STAFF PAPER

September 2022

IASB® meeting

Project	**Primary Financial Statements**	
Paper topic	Classification of incremental expenses	

CONTACT(S)	Nick Barlow	nbarlow@ifrs.org
	Roanne Hasegawa	rhasegawa@ifrs.org
	Aida Vatrenjak	avatrenjak@ifrs.org

Objective of this paper

1. This paper sets out staff analysis and recommendations which respond to stakeholder comments relating to the proposed requirement in the Exposure Draft *General Presentation and Disclosures* for an entity to classify incremental expenses incurred generating income and expenses from investments in the investing category (referred to below as 'incremental expenses in the investing category'). The analysis considers the effects of the IASB's tentative decisions in redeliberations relating to the classification of income and expenses in the investing category.

Summary of staff recommendations and questions for the IASB

2. The staff recommends the IASB withdraw the proposed requirement in the Exposure Draft for an entity to classify incremental expenses in the investing category.

Structure of this paper

3. This paper is structured as follows:

   (a) background (paragraphs 4–15):

      (i) proposals in the Exposure Draft (paragraphs 4–6);

(ii) summary of related tentative IASB decisions from its redeliberations to date (paragraphs 7–10);

(iii) comment letter feedback on incremental expenses (paragraphs 11–14);

(iv) fieldwork results (paragraph 15);

(b) staff analysis, staff recommendations, and questions for the IASB (paragraphs16–48):

(i) incremental expenses in the investing category (paragraphs 18–41);

(ii) incremental expenses in the financing category (paragraphs 42–45);

(iii) staff recommendation and questions for the IASB (paragraphs 46–48); and

(c) Appendix—definition of transaction costs.

Background

Proposals in the Exposure Draft

4. Paragraph 47 of the Exposure Draft proposed the objective of the investing category is to communicate information about the returns from investments that are generated individually and largely independently of other resources held by an entity. An entity shall classify in the investing category:

(a) income and expenses from investments, including from non-integral associates and joint ventures[1]; and

(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.

[1] The Exposure Draft proposed that an entity that invests in the course of main business activities would classify in the operating category income and expenses from investments that would otherwise be classified in the investing category. This proposal was not applied to income and expenses from non-integral associates and joint ventures that would be classified in the investing category by all entities.

5. Paragraph BC50 of the Basis for Conclusions on the Exposure Draft explains the IASB proposes that the investing category include incremental expenses related to the investments only—expenses that would not have been incurred had the investment not been made. The IASB considered whether it should include all income and expenses directly related to investments in this category. However, it rejected this approach because it would result in expense allocations that could be complex and costly.

6. For example, expenses directly related to an investment may include an allocation of labour costs if some employees of an entity are engaged in both operating and investing activities. The IASB's objective for the investing category is not to present the profit from an entity's investing activities, but to separate investing income and expenses from operating income and expenses without imposing undue cost or effort on preparers of financial statements. Therefore, the IASB decided to limit the allocation to the investing category to incremental expenses related to the investments.

Summary of related tentative IASB decisions from its redeliberations to date

7. The following paragraphs describe the IASB's tentative decisions from its redeliberations to date related to the investing category. As a result of these tentative decisions to date the investing category would include:

   (a) income and expenses from assets that generate a return individually and largely independently of other resources held by an entity, including cash and cash equivalents;

   (b) income and expenses from associates and joint ventures accounted for using the equity method; and

   (c) incremental expenses—subject to the IASB's tentative decisions on this paper.

8. In May 2021 (see Agenda Paper 21B), the IASB tentatively decided to require an entity to classify income and expenses from cash and cash equivalents in the investing category rather than the financing category.

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

(a) confirm the proposal 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) withdraw 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) withdraw 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.

