IFRS Accounting

Staff paper

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Objective

1. This paper sets out the staff analysis and recommendations for outstanding issues for categories in the statement of profit or loss in the Exposure Draft *General Presentation and Disclosures*. This paper discusses classification of:
   (a) foreign exchange differences on liabilities that arise from transactions that do not involve only the raising of finance ('other liabilities' thereon) that are denominated in a foreign currency;
   (b) the gain or loss on the net monetary position[1] recognised applying IAS 29 *Financial Reporting in Hyperinflationary Economies*; and
   (c) income and expenses from specific hybrid contracts with host liabilities that arise from transactions that do not involve only the raising of finance.

[1] The gain or loss on the net monetary position may be: (i) derived as the difference resulting from the restatement of non-monetary assets, owners' equity and items in the statement of other comprehensive income and the adjustment of index linked assets and liabilities; or (ii) estimated by applying the change in a general price index to the weighted average for the period of the difference between monetary assets and monetary liabilities (paragraph 27 of IAS 29 *Financial Reporting in Hyperinflationary Economies*).

2. Appendix A summarises other outstanding issues related to categories in the statement of profit or loss for which the staff conclude no further action is required, including:

   (a) classification of foreign currency differences;

   (b) classification of interest and penalties on income taxes;

   (c) disclosure requirements for hybrid contracts designated at fair value through profit or loss with host liabilities that arise from transactions that do not involve only the raising of finance;

   (d) classification of the change in the value of the undesignated forward element of a forward contract or the foreign currency basis spread of a financial instrument; and

   (e) classification of loan commitment fees.

3. In future papers we plan to discuss outstanding issues related to subtotals and categories including:

   (a) issues related to associates and joint ventures accounted for using the equity method (see Agenda Paper 21A of the January 2023 IASB meeting);

   (b) whether a general principle or further guidance is needed to clarify the classification of income and expenses arising from transactions which result in a change in the category in which income and expenses from assets are classified (for example, in which category to classify gains and losses that arise when an investment in an equity instrument becomes a subsidiary); and

   (c) how to apply the proposals when required subtotals are almost equal.

Summary of staff recommendations in this paper

4. We recommend the IASB:

   (a) require an entity to classify foreign exchange differences on other liabilities as described in paragraph 1(a) of this paper in the operating category of the statement of profit or loss;

(b) amend IAS 29 and IFRIC 7 *Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies* to require an entity to classify the gain or loss on the net monetary position in the operating category of the statement of profit or loss; and

(c) require an entity to classify in the financing category of the statement of profit or loss all income and expenses arising after initial recognition for hybrid contracts with host liabilities that arise from transactions that do not involve only the raising of financing, and are measured at amortised cost in their entirety.

Structure of the paper

5. This paper is structured as follows:

(a) Background (paragraphs 6–8);

(b) Classification of foreign exchange differences on other liabilities (paragraphs 9–24);

(c) Classification of the gain or loss on the net monetary position recognised applying IAS 29 (paragraphs 25–42);

(d) Classification of income and expenses from specific hybrid contracts (paragraphs 43–57);

(e) Feedback for which the staff conclude no further action is required (paragraph 58);

(f) Appendix A – Feedback for which the staff conclude no further action is required;

(g) Appendix B – Background information for hybrid contracts;

(h) Appendix C – Extracts from IFRS 9 *Financial Instruments* in reference to closely related embedded derivatives; and

(i) Appendix D – Accounting for the forward element of forward contracts and the foreign currency basis spreads of financial instruments.

Background

6. In its meeting in July 2021, the IASB tentatively decided to:

   (a) require an entity to classify foreign exchange differences in the same category of the statement of profit or loss as the income and expenses from the items that gave rise to the foreign exchange differences[2], except when doing so would involve undue cost or effort in which case an entity classifies the foreign exchange differences on the item in the operating category (see Agenda Paper 21C); and

   (b) require an entity to classify in the financing category of the statement of profit or loss interest expense and the effect of changes in interest rates on other liabilities (as described in paragraph 1(a) of this paper) when such amounts are identified applying the requirements of IFRS Accounting Standards (see Agenda Paper 21A).

7. A consequence of the tentative decision in paragraph 6(b) is that such liabilities may give rise to income and expenses classified in more than one category of the statement of profit or loss. For example, income and expenses on payables for goods and services received negotiated on extended credit terms are generally classified in two categories in the statement of profit or loss, that is (i) income and expenses from the purchase of goods and services in the operating category and (ii) interest expense in the financing category.

8. The tentative decision in paragraph 6(b) does not relate to hybrid contracts with host liabilities that arise from transactions that do not involve only the raising of finance.

[2] Foreign exchange differences arising from income tax payables or receivables denominated in a foreign currency are classified in the operating category because paragraph 54 of Exposure Draft requires an entity to classify in the income tax category only income tax expense or income included in profit or loss applying IAS 12 *Income Taxes*.

These are discussed separately in this paper (see paragraph 43). For such hybrid contracts, the IASB decided to explore an approach that would classify all income and expenses in the financing category of the statement of profit or loss (see Agenda Paper 21A of the July 2021 IASB meeting). Appendix B of this paper provides background information on the relationship between the requirements in IFRS 9 for hybrid contracts and the IASB's tentative decisions on the financing category and a summary of the discussions from the July 2021 IASB meeting.

Classification of foreign exchange differences on other liabilities

9. This section discusses:

   (a) feedback from targeted outreach (paragraph 10); and

   (b) staff analysis, staff recommendation and question for the IASB (paragraphs 11–24).

Feedback from targeted outreach

10. In targeted outreach (see Agenda Paper 21A of the January 2023 IASB meeting), one participant said that using the undue cost or effort relief and classifying foreign exchange differences in the operating category (see paragraph 6(a) of this paper) may result in what they view to be counterintuitive outcomes for the other liabilities described in paragraph 1(a) of this paper. The interest expenses for such liabilities are classified in the financing category, for example the unwinding of the discount on a provision denominated in a foreign currency. In their view, foreign exchange differences arising from other liabilities should also be classified in the financing category.

