IFRS

# STAFF PAPER

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**IASB® meeting**

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| **Project** | **Primary Financial Statements** | |
| Paper topic | Entities with specified main business activities—Issues specific to the financing category | |
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## Objective of this paper

1. This paper sets out the staff analysis and recommendations relating to the proposals in the Exposure Draft *General Presentation and Disclosures* for entities with specified main business activities that are specific to the financing category[1]. It should be read in conjunction with Agenda paper 21A of this meeting which discusses the proposals for entities with specified main business activities specific to the investing category.

2. This paper is the fourth in a series of papers[2] on entities with specified main business activities. It discusses:

   (a) the feedback on the proposals specific to the financing category for entities with specified main business activities; and

[1] Entities that invest in the course of main business activities in assets that generate a return individually and largely independently of the other resources held by the entity (referred to as 'entities that invest in the course of main business activities') or provide financing to customers as a main business activity.

[2] The first paper in the series considered the feedback on the key concept of 'main business activities' that is related to both the investing category and the financing category (see Agenda Paper 21A of the March 2022 IASB Meeting). The second paper discusses the proposal for entities with specified main business activities to classify income and expenses from associates and joint ventures accounted for using the equity method outside of the operating category (see Agenda paper 21D of the May 2022 IASB meeting).

(b) the consequences for entities with specified main business activities of the IASB redeliberations to date on the financing category, including the change in approach for classifying income and expenses within the financing category and the change in category for classifying income and expenses from cash and cash equivalents.

3. In future papers, we plan to discuss:

(a) the feedback asking for clarity on when providing financing to customers constitutes a main business activity, including the feedback on classification of income and expenses from liabilities that are financing *from* customers;

(b) the feedback on paragraph 52(b) of the Exposure Draft on income and expenses on liabilities arising from issued investment contracts with participation features recognised applying IFRS 9 *Financial Instruments*; and

(c) the feedback on paragraph 52(c) of the Exposure Draft on the classification of insurance finance income and expenses included in profit or loss.

## Summary of staff recommendations

4. The staff recommend the International Accounting Standards Board (IASB):

(a) confirm the accounting policy choice for financing transactions proposed in paragraph 51 of the Exposure Draft;

(b) confirm that the accounting policy choice proposed in paragraph 51 of the Exposure Draft is not applied to specified income and expenses from other liabilities; and

(c) confirm the proposed requirement for entities that invest in financial assets in the course of main business activities to classify income and expenses from cash and cash equivalents in the operating category; and

(d) explore removing the accounting policy choice for income and expenses from cash and cash equivalents proposed in paragraph 51 of the Exposure Draft.

## Structure of the paper

5. This paper is structured as follows:

   (a) background (paragraphs 7–28):

      (i) proposals in the Exposure Draft (paragraphs 7–13);

      (ii) feedback on the Exposure Draft (paragraphs 14–23);

      (iii) summary of tentative IASB decisions (paragraphs 24–28);

   (b) staff analysis, staff recommendations and questions for the IASB (paragraphs 29–69):

      (i) whether to confirm the accounting policy choice for financing transactions proposed in paragraph 51 of the Exposure Draft (paragraphs 30–45);

      (ii) whether to confirm that the accounting policy choice proposed in paragraph 51 of the Exposure Draft is not applied to specified income and expenses from other liabilities (paragraphs 46–54);

      (iii) whether to confirm the proposed requirement for entities that invest in financial assets in the course of main business activities to classify income and expenses from cash and cash equivalents in the operating category (paragraphs 55–62); and

      (iv) whether the accounting policy choice for cash and cash equivalents proposed in paragraph 51 of the Exposure Draft or other requirements are needed for entities that provide financing to customers as a main business activity (paragraphs 63–69).

6. There are two appendices to this paper:

   (a) Appendix A—Practical expedients used in IFRS Accounting Standards

   (b) Appendix B—Extracts from the Exposure Draft

## Background

### *Proposals in the Exposure Draft*

7. This section explains the proposals that were included in the Exposure Draft. A summary of the IASB's redeliberations and the resulting tentative decisions which amend the proposals in the Exposure Draft are included in paragraphs 24–28 of this paper.

8. The Exposure Draft proposed that the financing category would include:
   (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 (see paragraph 49 of the Exposure Draft).

9. For an entity that provides financing to customers as a main business activity, paragraph 51 of the Exposure Draft proposed that the operating category include, as an accounting policy choice, either:
   (a) income and expenses from financing activities, and from cash and cash equivalents, that relate to the provision of financing to customers; or
   (b) all income and expenses from financing activities and all income and expenses from cash and cash equivalents.

10. The accounting policy choice would not be applied to interest income and expenses on other liabilities (see paragraph 49(c) of the Exposure Draft), such as interest expense on defined benefit liabilities and decommissioning provisions, which the IASB proposed be classified in the financing category by all entities.

11. Paragraph B29 of the Exposure Draft explains that:
    (a) whether an entity provides financing to customers as a main business activity is a matter of judgement;
    (b) in general, providing financing to customers is likely to be a main business activity when the difference between interest income and the related interest expense is an important indicator of operating performance; and

(c) examples of entities that provide financing to customers as a main business activity include:

(i) banks;

(ii) entities that provide financing to customers to enable those customers to purchase the entity's products; and

(iii) lessors that provide finance leases to customers.

12. The Exposure Draft also proposed to classify in the operating category income and expenses from cash and cash equivalents if the entity, in the course of its main business activities, invests in financial assets that generate a return individually and largely independently of other resources held by the entity (referred to as 'entities that invest in financial assets in the course of main business activities') (see paragraphs 52(a) and B28 of the Exposure Draft); and

13. The application guidance in paragraph B30 of the Exposure Draft explains that the requirement to classify income and expenses from cash and cash equivalents in the operating category does not apply to an entity that invests in the course of main business activities in only non-financial assets that generate a return individually and largely independently of other resources held by the entity (referred to as 'entities that invest in only non-financial assets in the course of main business activities').

