STAFF PAPER

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IASB® meeting

Project	**Primary Financial Statements**
Paper topic	Subtotals and categories—profit before financing and income tax

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Objective

1. This paper sets out staff analysis and recommendations on the boundary between the investing and financing categories proposed in the Exposure Draft *General Presentation and Disclosures*. The paper considers whether the Board should proceed with its proposals to:
   (a) introduce separate investing and financing categories in the statement of profit or loss below operating profit;
   (b) classify income and expenses from cash and cash equivalents in the financing category as a proxy for income and expenses from excess cash and investments of excess cash; and
   (c) require entities to present a profit before financing and income tax subtotal between the investing and the financing category.
2. The Board tentatively decided at its March 2021 meeting that investing and financing income and expenses should not be classified in operating profit. The discussions in this paper do not affect that tentative decision or the content of the operating category.
3. This paper does not address the following related topics:

(a) the classification of income and expenses from liabilities in the financing category—this topic is discussed in Agenda Paper 21A *Subtotals and categories—financing category*;

(b) topics to be discussed at future meetings:

  (i) the classification of income and expenses for entities with specific main business activities, such as investing and the provision of financing to customers. The discussion in this paper relates only to entities that do not have such main business activities.

  (ii) the definition of the investing category (except whether the category should include income and expenses from cash and cash equivalents, which is discussed in this paper).

  (iii) the classification and presentation of income and expenses from equity-accounted associates and joint ventures. For the purpose of this paper, we assume that such income and expenses would continue to be presented between operating profit and profit before financing and income tax, regardless of whether the Board decides to pursue the proposed split between integral and non-integral associates and joint ventures.

  (iv) minimum line items in the primary financial statements.

4. 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

5. We recommend the Board:

(a) retain the proposal to introduce separate investing and financing categories in the statement of profit or loss;

(b) retain the proposal to define the profit before financing and income tax subtotal but make it a specified subtotal, rather than a required subtotal;

(c) require a minimum line item for income and expenses from investments to delineate the investing and financing categories; and

(d) require entities to classify income and expenses from cash and cash equivalents in the investing category rather than the financing category.

Structure of the paper

6. This paper is structured as follows:

 (a) proposals in the Exposure Draft (paragraphs 8–16);

 (b) feedback (paragraphs 17–26);

 (c) staff analysis (paragraphs 27–61);

  (i) assessment of the approach proposed in the Exposure Draft against objectives (paragraphs 31–45); and

  (ii) should the Board consider adjusting its proposals? (paragraphs 46–61).

7. There are six appendices to this paper:

 (a) Appendix A—Linkages with other project areas that will be discussed in future meetings;

 (b) Appendix B—The role of the primary financial statements;

 (c) Appendix C—Fieldwork results;

 (d) Appendix D—Database research; and

 (e) Appendices E and F—Illustrative examples.

Proposals in the Exposure Draft

Profit before financing and income tax

8. Many users of financial statements seek to analyse an entity's performance independently of how that entity is financed. To facilitate such analysis, the Board proposed to require an entity to present a profit or loss before financing and income tax subtotal in the statement of profit or loss (paragraphs 60(c) and BC33 of the

Exposure Draft). The Board expected users to use the subtotal in a similar way to how they use EBIT today (paragraphs BC47 and BC255 of the Exposure Draft).

9. Paragraph 63 of the Exposure Draft proposed that an entity include in profit or loss before financing and income tax:

   (a) operating profit or loss;

   (b) income and expenses from integral associates and joint ventures; and

   (c) income and expenses classified in the investing category.

10. Consequently, the profit before financing and income tax subtotal would be presented between the investing and the financing category as illustrated below:

Revenue	X	Operating
Operating expenses	(X)	
Operating profit or loss	**X**	
Share of profit or loss of integral associates and joint ventures	X	Integral associates and joint ventures
Operating profit or loss and income and expenses from integral associates and joint ventures	**X**	
Share of profit or loss of non-integral associates and joint ventures	X	Investing
Income from investments	X	
Profit or loss before financing and income tax	**X**	
Interest revenue from cash and cash equivalents	X	Financing
Expenses from financing activities	(X)	
Unwinding of discount on pension liabilities and provisions	(X)	
Profit or loss before tax	**X**	

11. The investing category would include income and expenses from assets (except cash and cash equivalents) that generate a return individually and largely independently of other resources held by an entity. The investing category would also include related incremental expenses (paragraph 47 of the Exposure Draft).

12. The financing category would include (paragraph 49 of the Exposure Draft):

   (a) income and expenses from cash and cash equivalents;

   (b) income and expenses on liabilities arising from financing activities; and

(c) interest income and expenses on other liabilities, for example, the unwinding of discounts on pension liabilities and provisions.

13. Paragraph 64 of the Exposure Draft proposed that an entity should not present the profit or loss before financing and income tax subtotal if, applying paragraph 51 of the Exposure Draft, it classifies all income and expenses from financing activities and all income and expenses from cash and cash equivalents in the operating category. For example, applying this requirement, most banks are not expected to present a profit before financing and income tax subtotal.