Staff analysis, staff recommendation and question for the IASB

11. We recommend the IASB require an entity to classify foreign exchange differences on other liabilities in the operating category. The staff analysis is structured as follows:

(a) why a requirement on classification of foreign exchange differences on other liabilities is required (paragraphs 12–15);

(b) classification in the financing category (paragraphs 16–20);

(c) classification in the operating category (paragraphs 21–23); and

(d) staff recommendation and question for the IASB (paragraph 24).

Why a requirement on classification of foreign exchange differences on other liabilities is required

12. When discussing classification of foreign exchange differences in July 2021 (see [Agenda Paper 21C]), the IASB did not specifically discuss classification of foreign exchange differences on other liabilities. Paragraph A6 of [Agenda Paper 21C] of the July 2021 IASB meeting explains that, for liabilities that involve activities in addition to financing, an entity would use its judgement to decide in which category in the statement of profit or loss to classify the foreign exchange differences to give the most complete picture of the respective activities.

13. We think that without clear guidance on which to base this judgement, differing views may arise in practice. For example:

(a) some may view the foreign exchange differences on other liabilities arising as a consequence of the entity's financing decisions and, therefore, that all foreign exchange differences on other liabilities should be classified in the financing category (see paragraph 10 of this paper);

(b) some may view the foreign exchange differences on other liabilities arising as a consequence of the decision to enter into a transaction in a foreign currency or conduct operations in other jurisdictions and, therefore, that all foreign exchange differences on other liabilities should be classified in the operating category; and

(c) some may view the foreign exchange differences on other liabilities arising as a consequence of both (a) and (b) and hence that foreign exchange differences on other liabilities should be allocated to both the financing category and the operating category.

14. In order to avoid diversity in practice, we think that the IASB should introduce a requirement for the classification of foreign exchange differences arising from other liabilities in a single category in the statement of profit or loss because such an approach would be simple and easy to apply. We therefore considered whether the foreign exchange differences on other liabilities should be classified in the operating category or the financing category based on the views in paragraphs 13(a) and 13(b).

15. We also considered and rejected an approach based on the view in paragraph 13(c) where an entity would allocate foreign exchange differences on other liabilities between the operating and financing categories. This is because assessing which portion of the foreign exchange differences on the other liability is related to the operating category and which portion is related to the financing category would be burdensome for preparers and the costs of such an approach are likely to exceed the benefits.

Classification in the financing category

16. In this section we consider whether the IASB should require an entity to classify all foreign exchange differences on other liabilities in the financing category because some view the foreign exchange differences on other liabilities as arising as a consequence of the entity's financing decisions (paragraph 13(a) of this paper).

17. Applying the IASB's tentative decisions, an entity would be required to classify interest expense on other liabilities in the financing category (see paragraph 6(b) of this paper). Due to the economic link between interest rates and foreign exchange rates, one view is that foreign exchange differences on other liabilities should also be classified with interest expense in the financing category.

18. However, in some cases, no interest expense arises from other liabilities. For example, interest expense is generally recognised on payables for goods and services received

negotiated on extended credit terms, but it is not recognised on payables for goods and services received without extended credit terms.

19. Classifying foreign exchange differences on other liabilities in the financing category when no interest expense is recognised on other liabilities in the statement of profit or loss could result in a conflict with the general principle to classify foreign exchange differences in the same category as the income and expenses from the items that gave rise to the foreign exchange differences (see paragraph 6(a) of this paper).

20. In order to remove this conflict, we considered and rejected an approach to requiring an entity to classify foreign exchange differences on other liabilities in the financing category only when interest expense is recognised on those liabilities in the statement of profit or loss. We think that such an approach would be burdensome for preparers and the costs are likely to exceed the benefits and, therefore, could result in entities applying the undue cost or effort relief rather than the general principle described in paragraph 6(a) of this paper. This is because, in order to determine how to classify foreign exchange differences, an entity would be required to distinguish between:

    (a) foreign exchange differences arising on other liabilities with interest expenses recognised in the statement of profit or loss (e.g. payables for goods and services received negotiated on extended credit terms); and

    (b) foreign exchange differences arising on other liabilities for which no interest expenses are recognised in the statement of profit or loss (e.g. payables for goods and services received without extended credit terms).

Classification in the operating category

21. In this section we consider whether the IASB should require an entity to classify all foreign exchange differences on other liabilities in the operating category because some view the foreign exchange differences on other liabilities arising as a consequence of the decision to enter into a transaction in a foreign currency or conduct operations in other jurisdictions as explained in paragraph 13(b).

22. Other liabilities as described in paragraph 1(a) of this paper do not arise purely from financing activities but also operating activities (see paragraph 7 of this paper). Therefore, we expect that some or all foreign exchange differences would relate to operating activities. For example, foreign exchange differences on payables for goods and services received arise as a result of the decision to purchase goods or services in a foreign currency and relate to the operating activities where those goods and services are used.

23. This approach would result in interest expenses on other liabilities as described in paragraph 1(a) being classified in the financing category and foreign exchange differences on such other liabilities being classified in the operating category. Foreign exchange differences are classified in the operating category when the undue cost or effort relief (see paragraph 6(a) of this paper) is applied because the operating category is the residual category. The classification outcome for foreign exchange differences on other liabilities as described in paragraph 1(a) of this paper when applying this approach would be the same as the classification outcome when the undue cost or effort relief for foreign exchange differences is applied. Therefore, we think that the IASB can make the requirements easier to apply by requiring an enity to classify foreign exchange differences on other liabilities in the operating category in the statement of profit or loss.

Staff recommendation and question for the IASB

24. The approaches explored in paragrahs 15–23 of this paper have advantages and disadvantages. On balance, we recommend that the IASB require an entity to classify foreign exchange differences on other liabilities as described in paragraph 1(a) of this paper in the operating category in the statement of profit or loss because:

    (a) the operating category is the default category; and

    (b) the IASB can make the requirements easier to apply by requiring an approach that would result in the same classification outcome as the classification outcome when the undue cost or effort relief is applied (see paragraph 6(a) of this paper).