## *Feedback on the proposals in the Exposure Draft*

### *Comment letter feedback on the accounting policy choice*

14. Almost all respondents, including all users, agreed with requiring an entity that provides financing to customers as a main business activity to classify all income and expenses from financing activities and cash and cash equivalents or the portion related to providing financing to customers in the operating category (see paragraph 51 of the Exposure Draft). However, feedback on the requirement in paragraph 51 of the Exposure Draft being formulated as an accounting policy choice was mixed.

15. Some respondents, including banks, explicitly agreed with the requirement being formulated as an accounting policy choice because:

(a) it would be difficult for entities, such as banks with investment activities, to identify the portion of financing expenses that relates to the provision of financing to customers; and

(b) it would reduce cost and complexity.

16. However, many respondents, including most regulators and accounting networks, disagreed with the requirement being formulated as an accounting policy choice because, in their view, it would undermine the comparability of operating profit, result in a loss of useful information and make the statement of profit or loss more complex for users to understand.

17. Alternative approaches suggested by these respondents included:

(a) requiring an entity to allocate income and expenses from financing activities and from cash and cash equivalents between the operating and financing categories (see paragraph 51(a) of the Exposure Draft):

(i) without any exemptions;

(ii) unless such an allocation would be arbitrary or would involve undue cost or effort; or

(iii) except when the entity's *only* main business activity is providing financing to customers.

(b) retaining the accounting policy, but requiring that an entity's policy should be based on how it allocates income and expenses in internal management reporting; and

(c) replacing the accounting policy choice with a practical expedient[3].

18. A few respondents suggested the IASB should provide additional guidance on how to allocate financing expenses between providing financing to customers and other business activities. A few respondents also suggested entities should be required to disclose how they have made the allocation.

[3] A few respondents said the IASB's approach to introducing accounting policy choices and practical expedients in different proposals appeared inconsistent and suggested the IASB should develop principles to help it develop such requirements more consistently.

*Other comment letter feedback*

19. Some respondents, including many banks, suggested that when an entity classifies all financing expenses in the operating category, it should also classify interest on liabilities not arising from financing activities (such as the unwinding of a discount on provisions) in the operating category because it would be consistent with current practice and regulatory templates and otherwise such interest would be the only remaining item in the financing category.

20. Few respondents provided comments on the proposed requirements for entities that invest in financial assets in the course of main business activities to classify income and expenses from cash and cash equivalents in the operating category. Most of the respondents who commented on this proposal agreed with it.

*Feedback from fieldwork participants*

21. Most banks made an accounting policy choice to classify all income and expenses from financing activities and cash and cash equivalents in the operating category because it was consistent with their current practices and, in their view, provided better information for users.

22. Two banks made an accounting policy choice to classify only income and expenses from financing activities and cash and cash equivalents related to providing financing to customers in the operating category. For these banks income and expenses judged not to relate to providing financing to customers were those from instruments held for regulatory capital purposes.

23. All other entities that provided financing to customers as a main business activity made an accounting policy choice to classify only income and expenses from financing activities and cash and cash equivalents related to providing financing to customers in the operating category.

## *Summary of related IASB tentative decisions from redeliberations to date*

24. In May 2021 (see Agenda Paper 21B), the IASB tentatively decided to:

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

(b) confirm the proposal to define the 'profit or loss before financing and income tax' subtotal and require it to be presented in the statement of profit or loss; and

(c) require an entity to classify income and expenses from cash and cash equivalents in the investing category rather than the financing category.

25. In July 2021 (see Agenda Paper 21A), the IASB tentatively decided to:

(a) require an entity to classify in the financing category:

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

(ii) specified income and expenses from other liabilities;

(b) require an entity to describe a transaction that involves only the raising of finance as a transaction that involves:

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

(iv) the return by the entity of cash or an entity's own equity instruments; and

(c) require an entity to classify in the financing category interest expense and the effect of changes in interest rates on other liabilities (liabilities that arise from transactions that do not involve only the raising of finance) when such amounts are identified applying the requirements of IFRS Accounting Standards.

26. The change in approach to classifying income and expenses within the financing category tentatively agreed by the IASB in paragraph 25 is intended to make the proposals in the Exposure Draft easier to apply[4]. The only change in outcome from the Exposure Draft is that interest expenses on lease liabilities and amounts payable for goods and services received were captured by 'income and expenses on liabilities arising from financing activities' in the Exposure Draft (paragraph 49(b) of the

[4] The IASB plan to conduct targeted outreach to assess whether these changes will function as intended during the second half of 2022 (see Agenda Paper 6 of the July 2022 meeting of the Accounting Standards Advisory Forum).

Exposure Draft) but are now captured by 'specified income and expenses from other liabilities' (paragraph 49(c) of the Exposure Draft).

27. In February 2022 (see Agenda Paper 21A), the IASB tentatively decided not to specify any required line items to be presented in the financing category in the statement of profit or loss.

28. In March 2022 (see Agenda Paper 21A), the IASB tentatively decided to clarify that:

    (a) the role of main business activities in the requirements of the [draft] Accounting Standard is limited to assessing whether an entity invests in the course of its main business activities or provides financing to customers as a main business activity. The assessment is performed at the reporting-entity level. Any changes in the outcome of the assessment should be applied prospectively with disclosure of the fact that there has been a change and information about the effect of the change that would allow users to perform trend analysis on operating profit.

    (b) investing in the course of main business activities or providing financing to customers as a main business activity is a matter of fact and not an assertion. An entity will need to use its judgement in assessing whether it invests in the course of its main business activities or provides financing to customers as a main business activity. The assessment should be based on observable evidence to the extent available.

