STAFF PAPER

September 2018

IASB® Meeting

Project	**Primary Financial Statements**		
Paper topic	Scope of proposals for subtotals in the statement of profit or loss		
CONTACT(S)	Aida Vatrenjak	avatrenjak@ifrs.org	+44 (0)20 7246 6956
	Karlien Conings	kconings@ifrs.org	+44 (0)20 7246 6913

Purpose of this paper

1. This Agenda Paper discusses:
   (a) the scope of the Board's proposal for a subtotal of profit before finance income/expenses and income tax (EBIT);
   (b) the scope of the Board's proposal for a subtotal of profit before income/expenses from investments, finance income/expenses and income tax;
   (c) the implications of proposals in the paper for the presentation of:
      (i) the share of profit or loss from investments in associates and joint ventures; and
      (ii) subtotals for entities with diverse operations.
2. The objective of this paper is to consider the subtotals that the Board has tentatively decided to require for non-financial entities (see paragraph 1(a) and 1(b)) and to define the scope of these subtotals in a way that ensures they are only required when they result in useful information.
3. This agenda paper should be read in conjunction with the slides presented in Agenda Paper 21B, which includes illustrations of the likely effect of our tentative decisions as well as the effect of staff proposals in this paper on the subtotals presented.

Summary of staff recommendations

4. The staff recommends that:

   (a) entities are not required to present a subtotal of profit before finance income/expenses and income tax if their only main business activity is to provide financing to customers and they separately present financing income. Entities that do not present a subtotal of profit before finance income/expenses and income tax shall include, within the subtotal of business profit from consolidated entities:

      (i) interest income on cash and cash equivalents using the effective interest method;

      (ii) other income from cash and cash equivalents and financing activities; and

      (iii) expenses from financing activities.

   (b) entities that incur insurance finance expense should include it in the business profit subtotal;

   (c) entities are not required to present a subtotal of profit before income/expenses from investments, finance income/expenses and income tax if, in the course of their only main business activity, they invest in assets that generate a return individually and largely independently from other resources held by the entity. Entities that do not present a subtotal of profit before income/expenses from investments, finance income/expenses and income tax shall include income/expenses from investments made in the course of their main business activity within the subtotal of business profit from consolidated entities.

   (d) entities that have more than one main business activity and those activities include both investing and financing activities are:

      (i) not required to present a subtotal of profit before finance income/expenses and income tax and shall include, within the subtotal of business profit from consolidated entities:

         1. interest income on cash and cash equivalents using the effective interest method;

2. other income from cash and cash equivalents and financing activities; and

3. expenses from financing activities.

(ii) not required to present a subtotal of profit before income/expenses from investments, finance income/expenses and income tax and shall include income/expenses from investments made in the course of their investing business activity within the subtotal of business profit from consolidated entities.

(e) entities that have more than one main business activity and those activities include financing or investing activities are not exempt from the requirement to present subtotals. Such entities are permitted to move some income and/or expenses to business profit from consolidated entities as follows

(i) if those entities that have more than one main business activity provide finance to customers as one of their main activities, they are permitted to include, in the business profit from consolidated entities:

1. interest income on cash and cash equivalents using the effective interest method;

2. other income from cash and cash equivalents and financing activities; and

3. expenses from financing activities

that relate to the provision of financing to customers.

(ii) if those entities that have more than one main business activity invest in assets that generate a return individually and largely independently from other resources held by the entity in the course of one of their main activities, they are permitted to include, in the business profit from consolidated entities income/expenses from investments made in the course of investing business activity.

(f) all entities are required to separately present the share of profit or loss from integral and non-integral associates and joint ventures, after business profit from consolidated entities.

What effect would the staff proposals have on the presentation of the statement of profit or loss for common types of financial entities?

5. Agenda Paper 21B includes illustrations of the presentation of the statement of profit or loss for the following types of entities:
   (a) investment property companies;
   (b) insurers;
   (c) traditional banks (ie banks that have no material investing activities);
   (d) entities whose main business activities include both investing **and** financing activities:
      (i) banks with significant investing activities;
      (ii) bank-insurers;
   (e) entities that have more than one main business activity including investing **or** financing—manufacturers that provide financing to customers.
6. For the entities in paragraph 5(a)–5(c), the slides in Agenda Paper 21B show an illustration of:
   (a) current reporting practice.
   (b) what the statement of profit or loss would look like if the Board's tentative decisions for non-financial entities were applied to such entities without any adjustment. This leads to outcomes that do not provide useful information in our view.
   (c) what the statement of profit or loss would look like applying the staff proposals in this agenda paper.
7. For entities in paragraph 5(d)–5(e), we have only prepared an illustration of what the statement of profit or loss would look like applying the staff proposals in this agenda paper.
8. Throughout this Agenda Paper, we have included footnotes with references to relevant slides in Agenda Paper 21B.

