UKEB
UK Endorsement Board

Primary Financial Statements–General Update

Executive Summary

Project Type	Monitoring
Project Scope	Various
Purpose of the paper	
This paper provides the UKEB with an update on the IASB's Primary Financial Statements project which the UKEB Secretariat is currently monitoring. The aim is to ensure the UKEB is informed about the progress and decisions being made by the IASB on this project.	
Summary of the Issue	
The paper contains a summary of the tentative decisions made by the IASB at its meeting held in March 2023 covering the following topics: a) Operating expenses by nature when an entity uses a function of expense method. i. Requiring additional operating expenses by nature when an entity uses a function of expense method and disclosing this information in a single note. ii. Application guidance for disclosing the required amounts. iii. Expanding the scope of the proposed exemption from the general requirement to disaggregate material information. b) Management performance measures: i. Rebuttable presumption. ii. Relationship with the requirements in IAS 8 and IAS 34. iii. Tax disclosure. c) Classification of: i. Income and expenses from specific hybrid contracts with host liabilities that arise from transactions that do not involve only the raising of	

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	finance and that are measured at amortised cost in its entirety. ii. Foreign exchange differences on liabilities that arise from transactions that do not involve only the raising of finance ('other liabilities') that are denominated in a foreign currency. iii. Income and expenses arising from cash and cash equivalents for entities that provide financing to customers as a main financing activity.
Decisions for the Board	
No decisions are required. Comments or questions are welcomed on any topic. • Does the Board have any comments on the updates in the paper?	
Recommendation	
N/A	
Appendices	
Appendix A	Example illustrating the disclosure of some of the required operating expenses by nature.
Appendix B	Example illustrating the simplified approach for calculating the tax effects of MPMs.

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UKEB Project Status: Active Monitoring **IASB Next Milestone:** IFRS Accounting Standard	**UKEB project page** **FRC Comment Letter (FCL)** (before UKEB Chair was appointed) **(Published in September 2020)**

Background

1. At its March 2023 meeting the IASB continued its redeliberations on the proposals in the **Exposure Draft General Presentation and Disclosures** (the ED) as part of its project on **Primary Financial Statements** (PFS).

2. As a result of these discussions the IASB made some tentative decisions. At this meeting we would like to ask the Board for any comments on these decisions. We list below the topics discussed at the March IASB meeting:

   a) Disclosure of **operating expenses by nature in the notes** when an entity uses a function of expense method **(Topics 1A–1C)**.

   b) **Management performance measures (MPMs):** rebuttable presumption, relationship with the requirements in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* and in IAS 34 *Interim Financial Reporting* and tax effects of reconciling items **(Topics 2A–2D)**.

   c) Classification of: income and expenses from **specific hybrid contracts in IFRS 9; foreign exchange differences** on liabilities that arise from transactions that **do not involve only the raising of finance**; and of income and expenses arising from **cash and cash equivalents for entities that provide financing to customers as a main financing activity (Topics 3A–3C).**

3. For each of these topics we provide some background information around the IASB's tentative decisions (i.e. how they relate to the ED proposals and the IASB's rationale for making those decisions). When applicable we have included commentary on the consistency of these decisions with UKEB's recommendations and with the recommendations of UKEB advisory groups: the Investor Advisory Group (IAG) (meeting on 3 October 2022); the Preparers Advisory Group (PAG) (meeting on 31 October 2022); the Accounting Firms and Institutes Advisory Group (AFIAG) (meeting on 3 November 2022). The UKEB Secretariat reported to the Board the feedback from advisory groups in November 2022.