Questions for the IASB
1. Does the IASB agree with the staff recommendation to require an entity to classify foreign exchange differences on other liabilities as described in paragraph 1(a) of this paper in the operating category of the statement of profit or loss?

Classification of the gain or loss on the net monetary position recognised applying IAS 29

25. This section discusses:

(a) proposals in the Exposure Draft and current requirements in IAS 29 (paragraphs 26–27);

(b) comment letter feedback (paragraph 28); and

(c) staff analysis, staff recommendation and question for the IASB (paragraphs 29–42).

Proposals in the Exposure Draft and current requirements in IAS 29

26. The Exposure Draft did not provide guidance on the classification of the gain or loss on the net monetary position in the statement of profit or loss recognised applying IAS 29.

27. Paragraph 9 of IAS 29 requires an entity to include the gain or loss on the net monetary position in profit or loss and separately disclose it. Paragraph 28 of IAS 29 states that it may be *helpful* if other income and expense items, such as interest income and expense, and foreign exchange differences related to invested and borrowed funds, are presented together with the gain or loss on the net monetary position. The requirements in paragraph 28 of IAS 29 are repeated in the illustrative examples in IFRIC 7 (see paragraph IE6 of IFRIC 7).

Comment letter feedback

28. Some stakeholders (especially standard-setters and preparers) asked the IASB to clarify how an entity should classify the gain or loss on the net monetary position applying IAS 29, with:

    (a) a few raising concerns that the requirement in the Exposure Draft that an entity classify foreign exchange differences in the same category of the statement of profit or loss as the income and expenses from the items that gave rise to the foreign exchange differences (see paragraph 6(a) of this paper) may lead an entity to allocate the gain or loss on the net monetary position to each line item impacted in the statement of profit or loss; and

    (b) a few suggesting that the gain or loss on the net monetary position should be included in a separate category (other than operating, investing and financing categories) in the statement of profit or loss together with foreign exchange differences.

Staff analysis, staff recommendation and question for the IASB

29. We recommend that the IASB amend IAS 29 and IFRIC 7 to require an entity to classify the gain or loss on the net monetary position in the operating category. The staff analysis is structured as follows:

    (a) why an amendment to IAS 29 is required (paragraphs 30–32);

    (b) whether the IASB should require an entity to allocate the gain or loss on the net monetary position to each category of the statement of profit or loss (paragraphs 33–35);

    (c) category for classifying the net gain or loss on the net monetary position (paragraphs 36–41); and

    (d) staff recommendation and question for the IASB (paragraph 42).

Why an amendment to IAS 29 is required

30. Interest rates, exchange rates and inflation rates are economically linked. Paragraph 28 of IAS 29 states that it may be *helpful* if interest income and expense and foreign exchange differences are presented together with the gain or loss on the net monetary position.

31. However, applying the proposals in the Exposure Draft and the subsequent redeliberations to date, interest income and expenses and foreign exchange differences would be classified in different categories in the statement of profit or loss. For example:

    (a) interest revenue from financial assets arising from providing financing to customers would be classified in the operating category;

    (b) interest revenue from cash and cash equivalents would be classified in the investing category[3];

    (c) interest expenses from debt instruments issued would be classified in the financing category[4]; and

    (d) foreign exchange differences would be classified into all categories depending on the underlying items, except when applying the general principle would involve undue cost or effort. In that case, an entity classifies the foreign exchange differences on the item in the operating category (see paragraph 6(a) of this paper).

32. An inconsistency would arise when applying the requirements in IAS 29 with the IASB's tentative decisions to date[5] because in the proposed structure for the statement of profit or loss it is not possible to present interest income and expenses, foreign exchange differences and the gain or loss on the net monetary position together in a

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[3] When an entity invests in financial assets as a main business activity, they would be classified in the operating category.

[4] When an entity provides financing to customers as a main business activity, they would be classified in the operating category.

[5] We note that this inconsistency also arises applying the current requirements in paragraph 82(a)(i) of IAS 1 *Presentation of Financial Statements* because interest revenue calculated using the effective interest rate method is required to be presented separately from other revenue and finance costs.

single category. Therefore, we think that the IASB should amend IAS 29 and IFRIC 7 to remove this inconsistency.

Whether the IASB should require an entity to allocate the gain or loss on the net monetary position to each category of the statement of profit or loss

33. Although IAS 29 requires an entity to include the gain or loss on the net monetary position in the statement of profit or loss, it does not require the entity to allocate it to the items that give rise to it. The gain or loss on the net monetary position is not calculated for each individual asset or liability. It may be:

(a) derived as the difference resulting from the restatement of non-monetary assets, owners' equity and items in the statement of other comprehensive income and the adjustment of index linked assets and liabilities; or

(b) estimated by applying the change in a general price index to the weighted average for the period of the difference between monetary assets and monetary liabilities (paragraph 27 of IAS 29).

34. Requiring an entity to allocate the gain or loss on the net monetary position to different categories in the statement of profit or loss may result in arbitrary allocations and would go beyond the requirements of IAS 29. However, some might think that IAS 29 in combination with our proposal in the Exposure Draft and redeliberetions to date relating to the categories of income and expenses in the statement of profit or loss would mean an entity is required to allocate the gain or loss on the net monetary position to the categories in which other income and expenses associated with the net monetary position are classified (see paragraph 28(a) of this paper).

35. To address the feedback from stakeholders, we think that a consequential amendment to IAS 29 and IFRIC 7 is required to clarify that the gain or loss on the net monetary position should be classified in a single category in the statement of profit or loss.

Category for classifying the net gain or loss on the net monetary position

36. We think that the gain or loss on the net monetary position should be classified in the operating category because the operating category is the default category and the gain or loss on the net monetary position does not meet the requirements to be classified in the investing or financing categories[6].