10. In December 2021 (see Agenda Paper 21B), the IASB tentatively decided to:

(a) confirm the proposal for entities to classify in the investing category income and expenses from assets that generate a return individually and largely independently of other resources held by an entity;

(b) confirm the proposed application guidance in the Exposure Draft and add further application guidance clarifying that the following are not classified in the investing category:

(i) income and expenses arising from individual assets and disposal groups classified as held for sale; and

(ii) income and expenses arising from business combinations;

(c) classify income and expenses from associates and joint ventures accounted for using the equity method in the investing category[2];

(d) remove the discussion of the objective of the requirements in the Accounting Standard and explain in the Basis for Conclusions the reasons for including specific items in the investing category, without referring to that explanation as being an 'objective';

(e) confirm the label 'investing category'; and

---

[2] Classification of income and expenses from associates and joint ventures accounted for using the equity method held by entities with specified main business activities is discussed in Agenda Paper 21B of this meeting.

(f) withdraw the proposed use of the defined term 'income and expenses from investments'.

Comment letter feedback on incremental expenses

11. The Exposure Draft asked whether stakeholders agreed with the proposal for an entity to classify in the investing category income and expenses (including related incremental expenses) from assets that generate a return individually and largely independently of other resources of held by the entity, unless they are investments made in the course of the entity's main business activities. Most respondents, including most users, agreed with the proposal to include 'income and expenses from investments', defined as 'income and expenses from assets that generate a return individually and largely independently of other resources held by an entity'. However, many did not specifically comment on incremental expenses.

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

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

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

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

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

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

Fieldwork results

15. A few fieldwork participants said that it was unclear which expenses were considered incremental expenses and suggested further guidance would be helpful. One participant asked how it should allocate to the investing category interest expenses arising from the financing of investments such as its investment properties.

Staff analysis, staff recommendations, and questions for the IASB

16. The staff recommend the IASB withdraw the proposed requirement in the Exposure Draft for an entity to classify incremental expenses in the investing category. The staff also recommends that the IASB does not introduce a requirement for an entity to classify incremental expenses in the financing category.

17. The staff analysis is structured as follows:

    (a) incremental expenses in the investing category:

        (i) analysis of the feedback on the proposal in the Exposure Draft (paragraphs 18–21);

        (ii) impact of the IASB's tentative decisions to date on the proposal in the Exposure Draft (paragraphs 22–26);

        (iii) clarifying the scope of incremental expenses (paragraphs 27–34); and

        (iv) withdrawing the proposal to include incremental expenses (paragraphs 35–41);

    (b) incremental expenses in the financing category (paragraphs 42–45); and

(c) staff recommendation and questions for the IASB (paragraphs 46–48).

Incremental expenses in the investing category

Analysis of the feedback on the proposal in the Exposure Draft

18. The staff share the concerns of those stakeholders that said the application of the requirement to include incremental expenses in the investing category may lead to application issues and diversity in practice (see paragraph 13).

19. The introduction of comparable subtotals is a fundamental objective of the primary financial statements project. Having consistent classification of income and expenses in each of the categories is important to achieving this objective. The staff think that the application questions raised by stakeholders provide evidence that classifying incremental expenses in the investing category as proposed in the Exposure Draft may lead to inconsistent classification of income and expenses between categories. This in turn would reduce comparability of subtotals between entities, including operating profit.

20. In addition, the staff are concerned that reclassifying expenses into the investing category from the financing category because they are incremental expenses related to an asset with income and expenses classified in the investing category would confuse the distinction between these categories (see stakeholder question in paragraph 13(a) and fieldwork participant question in paragraph 15).

21. The staff consider below whether the IASB could reduce the potential application issues and diversity in practice by clarifying the scope of incremental expenses (see paragraphs 27–33) or whether it should withdraw the proposal in the Exposure Draft (see paragraphs 35–41).