The boundary between investing and financing

14. In developing the Exposure Draft, the Board had many discussions about the boundary between the investing and the financing category—particularly about the classification of income and expenses from excess cash and temporary investments of excess cash. The Exposure Draft (paragraph BC39) explains that users of an entity's financial statements typically treat excess cash and temporary investments of excess cash as part of the entity's financing. They treat such assets as part of financing because how an entity manages such assets is interrelated with its decisions about debt and equity financing. Excess cash can, for instance, be used to pay dividends, repay debt or buy back shares.

15. The Board proposed to classify income and expenses from cash and cash equivalents in the financing category because (paragraphs BC38–BC41):

(a) cash and cash equivalents represent a reasonable proxy for excess cash and the temporary investments of excess cash for many entities.

(b) cash and cash equivalents are defined in IAS 7 *Statement of Cash Flows*. Using existing definitions that are well understood helps to ensure that the requirement is applied consistently and that the amounts classified in the financing category are comparable.

(c) while most entities require some cash for operational purposes (for example, as a part of working capital) requiring entities to split cash and cash equivalents between amounts used for operational purposes and excess cash would impose undue cost or effort.

16. The Board acknowledged that some users of financial statements view investments other than cash and cash equivalents as part of an entity's financing—for example, some liquid financial assets. However, the Board explained its proposal to require an entity to provide information about income and expenses from investments in the investing category should enable users to make adjustments in their analysis if they regard a particular investment as part of the entity's financing. For example, a user could reclassify items of income from the investing category and include them in the financing category (paragraph BC41).

Feedback

Profit before financing and income tax

17. Most respondents, including almost all users, agreed with requiring entities (except for some specified entities) to present a profit or loss before financing and income tax subtotal in the statement of profit or loss. A few respondents disagreed with requiring the subtotal and some respondents did not express a view.

18. Some respondents explained they agreed with requiring entities to present a profit or loss before financing and income tax subtotal for the reasons set out in the Basis for Conclusions—they said such a subtotal:

    (a) would provide useful information, allowing users to analyse an entity's performance independently of how that entity is financed. A few academics added that distinguishing between an entity's operating and financing activities in valuing an entity is supported by corporate finance theory.

    (b) would be similar to an EBIT subtotal, which is commonly presented and commonly analysed by users.

19. Many of the respondents who disagreed with requiring the subtotal suggested the Board should not require the subtotal and should merge the investing and financing categories, because:

    (a) in their view, merging the investing and financing categories would be one possible approach to address classification issues between those two categories (see paragraphs 25–26); and

(b) they expect the investing category would include few items for many entities. In their view, when the investing category is relatively small:

(i) the profit before financing and income tax subtotal would not provide much incremental value compared to operating profit. For example, the Corporate Reporting Users' Forum said: 'CRUF participants agree that the key new subtotal is operating profit. Assuming that there are not too many lines between this new subtotal and profit before tax, it would be reasonable to leave other subtotals as MPMs which would be reconciled in the notes.'

(ii) a separate investing category and profit before financing and income tax subtotal may clutter the statement of profit or loss.

20. A few respondents asked the Board to clarify in general whether a required subtotal can be omitted from the statement of profit or loss if it is not materially different from another required subtotal.

The boundary between investing and financing

21. Feedback on the boundary between the investing and the financing category mainly related to the classification of income and expenses from excess cash and investments of excess cash.

22. Many respondents, including some users, agreed with the Board's proposal to classify income and expenses from cash and cash equivalents in the financing category as a proxy for income and expenses from excess cash and investments of excess cash. Some respondents disagreed and many respondents, including many users, did not express a view.

23. A few respondents explained they agree with the proposal to classify income and expenses from cash and cash equivalents in the financing category because they agree with the Board's rationale set out in paragraph 15.

24. A few other respondents said they acknowledge different views exist on how to classify income and expenses from cash and cash equivalents, and they accept the Board's proposal as a reasonable compromise. They welcome that such income and

expenses would be classified in a consistent location across entities, which would enable users to reclassify income and expenses from cash and cash equivalents to other categories if they wish to do so.

25. Some respondents expressed concerns about the proposal to classify income and expenses from cash and cash equivalents in the financing category:

    (a) some of those respondents (mainly preparers) think that cash and cash equivalents are too narrow as a proxy for excess cash and temporary investments of excess cash. They are concerned the proposals would not allow entities to faithfully represent their financing activities in the statement of profit or loss.

    (b) some other respondents think that income and expenses from cash and cash equivalents do not belong in the financing category because:

        (i) income and expenses from cash and cash equivalents meet the definition of income and expenses from investments (see paragraph 11);

        (ii) income and expenses from cash and cash equivalents do not arise from 'financing activities' as defined by the Board;

        (iii) the financing category would be simpler to understand if it only included income and expenses from liabilities, not assets; and

        (iv) such classification would be inconsistent with the statement of cash flows, where all interest received, including interest on cash and cash equivalents, would be classified as cash flows from investing activities.