37. We considered and rejected an approach of creating a separate category suggested by some stakeholders (see paragraph 28(b) of this paper) because we think that a separate category does not necessarily provide an understandable overview and would make the statement of profit or loss complex, especially when only some of the entities in a reporting entity group are required to apply IAS 29. We also note that creating a separate category would not resolve the inconsistency between the requirements in IAS 29 and the proposed requirements in IFRS X mentioned in paragraph 32 unless the separate category also included interest income and expenses and foreign exchange differences, but such an approach would be inconsistent with the proposed structure of the statement of profit or loss.

38. We also considered and rejected an approach to including the gain or loss on the net monetary position in the financing category because an exception to the requirements for the financing category would be required. We also note that such an approach was not requested by stakeholders and would not resolve the inconsistency between the requirements in IAS 29 and the proposed requirements in IFRS X mentioned in paragraph 32 because interest income on financial assets is not classified together with interest expense in the financing category.

39. Classifying the gain or loss on the net monetary position in operating category is consistent with the IASB's tentative decision in the July 2021 IASB meeting that the operating category will be the default category for foreign exchange differences when

[6] The gain or loss on the net monetary position is not:
(a) an asset that that generates a return individually and largely independently of other resources held by an entity;
(b) a liability that arises from transactions that involve only the raising of finance; and
(c) a liability that arises from transactions that do not involve only the raising of finance ('other liability' in this paper).

the undue cost or effort relief is applied because the operating category is the residual category (see paragraph 6(a) of this paper).

40. We do not think that the outcome of applying the requirements in IAS 29 will be impacted by classifying the gain or loss on the net monetary position in the operating category because paragraph 9 of IAS 29 requires an entity to separately disclose the gain or loss on the net monetary position, so users can obtain information about the impact of the gain or loss on the net monetary position from that disclosure. In addition, an entity could also present an additional subtotal of 'operating profit before the gain or loss on the net monetary position' when this subtotal provides an understandable overview (see Agenda Paper 21A of the February 2022 IASB meeting).

41. In addition, entites would still be required to present or disclose income and expense items associated with the net monetary position, such as interest income and expense, and foreign exchange differences related to invested or borrowed funds in accordance with the applicable IFRS Accounting Standards.

Staff recommendation and question for the IASB

42. Based on our analysis in paragraphs 29–41 of this paper, we think that the IASB should amend IAS 29 and IFRIC 7 and require an entity to classify the gain or loss on the net monetary position in the operating category in the statement of profit or loss. The proposed amendments to IAS 29 are:

> The gain or loss on the net monetary position is included in profit or loss in the operating category. The adjustment to those assets and liabilities linked by agreement to changes in prices made in accordance with paragraph 13 is offset against the gain or loss on net monetary position. Income ~~Other income~~ and expense items associated with the net monetary position, such as interest income and expense, and foreign exchange differences related to invested or borrowed funds~~, are also associated with the net~~

~~monetary position. Although such items~~ are separately presented or disclosed in accordance with the applicable IFRS Accounting Standards.~~, it may be helpful if they are presented together with the gain or loss on net monetary position in the statement of comprehensive income.~~

The proposed amendments to IFRIC 7 are:

IE 6 …The loss on tax base is a monetary loss. Paragraph 28 of IAS 29 explains this as follows:

The gain or loss on the net monetary position is included in net income. The adjustment to those assets and liabilities linked by agreement to changes in prices made in accordance with paragraph 13 is offset against the gain or loss on the net monetary position. Income ~~Other income~~ and expense items associated with the net monetary position, such as interest income and expense, and foreign exchange differences related to invested or borrowed funds~~, are also associated with the net monetary position. Although such items~~ are separately presented or disclosed in accordance with the applicable IFRS Accounting Standards.~~, it may be helpful if they are presented together with the gain or loss on net monetary position in the statement of comprehensive income.~~

Questions for the IASB
2. Does the IASB agree with the staff recommendation to amend IAS 29 and IFRIC 7 to require an entity to classify the gain or loss on the net monetary position in the operating category of the statement of profit or loss?

Classification of income and expenses from specific hybrid contracts

43. The staff analysis in this section is organised as follows:

    (a) A concern raised about specific hybrid contracts (paragraphs 44–45);

    (b) Circumstances when identifying the nature of income or expenses may be unclear (paragraphs 46–49);

    (c) Classifying all income and expenses in the financing category (paragraphs 50–53);

    (d) Classifying income and expenses of a different nature separately (paragraphs 54–56); and

    (e) Staff recommendation and question for the IASB (paragraph 57).

A concern raised about specific hybrid contracts

44. At its meeting in July 2021 (see Agenda Paper 21A), the IASB raised a concern that classifying income and expenses arising from specific hybrid contracts may not be clear when applying IFRS X. We think that these concerns can be addressed by requiring an entity to classify all income and expenses arising from specific hybrid contracts after initial recognition in the financing category (see Appendix B of this paper for further details of the IASB's discussion and tentative decisions to date).

45. The specific hybrid contracts for which the IASB asked the staff to explore an alternative approach to classifying income and expenses in the financing category are liabilities that are hybrid contracts in the scope of IFRS 9 (see Appendix B of this paper for a summary of other relevant requirements of IFRS 9) and that:

    (a) are measured at amortised cost; and

    (b) include an embedded derivative that is not separated from the host liability applying paragraph 4.3.3 of IFRS 9 because the economic characteristics and risks of the embedded derivative are closely related to the economic characteristics and risks of the host.

Circumstances when identifying the nature of income or expense may be unclear

46. A hybrid contract with a closely related embedded derivative that is measured at amortised cost may include a host liability that arises from a transaction that does not involve only the raising of finance. For example, a payable for goods or services received with extended credit terms that includes an early repayment option. Such a contract could give rise to income and expenses resulting from the changes in the expected future cash flows of the instrument as and when expectations regarding the use of the early repayment option are updated.