Impact of the IASB's tentative decisions to date on the proposal in the Exposure Draft

22. As a result of the redeliberations to date, all associates and joint ventures accounted for using the equity method would be classified in the investing category (see paragraph 10(c)). If the IASB were to procced with the proposal in the Exposure Draft for incremental expenses in the investing category it would need to consider whether

the proposal applies only to assets that generate a return individually and largely independently of other resources held by the entity as proposed in the Exposure Draft or to all assets with income and expenses classified in the investing category.

23. The staff think that there are expenses related to an associate or joint venture accounted for using the equity method that would meet the definition of incremental—expenses that an entity would not have incurred had the investments not been made. For example, an entity may incur incremental costs to monitor, manage, and report on the investment in the associate or joint venture.

24. Some associates and joint ventures accounted for using the equity method would be considered assets that generate returns individually and largely independently of other resources held by an entity while other associates and joint ventures accounted for using the equity method would not (see Agenda Paper 21B of the December 2021 IASB meeting). Requiring classification in the investing category of incremental expenses on only assets that generate a return individually and largely independently of other resources held by the entity and not all assets with income and expenses classified in the investing category would reintroduce the same complexities in identifying integral and non-integral associates and joint ventures which were removed by withdrawing those proposals (see Agenda Paper 21A of the October 2021 IASB meeting).

25. The complexity of identifying different types of associates and joint ventures accounted for using the equity method could be resolved by applying the requirement to classify incremental expenses in the investing category to all associates and joint ventures accounted for using the equity method. This would be a change from the proposal in the Exposure Draft for some associates and joint ventures accounted for using the equity method as the Exposure Draft did not propose to include incremental expenses in the 'integral associates and joint ventures category' (see paragraph B38 of the Exposure Draft).

26. Applying the requirement to classify incremental expenses in the investing category to all associates and joint ventures accounted for using the equity method may also introduce other complexities. For example, it may be challenging to identify which expenses are incremental for associates and joint ventures accounted for using the equity method that are closely integrated with a group. Therefore, the staff also

considered below whether the IASB could reduce this complexity by clarifying the scope of incremental expenses (see paragraphs 27–33) or whether it should withdraw the proposal the proposal in the Exposure Draft (see paragraphs 35–41).

Clarifying the scope of incremental expenses

27. Clarifying the scope of incremental expenses in the investing category by providing guidance on the specific expenses to be included and excluded would reduce the amount of judgement and complexity involved in identifying the relevant expenses, limiting the potential for application issues and diversity in practice and better distinguishing between income and expenses included in the investing and financing categories.

28. Taking such an approach would allow the IASB to specify the expenses clearly intended to be classified in the investing category and to prohibit expenses clearly not intended to be classified in the investing category. For example, additional guidance could identify:

    (a) management fees paid to a third party to manage an investment to be classified in the investing category; and

    (b) financing expenses on liabilities incurred to invest in an asset with income and expenses classified in the investing category to be prohibited from being classified in the investing category.

29. This would be similar to the approach to transaction costs taken in IFRS 9. Transaction costs are defined in IFRS 9 in a similar way to incremental expenses in the Exposure Draft. The application guidance in paragraph B5.4.8 of IFRS 9 clarifies the scope of the definition by specifying the items that are included and excluded when applying this definition (see Appendix).

30. The staff think the approach in IFRS 9 to transaction costs could be a good model to base an approach on for incremental expenses in the investing category because it identifies a similar concept of incremental costs related to an asset or liability—in IFRS 9 transaction costs are identified for purpose of initial measurement. If a financial asset or financial liability is not measured at fair value through profit or loss the transaction costs are included in the initial measurement of the asset or liability. If a financial asset or financial liability is measured at fair value through profit or loss

the transaction costs are recognised immediately in profit or loss (see paragraph 5.1.1 of IFRS 9).

31. The staff think that the definition of transaction costs in IFRS 9 having a similar concept to that intended for incremental expenses in the investing category in the Exposure Draft also means that the scope of transaction costs in IFRS 9 could be a good starting point for clarifying the scope of incremental expenses in the investing category. For example, all of the transaction costs specifically listed in paragraph B5.4.8 of IFRS 9 would likely be incremental expenses in the investing category as intended in the Exposure Draft (see Appendix).