    (c) examples of observable evidence are:

        (i) operating performance measures used in public communications; and

        (ii) information about segments, if an entity applies IFRS 8 *Operating Segments*. Specifically:

            1. a reportable segment that comprises a single business activity indicates that the business activity is a main business activity of the entity.

            2. an operating segment that comprises a single business activity indicates the business activity could be a main business activity of the entity—if the performance of the operating segment is an important indicator of the operating performance of the entity.

(d) the subtotals similar to gross profit[5] in paragraph B78 of the Exposure Draft are examples of important indicators of operating performance for an entity that invests in the course of its main business activities or provides financing to customers as a main business activity.

## Staff analysis, staff recommendations and questions for the IASB

29. In this paper we analyse:

(a) whether to confirm the accounting policy choice for financing transactions proposed in paragraph 51 of the Exposure Draft (paragraphs 30–45);

(b) whether the accounting policy choice proposed in paragraph 51 of the Exposure Draft should be applied to specified income and expenses from other liabilities (paragraphs 46–54);

(c) whether to confirm the proposed requirement for entities that invest in financial assets in the course of main business activities to classify income and expenses from cash and cash equivalents in the operating category (paragraphs 55–62); and

(d) whether the accounting policy choice for cash and cash equivalents proposed in paragraph 51 of the Exposure Draft or other requirements are needed for entities that provide financing to customers as a main business activity (paragraphs 63–69).

### *Whether to confirm the accounting policy choice for financing transactions*

30. Some stakeholders expressed concerns over the proposal in paragraph 51 of the Exposure Draft to provide an accounting policy choice for entities that provide financing to customers as a main business activity to classify in the operating category, either:

[5] A subtotal is similar to gross profit when it represents the difference between a type of revenue and directly related expenses incurred in generating that revenue.

(a) income and expenses from financing activities, and from cash and cash equivalents, that relate to the provision of financing to customers; or

(b) all income and expenses from financing activities and all income and expenses from cash and cash equivalents.

31. The IASB's tentative decision on the financing category set out in paragraphs 25 and 26 of this paper potentially affect the population of income and expenses to which the accounting policy in paragraph 51 of the Exposure Draft applies:

(a) cash and cash equivalents will be classified in the investing category rather than the financing category. Paragraphs 55–69 of this paper consider the accounting policy choice for cash and cash equivalents; and

(b) the income and expenses arising on liabilities classified in the financing category will be:

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

(ii) specified income and expenses from other liabilities. Paragraphs 46–54 of this paper consider the accounting policy choice for these items of income and expenses.

32. In this section of the paper, we analyse:

(a) the accounting policy choice for income and expenses from liabilities that arise from transactions that involve only the raising of financing (referred to as 'accounting policy for financing transactions') (paragraphs 33–37);

(b) the alternative approaches suggested by stakeholders (paragraphs 38–39); and

(c) whether a viable alternative would be an approach that requires allocation but with a practical expedient that permits an entity not to allocate (paragraphs 40–45).

### *Accounting policy choice proposed in the Exposure Draft*

33. When developing the proposal in the Exposure Draft, the IASB recognised that:

(a) permitting an accounting policy choice may result in a loss of comparability between entities; and

(b) only classifying the portion of income and expenses from financing transactions that relate to providing financing to customers would provide useful information for all entities that provide financing to customers as a main business activity (see BC68 of the Basis for Conclusions on the Exposure Draft).

34. However, the IASB decided to permit, but not require allocation of the applicable income and expenses between the operating and financing categories, because for some entities such an allocation may require undue cost or effort or cannot be done on a non-arbitrary basis (see BC64–BC68 of the Basis for Conclusions on the Exposure Draft).

35. When developing the accounting policy choice for financing transactions, the staff expected that entities that can allocate on a non-arbitrary basis without undue cost or effort to choose to classify in the operating category only income and expenses from financing transactions that relate to providing financing to customers. The staff also noted that current practice by banks was not to allocate and that users of financial statements of banks had not requested such an allocation (see Agenda Paper 21A of the February 2019 IASB meeting).

36. The staff acknowledge that by using an accounting policy choice it means that the two approaches in paragraph 51 of the Exposure Draft are regarded as equally valid (subject to the requirements in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* governing accounting policy choices) and when an entity transitions to the [draft] IFRS Accounting Standard it can choose which approach it applies. As a result, some entities that can allocate on a non-arbitrary basis without undue cost or effort may choose to apply the accounting policy to classify in the operating category all applicable income and expenses rather than just those that relate to providing financing to customers. However, in our fieldwork we did not find evidence of entities other than banks choosing the accounting policy to classify all applicable income and expenses in the operating category (see paragraph 21–23).

37. There is no specific guidance in IAS 8 about how to initially select an accounting policy specified in IFRS Accounting Standards, but there are requirements to disclose significant accounting policies and specific requirements that an entity must meet in order to subsequently change its accounting policies. The fact that an accounting

policy is disclosed and subsequently cannot be freely changed helps to ensure that an entity will exercise appropriate judgement when selecting its initial accounting policy.

