STAFF PAPER

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IASB® meeting

Project	**Primary Financial Statements**
Paper topic	Subtotals in the statement of profit or loss—operating profit

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Objective

1. This paper initiates the Board's redeliberations on subtotals and categories in the statement of profit or loss. In this paper, we ask the Board to confirm aspects of its approach to require and define an operating profit subtotal and an operating category in the statement of profit or loss.

2. Future papers will discuss other aspects of the proposals for subtotals and categories in the statement of profit or loss including:
   (a) the content of the investing and financing categories;
   (b) the classification of income and expenses from equity-accounted associates and joint ventures;
   (c) the classification of foreign exchange differences and gains and losses from derivatives;
   (d) how an entity should identify its 'main business activities';
   (e) the classification of income and expenses for entities with specific main business activities, such as investing and the provision of financing to customers;
   (f) the alignment between the categories in the statement of profit or loss and the statement of cash flows;

(g) the labelling of subtotals, including whether labels should be prescribed by the Board; and

(h) the presentation of subtotals that are equal or almost equal.

3. The key linkages between topics discussed in this paper and topics to be discussed at future meetings are set out in Appendix A. However, we believe these linkages should not prevent the Board from answering the questions in this paper at this meeting.

Summary of staff recommendations

4. The staff recommend the Board:

(a) proceed with the proposal to require all entities to present an operating profit subtotal in the statement of profit or loss;

(b) confirm the following types of income and expenses shall not be classified in the operating category:

(i) investing;[1]

(ii) financing;[1]

(iii) income tax; and

(iv) discontinued operations;

(c) confirm that the operating category:

(i) comprises all income and expenses arising from an entity's operations, including volatile and unusual income and expenses arising from an entity's operations; and

(ii) includes, but is not limited to, income and expenses from an entity's main business activities; and

(d) not explore developing a direct definition of operating profit.

[1] Excluding income and expenses from main business activities—this aspect of the proposals will be discussed at a future meeting as explained in paragraph 2(d)–(e).

Structure of the paper

5. This paper is structured as follows:

   (a) proposals in the Exposure Draft (paragraphs 7–14);

   (b) feedback and staff analysis on *whether* the Board should *require* and *define* operating profit for all entities (paragraphs 15–24);

   (c) feedback and staff analysis on *how* operating profit should be *defined*:

      (i) we first ask the Board to confirm that income and expenses such as investing and financing that are generally agreed to be non-operating should be excluded from operating profit (paragraphs 25–36); and

      (ii) we then discuss the more contentious aspects of the proposed definition of the operating category (paragraphs 37–83).

6. This paper includes four appendices:

   (a) Appendix A describes the linkages with other project areas that will be discussed in future meetings.

   (b) Appendix B includes the definitions of investing and financing proposed in the Exposure Draft (paragraphs 47–52 of the Exposure Draft).

   (c) Appendix C summarises relevant fieldwork findings.

   (d) Appendix D sets out a few possible approaches to drafting the definition of operating profit. We welcome Board members' views on these approaches, but we are not asking the Board to make any decisions on the drafting.

Proposals in the Exposure Draft

7. The Board proposed requiring all entities to classify specified income and expenses into an operating category and present an operating profit or loss subtotal in the statement of profit or loss (paragraph 60(a) of the Exposure Draft).

8. In the Basis for Conclusions, the Board explained its proposal to define and require operating profit would:

(a) provide users of financial statements (users) with relevant information about an entity’s operating performance, including its main business activities (see paragraphs BC251(a) and BC253); and

(b) enhance comparability between entities (see paragraphs BC53 and BC265).

9. Paragraph 46 of the Exposure Draft proposed that:

The operating category includes information about income and expenses from an entity’s main business activities. An entity shall classify in the operating category all income and expenses included in profit or loss that are not classified in:

(a) investing;

(b) financing;

(c) integral associates and joint ventures;

(d) income tax; or

(e) discontinued operations.

10. The definitions of financing and investing include exceptions for entities for which investing and financing are main business activities, requiring them to classify income and expenses from those main business activities in operating profit. The definitions of investing and financing are included in Appendix B. Therefore, disregarding items (c)–(e), operating profit could be expressed as:

$$\text{Operating profit} = \underbrace{\text{Profit before tax} - \text{Investing and financing income and expenses}}_{\text{‘Residual’ or ‘default’ component}} + \underbrace{\text{Investing and financing income and expenses from main business activities}}_{\text{‘Positive’ or ‘direct’ component}}$$

11. In essence, the Board’s proposed definition of operating profit is a ‘residual’ definition—that is, it identifies which income and expenses should be *included* in operating profit by defining which income and expenses should be *excluded* from operating profit. The operating category acts as a default category for items that are

not included in other categories. However, the proposed definition also includes a 'positive' or 'direct' component—that is, it also specifies income and expenses that should be *included* in operating profit. The 'direct' component only applies to entities for which investing or providing financing to customers is a main business activity. Therefore, we expect most entities would only apply the 'residual' component of the definition.

