IFRS

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STAFF PAPER

IASB® meeting

Project	**Primary Financial Statements**		
Paper topic	Expenses from investments		
CONTACT(S)	Kensuke Okabe	kokabe@ifrs.org	+44 (0) 20 7246 6439
	Aida Vatrenjak	avatrenjak@ifrs.org	+44 (0) 20 7246 6456

Purpose of this paper

1. At its November 2017 meeting, the Board tentatively decided to introduce an investing section into the statement(s) of financial performance which would include income and expenses from investments. The purpose of this paper is to discuss whether expenses related to the investment (for example, investment management fees) should also be included in the investing section.

Summary of staff recommendation

2. The staff recommends that the Board:
   (a) include expenses related to an investment in the investing section of the statement(s) of financial performance; and
   (b) define those expenses as incremental expenses—that is, those expenses that the entity would not have incurred if the investment had not been made.

Structure of the paper

3. This paper is structured as follows:

   (a) background (paragraphs 4–8).

   (b) current tentative definition of income and expenses from investments (paragraphs 9–10).

   (c) should expenses related to an investment be included in the investing section (paragraphs 11–19)?

   (d) appendix—illustrative example—the statement of profit or loss including incremental expenses in investing section

Background

4. At its November 2017 meeting, the Board tentatively decided:[1]

   (a) to define 'income and expenses from investments' as 'income and expenses from assets that generate a return individually and largely independently of other resources held by the entity'; and

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

5. The list of items that would typically be treated as 'investing' includes:[2]

   (a) interest income and other income on financial assets (for example interest income on debt investments), other than on cash and cash equivalents; and

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

      (i) the share of profit or loss of non-integral associates and joint ventures;

      (ii) fair value changes and rental income on investment property;

[1] See November 2017 IASB Update

[2] The list is based on examples in AP21A of the November 2017 Board meeting, adjusted for subsequent Board decisions – for example introduction of integral and non-integral investments accounted for using the equity method.

(iii) dividends and fair value changes on non-consolidated equity investments;

(iv) speculative investments, such as investments in artwork; or

(v) disposal gains and losses associated with the sale of an investment.

6. The list of items that would typically not be treated as 'investing' includes:

   (a) income and expenses from assets used in the production of goods and delivery of services; and

   (b) income and expenses from other investments in 5(a) and 5(b) above to the extent an entity invests in those assets in the course of their main business activities.

7. The Board tentatively decided to introduce an investing section in order to:

   (a) provide relevant information to users about an entity's investments. Users often seek to value an entity's investments separately from the entity's main business activities when valuing the entity's business.

   (b) provide more transparent and comparable information for users about income and expenses from investments that would not be classified in the financing section but may nevertheless be treated by some users as part of financing activities.

8. During outreach meetings, a preparer asked about classification of management fees paid to an organisation that manages investments in financial assets. The preparer thought it would be unclear whether such fees would be classified in the investing section.

Current tentative definition of income and expenses from investments

9. The current tentative definition of income and expenses from investments refers to 'income and expenses from assets'. The definition does not refer to expenses arising from activities related to investments. It was not the staff's intention when drafting the original paper to capture such expenses. The reference to expenses in the definition was intended to capture items such as fair value losses or impairment of investment assets.

10. However, in the light of the question raised during outreach and the subsequent Board decision to require an 'operating profit' subtotal, we think that the Board should consider whether expenses related to an investment—such as the asset management fees, maintenance fees for investment properties and employee benefit expenses related to investing—should be included in the investing section.

Should expenses related to an investment be included in the investing section?

11. The staff's original intention was to identify and present separately the income or expenses arising from investments to facilitate users in valuing those investments separately from the other activities of the entity. It was not the staff's intention to create an investing section that presents the results of an entity's investment activities net of related expenses. In addition, the staff were concerned that it might be difficult or complex to identify costs related to an investment—identifying the income or expenses arising from the investment only would be a simpler approach.

12. However, when users evaluate the return on an entity's investments, we think they would consider expenses arising from activities related to the investments. We therefore think including some expenses relating to investments in the investing section would give investors better information about the performance of investments. In addition, including those expenses in the operating section would not result in a faithful representation of the entity's operating profit.

13. Consequently, we have sought an approach that would include expenses related to investments in the investing section while limiting the costs of classification.

14. The staff considered the following terms used in IFRS Standards[3] that could be used to describe those expenses we want to include:

    (a) incremental expenses; and

    (b) directly related expenses

[3] Some older IFRS Standards, for example IAS 2 and IAS 16 *Property, Plant and Equipment* use the term 'directly attributable' to identify the costs to be included in the cost of an asset. However, we have not considered using this term because it has not been used in recently issued IFRS Standards.

15. ‘Incremental’ is a term used in IFRS 15 *Revenue from Contracts with Customers* to describe the costs of obtaining a contract to be capitalised. Paragraph 92 of IFRS 15 states that the incremental costs of obtaining a contract are ‘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’.

16. If this term is applied to expenses related to investments, incremental expenses would be those expenses that an entity incurs in relation to an investment that it would not have incurred if the investment had not been made.

17. ‘Directly related’ is a term used to specify the costs to be included in costs to fulfil a contract in IFRS 15, the costs of conversion of inventories in IAS 2 *Inventories* and to identify fulfilment cash flows for an onerous contract test in IFRS 17 *Insurance Contracts*. Directly related expenses include allocations of costs that relate directly to a contract or to contract activities.[4] Additionally, Exposure Draft *Onerous Contracts–Cost of Fulfilling a Contract* refers to both incremental and directly related costs. Its Basis for Conclusions[5] states that directly related costs include all the costs an entity cannot avoid because it has a contract and such costs include both the incremental costs of the contract and an allocation of other costs incurred on activities required to fulfil the contract.

18. Directly related expenses are therefore broader in scope than incremental expenses. For example, the staff think that directly related expenses of an investment may include an allocation of labour costs if, for example, some employees of an entity are engaged in both operating and investing activities. Such allocations could be complex and costly. In addition, the allocations may reduce the understandability of an analysis of operating expenses by nature (for example, if staff costs disclosed in a by nature analysis do not include all staff costs because some of those costs are included in the investing section).

19. Consequently, we recommend that only incremental expenses should be included in the investing section. This approach would help users of financial statements better understand investing activities without requiring allocations that may be costly.

[4] See paragraph 97(c) of IFRS 15.

[5] Paragraph BC16(b)

20. The appendix includes an illustrative example of the statement of profit or loss for a non-financial entity which includes incremental expenses in the investing section.

Question
Does the Board agree to: (a) include expenses related to an investment in the investing section of the statement(s) of financial performance; and (b) define those expenses as incremental expenses—that is, those expenses that the entity would not have incurred if the investment had not been made?

Appendix—Illustrative example—the statement of profit or loss including incremental expenses in investing section

Revenue	XX
Cost of sales	(XX)
Gross profit	XX
Selling, general and administration costs	(XX)
Operating profit	XX
Share of profit of integral joint ventures and associates	XX
Operating profit and share of profit of integral associates & JVs	XX
Changes in the fair value of financial assets	XX
Dividend income	XX
Asset management fees	(XX)
Share of profit of non-integral joint ventures and associates	XX
Profit before financing and income tax	XX
Interest income from cash and cash equivalents	XX
Expenses from financing activities	(XX)
Unwinding of discount	(XX)
Profit before tax	XX
Income tax expenses	(XX)
Profit for the year	XX