*Alternative approaches suggested by stakeholders*

38. The staff analysed the alternative approaches suggested by stakeholders in the following table to see if any of the approaches would better reflect the IASB's intentions that when an entity can allocate on a non-arbitrary basis and without undue cost or effort it should only classify in the operating category income and expenses from financing transactions that are related to providing financing to customers.

| Alternative approach | Staff analysis |
|---|---|
| Requirement to allocate with no exceptions (see paragraph 17(a)(i)) | Approach considered and rejected when developing the Exposure Draft. No new information that indicates the IASB should reconsider its conclusion. |
| Requirement to allocate unless the allocation would be arbitrary or requires undue cost or effort (see paragraph 17(a)(ii)) | Arbitrary allocations and undue cost or effort are the reasons for proposing the accounting policy choice in the Exposure Draft. Using them as the required basis for not allocating would add costs and complexity as it would require the entity to prove that an allocation is arbitrary or perform a cost-benefit assessment. |
| Requirement to allocate except when the entity's *only* main business activity is providing financing to customers (see paragraph 17(a)(iii)) | Approach considered and rejected when developing the Exposure Draft. No new information that indicates the IASB should reconsider its conclusion. |
| Require that the accounting policy chosen be based on how income and expenses are allocated in internal reporting (see paragraph 17(b)) | The staff think that an entity would consider how income and expenses are allocated in internal reporting when selecting its accounting policy. The staff do not think that making this a requirement would provide additional discipline that would not be provided through the disclosure requirements for selection, application and changes to accounting policies. |
| Replacing the accounting policy choice with an approach that requires allocation but with a practical expedient that permits an | Approach considered below as it was not considered when developing the proposals in the Exposure Draft. |

| Alternative approach | Staff analysis |
|---|---|
| entity not to allocate (see paragraph 17(c)) | |
| Provide guidance on how to allocate (see paragraph 18) | The staff think that it would be difficult for the IASB to develop allocation criteria that would be applicable to the circumstances of all entities that provide financing to customers. |

39. In developing the proposals in the Exposure Draft, the IASB considered and rejected a variety of approaches (see Agenda Paper 21A of the February 2019 IASB meeting). Of the alternative approaches suggested in the table above, the staff explored an approach that requires allocation but with a practical expedient that permits an entity not to allocate in the next section because this approach was not considered in developing the proposals in the Exposure Draft.

### *Approach that requires allocation but with a practical expedient that permits an entity not to allocate*

40. Practical expedients have been used in recent IFRS Accounting Standards, including IFRS 9, IFRS 13 *Fair Value Measurement*, IFRS 15 *Revenue from Contracts with Customers* and IFRS 16 *Leases*. A list of practical expedients used in IFRS Accounting Standards is included in Appendix A. The staff note that:

    (a) practical expedients tend to be used to make the requirements easier to apply, for example, when an entity would incur costs to apply a more complex requirement that is not likely to provide additional useful information;

    (b) some practical expedients are a requirement that is applied when conditions are met and some practical expedients have a required approach with a choice to apply an alternative approach as a practical expedient either freely or when conditions are met;

    (c) some practical expedients were introduced when a simplified approach was likely to be needed by some entities, but other entities were likely to prefer to apply the required approach;

    (d) expected differences between the outcome of applying the practical expedient and the required approach tend to be justified on cost-benefit grounds; and

(e) practical expedients are usually accompanied by a requirement to disclose when the practical expedient is applied.

41. The staff think that if the IASB were to change the accounting policy choice for financing transactions, it should consider an approach that requires allocation but with a practical expedient that permits an entity not to allocate only when specific conditions are met. The requirement to allocate would be for an entity that provides financing to customers as a main business activity to classify in the operating category income and expenses from financing transactions that relate to providing financing to customers. If the entity were to meet specific conditions, it would be permitted to apply the practical expedient to classify in the operating category all income and expenses from financing transactions.

42. The advantage of this approach would be that the two options in the accounting policy for financing transactions would no longer be equally valid. However, if there are no conditions to meet in order to apply the practical expedient, the approach would be the same as the accounting policy choice and not address the concerns raised by stakeholders about a 'free' choice.

43. The staff considered and rejected a number of possible conditions that an entity would have to meet in order to apply the practical expedient, including requiring that classifying all income and expenses from financing transactions in the operating category is consistent with how operating performance is reported internally. The staff noted that there is no single condition that could be applied to achieve the IASB's objectives and using multiple conditions will introduce costs and complexity that outweighs the benefit of switching from the accounting policy choice to an approach that requires allocation but with a practical expedient that permits an entity not to allocate.

44. The staff also note that an approach that requires allocation but with a practical expedient that permits an entity not to allocate would need to be coupled with a requirement to disclose:

(a) the fact that the practical expedient has been applied; and

(b) the reasons why the conditions to apply the practical expedient have been met.

45. On balance, the staff do not think that an approach that requires allocation but with a practical expedient that permits an entity not to allocate will be a viable alternative to the accounting policy choice for financing transactions. Therefore, the staff recommend that the IASB confirm the accounting policy choice for financing transactions as proposed in the Exposure Draft.

| Question for the IASB |
| --- |
| Q1 Does the IASB agree with the staff recommendation to confirm the accounting policy choice for financing transactions proposed in paragraph 51 of the Exposure Draft? |

### *Specified income and expenses from other liabilities*

46. As set out in paragraphs 25–26 of this paper, in July 2021 the IASB tentatively decided not to require the identification of income and expenses from financing activities. Instead, it tentatively decided to require the identification of:

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

   (b) specified income and expenses from other liabilities.

47. As a result, some income and expenses that would have been captured in 'income and expenses from financing activities' are now captured in 'specified income and expenses from other liabilities', for example interest expenses of lease liabilities and payables for goods and services.  In addition, some respondents suggested that when an entity classifies all income and expenses from transactions that involve only the raising of financing in the operating category, it should also classify specified income and expenses from other liabilities in the operating category (see paragraph 19).

48. The objective of the proposal in paragraph 51 of the Exposure Draft is to enable an entity to reflect net interest income, a subtotal similar to gross profit, in the operating category (see paragraph BC63 of the Basis for Conclusions on the Exposure Draft). The staff analysed the most recent annual financial statements of 16 entities (9 banks and 7 non-banks) that participated in the fieldwork that provide financing to customers as a main business activity and noted that:

(a) seven banks included interest expenses on lease liabilities in net interest income, one bank and one non-bank included it in another line item within operating profit and for the remaining seven entities (of which one was a bank) it was either classified outside of operating profit or it was unclear because there was no operating profit subtotal presented; and

(b) two banks included interest expenses on defined benefit liabilities in net interest income, five banks included it in another line item within operating profit and for the remaining nine entities (of which two were banks) it was either classified outside of operating profit or it was unclear as there was no operating profit subtotal presented.