Overview

9. This paper is structured as follows:

   (a) Background

      (i) Previous Board discussion on financial entities (paragraphs 10-12)

      (ii) Staff approach to addressing the issues in this paper (paragraph 13)

   (b) Profit before finance income/expenses and income tax (EBIT)

      (i) The Board's objective and tentative decisions for non-financial entities (paragraphs 14–16)

      (ii) What is the problem? (paragraphs 17–16)

      (iii) How can we ensure the EBIT subtotal is only required when it provides useful information? (paragraphs 21–40)

         1. Exemption from the requirement to present an EBIT subtotal (paragraphs 22–34)

         2. Alternative requirement for entities not required to present EBIT (paragraphs 35–40)

   (c) Profit before investing, financing and income tax

      (i) The Board's objective and tentative decisions for non-financial entities (paragraphs 41–42)

      (ii) What is the problem? (paragraphs 43–46)

      (iii) How can we ensure the subtotal is only required when it provides useful information (paragraphs 47– 57)?

         1. Exemption from the requirement to present profit before investing, financing and income tax (paragraphs 48–52)

         2. Alternative requirement for entities not required to present a subtotal of profit before investing, financing and tax (paragraphs 53-57)

   (d) What are the implications of the proposals in this paper for entities that have more than one main business activity? (paragraphs 58–68)

(e) What are the implications of the proposals in this paper for the presentation of any share of profit or loss from investments in associates and joint ventures? (paragraphs 69–72)

(f) What are the next steps in addressing financial entities in the project? (paragraphs 67– 75)

Background

Previous Board discussion on financial entities

10. At its June 2018 meeting the Board discussed the application of the Board’s tentative decisions to financial entities, specifically:

    (a) an analysis of the project areas in which the tentative Board decisions could apply with little or no change to financial entities, including decisions about:

        (i) management performance measures;

        (ii) aggregation and disaggregation; and

        (iii) other comprehensive income.

    (b) an analysis of project areas in which the Board would need to adjust the tentative decisions to apply them to financial entities, including decisions about:

        (i) profit before finance income/expenses and income tax;

        (ii) income and expenses from investments; and

        (iii) the statement of cash flows.

    (c) a summary of research on reporting practices for a sample of financial entities.

11. The Board was not asked to make any decisions. The Board has asked the staff to bring an analysis of how to address project areas where the proposals need to be adjusted for financial entities, starting with the scope of proposals for subtotals in the statement(s) of financial performance.

12. The Board made the following observations:

(a) we should focus on differences in the nature of earnings, rather than industries;

(b) we need to acknowledge there are fundamental differences in the nature of the earnings of the financial and non-financial sectors;

(c) it is hard to see how subtotals as defined for general corporates could work for banks, except perhaps for the business profit subtotal;

(d) real estate companies could be considered separately from financial entities as the nature of their earnings is different;

(e) a better understanding of the relative sizes of different sectors would be helpful, in particular financials and conglomerates[1];

(f) although IAS 30 *Disclosures in the Financial Statements of Banks and Similar Financial Institutions* has been superseded, many banks still follow the presentation requirements of that Standard;

(g) more disaggregation would be helpful, particularly if some entities are not required to present the proposed subtotals; and

(h) there are two main approaches to consider: (i) scope out financial entities from the requirements to present subtotals, or (ii) keep the principle of subtotals but add additional criteria for financial entities.

Staff approach to addressing the issues in this paper

13. The staff's objective in this paper is to consider the subtotals that the Board has tentatively decided to require for non-financial entities and to define the scope of these subtotals (ie which entities are required to provide them) in a way that ensures that they are only required when they result in useful information. We have approached this by considering how to ensure that revenue and expenses that form a part of the key performance measures for financial entities are included within business profit from consolidated entities. Whilst this approach seeks to ensure that the proposed subtotals are only presented when they provide useful information, it does not seek to require new subtotals or disaggregated line items that might provide

[1] The staff are analysing this issue and are planning to share their findings at a future Board meeting.

additional useful information for financial entities. The staff currently do not plan to ask the Board to consider requiring new subtotals for financial entities however we plan to address further disaggregation in a future board meeting.

Profit before finance income/expenses and income tax (EBIT)

The Board's objective and tentative decisions for non-financial entities

14. In response to requests from users for more comparable subtotals in the statement(s) of financial performance, the Board tentatively decided to require non-financial entities to present an EBIT subtotal in the statement(s) of financial performance. The Board chose the EBIT subtotal because:

    (a) it is commonly used by users of financial statements to analyse the financial performance of a non-financial entity independently from how the entity is financed; and

    (b) the Board considered EBIT would be easier to define than operating profit and users told us that it is unnecessary to define both operating profit and EBIT.