Topic 1: Disclosure of operating expenses by nature in the notes

4. The IASB issued tentative decisions on the following topics:

   a) **Requiring additional operating expenses by nature** when an entity uses a function of expense method and disclosing this information in a **single note** **(Topic 1A)**. The IASB decided (emphasis added):

      *a. to **change the specific disclosure requirement** for operating expenses by nature proposed in the Exposure Draft **to require an entity to disclose the amounts of depreciation, amortisation, employee benefits, impairments and write-downs of inventory included in each function line item** in the statement of profit or loss.*

      *b. to confirm the proposal in the Exposure Draft that an entity would disclose the information described in (a) in a **single note**.*

   b) **Application guidance** for **disclosing** the required amounts **(Topic 1B)**. The IASB decided:

      *a. to provide application guidance clarifying that the amounts described in (a) are **not required to be expense amounts**.*

      *b. to require an entity to **provide a qualitative explanation** if part of the amount disclosed has been included in the carrying amount of assets. The explanation would include identifying in which assets the amounts have been included.*

   c) **Expanding the scope of the proposed exemption** from the general requirement to disaggregate material information **(Topic 1C).** The IASB decided:

      *a. to **expand the scope of the proposed exemption from the general requirement to disaggregate material information** that the IASB tentatively decided on in January 2023. As a result, an entity would be exempt from disclosing*

         i. in relation to function line items in the statement of profit or loss, the amounts of nature expenses included therein (beyond those specifically required); and

         ii. in relation to nature expenses that are required to be disclosed by an IFRS Accounting Standard, the amounts included in each function line item in the statement of profit or loss.

5. The tables below provide context around those decisions.

Topic 1A: Requiring additional operating expenses by nature and disclosing information in a single note

ED proposals and changes	Rationale for the IASB's decision	Consistency with UKEB proposals
Paragraph 72 of the ED proposed to require an entity that uses the function of expense method to disclose in a *single* note an analysis of *total* operating expenses by nature. In response to cost concerns the IASB limited this *specific disclosure requirement* to the following specific items by nature: depreciation, amortisation and employee benefits. In March 2023 the IASB expanded the scope of the specific disclosure requirement to require the disclosure of amounts of impairments and write-downs of inventory and to disclose all this information in a single note.[1]	Information by nature in a single note is useful for users. For preparers disaggregating specified expenses by functional category is feasible (i.e. some entities provide this information already in function line items or in a single line item) and it is less costly than providing the full analysis by nature proposed in the ED.	Advisory group members expressed some concerns:[2] PAG minutes indicate that: • "Amounts of depreciation, amortisation and employee costs might not always be the most relevant costs to analyse by functional category. Other expenses, e.g. raw materials, might be more relevant". • "Expanding the list of expenses to be analysed by functional category could reduce levels of voluntary disclosure as entities may stop disclosing expenses they do not want to analyse by functional category". AFIAG minutes indicate that: "since inventory write-downs would always be allocated to the cost of sales functional category, the proposal to require analysis by functional category of inventory write-downs would provide limited additional information". IAG noted that the "analysis of other expenses (e.g. advertising) could be more useful". The UKEB agreed with the presentation of this information in a single note.[3]

1 **Appendix A** provides an illustration of the intended disclosure for some of the required operating expenses by nature.
2 Refer to paragraphs 8(a), 8(d) and 8(f) in the PAG Minutes and to paragraph 10 in the AFIAG Minutes and paragraph 60 (UKEB Agenda Paper 8 IASB General Update–Nov 22).
3 Refer to paragraph A46 in the GPD FCL.

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Topic 1B: Application guidance for disclosing the required amounts

ED proposal and changes	Rationale for the IASB's decision	Consistency with UKEB proposals
No specific proposals in the ED. In March 2023 the IASB decided to: • clarify that the specific items required to be included in each function line item are not required to be expense amounts. • require an entity to provide a qualitative explanation if part of the amount disclosed has been included in the carrying amount of assets. The explanation would include identifying in which assets the amounts have been included.[4]	The IASB observed that it is common practice for entities presenting operating expenses by nature to include a combination of expenses[5] recognised in the period (e.g. depreciation) and amounts that have been included in the carrying amount of assets that *will be* recognised as expenses in future periods (e.g. 'changes in inventories of finished goods and work in progress'[6]). Users agreed to have a reasonable approximation of the amounts included in line items by function.	The UKEB Secretariat considers that the IASB's redeliberations to list specific disclosure requirements helps to address preparers' concerns that an analysis of expenses by nature will be costly and complex.