49. The staff acknowledge that classifying interest expenses on lease liabilities in the financing category may result in a change in current practice for some banks. However, the staff think that the classification of specified income and expenses from other liabilities should be the same for all these liabilities. For example, the staff do not think it would be appropriate for interest expense on lease liabilities to be classified in the operating category and interest expense on defined benefit plans and other liabilities to be classified in the financing category.

50. Specifically:

(a) the staff do not think that the IASB should select particular liabilities from the category of 'other liabilities' and apply a different classification to their interest expenses. As explained in Agenda Paper 21A of the July 2021 IASB meeting, it is not possible to draw a conceptual distinction between the interest expenses arising from the different liabilities.

(b) the staff do not think that entities should be allowed to make their own entity-specific selection. In developing the proposals in the Exposure Draft, the IASB noted that there are differing views on whether specified income and expenses from other liabilities should be classified in the operating category or in the financing category. The proposal in the Exposure Draft to classify these income and expenses in the financing category ensures a consistent presentation across all entities which will allow users that disagree with this classification to make their own adjustments (see paragraphs BC42–BC45 of the Basis for Conclusions on the Exposure Draft).

51. The staff also considered whether the IASB's tentative decision to require the presentation in the statement of profit or loss to provide an understandable overview of the entity's income and expenses (see Agenda Paper 21A of the February 2022 IASB meeting) would affect the presentation of specified income and expenses from other liabilities.

52. Specifically, an entity that provides financing to customers as a main business activity might only have relatively small amounts[6] left in the financing category—because it provides financing to customers as a main business activity it presents most expenses that would otherwise be presented in the financing category in the operating category. Such an entity could argue that presenting a financing category that includes only those small amounts is not necessary to provide an understandable overview of the entity's income and expenses.

53. As discussed in Agenda Paper 21A of the February 2022 IASB meeting, the role of the statement(s) of financial performance combines comparability and understandability. The categories and required subtotals provide the necessary comparability, and also contribute to an understandable overview of the entity's income and expenses. The need for additional line items and subtotals to provide an understandable overview does not allow an entity to override the requirements to classify income and expenses in the specified categories.

54. Accordingly, the staff recommend that the IASB confirm the proposal in the Exposure Draft that the accounting policy choice proposed in paragraph 51 is not applied to specified income and expenses from other liabilities and thus these income and expenses are classified in the financing category by all entities.

[6] The amounts in question would have to be material. Otherwise, they would not need to be disaggregated and disclosed separately.

| Question for the IASB |
| --- |
| Q2 Does the IASB agree with the staff recommendation to confirm that the accounting policy choice proposed in paragraph 51 of the Exposure Draft is not applied to specified income and expenses from other liabilities? |

### *Classification of income and expenses from cash and cash equivalents*

55. The Exposure Draft proposed that:

    (a) entities that invest in financial assets in the course of main business activities are required to classify in the operating category all income and expenses from cash and cash equivalents (see paragraph 52(a) of the Exposure Draft); and

    (b) entities that provide financing to customers as a main business activity have an accounting policy choice to classify in the operating category either:

        (i) all income and expenses from cash and cash equivalents; or

        (ii) the portion of income and expenses from cash and cash equivalents that are related to providing financing to customers as a main business activity (see paragraph 51 of the Exposure Draft).

56. There was little stakeholder feedback specifically related to classification of income and expenses from cash and cash equivalents for entities with specified main business activities (see paragraph 20). On that basis we could confirm the proposals in the Exposure Draft. However, the staff note that in order to confirm the proposals, the IASB would need to consider:

    (a) how an entity that both invests in financial assets in the course of main business activities and provides financing to customers as a main business activity would classify income and expenses from cash and cash equivalents; and

    (b) whether the accounting policy choice an entity applies to income and expenses from financing transactions should also be applied to income and expenses from cash and cash equivalents.

57. Therefore, given the IASB's tentative decision for entities that do not have specified main business activities to classify income and expenses from cash and cash equivalents in the investing rather than financing category, the staff think it is worth considering whether the proposals could be simplified to reduce complexity (see paragraph 24).

58. In this section of the paper, we analyse:

   (a) whether the IASB should confirm the requirement for entities that invest in financial assets in the course of main business activities to classify in the operating category all income and expenses from cash and cash equivalents (see paragraphs 59–62); and

   (b) whether the accounting policy choice for cash and cash equivalents proposed in paragraph 51 of the Exposure Draft or other requirements are needed for entities that provide financing to customers as a main business activity (see paragraphs 63–69).

*Entities that invest in financial assets in the course of main business activities*

59. The staff recommend that the IASB proceed with the proposal for an entity that invests in financial assets in the course of main business activities to classify income and expenses from cash and cash equivalents in the operating category because feedback from respondents in paragraph 20 does not indicate that the IASB needs to change its approach.

60. Likewise, the tentative decision to change from classifying income and expenses from cash and cash equivalents in the financing category to the investing category (see paragraph 24) does not indicate that the IASB needs to reconsider this proposal because the reasons given in paragraphs BC70–BC72 of the Basis for Conclusions on the Exposure Draft are still valid.

61. In summary, the reasons for the proposals are:

   (a) some entities, such as insurers and investment funds, require a significant balance of cash and cash equivalents for operational purposes and for such entities classifying income and expenses from cash and cash equivalents in the operating category provides more useful information; and

(b) classifying income and expenses from cash and cash equivalents in the operating category for entities that invest only in non-financial assets, such as property companies, would not provide useful information because cash is less likely to be interchangeable with their investments.