15. EBIT is defined as profit before finance income/expense and income tax. In order to maximise the comparability of the EBIT subtotal across non-financial entities, the Board tentatively specified the line items that comprise finance income or expenses as follows[2]:

    (a) interest income from cash and cash equivalents calculated using the effective interest method;

    (b) other income from cash, cash equivalents and financing activities;

    (c) expenses from financing activities;

    (d) other finance income (for example, unwinding of a discount on a defined benefit asset); and

[2] The appendix to Agenda Paper 21B illustrates the presentation of an EBIT subtotal and the specified line items for finance income and expenses for a non-financial entity.

(e) other finance expenses (ie unwinding of a discount on liabilities not arising from financing activities).

16. The Board tentatively decided to describe 'financing activities' as involving:

(a) the receipt or use of a resource from a provider of finance (or provision of credit).

(b) the expectation that the resource will be returned to the provider of finance.

(c) the expectation that the provider of finance will be appropriately compensated through the payment of a finance charge. The finance charge is dependent on both the amount of the credit and its duration.

What is the problem?

17. For some entities, requiring the presentation of an EBIT subtotal is unlikely to provide useful information, because presenting an EBIT subtotal would result in income and expenses arising from an entity's main business activities being presented below the business profit subtotal.

18. For example, in the banking business, interest expenses typically arise from the main business activities; interest expense for a bank is similar to inventory expenses for a manufacturing entity. The margin between interest revenue earned from customers and interest expenses incurred to obtain financing is a key measure of their performance[3]. Banks would be unable to present this margin as a subtotal if they were required to present an EBIT subtotal and the items the Board has tentatively defined as 'I' below it[4].

19. Although the amount that represents what is effectively business profit (business profit from consolidated entities subtotal) has been determined indirectly (ie by defining investing and financing), we do not think it is the Board's intention that this subtotal should exclude income and expenses arising from an entity's main business activities.

[3] See Agenda Paper 21B, slide 10.

[4] See Agenda Paper 21B, slide 11.

20. The Board proposed requiring EBIT for non-financial entities based on the understanding that it provided useful information for users of financial statements for such entities. However, our research indicates that this is not the case for financial entities. Therefore, we need to define the scope of the requirement to present an EBIT subtotal in a way that ensures EBIT is only required to be presented when it provides useful information.

How can we ensure the EBIT subtotal is required only when it provides useful information?

21. In order to ensure the EBIT subtotal is only required when useful, the staff believes that some entities need to be exempt from the requirement to provide an EBIT subtotal **and** be subject to alternative presentation requirements. We deal with the exemption and alternative presentation requirements separately below.

Exemption from the requirement to present an EBIT subtotal

22. The staff has identified three main approaches to exempt entities from the requirement to present an EBIT subtotal:
    (a) Approach A—let entities make their own assessment of whether an EBIT subtotal provides useful information, with possible accompanying disclosure requirements;
    (b) Approach B—define entities that are not required to present an EBIT subtotal using an industry definition; or
    (c) Approach C—describe entities that are not required to present an EBIT subtotal using a principle-based definition.

23. We examine each of the approaches below.

Approach A – exemption based on the entity's assessment of usefulness

24. In this approach, an entity would not be required to present an EBIT subtotal if it determines it would not provide useful information about its performance. The advantage of this approach is that an entity would be able to assess its individual circumstances and financing arrangements and determine what it thinks will be a useful presentation. However, the Board's key objective behind introducing the

subtotals is to improve comparability. If similar entities make different assessments as to whether to present EBIT there would be no improvement in comparability—instead comparability would be diminished. In the extreme, arguably, this would allow non-financial entities that disagree with presenting EBIT as defined by the Board to determine it is not useful.

25. To help make the outcome of entities' assessments comparable, guidance on how to make an assessment would be needed and accompanying disclosures may be required. The staff think that this approach would then be very similar to an approach which describes which entities would be exempt, using a principle (Approach C), but with a higher risk of lack of comparability. We have therefore concluded that the disadvantages of this approach outweigh its advantage and do not consider it further.

Approach B – exemption based on industry definition

26. In this approach, entities in defined industries would not be required to present an EBIT subtotal—for example the banking industry. Such an exemption based on industry definitions would provide clarity as to what types of entities are expected to present which subtotals and would achieve comparability within industries. The staff, however, thinks that the advantages of this approach do not outweigh its disadvantages, which include:

(a) we cannot use existing definitions of industries because there is not a single agreed definition for each industry, neither within IFRS Standards or externally; and

(b) developing our own definition is likely to be challenging—for example the Board explored and decided against creating a definition of an industry in a number of projects, most recently when considering deferring the effective date of IFRS 9 *Financial Instruments* for particular entities in the project that resulted in the issuance of Applying IFRS 9 *Financial Instruments* with IFRS 4 *Insurance Contracts* (in this project, the Board used qualifying criteria to capture the intended population).