26. Some respondents suggested the following alternative approaches to address the concerns in paragraph 25(a):

    (a) merging the investing and financing categories and allowing an entity to include additional, entity-specific subtotals. For example, some French entities currently present a 'cost of net debt subtotal' that consists of income and expenses from liabilities and assets that the entity considers to be part of its net debt.

(b) requiring an entity to classify income and expenses on a broader set of liquid assets in the financing category, including:

   (i) liquid financial instruments (other than cash equivalents) that are temporary investments of excess cash, including excess cash that will be used in planned future capital expenditure.

   (ii) assets that are held to secure specific liabilities, such as assets entities are legally required to hold to fund environmental liabilities. They argue that classifying returns on such assets in the financing category would be similar to the treatment of interest income on plan assets for defined benefit obligations.

Staff analysis

27. Many respondents supported the approach proposed in the Exposure Draft to:

   (a) introduce separate investing and financing categories in the statement of profit or loss;

   (b) classify income and expenses from cash and cash equivalents in the financing category as a proxy for income and expenses from excess cash and investments of excess cash; and

   (c) require entities to present a profit before financing and income tax subtotal between the investing and the financing category.

28. Nevertheless, we think the Board should consider whether its proposed approach should be adjusted in light of other respondents' arguments and suggestions, as well as our fieldwork and research findings.

29. We first assess the approach proposed in the Exposure Draft against the following objectives the Board has set out to achieve with its proposals for the statement of profit or loss:

   (a) introducing structure and comparability in the statement of profit or loss (paragraphs 31–34);

(b) providing useful information about the performance of an entity before the effect of its financing decisions (paragraphs 35–39); and

(c) providing an understandable overview of an entity's income and expenses in the statement of profit or loss (paragraphs 40–45).

30. We then consider whether the Board should make adjustments to its proposals to fulfil these objectives (paragraphs 46–58(b)).

Assessment of proposed approach against objectives

Structure and comparability

31. A key objective of the project is to respond to users' demands for more structure and comparability in the statement of profit or loss. In line with this objective, the Exposure Draft also proposed that part of the role of the primary financial statements would be to 'provide a structured and comparable summary' (see Appendix B for the full description of the role of the primary financial statements).

32. The approach proposed in the Exposure Draft described in paragraph 27 meets this objective by introducing:

(a) categories providing structure in the statement of profit or loss below the operating profit subtotal—the structure means users know where to find specific items of income or expenses. A defined and comparable structure is particularly helpful for users who access financial information digitally. It helps such users (and computers) understand how reported amounts relate to each other, in the absence of the context and formatting provided by a paper-based report.

(b) a comparable profit before financing and income tax subtotal:

(i) this subtotal would provide a comparable anchor point for users' analysis that would be consistently available for most entities. Some users may want profit before financing and income tax to be consistently available because they want to compare the subtotal across entities, even when the difference between operating profit and profit before financing and income tax is relatively small.

(ii) the Board would 'own' the label 'profit before financing and income tax', in the same way that it has claimed the label 'operating profit'. The label could only be used for subtotals that comply with the Board's definition and that are therefore comparable.

33. As explained in paragraph 15(b), comparability of the profit before financing and income tax subtotal was an important consideration for the Board in developing its proposal to include income and expenses from cash and cash equivalents in the financing category. The Board rejected alternative approaches for identifying investments of excess cash that would involve significant management judgement, because such approaches are more likely to be applied inconsistently than the proposed approach.

34. Although cash and cash equivalents are an imperfect proxy for what management may view as their excess cash and investments of excess cash, we think the Board's proposed approach would result in comparable information. Feedback from users suggested that what they want in terms of comparability in the statement of profit or loss is more clarity about where income and expenses of a particular nature are classified. Applying the Board's proposed approach, users would know that:

(a) income and expenses from cash and cash equivalents are classified in the financing category; and

(b) income and expenses on other investments, for example dividends on equity instruments measured at fair value through other comprehensive income, are classified in the investing category.

Providing useful information about performance before effects of financing decisions

35. The Board proposed requiring the profit before financing and income tax subtotal to provide useful information about the performance of an entity before the effect of its financing decisions.

36. Some respondents agreed the subtotal would fulfil this objective. Some added that the subtotal would be similar to EBIT, which companies commonly present and users commonly use in their analysis for this purpose.

37. However, we also have indications that users often use measures labelled 'EBIT' in their analysis that, in terms of their calculation, are closer to operating profit than to profit before financing and income tax as defined by the Board. Arguably, operating profit also provides an (imperfect) measure of an entity's performance before the effects of its financing decisions. We understand that users prefer to use a measure similar to operating profit that excludes income and expenses from associates and joint ventures and other investments because:

    (a) income and expenses from associates and joint ventures and other investments are net amounts that distort margins; and

    (b) they value associates and joint ventures and other investments separately.

38. In addition, some respondents are concerned that profit before financing and income tax as defined by the Board in the Exposure Draft would not accurately reflect income and expenses from investments of excess cash that entities may consider to be part of their financing activities (see paragraphs 25(a) and 26(b)).

