IFRS Accounting

Staff paper

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Topic	**Issues related to the proposals for entities with specified main business activities**
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Objective

1. This paper discusses the issues related to the proposals for entities with specified main business activities[1] in the Exposure Draft *General Presentation and Disclosures*. This paper is the sixth in a series of papers[2] on entities with specified main business activities. The issues discussed are:

[1] Entities that invest as a main business activity in assets that generate a return individually and largely independently of the other resources held by the entity (referred to as 'entities that invest as a main business activity') 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). The second paper was an educational paper that discussed 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 (see Agenda Paper 21D of the May 2022 IASB meeting). The third and fourth papers discussed aspects of the proposals for entities with specified main business activities that are related to investing and financing categories (see Agenda Paper 21A and Agenda Paper 21B of the July 2022 IASB meeting). The fifth paper was a decision-making paper that discussed 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 in the investing category (see Agenda Paper 21B of the September 2022 IASB meeting).

(a) the accounting policy choice for the classification of income and expenses arising from cash and cash equivalents for entities that provide financing to customers as a main business activity; and

(b) feedback for which the staff conclude no further action is required—classification of interest expense on lease liabilities for entities that sublease assets as an intermediate lessor (see paragraphs 29–41) and other feedback discussed in Appendix C on classification of income and expenses on liabilities arising from:

(i) investment contracts with participation features (in the scope of IFRS 9 *Financial Instruments*) or insurance contracts (in the scope of IFRS 17 *Insurance Contracts*), when neither are issued as part of an entity's main business activity; and

(ii) obtaining finance from customers as part of a main business activity.

2. In a future paper we plan to discuss the proposal in paragraph 64 of the Exposure Draft related to circumstances in which an entity would not present the subtotal 'profit or loss before financing and income tax'.

Summary of the staff recommendations in this paper

3. We recommend that the IASB:

(a) confirm the accounting policy choice proposed in paragraph 51 of the Exposure Draft for the classification of income and expenses arising from cash and cash equivalents for entities that provide financing to customers as a main business activity; and

(b) clarify that the requirement in paragraph 52(a) of the Exposure Draft for an entity that invests in financial assets as a main business activity *would apply regardless of whether the entity has any other specified main business activity*.

Structure of the paper

4. This paper is structured as follows:

   (a) Accounting policy choice for the classification of income and expenses arising from cash and cash equivalents (paragraphs 5–27);

   (b) Feedback for which the staff conclude no further action is required (paragraphs 28–42);

   (c) Appendix A—The classification of income and expenses arising from cash and cash equivalents: a decision tree;

   (d) Appendix B—Analysis of entities that sublease assets as an intermediate lessor; and

   (e) Appendix C—Other feedback for which the staff conclude no further action is required.

Accounting policy choice for the classification of income and expenses arising from cash and cash equivalents

Background

Proposals in the Exposure Draft

5. Paragraph 51 of the Exposure Draft proposed that:

> If an entity provides financing to customers as a main business activity, it shall make an accounting policy choice to not classify in the financing category[3] either (see paragraphs B28–B29):

[3] Paragraph 49 of the Exposure Draft proposed that income and expenses from cash and cash equivalents would be classified in the financing category.

(a) income and expenses from financing activities[4], and from cash and cash equivalents, that relate to the provision of financing to customers; or

(b) all income and expenses from financing activities and all income and expenses from cash and cash equivalents.

Such income and expenses are instead classified in the operating category.

6. Paragraph 52(a) of the Exposure Draft proposed that if an entity invests in financial assets that generate a return individually and largely independently of other resources held by the entity in the course of its main business activities[5] (referred to as 'entities that invest in financial assets as a main business activity'), it shall classify income and expenses from cash and cash equivalents in the operating category.

Summary of related tentative IASB decisions from its redeliberations to date

7. In May 2021 (see Agenda Paper 21B), the IASB tentatively decided to classify income and expenses arising from cash and cash equivalents in the investing category instead of the financing category.