12. An important implication of the Board's proposed definition of operating profit is that the following types of income and expenses may be classified in the operating category if they do not meet the definition of any of the other categories:

    (a) unusual and other volatile income and expenses—for example, litigation or restructuring expenses and gains or losses on disposal of operating assets. In other words, operating profit as proposed by the Board would not be a measure of 'persistent' or 'recurring' operating performance.

    (b) income and expenses from non-main business activities—for example, operating profit could include income and expenses from supporting activities that do not generate revenue directly or income and expenses from a subsidiary conducting ancillary activities that are not (yet) a main business activity of the group. In other words, operating profit as proposed by the Board would include, but would not be limited to, the results of an entity's main business activities.

13. It is also important to note that 'an entity's main business activities' only play a limited role in the proposed definition. There is no need for entities to assess for each activity they conduct whether it constitutes a main business activity or not. An entity only needs to determine whether it:

    (a) invests in the course of its main business activities; or

    (b) provides financing to customers as a main business activity.

14. Paragraphs BC55–BC56 of Basis for Conclusions explain that the Board defined operating profit as set out above because:

    (a) the Board's view is that all income and expenses included in profit or loss, other than those related to financing, tax, some investments or discontinued operations, arise from an entity's operations. The Board does not view predictive value as a characteristic that differentiates whether income or expenses are operating (or any other category).

(b) it is a pragmatic approach, in that:

  (i) it is easier for the Board to specify the income and expenses to be classified in the financing or investing categories than those in the operating category, because entities have various business activities; and

  (ii) a residual definition is simpler to apply for entities—in the Board's view, it involves less judgement and is more likely to be consistently applied than a direct definition, which in turn is more likely to result in comparability between entities.

Should the Board require and define operating profit for all entities?

Feedback

Agreement

15. Most respondents across all jurisdictions and stakeholder types (including all users) agreed that the Board should define operating profit and require all entities to present an operating profit subtotal in the statement of profit or loss.

16. Some respondents explained they agree with requiring entities to present operating profit because it is an important measure that provides relevant information to users. Some users explained they use operating profit in ratio analysis—for example in analysing operating margin—and as a starting point for forecasting in valuation models.

17. In our academic literature review, we found that academic research has established that users view operating profit as a useful measure of entity performance. Specifically, the academic evidence shows that operating profit is value relevant—

associated with stock prices and returns—and has predictive ability for future entity performance.[2]

18. Many respondents said the Board requiring and defining operating profit could improve comparability between entities. A few respondents emphasised the importance of comparable and consistently presented subtotals for electronic reporting.

Concerns

19. A few respondents said some entities may classify almost all income and expenses in the operating category. For example, for entities such as banks, operating profit could be almost equal to profit before tax. They questioned whether operating profit would provide additional useful information in such cases.

20. A few respondents asked the Board to clarify in general how entities should present required subtotals that are equal or almost equal to each other.

21. For example in the fieldwork, one real estate company did not have any income or expenses that would be classified in investing category nor any integral associates or joint ventures. Therefore, their operating profit was equal to profit before financing and income tax and they decided not to present a profit before financing and income tax subtotal. [3]

Staff analysis and recommendation

22. We recommend the Board proceed with its proposal to require all entities to present an operating profit subtotal. We note that most respondents agreed with the Board's reasons for this proposal—that is:

    (a) operating profit provides relevant information to users; and

    (b) the Board defining and requiring operating profit could enhance comparability between entities.

[2] See January 2021 Agenda Paper 21E for more details on the literature review.

[3] See December 2020 Agenda Paper 21A for more details about the set-up of the fieldwork.

23. We think the Board should address the concerns described in paragraphs 19–21 and should clarify how an entity should present subtotals that are equal or almost equal. However, we think the Board should discuss this topic separately at a future meeting. At that meeting, we plan to ask the Board to consider:

    (a) materiality and the role of the primary financial statements—not all material information belongs in the primary financial statements. We plan to ask the Board to consider whether there could be cases in which the difference between two subtotals is material but presenting both subtotals would clutter the statement of profit or loss.

    (b) electronic reporting—feedback has highlighted the importance for electronic reporting of subtotals being presented consistently across entities and over time. A user of paper-based financial statements may understand that a required subtotal is not reported because it is equal to another subtotal. However, it may be helpful to users consuming the information electronically if entities report or tag all required subtotals, even when they are equal.

    (c) presentation and labelling—for example, entities could be allowed or required to present two subtotals that are equal as a single amount with a double label. IFRS Standards allow such an approach when basic and diluted earnings per share are equal (see paragraph 67 of IAS 33 *Earnings per Share*).

24. We think having such a discussion at a future meeting should not prevent the Board from confirming at this meeting that all entities should, in principle, be required to present an operating profit subtotal.