62. If the IASB agrees with the staff recommendation in Agenda Paper 21A of this meeting to remove the term 'in the course of' a drafting change will be required to specify that an entity that invests in financial assets as a main business activity classifies income and expenses from cash and cash equivalents in the operating category.

*Entities that provide financing to customers as a main business activity*

63. Many entities that provide financing to customers as a main business activity also invest in financial assets in the course of main business activities, for example almost all banks, and many conglomerates. For such entities the requirement to classify in the operating category all income and expenses from cash and cash equivalents in paragraph 52(a) of the Exposure Draft would be triggered by their investment in financial assets, and no requirement in relation to providing financing to customers as a main business activity is needed.

64. Entities that provide financing to customers as a main business activity but do not invest in financial assets in the course of main business activities are likely to be entities that provide financing to customers to purchase the entity's products, like car manufacturers. For such entities cash and cash equivalents would generally have a similar function to cash and cash equivalents held by entities that do not have specified main business activities.

65. The Exposure Draft did not propose requiring entities that do not have specified main business activities to split cash and cash equivalents between the amounts used for operational purposes and excess cash as it would impose undue cost or effort (see paragraph BC40(c) of the Exposure Draft). The Exposure Draft also did not propose that an entity that invests in financial assets in the course of main business activities to split income and expenses from cash and cash equivalents into income and expenses from cash and cash equivalents that are held in relation to investing in the course of main business activities and cash and cash equivalents held for other purposes.

66. Therefore, for entities that provide financing to customers as a main business activity but do not invest in financial assets in the course of main business activities it can be argued that income and expenses from cash and cash equivalents should be classified in a single category, the investing category. Therefore, no requirement in relation to providing financing to customers is needed and the IASB can remove the accounting policy choice for cash and cash equivalents in paragraph 51 of the Exposure Draft.

67. This single approach would:

(a) reduce complexity and simplify the proposals making the requirements easier to understand and apply;

(b) not require any entities to incur costs to split cash and cash equivalents in line with the IASB's objectives for cash and cash equivalents; and

(c) result in classification of all income and expenses from cash and cash equivalents in a single category by each entity (even though the category would depend on whether the entity invests in financial assets in the course of main business activities or not).

68. However, this single approach could mean that there may be entities for which income and expenses from cash and cash equivalents are part of net interest income, a subtotal similar to gross profit, and which therefore (i) should classify income and expenses from cash and cash equivalents in the operating category but (ii) would not be able to. These could be entities like a bank that:

(a) provides financing to customers as a main business activity;

(b) does not invest in financial assets in the course of its main business activities; and

(c) is required to hold large amounts of cash for regulatory and operational purposes.

69. We don't think such scenarios would be common and therefore recommend the IASB explore the single approach and removing the accounting policy choice for cash and cash equivalents proposed in paragraph 51 of the Exposure Draft. If the IASB agree with the staff recommendation, we plan to test it during targeted outreach (see Agenda Paper 6 of the July 2022 meeting of the Accounting Standards Advisory Forum).

| Question for the IASB |
| --- |
| Q3 Does the IASB agree with the staff recommendation to:<br>(a) confirm the proposed requirement for an entity that invests in financial assets in the course of main business activities to classify income and expenses from cash and cash equivalents in the operating category; and<br>(b) explore removing the accounting policy choice for cash and cash equivalents proposed in paragraph 51 of the Exposure Draft? |

## Appendix A—Practical expedients used in IFRS Accounting Standards

| IFRS Accounting Standard | Circumstances where the practical expedient is used | Specific requirements to use the practical expedient | Disclosure requirements |
|---|---|---|---|
| IFRS 9 *Financial Instruments* (para. 5.4.7, B5.5.35) | A change in the basis for determining the contractual cash flows of a financial asset or financial liability that is required by interest rate benchmark reform. | The change is necessary as a direct consequence of interest rate benchmark reform and the new basis is economically equivalent to the previous basis (ie the basis immediately preceding the change). | No explicit disclosure requirements. |
| | Techniques for measuring expected credit losses (eg calculation of expected credit losses on trade receivables using a provision matrix). | Techniques used to measure expected credit losses should be consistent with the objectives for the measurement of expected credit losses (Section 5.5 of IFRS 9). | Disclosed as part of credit risk disclosures in accordance with paragraphs 35F–35N of IFRS 7 *Financial Instruments: Disclosures*. |
| IFRS 13 *Fair Value Measurement* (para. 71, 79, 91) | Permitted to use mid-market pricing or other pricing conventions that are used by market participants for fair value measurements within a bid-ask spread. | Applicable only when an asset or liability measured at fair value has a bid price and an ask price. | Disclosed as part of disclosures on valuation techniques. |
| | For large holdings of assets or liabilities that have level one prices, permitted to use an alternative pricing method that does not rely exclusively on quoted prices (eg matrix pricing). | When an entity holds a large number of similar (but not identical) assets or liabilities (eg debt securities) that are measured at fair value and a quoted price in an active market is available but not readily accessible for each of those assets or liabilities individually. | |

