a) income and expenses from investments, including from non-integral associates and joint ventures (see paragraphs B32–B33).

(b) incremental expenses incurred generating income and expenses from investments. Incremental expenses are expenses that the entity would not have incurred had the investments giving rise to the income and expenses from investments not been made.

48 An entity shall not classify in the investing category income and expenses specified in paragraphs 47(a)–47(b) generated in the course of its main business activities. Such income and expenses are instead classified in the operating category. An entity shall not classify income and expenses from non-integral associates and joint ventures in the operating category.

53 An entity shall classify in the integral associates and joint ventures category income and expenses from integral associates and joint ventures (see paragraph B38).

B27 Paragraph 48 requires an entity to classify in the operating category income and expenses from investments in the course of its main business activities. Whether income and expenses from investments arise in the course of an entity's main business activities is a matter of judgement. In general, investments are likely to have been made in the course of an entity's main business activity when investment returns are an important indicator of operating performance. Examples of entities that invest in the course of their main business activities may include:

(a) investment entities as defined by IFRS 10 *Consolidated Financial Statements*;

(b) investment property companies; and

(c) insurers.

B32 Paragraph 47 requires an entity to classify income and expenses from investments in the investing category except when paragraph 48 requires the entity to classify them in the operating category. Income and expenses from investments would typically include:

(a) income and expenses from financial assets, except for income and expenses from cash and cash equivalents, such as:

(i) interest revenue;
(ii) impairment losses and reversals of impairment losses;
(iii) gains and losses on disposal;
(iv) fair value gains and losses;
(v) dividends from equity investments;
(vi) the share of profit or loss of non-integral associates and joint ventures; and
(vii) income and expenses from associates and joint ventures not accounted for using the equity method; and

(b) income and expenses from other investments such as:

(i) income and expenses on investment property;
(ii) impairment losses and reversals of impairment losses;
(iii) income or expenses from speculative investments, such as investments in artwork held for capital appreciation; and
(iv) gains and losses on disposal.

B38 Only associates and joint ventures accounted for using the equity method can meet the definition of integral associates and joint ventures, thus giving rise to the share of profit or loss accounted for using the equity method. Applying IAS 28 *Investments in Associates and Joint Ventures* an entity may be required to recognise income and expenses from integral associates and joint ventures in addition to the share of profit or loss accounted for using the equity method.

Applying paragraph 53, income and expenses from integral associates and joint ventures include:

(a) the share of profit or loss of integral associates and joint ventures;
(b) impairment losses and reversals of impairment losses on integral

associates and joint ventures; and

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

B78 In accordance with paragraph 104(b) subtotals similar to gross profit are not management performance measures. A subtotal is similar to gross profit when it represents the difference between a type of revenue and directly related expenses incurred in generating that revenue. Examples include:

(a) net interest income;

(b) net fee and commission income;

(c) insurance service result;

(d) net financial result (investment income minus insurance finance expenses); and

(e) net rental income.

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

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

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

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

Appendix C—Extracts from IFRS Accounting Standards

C1. The paragraphs from IAS 28 are as follows.

18 When an investment in an associate or a joint venture is held by, or is held indirectly through, an entity that is a venture capital organisation, or a mutual fund, unit trust and similar entities including investment-linked insurance funds, the entity may elect to measure that investment at fair value through profit or loss in accordance with IFRS 9. An example of an investment-linked insurance fund is a fund held by an entity as the underlying items for a group of insurance contracts with direct participation features. For the purposes of this election, insurance contracts include investment contracts with discretionary participation features. An entity shall make this election separately for each associate or joint venture, at initial recognition of the associate or joint venture. (See IFRS 17 *Insurance Contracts* for terms used in this paragraph that are defined in that Standard.)

19 When an entity has an investment in an associate, a portion of which is held indirectly through a venture capital organisation, or a mutual fund, unit trust and similar entities including investment-linked insurance funds, the entity may elect to measure that portion of the investment in the associate at fair value through profit or loss in accordance with IFRS 9 regardless of whether the venture capital organisation, or the mutual fund, unit trust and similar entities including investment-linked insurance funds, has significant influence over that portion of the investment. If the entity makes that election, the entity shall apply the equity method to any remaining portion of its investment in an associate that is not held through a venture capital organisation, or a mutual fund, unit trust and similar entities including investment-linked insurance funds.

45F IFRS 17, issued in May 2017, amended paragraph 18. An entity shall apply that amendment when it applies IFRS 17.

C2. The paragraphs from IFRS 9 are as follows.

4.1.4 A financial asset shall be measured at fair value through profit or loss unless it is measured at amortised cost in accordance with paragraph 4.1.2 or at fair value through other comprehensive income in accordance with paragraph 4.1.2A. However an entity may make an irrevocable election at initial recognition for particular investments in equity instruments that would otherwise be measured at fair value through profit or loss to present subsequent changes in fair value in other comprehensive income (see paragraphs 5.7.5–5.7.6).

5.7.5 At initial recognition, an entity may make an irrevocable election to present in other comprehensive income subsequent changes in the fair value of an investment in an equity instrument within the scope of this Standard that is neither held for trading nor contingent consideration recognised by an acquirer in a business combination to which IFRS 3 applies. (See paragraph B5.7.3 for guidance on foreign exchange gains or losses.)

B5.7.1 Paragraph 5.7.5 permits an entity to make an irrevocable election to present in other comprehensive income changes in the fair value of an investment in an equity instrument that is not held for trading. This election is made on an instrument-by-instrument (ie share-by-share) basis. Amounts presented in other comprehensive income shall not be subsequently transferred to profit or loss. However, the entity may transfer the cumulative gain or loss within equity. Dividends on such investments are recognised in profit or loss in accordance with paragraph 5.7.6 unless the dividend clearly represents a recovery of part of the cost of the investment.

C3. The paragraphs from IFRS 17 are as follows.

80 Applying paragraphs 41 and 42, an entity shall disaggregate the amounts recognised in the statement(s) of profit or loss and other comprehensive income (hereafter referred to as the statement(s) of financial performance) into:

(a) an insurance service result (paragraphs 83–86), comprising insurance revenue and insurance service expenses; and

(b) insurance finance income or expenses (paragraphs 87–92).

87 Insurance finance income or expenses comprises the change in the carrying amount of the group of insurance contracts arising from:

(a) the effect of the time value of money and changes in the time value of money; and

(b) the effect of financial risk and changes in financial risk; but

(c) excluding any such changes for groups of insurance contracts with direct participation features that would adjust the contractual service margin but do not do so when applying paragraphs 45(b)(ii), 45(b)(iii), 45(c)(ii) or 45(c)(iii). These are included in insurance service expenses.

110 An entity shall disclose and explain the total amount of insurance finance income or expenses in the reporting period. In particular, an entity shall explain the relationship between insurance finance income or expenses and the investment return on its assets, to enable users of its financial statements to evaluate the sources of finance income or expenses recognised in profit or loss and other comprehensive income.

BC16 IFRS 17 reflects the Board's view that an insurance contract combines features of both a financial instrument and a service contract. In addition, many insurance contracts generate cash flows with substantial variability over a long period. To provide useful information about these features, the Board developed an approach that:

(a) combines current measurement of the future cash flows with the recognition of profit over the period that services are provided under the contract (see paragraphs BC18–BC26);

(b) presents insurance service results (including presentation of insurance revenue) separately from insurance finance income or expenses (see paragraphs BC27–BC37); and

(c) requires an entity to make an accounting policy choice at a portfolio level of whether to recognise all insurance finance income or expenses in profit or loss or to recognise some of that income or expenses in other comprehensive income (see paragraphs BC38–BC49).