Question 1
Does the Board agree with the staff recommendation to proceed with its proposal to require all entities to present an operating profit subtotal in the statement of profit or loss?

Defining operating profit—income and expenses generally agreed to be non-operating

25. Now that we have considered *whether* the Board should define operating profit, we move on to *how* the Board should define operating profit. In this section we ask the Board to confirm that income and expenses such as investing and financing that are generally agreed to be non-operating should be excluded from operating profit.

Feedback

26. Both respondents who supported a residual definition and respondents who preferred a direct definition agreed the following types of income and expenses should not be classified in the operating category:

    (a) financing income and expenses not arising from an entity's main business activities (paragraphs 28–30);

    (b) investing income and expenses not arising from an entity's main business activities (paragraphs 31–32); and

    (c) income tax and discontinued operations (paragraphs 33–34).

27. The Exposure Draft also proposed that income and expenses from equity-accounted associates and joint ventures should not be classified in operating profit. We plan to discuss this proposal at a future meeting.

Financing

28. Most respondents, including most users, agreed entities should classify financing income and expenses outside the operating category (except for entities with specific main business activities). Some respondents said such classification is useful because it helps users analyse an entity's performance independently of how that entity is financed.

29. Comment letters from academics and papers included in our academic literature review confirmed that distinguishing between an entity's operating and financing activities in financial reporting is useful for investors' decision-making. Academics argue such a distinction corresponds to the conceptual distinction between an entity's value generation and value distribution activities.

30. Some respondents said classifying financing income and expenses outside the operating category is consistent with current practice.

Investing

31. Most respondents, including most users, agreed entities should classify income and expenses from investments outside the operating category (except for entities with specific main business activities). A few users explained that such classification would be useful because they analyse and value entities' investments separately from an entity's operations. They added that such classification facilitates users' modelling of future operating margins by excluding from the operating category income and expenses from investments that do not contribute to revenue.

32. A few other respondents said they agreed with classifying income and expenses from investments outside the operating category because such classification would enhance comparability between entities. They said that some entities currently include income and expenses from investments in operating profit, whereas others exclude them.

Income tax and discontinued operations

33. Few respondents commented on the proposal to classify income tax and discontinued operations outside operating profit. Respondents may have provided limited feedback because:

   (a) the Exposure Draft did not explicitly ask respondents for their views on this aspect of the proposals. The presentation of discontinued operations was explicitly excluded from the project scope.

   (b) respondents are unlikely to have strong views about this aspect of the proposals because the location of income tax and discontinued operations would not change applying the proposals—that is, these items would continue to be presented as separate line items before profit or loss.

34. The respondents who commented agreed with the proposed classification of income tax and discontinued operations.

Staff analysis and recommendation

35. As described in paragraphs 28–32, the feedback on the Exposure Draft supported the Board's arguments and provided additional arguments for excluding investing and financing income and expenses from the operating category. Respondents did not object to the proposed classification of income tax or discontinued operations.

36. Therefore, we recommend the Board confirm this aspect of its proposals. Note that at this stage we are not yet asking the Board to decide:

    (a) the precise definitions of 'investing' or 'financing'—at a future meeting we plan to discuss possible refinements to the definitions proposed in the Exposure Draft. For example, we plan to discuss whether the financing category should include incremental expenses.

    (b) whether investing and financing should be separate categories— at a future meeting we plan to discuss the suggestion made by some respondents to merge the two categories.

    (c) whether to take a direct or a residual approach to defining operating profit—this is discussed in paragraphs 74–83. Here we are focusing on the outcome that investing and financing income and expenses would be excluded from operating, which could be achieved using either a direct or a residual definition.

    (d) whether to exclude all income and expenses from equity-accounted associates and joint ventures from operating profit. At a future meeting we plan to discuss whether the Board should consider allowing income and expenses from some associates and joint ventures to be classified in operating profit for entities with specific main business activities.

Question 2
Does the Board agree with the staff recommendation to confirm the following types of income and expenses shall not be classified in the operating category: (a) investing; (b) financing; (c) income tax; and (d) discontinued operations?

Defining operating profit—more contentious aspects of the proposed definition

Feedback

Agreement

37. Many respondents, including almost all users, agreed with the Board's proposed approach to define the operating category as a residual category.

38. Many of those respondents said it is a pragmatic approach, agreeing with the Board's arguments set out in paragraph 14(b). They added that they think:

    (a) a residual definition is easy for users to understand; and

    (b) it is not feasible for the Board to define all categories in such a way that all income and expenses meet the definition of one of the categories. Therefore, they think the statement of profit or loss must contain a residual category for items that do not meet the definitions of any of the other categories and they think the operating category is the most appropriate residual category.

39. Some respondents, including some users, explicitly stated they agreed with the Board's view that all income and expenses included in profit or loss, other than those related to financing, tax, some investments or discontinued operations, arise from an entity's operations (see paragraph 13(a)). They agreed this means that operating profit

includes some unusual, volatile and non-main business income and expenses and they thought this outcome was appropriate.