32. However, additional items would need to be considered. For example, holding costs are specifically excluded from the scope of transaction costs in IFRS 9 which would mean management fees after initial recognition would be excluded. The transaction costs specifically listed in paragraph B5.4.8 of IFRS 9 were developed for financial instruments accounted for in accordance with IFRS 9. Assets with income and expenses classified in the investing category also include other assets not accounted for in accordance with IFRS 9. If the IASB were to clarify which expenses are incremental expenses in the investing category based on the transaction costs specifically listed in paragraph B5.4.8 of IFRS 9, it would need to consider whether expenses applicable to these other assets should be included.

33. Further development of a list of specific expenses that should be included or excluded from incremental expenses in the investing category is the main disadvantage of this approach. It may be challenging to develop a comprehensive list of expenses that should be included or excluded without making potentially arbitrary distinctions between expenses. Including examples rather than a non-comprehensive list could result in diversity in practice.

34. Specifying those expenses considered incremental and those that are not may also have unintended consequences for other IFRS Accounting Standards that use the term incremental expenses. For example, paragraphs 91–92 of IFRS 15 *Revenue from Contracts with Customers* provides guidance on incremental costs which are defined in those paragraphs as those costs that an entity incurs to obtain a contract with a customer that it would not have incurred if the contract had not been obtained. An

example of sales commissions is provided, but no other specific inclusions or prohibitions on what may be included are provided.

Withdrawing the proposal to include incremental expenses

35. Alternatively, withdrawing the proposal to include incremental expenses in the investing category would remove diversity in the classification of such expenses as no incremental expenses would need to be identified. Only income and expenses from assets that generate returns individually and largely independently of other resources held by an entity (including cash and cash equivalents) and income and expenses from investments in associates and joint ventures accounted for using the equity method would be classified in the investing category.

36. Withdrawing the proposal to include incremental expenses in the investing category would simplify the classification of income and expenses making the categories easier to understand and more consistent between entities. This may be particularly important for income and expenses from associates and joint ventures accounted for using the equity method as discussed in paragraphs 22–26.

37. Withdrawing the proposal to classify incremental expenses in the investing category would also have the advantage of aligning the approaches of the investing and financing categories for classifying income and expenses—classifying only expenses that arise from changes in the measurement of the underlying asset or liability.

38. The main disadvantage of withdrawing the proposal to include incremental expenses in the investing category is that it would result in some expenses that some stakeholders intuitively think of as related to investing no longer being classified in the investing category. For example, management fees paid to a third party to manage an investment portfolio would no longer be included in the investing category. Such expenses would be classified in the operating category if material.

39. Another disadvantage of withdrawing incremental expenses from the investing category is that it may result in a difference in the classification of transaction costs on financial assets depending on whether the financial asset is measured at fair value through profit or loss or at amortised cost. Transaction costs are included in the carrying amount of a financial asset carried at amortised cost and are recognised in the statement of profit or loss through the application of the effective interest rate method.

Therefore, these transaction costs would be included in the investing category as part of the application of the effective interest rate method. However, when an asset is measured at fair value through profit or loss transaction costs are recognised immediately through profit or loss (see paragraph 5.1.1 of IFRS 9). As such costs do not arise from the financial asset they would be classified in the operating category if the proposal to classify incremental expenses in the investing category was withdrawn. Under the proposal in the Exposure Draft such expenses would be incremental expenses and classified in the investing category.

40. The staff think that the resulting difference in category for the classification of transaction costs for financial instruments is an acceptable trade-off that arises from the different measurement requirements and is similar to other classification differences that result from differences in measurement requirements in IFRS Accounting Standards.