47. Applying IFRS Accounting Standards to such instruments, it may be unclear whether the income or expenses arising from the change in expected future cash flows would be identified as interest or as another type of income or expense. For example, if there was a change in the expectation about the use of the early repayment option it may be unclear how any resulting income or expense should be classified. Applying the revised approach to classifying income and expenses in the financing category to such instruments, interest is classified in the financing category and other income and expenses are classified in the operating category.

48. IFRS 9 includes examples of other hybrid contracts with a host liability and an embedded derivative that would be measured at amortised cost in its entirety as described in paragraph 45 of this paper (see Appendix C of this paper for the examples included in IFRS 9).

49. To clarify the classification of income and expenses arising from these hybrid contracts that are measured at amortised cost in their entirety, the IASB asked the staff to explore simplifying the approach by classifying all income and expenses in the financing category.

Classifying all income and expenses in the financing category

50. Requiring all income and expenses arising after initial recognition to be classified in the financing category for a hybrid contract with a closely related embedded derivative that is measured at amortised cost would remove the need to identify the nature of income or expenses identified when applying the revised approach to the financing category—in all cases they would be included in the financing category. This approach resolves the concern of some IASB members that classification of some income and expenses may not be clear.

51. However, in some cases an approach of classifying all income and expenses arising from such liabilities in the financing category may not be appropriate. When a liability arises from a transaction that does not involve only the raising of finance, such a transaction may result in income and expenses that are more appropriately classified in another category.

52. For example, if a payable for goods or services received with extended credit terms arises from the purchase of inventory that has already been sold and the purchase price is adjusted, there will be income or expense that is more appropriately classified in the operating category. Under an approach of classifying all income and expenses in the financing category for hybrid contracts that are measured at amortised cost in their entirety, the income or expenses that relate to another category would be inappropriately classified in the financing category.

53. We expect such circumstances to be rare in practice as price changes such as those in the example are not expected to be common and would result in income or expense only when the related asset (ie inventory) has already been derecognised or the service been consumed.

Classifying income and expenses of a different nature separately

54. Given the inappropriate classification that could occur in some circumstances under an approach that classifies all income and expenses arising after initial recognition in

the financing category for specific hybrid liabilities, we considered whether it would be practical to identify income and expenses of a different nature and classify them separately.

55. However, we think that trying to identify the changes in cash flows arising from the embedded derivative separately from other changes in cash flows would be contrary to the measurement of the hybrid liability as a single unit of account. It may also be difficult to separately identify the income and expense arising from the embedded derivative from other changes in expected cash flows for such an instrument. Therefore, given the hybrid contract is accounted for as a single unit of account, income and expenses related to the embedded derivative are not separately assessed for classification.

56. We expect that it would be rare for income and expenses related to the initial transaction to arise after initial recognition of these specific hybrid contracts (see paragraph 52 of this paper). This means that generally the income and expenses for these specific hybrid contracts will relate to the financing category. Consequently, we think that the financing category is the most appropriate category for classifying all income and expenses arising from these specific hybrid contracts after initial recognition.

Staff recommendation and question for the IASB

57. We recommend that the IASB require an entity to classify in the financing category of the statement of profit or loss all income and expenses arising after initial recognition for a hybrid contract with a host liability that arises from transactions that do not involve only the raising of financing, and is measured at amortised cost in its entirety. Such classification avoids any lack of clarity that might arise regarding the classification of income and expenses related to the liability without adding additional complexity. We acknowledge that such an approach may result in inappropriate classifications in some circumstances. However, we expect that such circumstances will be rare.

Questions for the IASB
3. Does the IASB agree with the staff recommendation to require an entity to classify in the financing category of the statement of profit or loss all income and expenses arising after initial recognition for hybrid contracts with host liabilities that arise from transactions that do not involve only the raising of financing, and are measured at amortised cost in their entirety?

Feedback for which the staff conclude no further action is required

58. Appendix A of this paper contains issues arising from feedback for which the staff conclude no further action is required because:

    (a) the feedback received does not introduce any new information that the IASB did not already consider;

    (b) the proposals in the Exposure Daft or the requirements of other IFRS Accounting Standards provide sufficient information to resolve the issue; or

    (c) the issue can be resolved by clarifying the wording in drafting IFRS X.

Question for the IASB
4. Does the IASB have any comments on the staff's conclusion on the topics in Appendix A of this paper?

Appendix A – Feedback for which the staff conclude no further action is required

A1. The following table outlines the feedback for which the staff conclude no further action is required (see paragraph 2 of this paper).

	Issue	Why no further action is required
Classification of foreign currency differences	In targeted outreach (see Agenda Paper 21A of the January 2023 IASB meeting): (a) a few participants disagreed with classifying foreign currency differences in the operating category when the undue cost or effort relief is applied and think that such income and expenses should be classified in the financing category; and (b) one participant said, in their view, all income and expenses arising from foreign exchange differences should be separately presented in a single line item classified in the operating category.	In the July 2021 meeting (see Agenda Paper 21C), the IASB considered and rejected an approach that would require classification of all foreign exchange differences in a single category in the statement of profit or loss. The IASB also considered and rejected making the financing category the default category for foreign exchange differences when the undue cost or effort relief is applied. We do not think that this feedback introduces any new information that IASB did not consider when making its tentative decisions in July 2021.
Classification of interest and penalties on income taxes	Some stakeholders (standard-setters and preparers) asked the IASB to clarify how to classify the interest and penalties on income taxes in the statement of profit or loss. Some suggested: (a) classifying the interest income, interest expense and penalties on income taxes in the income tax category; and (b) classifying both interest income and interest expenses on income taxes in the same category	An entity would determine the category in the statement of profit or loss for classifying the interest or penalty on income taxes based on the facts and circumstances giving rise to that interest or penalty. The category will vary depending on: (a) which Accounting Standard (IAS 12 *Income Taxes* or IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*) is applied to interest and penalties on income taxes in accordance with the IFRIC agenda decision *IAS 12* Income Taxes *(September 2017) —Interest and penalties related to income taxes*; and