39. Based on the evidence and feedback currently available, we are not able to conclude whether profit before financing and income tax provides incremental value compared to operating profit. There was no question in the Exposure Draft that specifically asked about the incremental value of profit before financing and income tax. To answer this question, we would need to do have further discussions with users.

Understandability of the statement of profit or loss

40. At its April 2021 meeting, the Board tentatively decided that one aspect of the role of the primary financial statements is to provide 'an *understandable* overview of the entity's assets, liabilities, equity, income, expenses and cash flows.'[1] The Conceptual Framework for Financial Reporting explains that 'Classifying, characterising and presenting information clearly and concisely makes it understandable.'

41. In addition, the Exposure Draft proposed to carry over the existing requirement from IAS 1 *Presentation of Financial Statements* for an entity to present additional line items (including by disaggregating required minimum line items), headings and

[1] We are planning to discuss at a future meeting whether it is possible to give further guidance on how to determine what information to present in the primary financial statements (see April 2021 Agenda Paper 21A).

subtotals in the statement(s) of financial performance and the statement of financial position when such presentations *enhance an understanding* of the entity's financial performance or financial position. [2]

42. We agree with the views expressed by a few respondents that:

(a) the investing category is likely to be relatively small for many entities (paragraph 43); and

(b) when the category is small, presenting both operating profit and profit before financing and income tax may not enhance the understandability of the statement of profit or loss (paragraphs 44–45).

The investing category is likely to be relatively small

43. We think the investing category is likely to be small for many companies considering that:

(a) an entity's main purpose is to conduct its operations rather than to hold investments. If an entity holds a large portfolio of investments, it is likely that the entity 'invests in the course of its main business activities', in which case the income and expenses from such investments would be included in operating profit applying the proposals in the Exposure Draft.

(b) among the 50 entities that participated in the fieldwork, the investing category was generally small compared to the entities' revenue and profit before tax (see Appendix C for detailed findings). For the 36 non-financial companies in the fieldwork sample, the median of investing income and expenses (excluding associates and joint ventures) as a percentage of revenue and profit before tax was 0.12% and 1.09%, respectively. Even if income and expenses from associates and joint ventures and cash and cash equivalents were classified in the investing category, it would remain relatively small for most companies in the sample.

[2] The Exposure Draft retained the wording 'relevant to an understanding' from IAS1 but we intend to replace the term 'relevant to' with the term 'enhance' to avoid the potential confusion that all material (ie relevant to the specific entity) information should be presented in the primary financial statements (see April 2021Agenda Paper 21A).

(c) for a sample of 2000+ IFRS filers, we found that interest and investment income was generally small compared to entities' revenue and profit before tax over the past 20 years (see Appendix D for detailed findings).

Profit before financing and income tax may not enhance the understandability of the statement of profit or loss

44. When the investing category is relatively large—illustrated in example E1 in Appendix E—a profit before financing and income tax subtotal may aid the understandability of the statement of profit or loss. However, when the investing category is relatively small—illustrated in example F1 in Appendix F—the presentation of a profit before financing and income tax subtotal may not enhance the understandability of the statement of profit or loss. In such cases:

(a) the incremental information provided by profit before financing and income tax compared to operating profit is likely to be limited;

(b) the prominence of the line items and subtotals below operating profit may be disproportionate compared to the line items and subtotals within the operating category; and

(c) although a profit before financing and income tax subtotal may not reduce the understandability of the statement of profit or loss, it does make the statement less concise than it could be.

45. In addition, entities are currently required to present additional subtotals in the statement of profit or loss applying IAS 1 as described in paragraph 41. In practice, companies tend to present either an operating profit or EBIT subtotal in the statement of profit or loss but not both. In a sample of 85 non-financial companies, we found:

(a) 60 companies presented an operating profit subtotal in the statement of profit or loss and did not present an EBIT subtotal.

(b) 12 companies presented an EBIT subtotal in the statement of profit or loss and did not present an operating profit subtotal.

(c) three companies presented both operating profit and EBIT in the statement of profit or loss in a similar way to the proposals in the Exposure Draft. In other words, few entities appear to conclude that both subtotals enhance an understanding of the entity's financial performance.

Summary of assessment of proposed approach against objectives

Objective	**Does the approach proposed in the Exposure Draft meet the objective?**
Introducing structure and comparability in the statement of profit or loss	Yes
Providing useful information about the performance of an entity before the effect of its financing decisions	Yes, though the incremental value of the profit before financing and income tax subtotal is unclear based on evidence and feedback currently available.
Providing an understandable overview of an entity's income and expenses in the statement of profit or loss	Yes, if investing category is significant. However, our research suggests that for many companies the investing category would be relatively small. In such cases the subtotal may contribute little to understandability.

Should the Board consider adjusting its proposals?