27. The staff has therefore dismissed this approach and does not consider it further.

Approach C—Exemption based on a principle (staff's preferred approach)

28. In this approach, entities that are not required to present an EBIT subtotal are described using a principle. The staff thinks this principle needs to capture entities whose main and only business activity is to provide financing to its customers and who separately present financing income in the statement(s) of financial performance.

29. A key performance indicator for entities that provide financing to customers is the difference between their interest revenue and their interest expense (ie interest revenue and interest expense for such entities can be viewed as similar to inventory sales and inventory expense for a manufacturing entity). Having a business profit subtotal that excludes such income and expense would not result in useful information.

30. We acknowledge that some entities provide financing that is incidental to their main business activity (for example, an entity that has provided a one-off loan to facilitate business expansion). The staff thinks that that such entities should not be exempt from providing an EBIT subtotal as most of the financing expenses incurred by these entities are likely to relate to their main, non-financing, business activity. We could consider an approach that allows such entities to move the financing costs relating to their financing activity to the business profit section. However, the staff thinks the costs of such an approach, including the difficulty of allocating finance costs to different parts of the business, far exceed the benefits. Consequently, the staff proposes that only entities for whom the main and only business activity is to provide financing are exempt from the requirement to provide the subtotal.

31. Some entities provide financing to third parties other than customers (for example, investment entities that invest in third party debt). We understand that income from such investments is typically first assessed on a standalone basis and not by comparison with the cost of financing. Therefore, for such entities, a performance metric before financing costs could provide a useful measure of performance. Consequently, the staff proposes that only entities that provide financing to customers are exempt from the EBIT subtotal. Finally, some entities provide financing to customers but are not required to separately present finance income. For example, applying the lessor accounting model in IFRS 16 *Leases*, operating lessors do not recognise finance income in their financial statements. Instead, they recognise rental income, typically on a straight-line basis. For such entities, a key metric of

performance is the rental income less the direct costs (such as maintenance costs or depreciation of the underlying asset measured at cost)[5], without considering the costs of financing. For such entities, a performance metric before financing costs could provide a useful measure of performance[6]. Consequently, the staff thinks that only entities that separately present finance income should be exempt from the EBIT subtotal.

32. Thus, the full principle describing entities for whom an EBIT subtotal is not useful would be:

> Entities whose main and only business activity is providing financing to customers and who separately present financing income in the statement(s) of financial performance

33. In coming up with the principle, the staff has sought to use elements that are already defined and/or used in IFRS Standards or in this project, and as such would be familiar to stakeholders. This includes the following elements:

    (a) a definition of financing activities has been developed in this project as follows:

        (i) the receipt or use of a resource from a provider of finance (or provision of credit).

        (ii) the expectation that the resource will be returned to the provider of finance.

        (iii) the expectation that the provider of finance will be appropriately compensated through the payment of a finance charge. The finance charge is dependent on both the amount of the credit and its duration.

    (b) the term 'business activities' is used in *the Conceptual Framework for Financial Reporting*;

    (c) individual IFRS Standards, including IFRS 16 *Leases* set out requirements for disclosure and presentation of finance income;

[5] See Agenda Paper 21B, slide 4.

[6] See Agenda Paper 21B, slides 5-6.

(d) a customer is defined in IFRS 15 *Revenue from Contracts with Customers* as ‘a party that has contracted with an entity to obtain goods or services that are an output of the entity’s ordinary activities in exchange for consideration’ (the staff proposes to use the definition from IFRS 15, but not limit the assessment to contracts in the scope of IFRS 15).

34. This table provides a summary of how the principle would apply using four examples of financing:

	Financing is provided, with separate presentation of financing income	**To customers**	**Main business activity?**	**EBIT subtotal required?**
An entity whose main business activity is to take deposits and provide loans to its customers[7]	Yes	Yes	Yes	No
An entity whose main business activity is to operate as an operating lessor of office space[8]	No—financing income not separately presented applying IFRS 16 *Leases*	Yes	Yes	Yes
An entity whose main business activity is to invest, including investing in bonds	Yes—the entity provides financing to the issuer of the bonds	No	Yes	Yes
An entity that has provided a one-off loan to a customer to facilitate their business expansion.	Yes	Yes	No	Yes

[7] See Agenda Paper 21B, slide 12.

[8] See Agenda Paper 21B, slide 6.

Question 1

Does the Board agree with the staff recommendation that an entity would not be required to present a subtotal of profit before finance income/expenses and income tax if their main and only business activity is providing financing to customers and if they separately present financing income in the statement of financial performance?

If not, what approach do you want the staff to explore and why?

Alternative requirement for entities not required to present EBIT

35. The Board tentatively specified the line items that comprise finance income or expenses as follows:

    (a) interest income from cash and cash equivalents calculated using the effective interest method;

    (b) other income from cash, cash equivalents and financing activities;

    (c) expenses from financing activities;

    (d) other finance income (for example, unwinding of a discount on a defined benefit asset); and

    (e) other finance expenses (ie unwinding of a discount on liabilities not arising from financing activities).