40. Some of those respondents added that:

    (a) disclosure in the notes should give users sufficient information about volatile, unusual and non-main business income and expenses. A few respondents suggested non-main business activities could be disaggregated in a separate column in segment reporting.

    (b) the Board's proposed approach would prevent entities excluding income or expenses from operating profit in an 'other' or 'non-operating' category, which some entities may use to draw away users' attention from unfavourable items.

Concerns

41. Some respondents, mainly from Asia and North America, disagreed with defining the operating category as a residual category and preferred a 'positive' or 'direct' definition:

    (a) most respondents preferred a direct definition because they disagreed with the content of operating profit applying the Board's proposed definition—these respondents (including mostly preparers and one Asian user group) think:

        (i) the Board's proposed definition would capture income and expenses that, in their view, do not belong in operating profit (paragraphs 43–46); and

        (ii) the proposed content of operating profit would prevent entities from communicating useful information in the statement of profit or loss (paragraphs 47–50);

    (b) a few respondents agreed with the content of operating profit applying the Board's proposed definition but think important measures should be defined directly (paragraph 51).

42. Some of the respondents who agreed with defining the operating category as a residual category said the role of an entity's main business activities in the definition is unclear (paragraphs 52–55).

The definition would capture items that do not belong in operating profit

43. Most respondents who disagreed with defining the operating category as a residual category did so because they disagreed with the Board's view that all income and expenses included in profit or loss, other than those related to financing, tax, some investments or discontinued operations, arise from an entity's operations.

44. These respondents were concerned that operating profit would be a 'dumping ground' for any items that do not fit in the other categories but do not truly belong in operating profit. They preferred a direct definition that would lead to a narrower set of income and expenses being included in operating profit than applying the Board's residual definition. In particular, some respondents disagreed with the operating category including:

    (a) unusual and volatile income and expenses; and

    (b) income and expenses not arising from an entity's main business activities.

45. In their view, the inclusion of such income and expenses would undermine the usefulness of operating profit as a predictive measure. A few respondents think that including unusual and volatile items in operating profit would reduce its comparability between entities and over time. In their view, income and expenses that are different in terms of persistence should not be made to look alike by being classified together in the operating category.

46. Some respondents added that their suggestions would involve the creation of an 'other' or 'non-operating' category for income or expenses that do not fit in the operating category or the other specified categories.

The Board's proposal would prevent entities from communicating useful information in the statement of profit or loss

47. Some respondents said unusual, volatile and 'non-main business' income and expenses should be separately presented in the statement of profit or loss, because such information is relevant to a user's understanding of an entity's financial performance.

48. These respondents said that, applying the proposals, separate presentation of unusual, volatile or 'non-main business' income and expenses may only be possible outside the

operating category, where the proposed ban on mixing nature and function would not apply. Therefore, they supported excluding such income and expenses from the operating category.

49. Alternatively, if the Board required such income and expenses to be included in operating profit, they suggested the Board should allow separate presentation, for example through:

(a) a subtotal within the operating category for operating profit before volatile, unusual and 'non-main' income or expenses;

(b) separate line item(s) within the operating category—for example a few respondents suggested entities should be allowed to present a separate 'mergers and acquisitions' function; or

(c) a separate column in the statement of profit or loss.

50. Many users did not express concerns about including unusual, volatile and non-main business income and expenses in operating profit, but they expressed mixed views on how such items should be presented. Some users would prefer such income and expenses to be separately presented in the statement of profit or loss. Other users said such presentation may clutter and disrupt the structure of the statement of profit or loss and preferred such information to be provided in the notes.

Important measures should be defined directly

51. A few respondents agreed with the classification outcome of the Board's proposed definition but disagreed with a residual definition in principle. They think important measures of performance such as operating profit should be defined directly. For example, the German standard-setter (DRSC) suggested defining operating profit as: 'income and expenses arising from an entity's activities in executing its business model'.

The role of an entity's main business activities in the definition is unclear

52. Some of the respondents who agreed with defining the operating category as a residual category said the proposed definition of operating profit is complex and should be articulated more clearly.

53. In particular, some respondents suggested the Board should clarify the interaction (or perceived tension) between the residual definition and the first sentence in paragraph 46 of the Exposure Draft (see paragraph 9) which states that 'The operating category includes information about income and expenses from an entity's main business activities'.

54. Some respondents are concerned this sentence could be read as requiring that the operating category *only* includes information about income and expenses from an entity's main business activities. Such a reading would contradict the definition of operating as a residual category.

55. Some respondents suggested the Board should more clearly explain the role of the concept of 'main business activities' in the definition. For example, the Footnotes Analyst commented:

The relevance of referring to 'main business activities' appears to be identifying items that would normally be regarded as investing or financing but should instead be classified as operating. We support this but think this approach needs to be explained more clearly.