Categories and profit before financing and income tax subtotal

46. In our view, the Board should:

(a) retain its proposal to introduce separate investing and financing categories in the statement of profit or loss to maintain the structure and comparability of the statement of profit or loss; but

(b) make the profit before financing and income tax subtotal a specified, rather than a required subtotal to avoid requiring entities to present the subtotal when it may not enhance the understandability of the statement of profit or loss. Instead of requiring presentation of the subtotal, we recommend the Board require a minimum line item for income and expenses from investments to delineate the investing and financing categories.[3]

47. Applying such an approach:

(a) the Board would define profit before financing and income tax and add it to the list of specified subtotals (paragraph 104 of the Exposure Draft), similar to its proposal for operating profit before depreciation and amortisation.

(b) the profit before financing and income tax subtotal would only be required to be presented when it enhances an understanding of the entity's financial performance applying the requirement described in paragraph 41.

(c) applying the requirements described in paragraphs 40–41, the entity would either:[4]

(i) present income and expenses from investments as a single line item (illustrated in example F2 in Appendix F), which would be disaggregated in the notes; or

(ii) disaggregate the components of income and expenses from investments and present a total for income and expenses from investments in the statement of profit or loss (illustrated in example E2 in Appendix E).

48. In other words, the investing category would be delineated using a line item for the total of the income and expenses included in the investing category rather than using a cumulative subtotal of profit before financing and income tax that adds up income and expenses starting from revenue.

49. The advantages of the approach described in paragraphs 46–47 are:

(a) it is likely to result in a more concise statement of profit or loss than applying the approach proposed in the Exposure Draft.

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[3] This recommendation does not apply to the presentation of income and expenses from equity-accounted associates and joint ventures, which will be discussed in a future paper.

[4] We are planning to discuss at a future meeting whether minimum line items can combine income and expenses or whether separate minimum line items are needed for income and for expenses to avoid offsetting (see Appendix A).

(b) the structure of the statement of profit or loss below operating profit would be retained, meaning that:

   (i) users could calculate profit before financing and income tax easily if they wished to do so, both using paper-based and digital reports.

   (ii) investing income and expenses would continue to be disaggregated from financing income and expenses in the statement of profit or loss. Such disaggregation would provide useful information because investing and financing items have different characteristics.

(c) defining profit before financing and income tax and making it a specified subtotal would retain the benefit of the Board ‘owning’ the label as explained in paragraph 32(b)(ii).

(d) it would make redundant the specific exemption from presenting the profit before financing and income tax subtotal for companies that provide financing to customers (see paragraph 13).

(e) the Board would no longer need to clarify whether the profit before financing and income tax subtotal is required to be separately presented when not materially different from another subtotal.

50. The main argument against the approach described in paragraphs 46–47 is that it is not responsive to the feedback we received from most respondents—most respondents supported requiring a profit before financing and income tax subtotal. However:

(a) as explained in paragraph 39, the Exposure Draft did not specifically ask about the *incremental* value of profit before financing and income tax compared to operating profit; and

(b) in providing feedback some respondents may not have considered that the investing category is expected to be relatively small.

51. We plan to have further discussions with users to understand the incremental value of profit before financing and income tax compared to operating profit as part of the effects analysis. We will report back to the Board about the findings of this outreach, including any new information.

Question 1 for the Board
Does the Board agree with the staff recommendations to: (a) retain the proposal to introduce separate investing and financing categories in the statement of profit or loss; (b) retain the proposal to define the profit before financing and income tax subtotal but make it a specified subtotal, rather than a required subtotal; and (c) require a minimum line item for income and expenses from investments to delineate the investing and financing categories?

Classification of excess cash and investments of excess cash

52. The Board could consider the following approaches in relation to the classification of excess cash and investments of excess cash:

(a) retain the proposed approach—that is, require income and expenses from cash and cash equivalents to be classified in the financing category as a proxy for income and expenses from excess cash and investments of excess cash;

(b) require an entity to classify income and expenses from cash and cash equivalents in the investing category;

(c) require an entity to classify income and expenses from 'excess cash and investments of excess cash' in the financing category and either:

(i) define a different proxy for 'excess cash and investments of excess cash' that is broader than cash and cash equivalents; or

(ii) allow a management to identify what it considers to be 'excess cash and investments of excess cash'.

53. Assuming the Board agrees with the recommendation in the previous section to maintain separate investing and financing categories, respondents' suggestion to merge the categories (see paragraph 26(a)) is no longer a possible solution to address

classification issues related to income and expenses from excess cash and investment of excess cash.

54. We think the Board should not pursue either of the approaches described in paragraph 52(c):

(a) defining a different proxy for 'excess cash and investments of excess cash'—in developing the Exposure Draft, the Board considered, but rejected this approach.[5] We retain the view that it would be difficult to develop a definition that would be consistently applied and provide a significantly better proxy for excess cash and investments of excess cash than cash and cash equivalents.

(b) allowing management to identify what it considers to be 'excess cash and investments of excess cash'—such an approach would undermine the Board's objective of introducing comparability in the statement of profit or loss. As explained in paragraph 34, feedback from users suggested that what they want in terms of comparability in the statement of profit or loss is consistent classification of income and expenses of a particular nature, rather than classification based on management's view.