	Issue	Why no further action is required
	(they do not mention the specific category in which to classify these items).	(b) how an entity applies the IFRIC agenda decision *Discounting current tax payables and classification of interest and penalties (IAS 12 Income Taxes)* (issued in June 2004) relating to the discount on current tax payable.
Disclosure requirements for hybrid contracts designated at fair value through profit or loss with host liabilities that arise from transactions that do not involve only the raising of finance	In the July 2021 meeting (see Agenda Paper 21A), the IASB asked the staff to explore a disclosure requirement for the situation in which an entity designates an entire hybrid contract at fair value through profit or loss and as a result does not separate an embedded derivative from the host financial liability that is otherwise required to be separated by IFRS 9. Providing users of financial statements with information about when the use of the fair value option changes the classification of income and expenses would be the objective of these suggested disclosure requirements.	We do not think that specific disclosure requirements are required for these hybrid contracts because: (a) the use of the fair value option for such instruments is likely to be rare; (b) an entity is required to disclose the difference between the financial liability's carrying amount and the amount the entity would be contractually required to pay at maturity to the holder of the obligation—when the entity has designated a financial liability as at fair value through profit or loss in accordance with paragraph 4.2.2 of IFRS 9 and is required to present all changes in the fair value of that liability in profit or loss (see paragraph 10A(b) of IFRS 7 *Financial Instruments: Disclosures*)—this information will help users to understand the difference in the carrying amount resulting from electing the fair value option; (c) an entity is required to disclose the amount of gain or loss recognised in profit or loss for liabilities designated at fair value through profit or loss (see paragraph 20(a)(i) of IFRS 7)—this information will help users to understand the current period income and expenses from the instrument and the related classification; and (d) requiring the disclosure of the amounts of income and expenses that would have been classified differently had the fair value election not been used may be contrary to the basis for which the IASB permits the fair value option— measuring the

	Issue	Why no further action is required
		embedded derivative as a stand-alone derivative might be more complex or less reliable (see paragraph B4.3.9 of IFRS 9).
Classification of the change in the value of the undesignated forward element of a forward contract or the foreign currency basis spread of a financial instrument	To apply the requirements in IFRS 9 (see Appendix D of this paper for a summary of these requirements), an entity would need to make a decision on: (a) whether to exclude the forward element of a forward contract or foreign currency basis spread of a financial instrument (eg a cross-currency swap) from the designation of the hedging instrument; and (b) whether to account for the changes in the value of any 'undesignated portion' of the derivative directly in profit or loss (akin to ineffectiveness) or applying paragraphs 6.5.15 and 6.5.16 (ie accounted as a cost of hedging). Some stakeholders have requested that the IASB clarifies where the change in the value of the undesignated portion is classified in the statement of profit or loss.	In the paragraph 24 of Agenda Paper 21B for the July 2021 meeting, the staff explained that, for the proposed categories and subtotals (as defined in the Exposure Draft) to provide a faithful representation of an entity's activities, classification of income and expenses from derivatives should reflect the purpose for which the entity is holding the derivatives. If the purpose of holding the forward contract or the cross-currency swap is to designate it as a hedging instrument in a qualifying hedge relationship for risk management purposes, then it may be argued that both the designated and the undesignated portions should be classified in the same category, ie the category affected by the risk that the entity is intending to manage. Furthermore, paragraph 57 of the Exposure Draft refers to the classification of gains or losses on instruments designated as hedging instruments, and makes no distinction between the effective and ineffective portions. Therefore, if the entity chooses to account for the changes in the value of the undesignated portion directly in profit or loss (ie akin to accounting for hedge ineffectiveness), then it would be appropriate for these changes to be classified in the same category as the changes relating to the designated portion (ie the effective portion). If the changes in the undesignated portion are considered as a 'cost of hedging', then they are initially recognised in the other comprehensive income to the extent they relate to the hedged item, and then either subsequently reclassified to profit or loss or capitalised as part of the cost or carrying value of the hedged item. Therefore, in each case, it would be considered appropriate to

	Issue	Why no further action is required
		classify these in the same category affected by the risk the entity is intending to manage under the designated hedge relationship. However, entities may present changes in designated and undesignated portions in separate line items within the same category. Therefore staff recommend no amendments to the classification requirements in the Exposure Draft. The staff will clarify in drafting that when the ineffectiveness of a hedge relationship is recognised directly in profit or loss, income and expenses from both the effective and ineffective portions are classified in the same category.
Classification of loan commitment fees	Some stakeholders asked the IASB to clarify how to classify origination fees for loan commitments that cannot be settled net in cash or another financial instrument, and are not designated as financial liabilities at fair value through profit or loss.	In accordance with the requirements in paragraph B5.4.2(b) of IFRS 9, commitment fees received by an entity (ie lender) are considered as an integral part of the effective interest rate of the financial asset if it is probable that the entity will enter into a specific lending arrangement. This is because these fees are regarded as compensation for the ongoing involvement with the acquisition of the financial asset. If the commitment expires without the entity making the loan, the fee is recognised as revenue in accordance with IFRS 15 *Revenue from Contracts with Customers* on expiry. Similarly, if it is unlikely that a specific lending arrangement will be entered into, loan commitment fees are recognised in line with the requirements of IFRS 15. Accounting for the loan commitment fees by the borrower would be similar to that of the lender, ie the commitment fee would either be an integral part of the effective interest rate of the financial liability or recognised in profit or loss upon expiry if the entity does not draw down or is unlikely to draw down the loan.

	Issue	Why no further action is required
		We do not think that specific guidance on classification of loan commitment fees is required, because it is clear that applying the IASB's tentative decisions: (a) loan commitment fees paid or received that are an integral part of the effective interest rate of the loan originated are accounted as part of the interest income or expense, and are classified accordingly in the statement of profit or loss; (b) loan commitment fees received that are accounted for in accordance with IFRS 15 are classified in the operating category in the statement of profit or loss, given in both scenarios considered above under which the fees are in scope of IFRS 15, the commitment does not result in the origination and recognition of a financial asset in the statement of financial position; and (c) loan commitment fees paid on commitments that expire without the loan being drawn down or in cases where it is unlikely that the loan will be drawn down are classified in the operating category because they do not meet the requirements to be classified in the financing category given the commitment does not result in the recognition of a financial liability in the statement of financial position.