4 **Appendix A** provides an illustration of the intended disclosure for some of the required operating expenses by nature.
5 Paragraph 4.69 of the IASB's *Conceptual Framework*: defines 'expenses' as "decreases in assets, or increases in liabilities, that result in decreases in equity, other than those relating to distributions to holders of equity claims".
6 This presentation is permitted in IAS 1 *Presentation of Financial Statements*" (see illustration below paragraph 102 of IAS 1).

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Topic 1C: Expanding the scope of the proposed exemption from the general requirement to disaggregate material information

ED proposal and changes	Rationale for the IASB's decision	Consistency with UKEB proposals
Paragraph 72 of the ED required an analysis of total operating expenses by nature when using a function of expense method and a general requirement to disclose *material* information. In January 2023 the IASB tentatively decided to add an exemption to the general requirement to disaggregate material information. The exemption would apply to information about the nature of operating expenses included in a function line item. In March 2023 the IASB extended the scope of this exemption. An entity would be exempt from disclosing in relation to: • function line items in the statement of profit or loss, the amounts of nature expenses included therein (beyond those specifically required); and • nature expenses that are required to be disclosed by an IFRS Accounting Standard, the amounts included in each function line item in the statement of profit or loss.	The IASB decided to limit the specific requirements on the disclosure of operating expenses by nature because of the costs involved for some entities in obtaining the information. Users prefer as much information about the allocation of nature expenses to function line items but acknowledged the cost constraints of some entities providing such information.	The UKEB Secretariat considers that extending the exemption is addressing the concerns from UK stakeholders that the proposals in the ED were too costly and complex. It is also responding to their recommendation to further consider the costs and benefits of the proposals. It is also responding to the observation made in the FCL that the ED was unclear on the level of disaggregation required in the proposed analysis of operating expenses by nature and on the extent to which flexibility to present separate material items of income and expense was retained or prohibited by the proposals.[7]

[7] Refer to paragraph A47 in the FCL and paragraph 16 in Agenda Paper 6 IASB Update (February 2023).

Topic 2: Management performance measures (MPMs)

6. The IASB discussed the following topics:

   a) **Rebuttable presumption**–application guidance **(Topic 2A)**.

   b) The **relationship with the requirements in IAS 8** *Accounting Policies, Changes in Accounting Estimates and Errors* **(Topic 2B).**

   c) The **relationship with the requirements in IAS 34** *Interim Financial Reporting*. **(Topic 2C)**.

   d) **Tax disclosure**–Revised approach for calculating the tax effect of reconciling items and specific disclosure requirements **(Topic 2D)**.

Topic 2: Management performance measures (MPMs)

Background

7. Paragraph 103 of the ED defined MPMs as follows (emphasis added):

   Management performance measures are subtotals of income and expenses that:

   *a) are used in **public communications** outside financial statements*

   b) complement totals or subtotals specified by IFRS Accounting Standards; and

   *c) **communicate** to users of financial statements **management's view of an aspect of an entity's financial performance**.*

8. The IASB decided during its redeliberations in September and November 2021 to:

   a) Exclude from the scope of 'public communications' oral communications, transcripts and social media posts.[8]

   b) Remove the second criterion (refer to paragraph 9(b) above) "complement totals or subtotals specified by IFRS Accounting Standards".[9]

   c) Establish a 'rebuttable presumption' to reduce subjectivity in judging when a subtotal represents management's view.

8 Refer to IASB Update November 2021.

9 This was because, as explained in paragraph 10 in IASB agenda paper 21B (September 2021), some MPMs might not be judged as complementing totals or subtotals specified by IFRS Standards.