8. In July 2022 (see Agenda Paper 21B), the IASB tentatively decided to confirm the proposed requirement for an entity that invests in financial assets in the course of[6] main business activities to classify income and expenses arising from cash and cash equivalents in the operating category.

9. In July 2022 (see Agenda Paper 21B), the IASB tentatively decided to explore withdrawing the accounting policy choice proposed in paragraph 51 of the Exposure Draft for the classification of income and expenses arising from cash and cash

[4] In July 2022, the IASB tentatively decided to replace 'financing activities' with 'liabilities that arise from transactions that involve only the raising of financing' (see Agenda Paper 21B).

[5 & 6] The IASB has tentatively decided to change the wording to 'invest in financial assets as a main business activity' (see Agenda Paper 21A of the July 2022 IASB meeting).

equivalents for entities that provide financing to customers as a main business activity.

10. The reasons for exploring whether to withdraw this proposal were to reduce the complexity of the proposals and because we expect that many entities that provide financing to customers as a main business activity also invest in financial assets as a main business activity. For such entities, the requirement to classify all income and expenses from cash and cash equivalents in the operating category as per paragraph 52(a) of the Exposure Draft would be triggered by their investment in financial assets, and no requirement in relation to providing financing to customers as a main business activity would be needed.

11. During the discussions at the July 2022 meeting, an IASB member suggested that if the proposal could not be withdrawn, the IASB should consider whether the requirement for entities that invest in financial assets as a main business activity in paragraph 52(a) of the Exposure Draft should take precedence.

12. That is to say, the accounting policy choice for income and expenses arising from cash and cash equivalents in paragraph 51 of the Exposure Draft would only be applied by entities that provide financing to customers as a main business activity, but do not invest in financial assets as a main business activity.

Feedback from targeted outreach[7]

13. Some participants of the targeted outreach were aware of entities that provide financing to customers as a main business activity but do not invest in financial assets as a main business activity. Some of these participants raised concerns in regard to the withdrawal of the accounting policy choice for classifying income and expenses arising from cash and cash equivalents because, in their view, it was important that entities that provide financing to customers were able to include income and expenses

[7] A summary of the feedback is included in paragraphs 23-26 of Agenda Paper 21A of the January 2023 IASB meeting.

arising from cash and cash equivalents in the operating category even if they do not invest in financial assets.

14. One participant also said, in their view, retaining the accounting policy choice proposed in paragraph 51 of the Exposure Draft for classifying income and expenses arising from cash and cash equivalents for entities that provide financing to customers as a main business activity better reflects the economic reality of how cash is used in their business.

15. Participants identified certain types of entities with main business activities that would fall under the category of providing financing to customers without investing in financial assets, for example entities that:

    (a) are structured to finance customer purchases;

    (b) provide micro-financing;

    (c) provide payday loans;

    (d) provide financing to customers as one of multiple main business activities (e.g. the automotive industry); and

    (e) are smaller or specialised financial institutions.

16. A few financial institutions said that, in their view, the accounting policy choice for the classification of income and expenses arising from cash and cash equivalents should be retained because they did not view their business as comprising two separate business activities of investing and financing and would find the distinction between the two artificial. However, these participants said that they did invest in financial assets as a part of their main business activities.

17. A few participants agreed with removing the accounting policy choice for the classification of income and expenses arising from cash and cash equivalents because they thought it would reduce diversity in practice.

Staff analysis, recommendations and the question for the IASB

18. We recommend the IASB retain the accounting policy choice for the classification of income and expenses arising from cash and cash equivalents for entities that provide financing to customers as a main business activity as proposed in paragraph 51 of the Exposure Draft. As discussed by the IASB in July 2022 (see paragraphs 11–12 of this paper), we also recommend that the IASB clarify that for an entity that invests in financial assets as a main business activity it applies the requirement in paragraph 52(a) of the Exposure Draft regardless of whether it has any other specified main business activities.