55. We can see the advantages of the approach described in paragraph 52(b) to require an entity to classify income and expenses from cash and cash equivalents in the investing category. Compared to the approach proposed in the Exposure Draft this approach is simpler because:

(a) it could make the structure of the statement of profit or loss easier to understand—the investing category would relate mainly to assets and the financing category would relate mainly to liabilities.

(b) it would avoid entities having to present a separate line item for income and expenses from cash and cash equivalents that is material but does not enhance an understanding of performance. Applying the approach proposed in the Exposure Draft, entities may need to present such a line item because there are no suitable line items in the financing category with which it could be aggregated.

[5] See September 2017 Agenda Paper 21A and November 2017 Agenda Paper 21B.

56. In addition, applying this approach, entities could group income and expenses within the investing category from assets they consider to be excess cash and investments of excess cash (including cash and cash equivalents) and disaggregate them from other income and expenses included in the investing category if they think such presentation enhances an understanding of their performance.

57. Classifying income and expenses from cash and cash equivalents in the investing category would also have similar benefits to the approach proposed in the Exposure Draft because:

    (a) it would also achieve the objective of comparability—investors would know where to find income and expenses from cash and cash equivalents (see paragraph 15(b)); and

    (b) it would also avoid the need for entities to identify which portion of cash is used for operating purposes (see paragraph 15(c)).

58. Arguments against classifying income and expenses from cash and cash equivalents in the investing category are:

    (a) that it is not responsive to the feedback we received from many respondents—many respondents supported the approach proposed in the Exposure Draft.

    (b) it seems to contradict the rationale explained in the Basis for Conclusions that users typically treat excess cash and investments of excess cash as part of the entity's financing.

59. We think the arguments for classifying income and expenses from cash and cash equivalents as investing or financing are finely balanced.

60. Having considered the argument described in paragraph 58(b) further, we think it focuses on users' classification of excess cash and investments of excess cash from the perspective of financial position in calculating 'net debt'-type measures, rather than performance. Agenda Paper 21A for this meeting recommends an approach for the classification of income and expenses from liabilities in the financing category that avoids perceived links between classification in the statement of profit or loss and net debt and capital structure. Equally, we think classification of income and expenses

from cash and cash equivalents should not be guided by the financial position perspective either.

61. On balance, we recommend the Board require entities to classify income and expenses from cash and cash equivalents in the investing category rather than the financing category.

Question 2 for the Board
Does the Board agree with the staff recommendation to require entities to classify income and expenses from cash and cash equivalents in the investing category rather than the financing category?

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?**
Definition of the investing category	This paper asks the Board to consider the size of the investing category as a factor in making its decisions. However, at future meetings the Board may adjust the definition of the investing category. As a result, items may be classified differently between the investing and operating category compared to the proposals in the Exposure Draft, which may make the investing category smaller or larger.
Classification of income and expenses from equity-accounted associates and joint ventures	This paper asks the Board to consider the size of the investing category as a factor in making its decisions. The Board may decide to change the proposed classification of income and expenses from integral and non-integral associates and joint ventures, which may affect the content and size of the investing category. The Board may also decide to change the proposed subtotal of 'operating profit and income and expenses from integral associates and joint ventures' which may affect the incremental value provided by a profit before financing subtotal.
Classification of income and expenses for entities with specific main business activities	This paper asks the Board to confirm the classification of income and expenses into separate investing and financing categories outside the operating category. 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.
Minimum line items in the primary financial statements	This paper recommends adding a minimum line item for income and expenses from investments. However, at a future meeting, we are planning to discuss minimum line items in the primary financial statements more holistically. At that meeting we are planning to discuss overarching issues, including whether minimum line items can combine income and expenses or whether separate minimum line items are needed for income and for expenses to avoid offsetting.

Appendix B—The role of the primary financial statements

B1. Paragraphs 20 and 21 of the Exposure Draft describe the role of the primary financial statements. At its April 2021 meeting the Board tentatively decided to make the underlined addition:

The role of the primary financial statements is to provide a structured and comparable summary of a reporting entity's recognised assets, liabilities, equity, income and expenses and cash flows which is useful for:

(a) obtaining an <u>understandable</u> *overview of the entity's assets, liabilities, equity, income expenses and cash flows;*

(b) making comparisons between entities, and between reporting periods for the same entity; and

(c) identifying items or areas about which users of financial statements may wish to seek additional information in the notes.