9. The **rebuttable presumption** states that (emphasis added):

- *a subtotal of income and expenses **included in an entity's public communications outside the financial statements** represents management's view of an aspect of the entity's financial performance.*[10]

10. This presumption can be rebutted when:

- *the entity has **reasonable and supportable information** demonstrating that a subtotal of income and expenses does not represent management's view of an aspect of performance.*[10]

Topic 2A: Application guidance for the rebuttable presumption

11. The IASB tentatively decided at its March 2023 meeting (emphasis added):

- *To **develop further the application guidance to explain that reasonable and supportable information for rebutting the presumption** would include management communicating or using a subtotal in a way that is consistent with the assertion that the subtotal does not communicate management's view. The IASB also tentatively decided to include some examples of when this could be the case.*

12. The IASB staff papers from November 2021 and March 2023[11] proposed that the application guidance could be based on information supporting why the subtotal:

    a) *Is included in the public communication*. For example, subtotals of income and expenses do not reflect management's view of an aspect of financial performance when they are solely used:

        i. to meet an externally imposed requirement (e.g. regulatory reports);

        ii. to satisfy the request of an external party (e.g. publishing EBITDA solely because investors asked for this information); or

        iii. communicate information other than performance (e.g. sustainability or governance).

    b) *Does not communicate management's view*. For example, a subtotal that is communicated in a single location in the management commentary, that is described as not representing management's view, but that is requested by users would support rebutting the presumption. Alternatively, an entity communicating numerous subtotals in its public communications would appear inconsistent with an assertion that none of those subtotals communicate management's view.

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10 Reproduced (with emphasis added) from IASB Update November 2021.

11 Refer to paragraphs 37–45 in IASB agenda paper 21A (November 2021) and paragraphs 29–31 in IASB agenda paper 21B (March 2023).

Consistency with UKEB's proposals

13. We think that adding application guidance for the rebuttable presumption could add more clarity on the identification of MPMs as different interpretations exist in the identification of those measures.[12]

14. UKEB Advisory group members were generally supportive[13] of including a rebuttable presumption in the definition of MPMs, but some concerns were raised on the identification of MPM's:

    a) PAG minutes observe that: "The [MPM] proposals could cause confusion about which measures used by management to measure performance fall within scope".[14]

    b) AFIAG minutes observe that: "The proposed rebuttable presumption for the definition of MPMs would still leave the challenge of identifying MPMs, given the proposed scope extended to MPMs in any public communications outside financial statements".[15]

Topic 2B: MPMs–Relationship with the requirements in IAS 8

15. The IASB tentatively decided at its March 2023 meeting (emphasis added):

    *a. to confirm the proposal that **if an entity changes the calculation of its management performance measures, introduces a new management performance measure or removes** a previously disclosed management performance measure from its financial statements, it would be required:*

    *i. to **disclose sufficient explanation** for users of financial statements to understand the change, addition or removal and its effects; and*

    *ii. to **disclose the reasons** for the change, addition or removal (see paragraphs 108(a) and 108(b) of the Exposure Draft).*

    *b. to **amend the proposed disclosure requirement in paragraph 108(c) of the Exposure Draft to say that an entity need not provide comparative information** when the entity changes a management performance measure or introduces a new one, if it is **impracticable** to do so.*

    c. to add a requirement that if an entity does not provide comparative information about a new or changed management performance measure because it is impracticable to do so, the entity shall disclose that fact.

    *d. to clarify that **the choice of a management performance measure, including how the measure is calculated**, is **not an accounting policy** as defined in IAS 8.*

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12 Refer to paragraph A74 in the FCL.
13 Refer to UKEB Agenda Paper 8 IASB General Update (17 November 2022) paragraph 66.
14 PAG minutes (paragraph 10(a)).
15 AFIAG minutes (paragraph 12(a)).