Staff analysis

56. In the light of the feedback received, the Board should consider:

(a) whether it still supports the arguments set out in the Basis for Conclusions for its approach to defining operating profit (see paragraph 14); and

(b) whether those arguments outweigh the concerns expressed by respondents (see paragraphs 41–55).

57. Consequently, the staff analysis is structured as follows:

(a) **Would the proposed definition capture the right income and expenses?** Paragraphs 59–73 discuss the Board's argument set out in paragraph 14(a) that all income and expenses included in profit or loss, other than those related to financing, tax, some investments or discontinued operations, arise from an entity's operations. This section also covers:

(i) the concern described in paragraphs 43–46 that the Board's proposed definition would capture income and expenses that do not belong in operating profit; and

(ii) the concern described in paragraphs 47–50 that the Board's proposal would prevent entities from communicating useful information in the statement of profit or loss.

(b) **Should the Board explore developing a direct definition of operating profit?** Paragraphs 74–83 discuss the Board's arguments set out in paragraph 14(b) that defining operating as a residual category is a more pragmatic approach than defining operating profit directly. This section also considers the view described in paragraph 51 that important measures should be defined directly.

58. Appendix D discusses the concern that the proposed definition of operating profit is difficult to understand and sets out a few possible approaches to clarify the definition in drafting. We do not think it would be effective for the Board to discuss the precise drafting of the definition at this meeting. Nevertheless, we welcome any comments on the approaches set out in Appendix D.

Would the proposed definition capture the right income and expenses?

59. A subtotal labelled 'operating profit' purports to represent income and expenses arising from an entity's operations. In order for operating profit to faithfully represent what it purports to represent, it should provide a complete and neutral depiction of the income and expenses arising from an entity's operations. The question is: which income and expenses arise from an entity's operations?

60. We support the Board's initial view that all income and expenses included in profit or loss, other than those related to financing, tax, some investments or discontinued operations, arise from an entity's operations—in our view:

(a) an entity's operations include, but are not limited to its main business activities (paragraphs 61–63);

(b) an entity's operations are inherently volatile (paragraphs 64–68);

(c) an entity can provide information about unusual, volatile and non-main business income and expenses in different ways (paragraphs 69–72).

An entity's operations include, but are not limited to, its main business activities

61. Applying the Board's proposed definition, operating profit would not be limited to income and expenses from an entity's main business activities. For example, operating profit could include income and expenses from supporting activities that do not generate revenue directly or income and expenses from a subsidiary conducting ancillary activities that are not (yet) a main business activity of the group. In our view, ancillary and supporting activities are conducted in the course of an entity's operations.

62. In addition, we think it may be difficult for entities to present main business activities separately from ancillary and supporting activities in the statement of profit or loss. When main business activities and ancillary and supporting activities use the same resources or there is intercompany trading between the activities, allocations of income and expenses may be difficult or arbitrary.

63. We also think it is unlikely that, applying the Board's proposed definition, operating profit would be a 'dumping ground' for income and expenses that do not fit in the other categories but do not truly belong in operating profit. We did not identify any examples of such income or expenses that would merit presentation outside operating profit in a separate category in our sample of 50 fieldwork companies (see Appendix C) or in the feedback on the Exposure Draft.

An entity's operations are inherently volatile

64. We retain the view that predictive value is not a characteristic that differentiates whether income or expenses are operating (or any other category).

65. Volatile and unusual income and expenses are inherent to an entity's operating activities. For example, if equipment is used to produce goods or provide services, depreciation of such equipment would be classified in operating profit. Excluding other, more volatile expenses that may arise from that same piece of equipment, such as its impairment, would provide an incomplete picture of the results from an entity's operations.

66. We also disagree with the view expressed by a few respondents that including volatile and unusual items in operating profit would reduce its comparability between entities and over time (see paragraph 45). Paragraph 2.27 of the *Conceptual Framework for Financial Reporting* explains that: 'for information to be comparable, like things must look alike and different things must look different.' These respondents argue that the proposed definition fails the 'different things must look different' aspect. They think that income and expenses that are different in terms of persistence should not be made to look alike by being classified together in the operating category.

67. We think the operating category will always include a mix of items with many different characteristics, such as persistence, nature and measurement basis. A binary 'operating vs non-operating' distinction cannot communicate all these different characteristics to make 'different things look different'. Instead, we think such information should be provided through disaggregation in the statement of profit or loss and the notes (this view is further explored in the next section). We think users considering operating profit in combination with such disaggregated information will be able to make comparisons.

68. In addition, all items included in the operating category would arguably be 'like things' in that they share the characteristic that they arise from an entity's operations. Therefore, we think operating profit would be a comparable measure of the results from an entity's operations.

An entity can provide information about unusual, volatile and non-main business income and expenses in different ways

69. We understand that information about volatile and unusual income and expenses and income and expenses from non-main business activities is useful to users. However, excluding such items from operating profit is not the only way for an entity to provide such information.