Reasons for retaining the accounting policy choice

19. We recommend the IASB retain the accounting policy choice for the classification of income and expenses arising from cash and cash equivalents for entities that provide financing to customers as a main business activity proposed in paragraph 51 of the Exposure Draft because if it were to be withdrawn some entities that provide financing to customers as a main business activity would be impacted as indicated by some targeted outreach participants (see paragraphs 13–15).

20. Entities that provide financing to customers as a main business activity would generally report their income and expenses arising from cash and cash equivalents as part of their net interest income, a subtotal similar to gross profit[8], that is a key operating performance metric of the entity. If the IASB were to withdraw the accounting policy choice proposed in paragraph 51 of the Exposure Draft for the classification of income and expenses arising from cash and cash equivalents for entities that provide financing to customers as a main business activity, some entities (such as those listed in paragraph 15 of this paper) would not be able to present ‘net interest income’ within the operating category.

[8] 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).

21. In July 2022 (see Agenda Paper 21B), in response to comment letter feedback, the IASB discussed whether the requirement in paragraph 51 of the Exposure Draft should be formulated as an accounting policy choice. This paper analysed the alternative approaches suggested by stakeholders and concluded that they were not viable alternatives.

22. The feedback received in targeted outreach did not provide any new information that indicates that the IASB should consider a different approach and the participants that commented supported the requirement being retained as an accounting policy choice. Therefore, we recommend that the IASB confirm the accounting policy choice proposed in paragraph 51 of the Exposure Draft for the classification of income and expenses arising from cash and cash equivalents for entities that provide financing to customers as a main business activity.

Clarification of the interaction between the requirements

23. Given that the IASB has tentatively decided to require entities that invest in financial assets as a main business activity to classify income and expenses from cash and cash equivalents in the operating category (see paragraph 8 of this paper) and some of these entities also provide financing to customers as a main business activity, we recommend the IASB clarify the interaction between:

    (a) the proposed requirement in paragraph 52(a) of the Exposure Draft for classifying income and expenses arising from cash and cash equivalents for entities that invest in financial assets as a main business activity; and

    (b) the accounting policy choice proposed in paragraph 51 of the Exposure Draft for classifying income and expenses arising from cash and cash equivalents for entities that provide financing to customers as a main business activity.

24. This clarification is required because an inconsistent outcome would arise if an entity:

(a) invests in financial assets as a main business activity and is required to classify *all* income and expenses arising from cash and cash equivalents in the operating category; and

(b) provides financing to customers as a main business activity and elects the proposed accounting policy in paragraph 51(a) of the Exposure Draft to only classify the portion of cash and cash equivalents related to providing financing to customers in the operating category.

25. We do not expect such an entity to select the accounting policy proposed in paragraph 51(a) of the Exposure Draft, and therefore propose not to develop additional requirements to address the potential outcome of such an election, for example requiring an entity to identify income and expenses arising from cash and cash equivalents that would not relate to provision of financing to customers and investment in financial assets—such a requirement would be burdensome and would not necessarily provide the users of the financial statements with more useful information.

26. Therefore, to address the current contradiction in the proposed requirements, the staff recommend that the IASB clarifies that paragraph 52(a) of the Exposure Draft is applied by entities that invest in financial assets as a main business activity *regardless of whether the entity has any other specified main business activities* as suggested by an IASB member during the IASB's redeliberations in July 2022 (see paragraph 11).

27. As illustrated in the decision tree in Appendix A, applying the IASB's tentative decisions and the staff recommendations in paragraphs 19 and 26, an entity shall classify income and expenses arising from cash and cash equivalents as follows:

(a) if an entity does not invest in financial assets or provide financing to customers as a main business activity (i.e., an entity that does not have any specified main business activities or an entity with a single specified main business activity of investing in non-financial assets), it shall classify all income and expenses arising from cash and cash equivalents in the investing category;

(b) if an entity invests in financial assets as a main business activity, it shall classify all income and expenses arising from cash and cash equivalents in the operating category *regardless of whether it has any other specified main business activity*; and

(c) if an entity provides financing to customers as a main business activity but does not invest in financial assets as a main business activity, it shall make an accounting policy choice to classify either all income and expenses arising from cash and cash equivalents or the portion related to providing finance to customers in the operating category.