16. The table below provides context on the IASB's March 2023 tentative decisions.

ED proposal and changes	Rationale for the IASB's decision	Consistency with UKEB proposals
Paragraph 108 of the ED proposes that if an entity changes the calculation of its MPMs, introduces a new MPM or removes a previously disclosed MPM from its financial statements, it has to: (a) provide explanations to understand the change, addition or removal and its effects; (b) disclose the reasons for the change, addition or removal; and (c) restate its comparative information, including in the required note disclosures, to reflect the change, addition or removal. The amendment to paragraph 108(c) (March 2023) indicates that an entity need not provide comparative information for the new or changed MPM if this is *impracticable* and to disclose this fact. It was also clarified that the choice of an MPM, including its calculation, is not an 'accounting policy'.	Having information about changes in MPMs enhances the transparency and comparability of MPMs. The amendments to paragraph 108(d) were in response to cost concerns raised by stakeholders. For example, an entity may not have collected the data in the prior period in a way that would allow it to provide the comparative information.[16] A change in an MPM is not an accounting policy because it was observed that an entity sets its accounting policies[17] for its financial statements, and <u>not</u> for its communications *outside* the financial statements.	The FCL supported the disclosure requirements in paragraph 108 of the ED.[18] The proposed clarifications (i.e. that the choice of how an MPM is calculated is not an accounting policy) are responding to IAG's and AFIAG's requests for clarification (i.e. these groups had noted that it would be important to clarify whether the simplified approach was an accounting policy choice or whether it could be used selectively, e.g. on cost grounds).[19]

16 Refer to paragraph 21 of Agenda Paper 21C (March 2023).
17 Accounting policies are "the specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements" (paragraph 6 of IAS 8).
18 Refer to paragraph A70 in the FCL.
19 Refer to paragraph 69 in UKEB Agenda Paper 8 IASB General Update (17 November 2022) and paragraph 12(b) of AFIAG minutes.

Topic 2C: MPMs–Relationship with the requirements in IAS 34

17. The IASB tentatively decided at its March 2023 meeting (emphasis added):

   a. *to confirm the proposal to amend IAS 34* ***to require the disclosure in interim financial reports of the management performance measures*** *set out in paragraph 106 of the Exposure Draft.*

   b. ***to expand the proposed amendment to IAS 34 to include the requirements that apply to changes in an entity's management performance measures*** *(see paragraph 108 of the Exposure Draft) in the list of 'other disclosures' required by paragraph 16A of IAS 34.*

18. The table below provides context around the IASB's March 2023 tentative decisions. No specific comments were made in the FCL or by UKEB advisory groups related to the topics discussed.

ED proposal and changes	Rationale for the IASB's decision
The ED proposed a consequential amendment to paragraph 16A of IAS 34 (which includes a list of required disclosures in interim financial reports) to require MPMs disclosures in interim financial reports. This proposal was confirmed in March 2023. The IASB also added the requirements that apply to changes in MPMs (i.e. paragraph 108 of the ED) to interim reports.	It was observed that including MPM disclosures in interim reports provides timely and useful information for users and helps them understand any changes made in the calculation of MPMs. The IASB also observed that it is also common for entities to include MPMs related to the interim period in public communications outside the interim financial statements.

Topic 2D: MPMs tax disclosure–revised approach for calculating the tax effect of reconciling items and specific disclosure requirements

Background

19. Paragraph 106 of the ED requires an entity to disclose separately the effect of income tax and the amount attributable to non-controlling interest for each reconciling item between an MPM and the most directly comparable total or subtotal specified by IFRS Accounting Standards.

20. The ED proposed a simplified approach for calculating the income tax effect of the reconciling items in response to cost concerns by preparers. This approach is based on "a reasonable pro rata allocation of the current and deferred tax of the entity in the tax jurisdiction(s) concerned or by another method that achieves a

more appropriate allocation in the circumstances" (see paragraph 107 of the ED).[20]

21. Respondents to the ED, however, said that the simplified approach did not significantly reduce the costs or the complexity of providing the required tax disclosures[21].

'Simplified approach' for tax calculation

22. At its May 2022 meeting the IASB decided to confirm the proposed requirements in the ED.[22] However, to alleviate the concerns raised, the IASB decided to clarify the intended simplified approach by specifying **how to calculate** the income tax effect of reconciling items. The IASB clarified that entities had **two** options:

    a) To calculate the tax effects of the underlying transaction(s) at the statutory tax rate(s) applicable to the transaction(s) in the relevant jurisdictions(s).[23]

    b) To calculate the tax effects as in a) *as well as* providing an allocation of any other tax effects. [24] This allocation could be based on either a reasonable pro rata allocation of current and deferred tax, or on another method that achieves a more appropriate allocation.