70. Applying the Board's proposals and existing IFRS Standards, some information about volatile and unusual income and expenses and non-main business activities would be disclosed in the notes:

(a) entities would be required to provide a disclosure of unusual income and expenses (although the Board may alter this proposal in redeliberations);

(b) entities can disclose a ‘recurring’ or ‘core’ operating profit as a management performance measure;

(c) line items presented in the statement of profit or loss would be required to be disaggregated in the notes on the basis of the characteristics of the underlying income and expenses; and

(d) non-main business activities can be disaggregated in segment reporting.

71. Nevertheless, we acknowledge respondents’ concern that the proposals in the Exposure Draft may prevent entities from providing useful information about volatile and unusual income and expenses and non-main business activities in the statement of profit or loss. In particular, the proposed ban on mixing nature and function in the statement of profit or loss and the proposed ban on columns for management performance measures may prevent such presentation. As discussed in paragraph 50, users have mixed views on this topic.

72. We are planning to discuss with the Board at a future meeting whether to:

(a) ease the proposed restrictions on mixing line items by nature and function in the operating category, and if so under which conditions, entities can present:

(i) volatile, unusual or non-main business income and expenses as separate line items above operating profit in the statement of profit or loss; and

(ii) subtotals in the statement of profit or loss not specified by the Board, including subtotals within the operating category; and

(b) present columns in the statement of profit or loss—the Exposure Draft does not discuss columns, except for the proposal to ban columns for the presentation of management performance measures.

Staff recommendation

73. We conclude that:

(a) the proposed definition of operating profit captures the right income and expenses. We recommend the Board confirm that the operating category:

(i) comprises all income and expenses arising from an entity's operations, including volatile and unusual income and expenses arising from an entity's operations; and

(ii) includes, but is not limited to, income and expenses from an entity's main business activities.

(b) further work is needed to ensure entities can provide relevant information about income and expenses classified in the operating category. We plan to bring this topic to a future Board meeting. However, we think these future discussions should not prevent the Board from answering the question below at this meeting.

Question 3
Does the Board agree with the staff recommendation to confirm that the operating category: (a) comprises all income and expenses arising from an entity's operations, including volatile and unusual income and expenses arising from an entity's operations; and (b) includes, but is not limited to, income and expenses from an entity's main business activities?

Should the Board explore developing a direct definition?

74. Having concluded that the proposed definition of operating profit captures the right income and expenses, we think we have rebutted the main arguments raised by some respondents for defining operating profit directly (see paragraph 41(a)). However, we understand some respondents' preference for important measures to be defined directly. In deciding whether to explore developing a direct definition, we think the Board should assess how likely it is that it would be able to develop a robust, direct definition that could achieve comparability—an important objective of the Board's proposals for subtotals in the statement of profit or loss.

75. As explained earlier, the Conceptual Framework states that: 'for information to be comparable, like things must look alike and different things must look different.'

76. The feedback supported the Board's view that:

    (a) it is easier to provide a robust definition of the income and expenses to be classified in the financing or investing categories than those in the operating category, because entities have various business activities; and

    (b) a residual definition is simpler to apply for entities, would involve less judgement and is more likely to be consistently applied than a direct definition.

77. As a consequence, we believe a residual definition is more likely to achieve 'like things looking alike' in that different entities (or the same entity at different points in time) would be more likely to classify similar income and expenses in the same way.

78. In particular, we expect a residual definition will be more consistently applied than a direct definition to items that are less straightforward to classify, such as donations and other items listed in paragraph C2(b) that we identified in the fieldwork. For example, suppose two entities need to classify expenses related to donations in the statement of profit or loss:

    (a) we think it is highly likely that, applying the proposed residual definition, both entities would conclude that donations do not meet the definition of investing, financing, income taxes or discontinued operations and would therefore classify donations in operating profit; but

(b) we think the two entities may reach different conclusions when applying a direct definition such as 'income and expenses arising from executing the entity's business model'.

79. We believe it would be difficult for the Board to provide further guidance to make any direct definition more robust and eliminate the potential for inconsistent application. In the example above, we think inconsistent application could only be avoided if the Board provided rules-based guidance that all donations are considered to arise from executing the entity's business model.

80. In developing the Exposure Draft, it was challenging for the Board to develop guidance to help entities identify their main business activities. Even though 'main business activities' play a relatively minor role in the definition of operating profit proposed in the Exposure Draft (see paragraph 13), the feedback indicated a strong demand for the Board to provide further guidance. Direct definitions of operating profit such as 'income and expenses from business activities' or 'income and expenses arising from executing the entity's business model' are likely to result in an even greater demand for guidance on 'main busines activities' or 'an entity's business model', which the Board is unlikely to be able to provide.