Question for the IASB

1. Does the IASB agree with the staff recommendation to:
   a) confirm the accounting policy choice proposed in paragraph 51 of the Exposure Draft for the classification of income and expenses arising from cash and cash equivalents for entities that provide financing to customers as a main business activity; and
   b) clarify that the requirement in paragraph 52(a) of the Exposure Draft for an entity that invests in financial assets as a main business activity *would apply regardless of whether the entity has any other specified main business activity*?

Feedback for which the staff conclude no further action is required

28. In this section of the paper, we discuss:

(a) background on the feedback received on subleases (paragraphs 29–36);

(b) staff analysis, recommendations and the question for the IASB related to the feedback received on subleases and the other feedback in Appendix C for which the staff conclude no further action is required (paragraphs 37–42).

Background on the feedback received on subleases

Proposal in the Exposure Draft

29. Paragraph 49 of the Exposure Draft proposed that the financing category would include income and expenses on liabilities arising from financing activities and interest income and expenses on other liabilities. Paragraph 51 of the Exposure Draft proposed an accounting policy choice for entities that provide financing to customers as a main business activity to classify in the operating category either: (i) all income and expenses from financing activities; or (ii) the portion related to providing financing to customers (see paragraph 5 of this paper).

30. The Exposure Draft proposed that the accounting policy choice proposed in paragraph 51 would not be applied to interest income and expenses on other liabilities and that all entities would classify it in the financing category (see paragraph 49(c) of the Exposure Draft).

Summary of related tentative IASB decisions from its redeliberations to date

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

    (a) require an entity to classify in the financing category:

        (i) all income and expenses from liabilities that arise from transactions that involve only the raising of financing; and

        (ii) specified income and expenses from other liabilities;

    (b) define a transaction that involves only the raising of finance as a transaction that involves:

        (i) the receipt by the entity of cash, an entity's own equity instruments or a reduction in a financial liability; and

        (ii) the return by the entity of cash or an entity's own equity instruments; and

(c) require an entity to classify in the financing category interest expense and the effect of changes in interest rates on other liabilities (liabilities that arise from transactions that do not involve only the raising of finance) when such amounts are identified applying the requirements of IFRS Accounting Standards.

32. The change in approach to classifying income and expenses within the financing category tentatively agreed by the IASB as outlined in paragraph 31 of this paper is intended to make the proposals in the Exposure Draft easier to apply. The only change in outcome from the Exposure Draft is that interest expenses on lease liabilities and amounts payable for goods and services received were captured by 'income and expenses on liabilities arising from financing activities' in the Exposure Draft (paragraph 49(b) of the Exposure Draft) but are now captured by 'specified income and expenses from other liabilities' (paragraph 49(c) of the Exposure Draft).

33. In July 2022 (see Agenda Paper 21B), the IASB confirmed that the proposed accounting policy choice for entities that provide financing to customers as a main business activity in paragraph 51 of the Exposure Draft is not applied to specified income and expenses from other liabilities.

Impact of the IASB's tentative decisions on intermediate lessors

34. Applying the proposals in the Exposure Draft, an intermediate lessor would have been able to apply the accounting policy choice in paragraph 51 of the Exposure Draft to interest expense on lease liabilities and classify it in the operating category if providing financing to customers is a main business activity.

35. As a result of the IASB's tentative decisions, interest expense on lease liabilities is no longer subject to the accounting policy choice in paragraph 51 of the Exposure Draft and is classified in the financing category by all entities. Therefore, intermediate lessors will no longer be able to classify interest expenses on lease liabilities in the operating category.