| IFRS Accounting Standard | Circumstances where the practical expedient is used | Specific requirements to use the practical expedient | Disclosure requirements |
|---|---|---|---|
| IFRS 15 *Revenue from Contracts with Customers* (para. 4, 63, 94, 121, 122, 129, B16, C5–C6) | Permitted to apply IFRS 15 to a portfolio of contracts (or performance obligations) with similar characteristics. | If reasonably expect the effects on the financial statements would not differ materially from applying IFRS 15 to individual contracts (or performance obligations) within the portfolio. | No explicit disclosure requirements. |
| | Not required to adjust the promised amount of consideration for the effects of a significant financing component. | When entity expects, at contract inception, that the period between when the entity transfers a promised good or service to a customer and when the customer pays for that good or service will be one year or less. | If an entity elects to use the practical expedient, it shall disclose that fact. |
| | Recognising the incremental cost of obtaining a contract as an expense when incurred. | When the amortisation period of the asset that the entity otherwise would have recognised is one year or less. | |
| | Not disclosing information about remaining performance obligations. | If the performance obligation is part of a contract that has an original expected duration of one year or less or the entity recognises revenue from the satisfaction of the performance obligation in accordance with paragraph B16. | Explain qualitatively whether practical expedient has been applied and whether any consideration from contracts with customers is not included in the transaction price and, therefore, not included in the information disclosed in accordance with paragraph 120. |

| IFRS Accounting Standard | Circumstances where the practical expedient is used | Specific requirements to use the practical expedient | Disclosure requirements |
|---|---|---|---|
| | When measuring progress towards complete satisfaction of a performance obligation, permitted to recognise revenue in the amount to which the entity has a right to invoice. | When an entity has a right to consideration from a customer in an amount that corresponds directly with the value to the customer of the entity's performance completed to date. | Disclosed as part of disclosures on determining the timing and satisfaction of performance obligations. |
| | Applying IFRS 15 retrospectively for completed contracts and for all contract modifications. | The entity shall apply the expedients used consistently to all contracts within all reporting periods presented. | Disclose the expedients that have been used and to the extent reasonably possible, a qualitative assessment of the estimated effect of applying each of those expedients. |
| IFRS 16 *Leases* (para. 12, 15–16, 46A, 46B, 60A, 105, B1, C3–C4, C10, C13) | A lessee may elect by class of underlying asset not to separate lease and non-lease components and instead account for them as a single lease component. | Practical expedient cannot be applied to embedded derivatives that meet the criteria in paragraph 4.3.3 of IFRS 9 *Financial Instruments*. | No explicit disclosure requirements. |
| | A lessee may elect not to assess whether a rent concession that meets the conditions in paragraph 46B is a lease modification. | Applies only to rent concessions occurring as a direct consequence of the covid-19 pandemic that meet all the conditions on changes in lease payments and there is no substantive change to other terms and conditions of the lease. | Disclose if practical expedient has been applied to all qualifying rent concessions (if only applied to some qualifying rent concessions, disclose information about the nature of the contracts to which it has been applied) and the amount recognised |

| IFRS Accounting Standard | Circumstances where the practical expedient is used | Specific requirements to use the practical expedient | Disclosure requirements |
|---|---|---|---|
| | | | in profit or loss for the reporting period to reflect changes in lease payments that arise from those rent concessions. |
| | Accounting for a lease modification required by interest rate benchmark reform. | The change is necessary as a direct consequence of interest rate benchmark reform and the new basis is economically equivalent to the previous basis (ie the basis immediately preceding the change). | No explicit disclosure requirements. |
| | Applying IFRS 16 to a portfolio of leases with similar characteristics. | If reasonably expect that the effects on the financial statements would not differ materially from applying IFRS 16 to the individual leases within that portfolio. | |
| | Not required to reassess whether a contract is, or contains a lease at the date of initial application. | If an entity chooses to apply the practical expedient, it shall apply it to all of its contracts. | If an entity chooses the practical expedient, it shall disclose that fact. |
| | Applying IFRS 16 retrospectively to leases that were previously classified as operating leases by a lessee. | Practical expedients can be applied on a lease-by-lease basis when a lessee applies IFRS 16 retrospectively with the cumulative effect of initial application recognised in accordance with paragraphs C7–C13. | If a lessee uses one or more of the practical expedients, it shall disclose that fact. |

## Appendix B—Extracts from the Exposure Draft

B1. The paragraphs from the Exposure Draft are reproduced below.

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

(a) income and expenses from cash and cash equivalents (see paragraph B34);

(b) income and expenses on liabilities arising from financing activities (see paragraphs B35–B36); and

(c) interest income and expenses on other liabilities (see paragraph B37).

**51** If an entity provides financing to customers as a main business activity, it shall make an accounting policy choice to not classify in the financing category either (see paragraphs B28–B29):

(a) income and expenses from financing activities, and from cash and cash equivalents, that relate to the provision of financing to customers; or

(b) all income and expenses from financing activities and all income and expenses from cash and cash equivalents.

Such income and expenses are instead classified in the operating category.

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

(a) income and expenses from cash and cash equivalents if the entity, in the course of its main business activities, invests in financial assets that generate a return individually and largely independently of other resources held by the entity (see paragraph B30);

(b) income and expenses on liabilities arising from issued investment contracts with participation features recognised applying IFRS 9 *Financial Instruments*; and

(c) insurance finance income and expenses included in profit or loss applying IFRS 17 *Insurance Contracts*.

**B28** Applying paragraph 51, when an entity provides financing to customers as a main business activity it is required to make an accounting policy choice to classify in the operating category either income and expenses from financing activities, and from cash and cash equivalents relating to the provision of financing to customers or all income and expenses from financing activities and all income and expenses from cash and cash equivalents.

**B29** Whether an entity provides financing to customers as a main business activity is a matter of judgement. In general, providing financing to customers is likely to be a main business activity when the difference between interest income and the related interest expense is an important indicator of operating performance. Examples of entities that provide financing to customers as a main business activity may include:

(a) banks;

(b) entities that provide financing to customers to enable those customers to purchase the entity's products; and

(c) lessors that provide finance leases to customers.

**B30** The requirement in paragraph 52(a) for an entity to classify income and expenses from cash and cash equivalents in the operating category applies when any entity invests in financial assets in the course of its main business activities. It does not apply to an entity that invests only in non-financial assets in the course of its main business activities.