Appendix B – Background information for hybrid contracts

B1. This appendix provides background information on the discussion of the classification of income and expenses from hybrid contracts considered in this paper. The appendix is structured as follows:

(a) IASB's tentative decisions related to classifying income and expenses in the financing category (paragraphs B2–B4);

(b) requirements in IFRS 9 regarding hybrid contracts (paragraphs B5–B7);

(c) examples of classifying income and expenses from hybrid contracts with host liabilities (paragraph B8); and

(d) discussion at the July 2021 IASB meeting (paragraphs B9–B10).

IASB's tentative decisions related to classifying income and expenses in the financing category

B2. At its July 2021 meeting (see Agenda Paper 21A) the IASB tentatively decided to revise the approach in the Exposure Draft for classifying income and expenses in the financing category of the statement of profit or loss. The IASB tentatively decided to classify in the financing category:

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

(b) the interest expense and the effect of changes in interest rates from other liabilities when such amounts are identified applying the requirements of IFRS Accounting Standards.

B3. A transaction that involves only the raising of finance is a transaction that involves:

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

(b) the return by the entity of cash or an entity's own equity instruments.

B4. To clarify application of this change in approach to hybrid contracts with host liabilities, the IASB also tentatively decided at its July 2021 meeting to require an entity to classify:

(a) income and expenses related to separated host liabilities in the same way as stand-alone liabilities ((i) all income and expenses are classified in the financing category if the host liability arises from transactions that involve only the raising of finance and (ii) interest and the effect of changes in interest rates are classified in the financing category if the host liability arises from transactions that do not involve only the raising of finance);

(b) income and expenses related to separated embedded derivatives in the same way as income and expenses related to stand-alone derivatives; and

(c) income and expenses related to hybrid contracts for which the embedded derivatives are not separated, in the same way as stand-alone liabilities ((i) all income and expenses are classified in the financing category if the host liability arises from transactions that involve only the raising of finance and (ii) interest and the effect of changes in interest rates are classified in the financing category if the host liability arises from transactions that do not involve only the raising of finance).

Requirements in IFRS 9 regarding hybrid contracts

B5. Paragraph 4.3.1 of IFRS 9 states that an embedded derivative is a component of a hybrid (combined) instrument that also includes a non-derivative host contract—with the effect that some of the cash flows of the combined instrument vary in a way similar to a stand-alone derivative. An embedded derivative causes some or all of the cash flows that otherwise would be required by the contract to be modified according to a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates or other variable (provided in the case of a non-financial variable that the variable is not specific to a party to the contract).

B6. An embedded derivative should be separated from its host contract and accounted for separately as a stand-alone derivative if the host contract is not a financial asset in the scope of IFRS 9 and the following criteria in paragraph 4.3.3 of IFRS 9 are met:

(a) the economic characteristics and risks of the embedded derivative are not closely related to the economic risks and characteristics of the host;

(b) a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative; and

(c) the hybrid contract is not measured at fair value with changes in fair value recognised in profit or loss.

B7. Considering the requirements in IFRS 9 that are summarised in paragraph B6:

(a) an embedded derivative is not separately accounted from its host liability if it is closely related to the host contract and the hybrid contract is measured at amortised cost in its entirety; or

(b) if the embedded derivative is not closely related to the host liability but the hybrid contract is designated at fair value through profit or loss in its entirety applying paragraph 4.3.5 of IFRS 9.[7]

Examples of classifying income and expenses from hybrid contracts with host liabilities

B8. Applying the IASB's tentative decisions for classifying income and expenses in the financing category to hybrid contracts for which the embedded derivative is not separated from the host liability, the following examples may arise. Applying the classification approach proposed in this paper and the IASB's redeliberations to date to these examples, income and expenses are classified as follows:

[7] A hybrid contract with a closely related embedded derivative may also be designated at fair value through profit or loss in its entirety applying paragraph 4.2.2 of IFRS 9.

		Hybrid contract	
		Measured at amortised cost in its entirety	Designated at fair value through profit or loss in its entirety
Host liability	Arising from a transaction that *does not* involve only the raising of finance	(a) a payable for goods or services received with extended credit terms that includes an early repayment option. (Considered as a closely related embedded derivative) Classification **(Staff recommendation in this paper)**: All income and expenses after initial recognition are classified in financing category	(b) a payable for a fixed amount plus or minus an indexation feature linked to movements in the local stock exchange index. (Considered as a non-closely related embedded derivative) Classification: Classification of the interest expense would depend on entity's application of paragraph B5(e) of IFRS 7. All other income and expenses or gains and losses are classified in operating category
Host liability	Arising from a transaction that involves only the raising of finance	(c) a term loan with an early repayment option. (Considered as a closely related embedded derivative) Classification: All income and expenses are classified in financing category	(d) a corporate bond for which the repayment of interest, principle or both are tied to the price of gold. (Considered as a non-closely related embedded derivative) Classification: All income and expenses or gains and losses are classified in financing category

Discussion at the July 2021 IASB meeting

B9. During the IASB's discussions in July 2021 IASB members raised two concerns with the approach to classifying income and expenses in the financing category for hybrid contracts with host liabilities:

(a) for a host liability described in paragraph B8, example (a) of this appendix and discussed in paragraphs 43–57 of the main section of this paper, it may not be clear from IFRS Accounting Standards whether income and expenses arising from the liability would be identified as interest expenses or changes in interest rates classified in the financing category or as another type of income or expense classified in a different category. The IASB asked the staff to explore an approach which would include all income and expenses from such liabilities in the financing category.

(b) for a host liability described in paragraph B8, example (b) of this appendix and discussed in more detail in Appendix A, the fact that the fair value measurement option has been used and could give rise to different classification of income and expenses than had the host liability been separated and measured at amortised cost may be useful information for users. The IASB tentatively decided to develop disclosure requirements for such liabilities with the objective of giving users information about when the use of the fair value option changes the classification of income and expenses.