81. We also agree with some respondents' arguments described in paragraph 38(b) that:

(a) it is not feasible for the Board to define all categories in the statement of profit or loss directly so that all income and expenses meet the definition of one of the categories, because we think the Board cannot foresee all possible types of income and expenses;

(b) the statement of profit or loss must contain a residual category for items that may 'fall through the cracks', that is, items that do not meet the definitions of any of the other categories; and

(c) the operating category is the most appropriate residual category—we think it is a reasonable assumption that an entity's income and expenses are by default operating, to the extent that they do not meet the definitions of any of the other categories, because an entity's main purpose is to conduct its operations.

Staff conclusion and recommendation

82. We think the Board should not explore developing a direct definition of operating profit because it is unlikely the Board would be able to develop a robust, direct definition that would achieve comparability. In other words, regardless of how the Board decides to draft the definition of operating profit, we think it needs to contain a residual component that describes income and expenses to be excluded from operating profit.

83. Appendix D explores different approaches to drafting a definition that include both residual and direct components.

Question 4

(a) Does the Board agree with the staff recommendation not to explore developing a direct definition of operating profit?

(b) Does the Board have any comments on the possible approaches to drafting set out in Appendix D?

Appendix A—Linkages with other project areas that will be discussed in future meetings

A1. The following table summarises the linkages between topics discussed in this paper and topics that the Board will redeliberate at a later time:

Linked topic	**How is the topic linked to the discussion in this paper?**
Subtotals and categories in the statement of profit or loss	
Content of the investing and financing categories	This paper asks the Board to confirm that investing and financing income and expenses are classified outside operating, but the Board may change the definitions of investing and financing at future meetings.
Classification of income and expenses from equity-accounted associates and joint ventures	The list of income and expenses to be excluded from operating in this paper is not complete—we plan to discuss the classification of income and expenses from associates and joint ventures at a future meeting.
Main business activities	This paper asks the Board to confirm that the operating category includes, but is not limited to, income and expenses from an entity's main business activities. At a future meeting we plan to discuss further guidance to help entities identify their main business activities.
Classification of income and expenses for entities with specific main business activities	This paper asks the Board to confirm that investing and financing income and expenses are classified outside operating. However, we are planning to ask the Board to confirm at a future meeting that entities that invest or provide financing as a main business activity should include some investing and financing income and expenses in operating.
Presentation of subtotals that are equal or almost equal	This paper asks the Board to confirm that all entities should present operating profit. However, we plan to discuss at a future meeting whether, and if so how, operating profit should be presented if equal or almost equal to another subtotal.

Disaggregation	
Analysis of expenses by nature and function	Some respondents said they would only agree with including unusual, volatile and non-main business income/expenses in the operating category if such items could be separately presented within the operating category in the statement of profit or loss, using: (a) separate line items; (b) columns; or (c) additional subtotals above operating profit. We plan to discuss at a future Board meeting whether such presentation and disaggregation should be permitted. The requirements proposed in the Exposure Draft—in particular the proposed ban on mixing nature and function in the statement of profit or loss and proposed ban on columns for management performance measures—may prevent such separate presentation.
Unusual income and expenses	In this paper, we argue that information about unusual items would be provided in the notes applying the Board’s proposals, which lessens the need for such items to be separately presented outside operating profit. However, the Board’s proposals on unusual items may be amended in future Board discussions.

Appendix B—Definitions of investing and financing proposed in the Exposure Draft (paragraphs 47–52 of the Exposure Draft)

Investing

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

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

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

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

Financing

49 **The objective of the financing category is to communicate information about income and expenses from assets and liabilities related to an entity's financing. Except as required by paragraphs 51–52, an entity shall classify in the financing category:**

- **(a) income and expenses from cash and cash equivalents (see paragraph B34);**
- **(b) income and expenses on liabilities arising from *financing activities* (see paragraphs B35–B36); and**
- **(c) interest income and expenses on other liabilities (see paragraph B37).**

50 Financing activities are those involving the receipt or use of a resource from a provider of finance with the expectation that:

- (a) the resource will be returned to the provider of finance; and
- (b) the provider of finance will be compensated through the payment of a finance charge that is dependent on both the amount of the credit and its duration.

51 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 either (see paragraphs B28–B29):

- (a) income and expenses from financing activities, 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.

52 An entity also excludes the following income and expenses from the financing category and classifies them in the operating category:

- (a) income and expenses from cash and cash equivalents if the entity, in the course of its main business activities, invests in financial assets that generate a return individually and largely independently of other resources held by the entity (see paragraph B30);
- (b) income and expenses on liabilities arising from issued investment contracts with participation features recognised applying IFRS 9 *Financial Instruments*; and
- (c) insurance finance income and expenses included in profit or loss applying IFRS 17 *Insurance Contracts*.

Appendix C—Non-operating items presented by fieldwork participants

C1. We identified those fieldwork participants that already present an operating profit subtotal today—these subtotals are defined by management in the absence of specific requirements in IFRS Standards. We analysed income and expenses that participants *included* in operating profit applying the Board's proposed definition, but which they currently report as 'non-operating' items, *excluded* from operating profit. We assumed that any 'dumping ground'-type items (see paragraphs 44 and 63) would be included in that set of income and expenses.