Feedback from targeted outreach

36. The IASB tested the changes to classification of interest expense on lease liabilities in targeted outreach (see Agenda Paper 21A of the January 2023 IASB meeting). A few targeted outreach participants said that some entities sublease assets as an intermediate lessor and questioned whether interest expense on lease liabilities should be included in the operating category by these entities. In particular, when the sublease is a finance lease and the difference between the finance income on the sublease receivable and the interest expense on the head lease liability is a key operating performance indicator for the intermediate lessor.

Staff analysis, recommendations and the question for the IASB

Staff analysis of subleases

37. Analysis of the financial statements of 80 entities (see Appendix B of this paper) and additional outreach did not indicate that the IASB should change its tentative decision for classifying interest expense on lease liabilities and require an entity that subleases assets as an intermediate lessor to classify it in the operating category rather than the financing category.

38. Of the 80 entities we analysed in Appendix B of this paper, only 29 entities reported finance subleasing in their financial statements. Of these 29 entities, 21 entities presented an operating profit subtotal and eight did not.

39. Of the 21 entities that presented an operating profit subtotal:

    (a) one entity included the finance income on the finance sublease receivable and interest expense on the head lease liability in an operating profit subtotal;

    (b) 16 entities classified the finance income on the finance sublease receivable in a line item called ‘finance income’ and the interest expense on the head lease liability in ‘finance cost’ presented after an operating profit subtotal;

(c) three entities classified the finance income on the finance sublease receivable and the interest expense on the head lease liability net in ‘finance cost’ presented after an operating profit subtotal; and

(d) one entity classified the interest expense on the head lease liability in ‘finance cost’ after an operating profit subtotal, however, it was unclear which line item contained the finance income from the finance sublease receivable.

40. Of the eight entities that did not present an operating profit subtotal, all entities presented interest expense on the head lease liability in ‘finance cost’, but presentation of the finance income on the finance sublease receivable was mixed with two entities including it in ‘revenue’, three entities including it in ‘other income’, two presenting it net in ‘finance cost’ and it was unclear where it was included for the remaining entity.

41. Based on the analysis in Appendix B of this paper and additional outreach, we concluded that no exception is required for intermediate lessors to classify interest expense on lease liabilities in the operating category because:

(a) subleases are generally operating subleases rather than finance subleases;

(b) subleasing is not likely to be a main business activity for the entities analysed with finance subleases because:

(i) generally, a secondary asset, such as idle office space, is finance subleased;

(ii) the difference between the finance income on the finance sublease receivable and the interest expenses on the head lease liability does not appear to be a key operating performance metric of these entities included in operating profit; and

(c) the issue raised in targeted outreach is not likely to be prevalent in practice.