Further simplifications to the 'simplified approach' at the March 2023 meeting

23. At its March 2023 meeting the IASB provided a wider range of approaches for calculating the tax effect for reconciling items. It tentatively clarified that an entity has now **three** options for calculating the tax effects (emphasis added):

    *a. to retain the option of **calculating the tax effects of the reconciling items at the statutory tax rate(s) applicable to the underlying transaction(s)** in the relevant jurisdiction(s);* **[Option1]**

    b. to replace the alternative option of adding an allocation of other income tax effects to the tax effects described in (a), with options:

    *i. to calculate the tax effects of the reconciling items on the basis of a **reasonable pro rata allocation of the current and deferred tax** of the entity in the tax jurisdiction(s) concerned;* **[Option 2]** *or*

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[20] This approach was intended to replicate the approach in paragraph 63 of IAS 12 *Income Taxes* for determining the income tax effect on items of other comprehensive income. However, the approach in the ED is not identical to the approach in IAS 12 as the latter requires the identification of the income tax effects of transactions or events to the categories of profit or loss, OCI, and equity and does not require an entity to calculate the tax effects of an individual item of income or expense.

[21] For example, some preparers mentioned that "it may be difficult or arbitrary to allocate tax losses applicable at a group level on consolidation to individual items" (refer to paragraph 42(a) in IASB Agenda Paper May 2022).

[22] Refer to IASB Update May 2022.

[23] We interpret that these are the tax effects directly related to the underlying transaction(s).

[24] We interpret that these are the tax effects indirectly related to the underlying transaction(s).

ii. to calculate the tax effects of the reconciling items by ***another method that achieves a more appropriate allocation in the circumstances****.* **[Option 3]**

24. The table below provides context around the IASB's March 2023 tentative decisions.

Rationale for the IASB's decision	Consistency with UKEB proposals
Participants in IASB's targeted outreach raised concerns over the costs and usefulness of the simplified tax calculation. To alleviate these concerns and to provide more flexibility in how an entity determines the tax effects, the IASB tentatively decided in March 2023 to: (a) permit a wider range of approaches for calculating income tax effects. (b) require specific disclosure requirements for the approach(es) an entity uses to calculate the income tax effect.	During targeted outreach, UKEB advisory groups expressed mixed views on the simplified approach for calculating the tax effects of reconciling items. For instance: a) PAG minutes indicate that: "MPMs in the UK do not tend to include tax effects and effects of non-controlling interests. Some PAG members believed that users prefer measures which are post-tax and at EPS level in order to interrogate the management performance number and assess validity of reconciling items. It was noted that the tax expense in the statement of profit or loss might not be the same as the cash tax payable, and that the cash tax payable may be of more interest to users". We note that the IASB has acknowledged similar concerns from stakeholders. However, The IASB has decided to go ahead with its proposals as information about tax effects and effects of non-controlling interests is important for users. The IASB also considered that allowing a wider range of approaches would maintain the balance between costs and benefits.[25] b) One PAG member agreed with the simplified approach and noted that they currently voluntarily disclose a similar reconciliation in response to investor requests. c) IAG members generally viewed the simplified approach as a pragmatic solution.

[25] See for example paragraphs 17 and 33 in IASB agenda paper 21D (March 2023).

25. The IASB also tentatively decided to require an entity to explain how it determined those effects as follows (emphasis added):

   a. ***to confirm the requirement in paragraph 106(d) of the Exposure Draft for an entity to disclose how it has determined the income tax effects*** *for items reconciling a management performance measure to the most directly comparable subtotal or total specified by IFRS Accounting Standards;*

   b. ***to provide application guidance requiring the disclosure in (a)*** *for each reconciling item if more than one method is used to calculate the tax effect; and*

   c. to revise the requirements in paragraph 108 of the Exposure Draft for disclosures relating to changes in management performance measures so that they apply to changes to the calculation of the tax effects of reconciling items.