C2. Out of the 50 fieldwork participants, 22 currently present an operating profit subtotal in the statement of profit or loss. Out of those:[4]

(a) 13 entities did *not* report any such 'non-operating' income or expenses;

(b) nine entities did report such 'non-operating' income or expenses, comprising:

(i) income and expenses related to investments and divestments, such as gains or losses on disposals of assets or shares in subsidiaries (other than discontinued operations) and gains on bargain purchases.

(ii) income and expenses from restructuring;

(iii) donations made by the company;

(iv) government grants received by the company;

(v) tax penalties that did not meet the definition of 'income taxes' and were not interest in nature;

(vi) foreign exchange gains or losses; and

(vii) gains or losses on the net monetary position applying IAS 29 *Financial Reporting in Hyperinflationary Economies*.

[4] We only analysed 'non-adjusted' operating profit—some of these entities also presented an adjusted operating profit from which they excluded more items.

C3. We plan to discuss the classification of some of these items at a future Board meeting:

(a) foreign exchange gains or losses—we plan to discuss whether practical concerns raised in the feedback outweigh the benefits of the proposed allocation of foreign exchange gains or losses to the related categories.

(b) gains or losses on the net monetary position applying IAS 29 *Financial Reporting in Hyperinflationary Economies*—the Board did not specifically consider the classification of these gains or losses in developing the Exposure Draft.

(c) income and expenses related to investments and divestments—applying the proposals in the Exposure Draft, such income and expenses would be classified as operating. However, a few respondents suggested classifying such income and expenses in the investing category. We plan to discuss this topic in a future paper on the investing category.

C4. We do not think any of the other income and expenses listed in paragraph C2(b) belong in the investing or financing categories or merit presentation outside operating profit in a separate ‘other’ or ‘non-operating’ category. In our view, they arise in the course of the entity’s operations.

Appendix D—Possible approaches to clarify the definition of operating profit

D1. We agree with respondents that paragraph 46 of the Exposure Draft was not sufficiently clear that the operating category includes, but is not limited to, information about income and expenses from an entity's main business activities (see paragraphs 52–55).

D2. We have identified a few possible approaches to clarify the definition of operating profit proposed in the Exposure Draft. These approaches would all achieve the same outcome—that is, the same income and expenses would be classified in operating profit.

Approach I—Reducing the prominence of main business activities

D3. Applying this approach, we would delete the first sentence from paragraph 46 of the Exposure Draft ('The operating category includes information about income and expenses from an entity's main business activities').

D4. We would only retain similar wording in the Basis for Conclusions (see paragraph BC57 of the Exposure Draft), where we explain that:

(a) the operating category is intended to include all income and expenses from an entity's main business activities; and

(b) this is the reason why the Board developed the exceptions for entities with specific main business activities to classify income and expenses in the operating category that would otherwise be classified in the investing or financing categories.

Approach II—Clarifying the role of main business activities

D5. Applying this approach, we would move the first sentence from paragraph 46 of the Exposure Draft to the Application Guidance and amend it to state that: 'The operating category includes, but is not limited to, information about income and expenses from an entity's main business activities'. No other changes would be made to the definition in paragraph 46 of the Exposure Draft.

Approach III—Increasing the prominence of main business activities

D6. Applying this approach, paragraph 46 of the Exposure Draft would be changed to:

~~The operating category includes information about income and expenses from an entity's main business activities.~~ An entity shall classify in the operating category all income and expenses included in profit or loss <u>arising from its main business activities and any other income and expenses included in profit or loss</u> that are not classified in:

(a) investing;

(b) financing;

(c) integral associates and joint ventures;

(d) income tax; or

(e) discontinued operations.

D7. The definitions of the investing and financing categories would exclude income and expenses arising from an entity's main business activities, similar to the proposed definitions in the Exposure Draft (see Appendix B).

D8. Approach III would be similar to the approach used in IAS 7 *Statement of Cash Flows* to define operating activities as: 'the principal revenue-producing activities of the entity and other activities that are not investing or financing activities.'

Initial staff thoughts

D9. All approaches would reduce the risk of misreading the definition as requiring that operating profit *only* includes income and expenses from main business activities.

D10. Approach I is the simplest approach, but some information would be lost in that the Standard would no longer communicate the objective of the operating category.

D11. Approach III would make the 'positive' or 'direct' component of the definition more prominent than Approaches I and II, which may address some respondents' view that important measures should be defined directly. However, Approach III may make it less clear that, for entities that do not invest or provide financing as a main business activity, there is no need to identify their main business activities (see paragraph 13).

D12. We think Approach II may strike a balance between clarifying, but not over-emphasising the role of an entity's main business activities in the definition.