36. The items a), b) and c) relate to an entity’s financing activities whilst items d) and e) relate to finance income/expenses not arising from financing activities.

37. The staff thinks that entities that do not present an EBIT subtotal should be required to present items relating to financing activities within the business profit from consolidated entities (ie items (a), (b) and (c) in paragraph 15)[9]. Such presentation is consistent with the reason these entities would not be required to present the EBIT subtotal – ie that financing expenses are taken into account in the calculation of their key measure of performance.

[9] Agenda Paper 21B, slide 12 illustrates this for a bank.

38. Other finance income and other finance expense (items (d) and (e) in paragraph 35) do not arise from financing activities. However, the Board has tentatively decided that they should be excluded from EBIT subtotal for non-financial entities because:

    (a) some of them are currently treated as financing costs in IFRS Standards (IFRIC 1.8 and IAS 37.60); and

    (b) many users consider them separately from business profit.

39. The staff therefore thinks that all entities, regardless of whether they present an EBIT subtotal or not, with an exception the staff identified and which is discussed in paragraph 40, should be required to present other finance income and other finance expense as separate line items outside the business profit category[7].

40. Insurance finance expense arises from insurance contract liabilities. Applying the proposals so far, insurance finance expense would be classified as 'Other finance expense' and insurers would be required to present this expense below the business profit subtotal. The staff does not think presentation of insurance finance expense below the business profit subtotal would provide useful information to users of financial statements. This is because insurance finance expense is an expense that relates to the main business activity of insurers and forms part of their key measures of financial performance. Consequently, the staff recommends that insurance finance expense should be presented within the business profit from consolidated entities subtotal[10].

Question 2

(a) Does the Board agree with the staff recommendation that entities that do not present a subtotal of profit before financing income/expenses and income tax shall include, within the subtotal of business profit from consolidated entities:

(i) interest income on cash and cash equivalents using the effective interest method;

(ii) other income from cash and cash equivalents and financing activities; and

(iii) expenses from financing activities?

[10] See Agenda Paper 21B, slide 9.

If not, what alternative approach does the Board want the staff to explore and why?

(b) Does the Board agree with the staff recommendation that insurance finance expense should be included in the business profit subtotal?

If not, what alternative approach does the Board want the staff to explore and why?

Income and expenses from investments

The Board's objective and tentative decisions for non-financial entities

41. Outreach with users of financial statements suggests that there are some types of assets that users typically seek to value separately from the main activities of a non-financial entity (for example, investments in financial assets, associates and joint ventures, and investment properties). In order to provide information about the income and expenses arising from such assets separately from other income and expenses, the Board tentatively decided to require entities to present a category in the statement(s) of financial performance for income/expenses from investments. Income/expenses from investments would be presented above the EBIT subtotal[11].

42. The Board tentatively decided to:

(a) define 'income/expenses from investments' using a principle-based approach as 'income/expenses from assets that generate a return individually and largely independently of other resources held by the entity'.

(b) provide a list of some items that would typically be considered 'investing' and a list of some items that would typically not be considered 'investing'.

[11] The appendix to Agenda Paper 21B illustrates the presentation of income and expenses from investments for a non-financial entity.

What is the problem?

43. For some entities, requiring the presentation of income and expenses from investments below business profit is unlikely to provide useful information, because it would result in:

    (a) income and expenses arising from an entity's main business activities being presented below business profit. Although the Board has only tentatively defined business profit as a residual, we think we should avoid such counter-intuitive outcomes.

    (b) an entity being unable to present other subtotals in its statement(s) of financial performance that constitute key measures of their performance, eg the margin between an insurer's investment returns and its insurance finance expense.

44. Many financial institutions invest in assets the returns on which would meet the definition of income/expenses from investments. For example, insurers invest in bonds and equities the returns on which are used to settle liabilities to customers. The difference between returns on investments and insurance finance costs is that insurance finance costs is one of the key metrics of performance for insurers. Similarly, banks' returns on investments and investment property companies' rental returns are key metrics of performance.

45. When investment returns are a key performance metric, we do not believe that it is useful to present investment returns separately from business profit. For some entities presenting investment returns separately from business profit would mean business profit would only include expenses. For example, an investment property company's business profit would exclude rental income and fair value changes[12]. For these entities a subtotal of profit before investments would not provide useful information.

46. We need to define the scope of the requirement to separately present a subtotal of profit before income/expenses from investment in a way that ensures the subtotal is only required to be presented when it provides useful information.

[12] See Agenda Paper 21B, slide 5.

How can we ensure the subtotal is required only when it provides useful information?

47. As with EBIT, in order to ensure the profit before investing, financing and income tax subtotal is required only when it is useful, the staff believes that some entities need to be exempt from the requirement to present the subtotal **and** be subject to alternative presentation requirements. We deal with the exemption and alternative presentation requirements separately below.