Appendix C—Fieldwork results

		As a % of revenue		As a % of profit before tax	
		Non-financials (36 companies)	Financials (14 companies)	Non-financials (36 companies)	Financials (14 companies)
Investing category—income and expenses other than from non-integral associates and joint ventures	Range	-0.72% – 2.01%	0%–11.50%	-4.03% – 33.21%	0%–502.24%
	Mean	0.37%	2.17%	4.12%	42.19%
	Median	0.12%	0%	1.09%	0%
Investing category—income and expenses from non-integral associates and joint ventures	Range	-0.52% – 2.13%	-0.48% – 2.52%	-2.90% – 13.65%	-7.63% – 9.39%
	Mean	0.19%	0.38%	1.20%	1.21%
	Median	0%	0.01%	0.04%	0.04%
Income and expenses from integral associates and joint ventures	Range	-0.38% – 3.73%	-0.43% – 3.09%	-14.12% – 44.46%	-1.24% – 150.65%
	Mean	0.43%	0.82%	4.88%	15.36%
	Median	0.03%	0.31%	0.30%	0.86%
Financing category—income and expenses from cash and cash equivalents	Range	0.01%–1.34%		0.33%–8.77%	
	Mean	0.35%		2.80%	
	Median	0.17%		2.77%	

Appendix D—Database research

D1. The fieldwork sample only contains a limited number of companies and is restricted to a single time period. Therefore, we have supplemented the fieldwork results with research using S&P CapitalIQ data.

D2. The Capital IQ standard template for the statement of profit or loss contains a line item for 'Interest and investment income' that is excluded from operating profit. It includes interest and dividend income and gains or losses from investments but excludes income and expenses from associates and joint ventures.

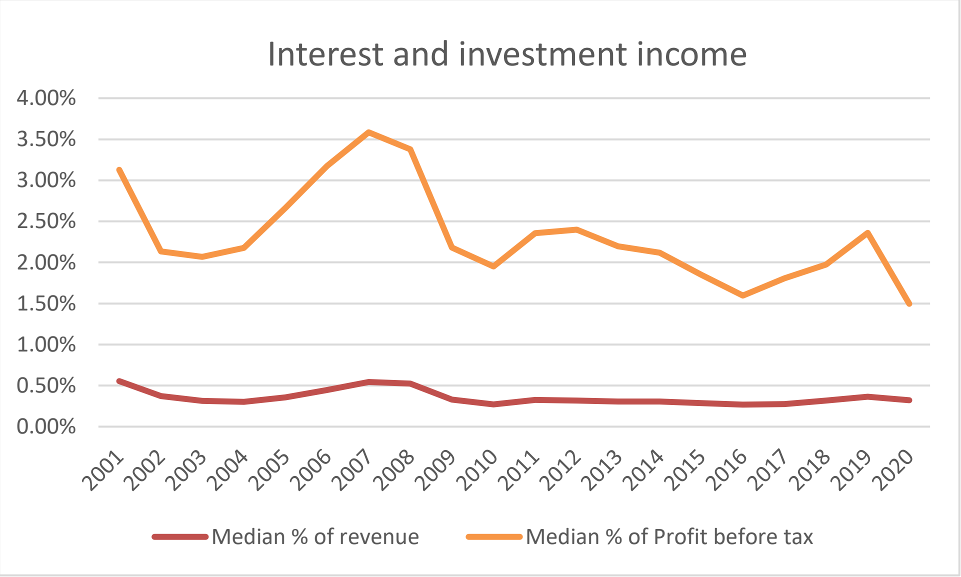
D3. We think the 'Interest and investment income' line item can be used as a rough proxy for the investing category as defined in the Exposure Draft plus income and expenses from cash and cash equivalents. It is an imperfect proxy—for example the line item does not contain income and expenses classified by Capital IQ as 'unusual', such as gains or losses on the sale of investments. We analysed IFRS filers in the S&P Global BMI index for 2001–2020.[6] The sample size varied between 2,192 companies in 2001 and 4,550 companies in 2020.

D4. We found that over the last 20 years:

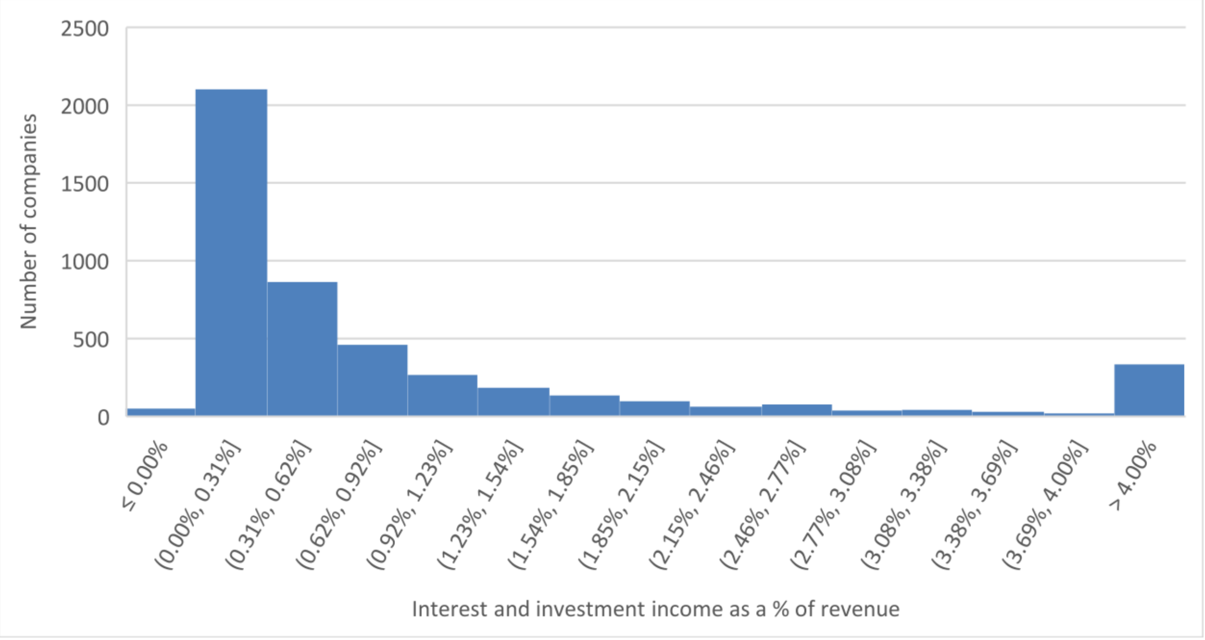
(a) the median 'Interest and investment income' as a percentage of revenue varied between 0 and 0.5%; and