Other feedback for which the staff conclude no further action is required

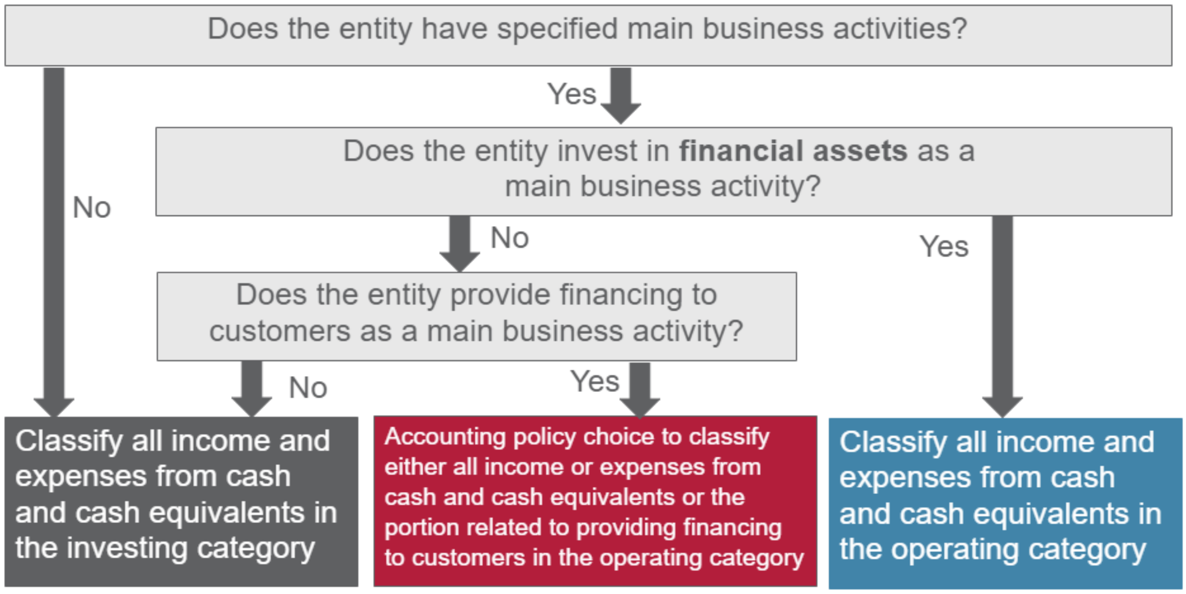
42. Appendix C of this paper contains two issues for which the staff conclude no further action is required because:

    (a) the feedback received can be addressed by changing the wording in the Basis for Conclusions to align with the IASB's intentions without changing the proposal in the Exposure Draft; or

    (b) changes are not required to the proposals as the issue is not likely to be pervasive.

Question for the IASB
2. Does the IASB have any comments on the staff's conclusion on subleases in paragraph 41 and the topics in Appendix C of this paper?

Appendix A—The classification of income and expenses arising from cash and cash equivalents: a decision tree



Appendix B—Analysis of entities that sublease assets as an intermediate lessor

B1. In order to determine a population of entities with subleases that are likely to be impacted by the proposal to classify interest expense on lease liabilities in the financing category, the staff extracted the latest annual figures[9] from S&P CapitalIQ for 36,943 entities applying IFRS Accounting Standards with industry and region classifications. From the extracted data[10], we identified 80 entities that reported subleasing in their financial statements.

B2. The industries covered were asset management (2), banking (2), capital market (2), consultancy (4), energy (4), entertainment (4), hospitality (2), industrial (27), insurance (1), investment banking (3), mining (1), pharma (2), real estate (3), shipping (1), telecommunication and information technology (7), and utilities (17). The regions covered were Europe (37), Asia-Oceania (33), Americas (8), and Africa and Middle East (2).

B3. We manually analysed the financial statements of these 80 entities and noted that:

(c) 51 entities reported only operating subleasing transactions;

(d) 11 entities reported only finance subleasing transactions; and

(e) the remaining 18 entities reported both operating subleasing and finance subleasing transactions.

B4. We further analysed the financial statements of the 29 entities with finance subleases to understand the classification of interest income on the sublease receivable and interest expense on head lease liability arising from finance subleasing transactions. The results of this analysis are included in the following table.

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[9] The figures extracted were for the following line items in the Capital IQ standard template: 'Supplementary items', 'Sub-lease income +1', 'Sub-lease income +2', 'Sub-lease income +3', 'Sub-lease income +4', 'Sub-lease income+5', 'Sub-lease income next 5 yrs.'.

[10] The number of entities considered to have sub-leasing income in the extracted data have disclosed either (i) 'operating sublease,' (ii) 'finance sublease' or (iii) both (i) and (ii). The data was extracted on 10 January 2023.