Exemption from the requirement to present profit before investing, financing and income tax

48. As with EBIT, we have identified three main possible approaches to exempt entities from the requirement to present the subtotal:

    (a) Approach A—do not require the subtotal when entities determine it would not be useful, with possible accompanying disclosure requirements;

    (b) Approach B—define entities that are not required to present the subtotal using an industry definition; or

    (c) Approach C—describe entities that are not required to present the subtotal using a principle-based definition, ie entities are not required to present the subtotal of profit before investing, financing and income tax if, in the course of their main and only business activity, they invest in assets that a generate a return individually and largely independently from other resources held by the entity.

49. The staff thinks that the disadvantages of approaches A and B outweigh the advantages for the same reasons discussed in paragraphs 24–27. The staff therefore does not consider these approaches further and focuses on approach C – describe exemption based on a principle.

Approach C—Exemption based on a principle (staff's preferred approach)

50. In this approach, entities that are not required to present the profit before investments subtotal are described using a principle. The staff thinks this principle needs to capture entities that earn returns from investments in the course of their main and only business activity. This is because, for those entities, in the staff's view, investment income is part of the key measure of financial performance and thus presenting a

business profit subtotal that excludes such income would not result in a useful presentation.

51. As with EBIT, in coming up with the principle, the staff has sought to use elements that are already defined and/or used in IFRS Standards or in this project, and as such would be familiar to stakeholders. This includes the following elements:

(a) the definition of income/expenses from investments developed in the project: 'income/expenses from assets that generate a return individually and largely independently of other resources held by the entity'; and

(b) the term 'business activities' is used in *the Conceptual Framework for Financial Reporting*.

52. This table provides a summary of how the principle would apply using four examples of investments:

	Generate returns from investments	**In the course of the entity's main business activity**	**Profit before investments, financing and income tax subtotal required?**
An entity that invests excess cash in bonds until it needs the funds for investments in its main business activities	Yes	No	Yes
An entity that invests in investment properties as its main business activity[13]	Yes	Yes	No
An insurer that invests in bonds to generate returns to fulfil its insurance contracts (and make profit)[14]	Yes	Yes	No (this enables insurers to present the margin between the return on their investments and the insurance finance expense, which is a key performance metric)
An entity whose main business purpose is to invest in other entities	Yes	Yes	No

[13] See Agenda Paper 21B, slide 6.

[14] See Agenda Paper 21B, slide 9.

Question 3

Does the Board agree that entities are not required to present a subtotal of profit before investing, financing and income tax if, in the course of their main and only business activity, they invest in assets that generate a return individually and largely independently from other resources held by the entity?

If not, what alternative approach does the Board want the staff to explore and why?

Alternative requirement for entities that are not required to present a subtotal of profit before investing, financing and income tax

53. Entities, that the staff proposes to be exempt from the requirement to separately present a subtotal of profit before investments, finance income/expenses and income tax, could present income/expenses from investments (except for the share of profit or loss of associates and joint ventures, which we address separately in paragraphs 68-71) in one of two ways:

    (a) Approach A: include only income/expenses from investments made in the course of the entity's main business activities in business profit from consolidated entities, and present all other income/expenses from investments outside the business profit category; or

    (b) Approach B: include all income/expenses from investments in business profit from consolidated entities.

54. The advantages of Approach A are:

    (a) all entities would present a measure of business profit that excludes income and expenses from investments that are not made in the course of the entity's main business activities, which increases comparability. For example, income from investments in bonds made by an investment property company would be excluded from the business profit subtotal in the same way as it would be excluded from the business profit subtotal by a manufacturing entity; and

(b) this approach could result in a more faithful representation of 'business profit' because the subtotal would exclude income or expenses that are not part of the main business activities.

55. The disadvantages of Approach A are:

(a) some entities that make investments in the course of their main business activities might find it difficult to determine which, if any, investments are not made in the course of their main business activities. These difficulties could lead to inconsistent presentation and may not result in useful information being provided to users of financial statements; and

(b) this approach could create an incentive for entities to present loss-making investments as investments not made in the course of main business activities and thus exclude them from the business profit subtotal.

56. Approach B would be simpler to apply than Approach A and would not allow entities to present loss-making investments outside business profit. However, the staff thinks that the benefits of a more faithful representation and comparability in Approach A are likely to outweigh the disadvantages and thus recommends Approach A.

57. If the Board tentatively decides to require this approach, the staff plans to test the benefits and challenges of the approach during the consultation on the first due process document.

Question 4

Does the Board agree that entities that do not present the subtotal of profit before investing, financing and income tax, shall include income/expenses from investments made in the course of the entity's main business activities in business profit from consolidated entities, and present all other income/expenses from investments outside the business profit category?

If not, which approach do you prefer and why?