B10. The IASB did not ask for further clarifications for hybrid contracts with host liabilities that arise from transactions that involve only the raising of finance either designated at fair value through profit or loss or measured at amortised cost (paragraph B8, examples (c) and (d) of this appendix). Applying the revised approach described in paragraph B4 of this appendix to classifying income and expenses in the financing category to these liabilities results in all related income and expenses being classified in the financing category.

Appendix C—Extract from IFRS 9 *Financial Instruments* in reference to closely related embedded derivatives

C1. This appendix incudes an extract of paragraph B4.3.8 of the Application Guidance to IFRS 9. The paragraph includes examples of when the economic characteristics and risks of an embedded derivative are closely related to those of the host contract.

…

Embedded derivatives (Section 4.3)

…

B4.3.8 The economic characteristics and risks of an embedded derivative are closely related to the economic characteristics and risks of the host contract in the following examples. In these examples, an entity does not account for the embedded derivative separately from the host contract.

(a) An embedded derivative in which the underlying is an interest rate or interest rate index that can change the amount of interest that would otherwise be paid or received on an interest-bearing host debt contract or insurance contract is closely related to the host contract unless the hybrid contract can be settled in such a way that the holder would not recover substantially all of its recognised investment or the embedded derivative could at least double the holder's initial rate of return on the host contract and could result in a rate of return that is at least twice what the market return would be for a contract with the same terms as the host contract.

(b) An embedded floor or cap on the interest rate on a debt contract or insurance contract is closely related to the host contract, provided the cap is at or above the market rate of interest and the floor is at or below the market rate of interest when the contract is issued, and the cap or floor is not leveraged in relation to the host contract. Similarly, provisions included in a contract to purchase or sell an asset (eg a commodity) that establish a cap and a floor on the price to be paid or received for the asset are closely related to the host contract if both the cap and floor were out of the money at inception and are not leveraged.

(c) An embedded foreign currency derivative that provides a stream of principal or interest payments that are denominated in a foreign currency and is embedded in a host debt instrument (for example, a dual currency bond) is closely related to the host debt instrument. Such a derivative is not separated from the host instrument because IAS 21 *The Effects of Changes in Foreign Exchange Rates* requires foreign currency gains and losses on monetary items to be recognised in profit or loss.

(d) An embedded foreign currency derivative in a host contract that is an insurance contract or not a financial instrument (such as a contract for the purchase or sale of a non-financial item where the price is denominated in a foreign currency) is closely related to the host contract provided it is not leveraged, does not contain an option feature, and requires payments denominated in one of the following currencies:

  (i) the functional currency of any substantial party to that contract;

  (ii) the currency in which the price of the related good or service that is acquired or delivered is routinely denominated in commercial transactions around the world (such as the US dollar for crude oil transactions); or

  (iii) a currency that is commonly used in contracts to purchase or sell non-financial items in the economic environment in which the transaction takes place (eg a relatively stable and liquid currency that is commonly used in local business transactions or external trade).

(e) An embedded prepayment option in an interest-only or principal-only strip is closely related to the host contract provided the host contract (i) initially resulted from separating the right to receive contractual cash flows of a financial instrument that, in and of itself, did not contain an embedded derivative, and (ii) does not contain any terms not present in the original host debt contract.

(f) An embedded derivative in a host lease contract is closely related to the host contract if the embedded derivative is (i) an inflation-related index such as an index of lease payments to a consumer price index (provided that the lease is not leveraged and the index relates to inflation in the entity's own economic environment), (ii) variable lease payments based on related sales or (iii) variable lease payments based on variable interest rates.

(g) A unit-linking feature embedded in a host financial instrument or host insurance contract is closely related to the host instrument or host contract if the unit-denominated payments are measured at current unit values that reflect the fair values of the assets of the fund. A unit-linking feature is a contractual term that requires payments denominated in units of an internal or external investment fund.

(h) A derivative embedded in an insurance contract is closely related to the host insurance contract if the embedded derivative and host insurance contract are so interdependent that an entity cannot measure the embedded derivative separately (ie without considering the host contract).

Appendix D—Accounting for the forward element of forward contracts and the foreign currency basis spreads of financial instruments

D1. As permitted by the paragraph 6.2.4(b) of IFRS 9 *Financial Instruments*, to improve hedge effectiveness, an entity may separate a forward contract's forward element and spot element and designate only the spot element as the hedging instrument in a qualifying hedge relationship. Similarly, an entity may separate the foreign currency basis spread from a financial instrument (eg a cross-currency swap) and exclude it from the designation of that financial instrument as the hedging instrument.

D2. When the forward element of a forward contract or the foreign currency basis spread is excluded from the hedge designation, IFRS 9 allows a policy choice as to how the 'undesignated portion' is accounted for. It may either be recognised in profit or loss on a fair value basis, or it may be treated as a 'cost of hedging' in a similar way to the time value of an option. This choice is made on a hedge-by-hedge basis and applies for the term of the designated qualifying hedge relationship.

D3. If the entity treats the undesignated portion as a 'cost of hedging', it recognises the changes in its value (some or all of it, depending on how much of it relates to the hedged item) in other comprehensive income with amounts subsequently reclassified or removed from equity and either recognised in profit or loss; or included directly in the initial cost or other carrying amount of the asset or the liability in accordance with paragraphs 6.5.15 and 6.5.16 of IFRS 9.

D4. Paragraph B6.5.34 of IFRS 9 explains that if an entity decides to recognise the changes in the value of the undesignated portion in other comprehensive income, the way the change in value of the undesignated portion is subsequently recognised in profit or loss depends on how much of it relates to the hedged item; and the nature of the hedged item (ie whether it is a transaction related item for example, forecast purchase of inventory in a foreign currency hedged for spot foreign currency risk; or a time-period related item for example, commodity inventory hedged for spot commodity price risk).