(b) the median 'Interest and investment income' as a percentage of profit before tax varied between 1.5% and 3.5%.

[6] The S&P Global BMI (Broad Market Index) is designed to capture the global, investable opportunity set. Spanning 50 developed and emerging market countries and more than 11,000 companies, it tracks over 99% of each constituent country's available market capitalisation.



D5. In most years, the data is right-skewed, with the mean greater than the median. For example among the 4,775 companies in the sample in 2019, 'Interest and investment income' as a percentage of revenue was distributed as follows:



Appendix E—Illustrative examples: multiple line items in the investing category*

E1. Applying the proposals in the Exposure Draft

Revenue	335,000
Cost of goods sold	(219,900)
Gross profit	115,100
Other income	4,100
Selling expenses	(27,350)
Research and development expenses	(22,400)
General and administrative expenses	(25,060)
Impairment losses on trade receivables	(3,800)
Operating profit	40,590
Share of profit or loss of integral associates and joint ventures	2,000
Operating profit and income and expenses from integral associates and joint ventures	42,590
Share of profit or loss of non-integral associates and joint ventures	1,000
Dividend income	3,210
Interest income	900
Gains on disposals of investments	1,300
Profit before financing and income tax	49,000
Expenses from financing activities	(4,500)
Unwinding of discount on provisions	(2,500)
Profit before tax	42,000
Income tax expense	(10,500)
Profit for the year	31,500

E2. Applying the approach set out in paragraph 46

Revenue	335,000
Cost of goods sold	(219,900)
Gross profit	115,100
Other income	4,100
Selling expenses	(27,350)
Research and development expenses	(22,400)
General and administrative expenses	(25,060)
Impairment losses on trade receivables	(3,800)
Operating profit	40,590
Share of profit or loss of integral associates and joint ventures	2,000
Operating profit and income and expenses from integral associates and joint ventures	42,590
Share of profit or loss of non-integral associates and joint ventures	1,000
Dividend income	3,210
Interest income	900
Gains on disposals of investments	1,300
Income from investments	6,410
Expenses from financing activities	(4,500)
Unwinding of discount on provisions	(2,500)
Profit before tax	42,000
Income tax expense	(10,500)
Profit for the year	31,500

* The presentation of line items in the financing category may change (see Agenda Paper 21A for this meeting).

Appendix F—Illustrative examples: single line item for income and expenses from investments*

F1. Applying the proposals in the Exposure Draft

Revenue	335,000
Cost of goods sold	(219,900)
Gross profit	115,100
Other income	4,100
Selling expenses	(27,350)
Research and development expenses	(22,400)
General and administrative expenses	(25,060)
Impairment losses on trade receivables	(3,800)
Operating profit	40,590
Share of profit or loss of integral associates and joint ventures	2,000
Operating profit and income and expenses from integral associates and joint ventures	42,590
Income from investments	500
Profit before financing and income tax	43,090
Expenses from financing activities	(4,500)
Unwinding of discount on provisions	(2,500)
Profit before tax	36,090
Income tax expense	(10,500)
Profit for the year	25,590

F2. Applying the approach set out in paragraph 46

Revenue	335,000
Cost of goods sold	(219,900)
Gross profit	115,100
Other income	4,100
Selling expenses	(27,350)
Research and development expenses	(22,400)
General and administrative expenses	(25,060)
Impairment losses on trade receivables	(3,800)
Operating profit	40,590
Share of profit or loss of integral associates and joint ventures	2,000
Operating profit and income and expenses from integral associates and joint ventures	42,590
Income from investments	500
Expenses from financing activities	(4,500)
Unwinding of discount on provisions	(2,500)
Profit before tax	36,090
Income tax expense	(10,500)
Profit for the year	25,590

*In this example, we assume that income from investments does not contain material interest revenue calculated using the effective interest method. Also note that the presentation of line items in the financing category may change (see Agenda Paper 21A for this meeting).