**B33** Income and expenses from investments do not include income and expenses from assets used by an entity in the production of goods and delivery of services. Income and expenses derived from such assets result from the combination of those assets with other resources of the entity, such as employees, raw materials or intangible assets, and not from the individual assets on their own. Examples of such income and expenses not from investments include:

(a) interest revenue from trade receivables, which would be classified in the operating category;

(b) income and expenses from property, plant and equipment and intangible assets, including depreciation, amortisation, impairment and disposal gains and losses, which would be classified in the operating category; and

(c) gains or losses on disposal of a discontinued operation, which would be classified in the discontinued operations category.

**B78** In accordance with paragraph 104(b) subtotals similar to gross profit are not management performance measures. A subtotal is similar to gross profit when it represents the difference between a type of revenue and directly related expenses incurred in generating that revenue. Examples include:

(a) net interest income;

(b) net fee and commission income;

(c) insurance service result;

(d) net financial result (investment income minus insurance finance expenses); and

(e) net rental income.

**BC 42** The Board proposes that the unwinding of a discount on liabilities that do not arise from financing activities be classified in the financing category.

**BC 43** This proposal is intended to capture income and expenses that reflect the effect of the time value of money on liabilities that do not arise from financing activities. These include, for example, net defined benefit liabilities (or assets) and decommissioning liabilities. Many users of financial statements consider such income and expenses to be similar to income or expenses from financing activities.

**BC44** The Board recognises that not all users of financial statements consider such income or expenses to be similar to income or expenses from financing activities. However, the Board's proposal provides a consistent basis for the presentation of information related to financing and the related disclosures should enable users that disagree with the classification of these income and expenses as financing to adjust the profit or loss before financing and income tax subtotal if they wish to do so.

**BC45** The Board's proposed subtotal of profit or loss before financing and income tax precedes the financing category. The financing category incorporates definitions of items that users of financial statements commonly regard as part of an entity's financing. This approach provides a consistent basis for the presentation of the information related to an entity's financing, resulting in a comparable subtotal. The requirements for separate presentation of items classified in the financing category enable users, when doing their own analyses, to adjust the amounts classified in this category if they have different views about whether those items form part of an entity's financing.

**BC63** When an entity provides financing to customers as a main business activity, the difference between the interest revenue from that activity and the related interest expense—a cost of earning that income—is an important indicator of operating performance. For example, in the lending business, a main business activity is earning interest revenue from providing financing to customers. The difference between interest revenue and interest expense incurred to obtain some or all of the financing needed for that main business activity is a key performance measure for financial institutions and is used by users of financial statements when analysing the performance of such entities. The Board's proposal would enable entities such as banks to continue presenting a net interest income subtotal.

**BC64** When an entity that provides financing to customers has more than one main business activity, it may have financing activities that are unrelated to the provision of financing to customers. In some such situations, the entity may be unable to identify which income and expenses from financing activities and income and expenses from cash and cash equivalents relate to the provision of financing to customers and which do not without undue cost or effort.

**BC65** For example, an entity with a central treasury that raises funding for all of the entity's activities and allocates those costs internally may not be able to identify a non-arbitrary basis for allocating financing expenses between those that do or do not relate to the provision of financing to customers.

**BC66** Some entities both provide financing to customers and invest in the course of their main business activities. It may be difficult to allocate expenses from financing activities to these two activities. For example, a bank that provides financing to customers, but also invests in equity instruments, may not be able to identify a non-arbitrary basis for allocating interest expense from its financing activities between these two activities.

**BC67** Therefore, the Board proposes that when an entity provides financing to customers, it should make an accounting policy choice between classifying in the operating category:

(a) only income and expenses that arise from financing activities and income and expenses from cash and cash equivalents relating to its provision of financing to customers; or

(b) all income and expenses from financing activities and all income and expenses from cash and cash equivalents.

**BC68** The Board recognised that permitting an accounting policy choice may result in some loss of comparability between entities and that classifying in the operating category only the income and expenses arising from financing activities related to providing financing to customers would provide more useful information. However, because of the difficulty in some cases in allocating income or expenses between the categories, the Board concluded that allocation should not be required but should be permitted.

**BC70** As discussed in paragraph BC40, the Board concluded that, for most entities, cash and cash equivalents are a reasonable proxy for excess cash and investments of excess cash and that income and expenses from cash and cash equivalents should therefore be classified in the financing category. However, the Board observed that some entities require a significant balance of cash and cash equivalents for operational purposes. The Board concluded that for such entities cash and cash equivalents are not a reasonable proxy of excess cash and investments of excess cash. For example:
(a) insurers need to maintain a significant balance of cash and cash equivalents to be able to pay out insurance claims;
(b) insurers and investment funds often have significant balances of cash and cash equivalents as a result of continuously rebalancing their investment portfolios; and
(c) open-ended investment funds need to maintain a significant balance of cash and cash equivalents to be able to buy back shares from investors who wish to redeem their shares.

**BC71** In cases where an entity needs a significant balance of cash and cash equivalents for operational purposes, classifying the income and expenses from cash and cash equivalents in the operating category provides more useful information than classifying such income and expenses in the financing category. Therefore, the Board proposes to address this issue.

**BC72** The Board considered different ways to describe entities that would classify income and expenses from cash and cash equivalents in the operating category. The Board decided to limit the scope of that requirement to entities that invest in financial assets in the course of their main business activities. Feedback from users of financial statements suggested that for entities that only invest in non-financial assets in the course of their main business activities, such as property companies, classifying income and expenses from cash and cash equivalents in the operating category would not be useful. The Board concluded that such classification would not be useful because entities such as property companies invest in non-current assets and therefore cash is less likely to be interchangeable with their investments.