What are the implications of the proposals in this paper for entities that have more than one main business activity?

58. In this paper, the staff recommended that:

(a) entities are not required to present a subtotal of profit before finance income/expenses and income tax if their main and only business activity is to provide financing to customers and they separately present financing income in the statement of financial performance. Entities that do not present a subtotal of profit before finance income/expenses and income tax shall include, within the subtotal of business profit from consolidated entities:

(i) interest income on cash and cash equivalents using the effective interest method;

(ii) other income from cash and cash equivalents and financing activities; and

(iii) expenses from financing activities

(b) entities are not required to present a subtotal of profit before investing, financing and income tax if, in the course of their main and only business activity, they invest in assets that generate a return individually and largely independently from other resources held by the entity. Entities that do not present a subtotal of profit before investing, financing and income tax shall include income/expenses from investments made in the course of their main business activity within the subtotal of business profit from consolidated entities.

59. We now need to address the implications of these proposals for entities that have more than one main business activity. We have considered three types of such entities:

(a) entities whose main business activities include both investing and financing activities (investing and financing entities);

(b) entities that have more than one main business activity including investing or financing (investing or financing entities); and

(c) entities that have more than one main business activity but none of those activities include investing and/or financing. Those entities would apply the same proposals as non-financial entities and thus are not discussed further.

Investing and financing entities

60. The staff thinks that entities whose main business activities include both investing and financing activities (for example, many banks[15] and bank-insurers[16]) should be exempt from the requirement to present both:

    (a) a subtotal of profit before finance income/expenses and income tax; and

    (b) a subtotal of profit before investing, financing and income tax.

61. This is because, as discussed in paragraphs 16 to 19 and paragraphs 42 to 45, these subtotals are unlikely to provide useful information. Requiring these subtotals to be presented may also make it difficult for these entities to present their key performance metrics.

62. In addition, such entities are likely to find it difficult to allocate:

    (a) income/expenses from investments between income/expense from investments made in the course of the investing business activity and other income/expenses from investments; and/or

    (b) income/expenses from financing activities between those that relate to customer financing and those that relate to financing of the investing business activities.

Question 5

Does the Board agree with the staff recommendation that entities whose main business activities include both investing and financing activities should:

(a) not be required to present a subtotal of profit before finance income/expenses and income tax and, if they elect to not present the subtotal, shall include, within the subtotal of business profit from consolidated entities:
(i) interest income on cash and cash equivalents using the effective interest method;

[15] See Agenda Paper 21B, slide 14.

[16] See Agenda Paper 21B, slide 15.

(ii) other income from cash and cash equivalents and financing activities; and
(iii) expenses from financing activities.

(b) not be required to present a subtotal of profit before investing, financing and income tax and, if they elect to not present the subtotal, shall include income/expenses from investments made in the course of their investing business activity within the subtotal of business profit from consolidated entities?

If not, which approach do you prefer and why?

Investing or financing entities

63. Entities that have more than one main business activity including investing or financing could be subject to requirements for subtotals that are either:

(a) Approach A - requirements consistent with their predominant activity, resulting in an exemption from the requirement to present subtotals in the following circumstances:

(i) if an entity's predominant activity is providing financing to customers – the entity would not be required to present a subtotal of profit before finance income/expenses and income tax, and is instead subject to the alternative presentation requirements for such entities (paragraphs 35–40).

(ii) if an entity's predominant activity is investing – the entity would not be required to present a subtotal of profit before investing, financing and income tax, and is instead subject to the alternative presentation requirements for such entities (paragraphs 53–57).

(iii) if an entity's predominant activity is neither investing nor financing to customers – they would be required to apply the Board's tentative decisions for non-financial entities and present all proposed subtotals.

(b) Approach B - requirements that reflect the entity's different main business activities, with all proposed subtotals still required but individual line items moved to the business profit subtotal in the following circumstances:

(i) if one of the entity's main activities is providing financing to customers – the entity would be permitted to include:

1. interest income on cash and cash equivalents using the effective interest method;
2. other income from cash and cash equivalents and financing activities; and
3. expenses from financing activities

which relate to financing to customers, within business profit from consolidated entities.

(ii) if one of the entity's main business activities is investing – the entity would be permitted to include income/expenses from investments made in the course of the investing business activity within business profit from consolidated entities.

64. Users of financial statements have told us that, when analysing financial performance of entities with several business activities, they want to look at the performance for each of the business activities separately.

65. The staff thinks that approach B facilitates this because, entities could, within the business profit subtotal, present key performance measures for their different business activities. This would not be possible applying approach A as business profit from consolidated entities might not include all components of business profit for each of the entity's main business activities. For example, if an entity assesses that providing financing to customers is its main and predominant activity but that investing is also a main activity, the entity could not include, within the business profit subtotal, income from investing activities, ie the business profit subtotal would only reflect income and expenses arising from the entity's predominant activity. Also, Approach A would require the Board to provide guidance on how to determine what is a 'predominant activity' and how is this different from an entity's 'main activity'.