41. For most entities transaction costs such as management fees are likely to be immaterial. As explained in Agenda Paper 21B of May 2021 the staff think the investing category is likely to be small for many companies considering investing is not the main purpose of an entity's business and experience from the fieldwork was that income and expense from investments was a small percentage of both revenue and profit. Transaction costs such as management fees are typically a small percentage of this already small population. Incremental expenses will be most important for those entities with investing as a main business activity. However, for these entities, income and expenses from investing and incremental expenses will always be included in the operating category. Hence, the staff do not think that excluding such costs from the investing category would reduce the usefulness of subtotals in the statement of profit or loss.

Incremental expenses in the financing category

42. The staff disagree with those stakeholders that suggested including incremental expenses in the financing category (see paragraph 14) because of the same risk of inconsistent classification of income and expenses between categories identified for the investing category (see paragraph 20). For example, judgements may be required to identify incremental expenses related to the carrying of liabilities, such as annual

fees to providers of finance (some of which may be integrated with other services such as payment processing or supply finance arrangements) and treasury function expenses that would otherwise be classified in the operating category.

43. The staff also think that if the IASB were to include incremental expenses in the financing category, the IASB would need to consider whether to require an entity to include incremental income in the financing category, such as interest revenue when an entity draws down a loan for a project before the project begins. Based on the IASB's tentative decisions in the redeliberations to date, such income would be classified in the investing category. Classifying it as incremental income in the financing category would be inconsistent with the IASB's tentative decision to change the category for classifying income and expenses from cash and cash equivalents from the financing category to the investing category (see Agenda Paper 21B of the May 2021 IASB meeting).

44. As with the investing category the scope of incremental expenses in the financing category could be clarified with specific guidance. However, for similar reasons to the investing category the staff think it may be challenging to specify expenses related to liabilities with income and expenses classified in the financing category that should be included as incremental expenses in the financing category.

45. The staff acknowledge the merit of having a similar approach to both the investing and financing categories. However, the staff think this would be better achieved by removing incremental expenses from the investing category rather than adding them to the financing category. Therefore, the staff do not recommend the IASB require an entity to classify incremental expenses in the financing category.

Staff recommendation and questions for the IASB

46. The staff think withdrawing the proposal to classify incremental expenses in the investing category will resolve the potential for diversity in classification of income and expenses between categories with a better balance of costs and benefits than clarifying the scope of incremental expenses to be included in the investing category. Withdrawing the proposal will simplify the classification of income and expenses, including resolving application question for associates and joint ventures, and align

the approach to classification of income and expenses between the investing and financing categories.

47. The staff acknowledge that some stakeholders supported including incremental expenses in the investing category. In some cases, this may seem like an appropriate classification. However, based on the feedback from other stakeholders there is a risk of inconsistent, and in some cases inappropriate, classification of income and expenses that may reduce the comparability of operating profit and the investing and financing categories. The staff also think that that in many cases incremental expenses will not be material.

48. Based on the analysis above, the staff recommend the IASB withdraw the requirement proposed in the Exposure Draft for an entity to classify incremental expenses in the investing category. The staff also do not recommend the IASB require an entity to classify incremental expenses in the financing category.

Questions for the IASB
Q1 Does the IASB agree with the staff recommendation to withdraw the proposed requirement in the Exposure Draft for an entity to classify incremental expenses in the investing category? Q2 Does the IASB agree with the staff recommendation not to require an entity to classify incremental expenses in the financing category?

Appendix—definition of transactions costs

A1. The definition of transaction costs in IFRS 9 Appendix A Defined Terms is:

> Incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or financial liability (see paragraph B5.4.8). An incremental cost is one that would not have been incurred if the entity had not acquired, issued or disposed of the financial instrument.

A2. The application guidance included in paragraph B5.4.8 further explains that:

> Transaction costs include fees and commissions paid to agents (including employees acting as selling agents), advisers, brokers and dealers, levies by regulatory agencies and security exchanges, and transfer taxes and duties. Transaction costs do not include debt premiums or discounts, financing costs or internal administrative or holding costs.