Presentation of finance income on the sublease and interest expense on the head lease in the statement of profit or loss	Entities that present an operating profit subtotal	Entities that did not present an operating profit subtotal	Total number
Finance income and interest expense included in an operating profit subtotal	1	-	1
Finance income included in revenue and interest expense included in finance cost below a total revenue subtotal	-	2	2
Finance income and interest expense included in a net interest expense line item and outside of operating profit when presenting operating profit subtotal	3	2	5
Finance income included in a line item called finance income and interest expense included finance cost after an operating profit subtotal	16	-	16
Classification of finance income is unclear but interest expense is included in finance cost and outside of operating profit when presenting operating profit subtotal	1	1	2
Finance income included in other income and interest expense included in finance cost are presented before a subtotal of profit from continuing operations before tax	-	1	1
Finance income included in other income and interest expense classified in finance cost before net profit subtotal.	-	2	2
Total	**21**	**8**	**29**

Appendix C—Other feedback for which the staff conclude no further action is required

C1. The following table outlines the feedback for which the staff conclude no further action is required (see paragraph 1(b) of this paper).

	Issue	Why no further action is required
Classification of income and expenses on liabilities arising from issued investment contracts with participation features (in the scope of IFRS 9) or insurance contracts when neither are issued as part of an entity's main business activity	Although most respondents to the Exposure Draft agreed with the IASB's proposals in paragraph 52(b) and (c), a few respondents suggested that the IASB should clarify whether: - income and expenses on liabilities arising from issued investment contracts with participation features recognised applying IFRS 9; and - insurance finance income and expenses included in profit or loss applying IFRS 17 should be classified in the operating category even when issuing investment contracts with participation features or insurance contracts is not an entity's main business activity (see paragraph 36 of Agenda Paper 21C of the December 2020 IASB meeting).	Application of paragraphs 52(b) and 52(c) of the Exposure Draft is not limited to entities with specified main business activities. However, the staff acknowledge that the IASB's intentions may not be clear because paragraphs BC73-BC76 of the Exposure Draft explain that classifying the income and expenses arising from issued investment contracts with participation features or insurance contracts in the operating category would provide useful information for entities that are issuing such contracts as a main business activity. The staff expect that most entities that issue such contracts will issue them as a main business activity. However, in response to the request for clarification, we recommend the IASB revise the wording in the Basis for Conclusions to clarify that it intends that the requirements in paragraphs 52(b) and 52(c) are not limited to entities with specified main business activities, but applicable to ***all*** entities issuing investment contracts with participation features or insurance contracts.
Classification of income and	During fieldwork for the proposals in the Exposure Draft (see Agenda Paper 21A of the December 2020 IASB	As mentioned in paragraph BC76 of the Exposure Draft and Agenda Paper 21B of the April 2019 IASB meeting, the IASB considered an

expenses arising from obtaining finance from customers as part of a main business activity	meeting) one participant noted that they obtained financing from customers by holding customer deposits but did not provide financing to customers (see Agenda Paper 21C of the December 2020 IASB meeting). This fieldwork participant said that the expenses on its customer deposits are part of its main business activities and classifying them in the operating category would provide better information to the users of its financial statements. However, given the participant does not provide financing to customers, the proposed requirements in the Exposure Draft would not permit classifying the income and expenses arising from obtaining finance in the operating category.	alternative approach of classifying all income and expenses related to financing from customers in the operating category. Although such an approach would be preferable for this specific fieldwork participant, the IASB concluded in paragraph BC76 that such an approach would likely have too broad an effect in that it would also apply to entities for whom such an outcome would not provide useful information—for example for construction companies recognising interest expense on customer prepayments. Comment letter feedback and the other fieldwork results did not indicate that the issue raised would be widespread. In addition, we examined the financial statements of this fieldwork participant for the reporting period ending 31 December 2021 and noted that the amount of interest expense from customer deposits held represented 0.02% of the entity's net revenue from the related business activities. Given that it is difficult to develop a principle-based exception and that the amount of interest expense arising from customer deposits held appears to be relatively insignificant to this fieldwork participant, we do not consider it necessary to provide a further exception for entities that obtain financing from customers but do not provide financing to customers.