66. The staff therefore prefers approach B[17].

[17] Slide 13 in Agenda Paper 21B illustrates approach B for a manufacturer that provides financing to customers.

67. The staff acknowledges that approach B assumes an entity can allocate:

    (a) income/expenses from investments between income/expense from investments made in the course of the investing business activity and other income/expenses from investments; and/or

    (b) income/expenses from financing activities between those that relate to customer financing and those that relate to financing of other business activities.

68. During the consultation on the first due process document, the staff plans to investigate whether the allocation can be achieved without undue costs. The staff notes that approach B permits, but does not require, allocations, and an entity for whom allocation may be costly or too judgemental could instead decide to follow the approach for general corporates.

Question 6

Does the Board agree with staff recommendation that:

(a) entities that have more than one activity including financing or investing are not exempt from the requirement to present subtotals;

(b) If such an entity has a main business activity which is to provide financing to customers, it is permitted to include, in the business profit from consolidated entities:

- (i) interest income on cash and cash equivalents using effective interest method;
- (ii) other income from cash and cash equivalents and financing activities; and
- (iii) expenses from financing activities,

that relate to this business activity;

(c) If such an entity has a main activity in the course of which it invests in assets that generate a return individually and largely independently from other resources held by the entity; it is permitted to include income/expenses from investments made in the course of the investing business activity in the business profit from consolidated entities?

If not, which approach do you prefer and why?

What are the implications of the proposals in this paper for the presentation of any share of profit or loss from investments in associates and joint ventures?

69. At its January 2018 meeting, the Board tentatively decided that[18]:

    (a) entities should present the share of profit or loss of ‘integral’ associates and joint ventures separately from the share of profit or loss of ‘non-integral’ associates and joint ventures;

    (b) entities should present the share of profit or loss of integral associates or joint ventures as a line item above the ‘income/expenses from investments’ category and present a new subtotal above that line item (we refer to this subtotal as ‘business profit from consolidated entities'); and

    (c) entities should present the share of profit or loss of non-integral associates and joint ventures as a line item within the ‘income/expenses from investments’ category, below the profit before investing, financing and income tax subtotal.

70. Under our proposals in paragraphs 48–52, some entities would be exempt from the requirement to present a profit before investing, financing and income tax subtotal. The staff thinks that such entities—consistently with entities that are required to present such a subtotal—should nevertheless be required to present[19]:

    (a) the share of profit or loss of ‘integral’ associates and joint ventures separately from the share of profit or loss of ‘non-integral’ associates and joint ventures, as described in paragraph 69(a); and

    (b) the share of profit or loss of all associates and joint ventures after business profit from consolidated entities.

71. The staff is of this view because we have not found evidence to suggest that associates and JVs of financial entities should be treated differently from general corporates – that is presented outside business profit from consolidated entities.

[18] The appendix to Agenda Paper 21B illustrates the presentation of the share of profit or loss of associates and joint ventures for a non-financial entity.

[19] See Agenda Paper 21B, slides 6, 9 and 12.

72. The staff thinks the proposed requirements in paragraph 69 could be redrafted as follows:

(a) all entities are required to separately present the share of profit or loss from integral and non-integral associates and joint ventures, after business profit from consolidated entities; and

(b) entities that are required to present a profit before investing, financing and income tax subtotal should present:

(i) the share of profit or loss of integral associates or joint ventures as a line item above the profit before investing, financing and income tax subtotal; and

(ii) the share of profit or loss of non-integral associates or joint ventures as a line item below the profit before investing, financing and income tax subtotal.

Question 7

Does the Board agree with the staff recommendation for redrafting of the requirements relating to the presentation of the share of profit or loss of integral and non-integral joint ventures and associates in paragraph 72?

If not, why not?

What are the next steps in considering financial entities on the project?

73. Depending on the Board's decisions at this meeting, the papers for future Board meeting will:

(a) review the remaining project areas that might need addressing with respect to financial entities (including proposals relating to the statement of cash flows); and

(b) review the overall model for financial entities and make sure the inter-relationships work.

74. We will also continue working on research relating to the sizing of entities with more than one business activity that include financials.

75. In parallel, we will continue addressing the project areas which the Board has not yet discussed, and consider proposals for all entities at the same time, with the following comments:

(a) the guidance on disaggregation could potentially be even more useful for entities which might tentatively be required to present fewer subtotals in the financial statements, such as banks (if the Board agrees with staff proposals in this paper). The staff will consider all entities together when bringing further proposals to the Board.

(a) templates: the Board's intention is to consider industry-specific templates and as such the staff think it would be useful to consider templates for financial entities at the same time as non-financial entities.

(b) the guidance on minimum line items will need to consider the entities for whom financing or investing is the main business activity.