Topic 3: Classification of other income and expenses

26. The IASB discussed and issued tentative decisions on the following topics:

   a) Classification of income and expenses from **'specific hybrid contracts'** **(Topic 3A)**

   b) Classification of **foreign exchange differences** on liabilities that arise from transactions that **do not involve only the raising of finance ('other liabilities')** that are denominated in a foreign currency **(Topic 3B)**.

   c) Classification of income and expenses arising from **cash and cash equivalents for entities that provide financing to customers as a main financing activity** **(Topic 3C).**

27. No specific comments were made in the FCL or by UKEB advisory groups related to topics (a) and (b).

Background

28. Paragraph 49 of the ED proposed that the **'financing category'** would include (emphasis added):

   a) *(…);*

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

   c) *interest income and expenses on* ***other liabilities****.*

29. At its July 2021 meeting the IASB revised the approach for identifying income and expenses in the financing category. This approach focused on distinguishing income and expenses arising from (emphasis added):[26]

a) ***transactions that involve only financing activities****, for example corporate bonds, bank loans and mortgages. The outcome of such transactions is solely the raising of finance* [[27]] *for the entity's operating or investing activities. The transactions do not themselves involve any operating or investing activities. Hence, all resulting income and expenses should be categorised as financing.*

b) ***transactions that combine financing with another activity****, for example payables to suppliers with extended credit terms, lease liabilities and pension liabilities. The outcome of such transactions is both an operating (or investing) activity and a financing component. Hence, it is necessary to identify which items of income and expenses should be classified as financing.*

30. Following this approach, the IASB revised paragraph 49 of the ED and required an entity to classify in the 'financing' category (emphasis added):

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

b) **specified** income and expenses from '***other liabilities***'[28] (i.e. **interest expense and the effect of changes in interest rates**)

Topic 3A: Classification of income and expenses from 'specific hybrid contracts'

Background

31. The revised approach to the financing category (see paragraph 31) did not apply to 'specific hybrid contracts' in the scope of IFRS 9 *Financial Instruments* that:

a) Are measured at **amortised cost**; and

b) Include an **embedded derivative**[29] that is **not separated**[30] from the **host liability** applying paragraph 4.3.3 of IFRS 9 because the economic

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[26] We extracted this information from paragraphs 15(a)–(b) in Agenda Paper 21A (July 2021).

[27] According to the IASB Update (July 2021) **transactions that involve only the raising of finance** are transactions that involve "the receipt by the entity of cash, an entity's own equity instruments or a reduction in a financial liability; and the return by the entity of cash or an entity's own equity instruments".

[28] This term refers to 'liabilities arising from transactions that do not involve only the raising of finance'.

[29] Paragraph 4.3.1 of IFRS 9 states that an embedded derivative is a component of a hybrid (combined) instrument that also includes a non-derivative host contract—with the effect that some of the cash flows of the combined instrument vary in a way similar to a stand-alone derivative. An embedded derivative causes some or all of the cash flows to be modified according to a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates or other variable.

[30] An embedded derivative cannot be separated from the host unless specified criteria are met in paragraph 4.3.3 of IFRS 9. For example, separation is allowed only if the economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host.

characteristics and risks of the embedded derivative are closely related to the economic characteristics and risks of the host. The host liability arises from transactions that **do not involve only the raising of finance**.

32. The IASB observed that applying the revised approach to the financing category (see paragraph 31(b)) would be complex for the 'specific hybrid contracts' described in paragraph 32 as it may not be always clear from IFRS Standards whether income and expenses arising from the host liability would be identified as interest expenses and/or changes in interest rates, or as any other type of income and expense.

33. For example[31], a payable for goods and services with extended credit terms that includes an early repayment option (considered a closely related embedded derivative). This contract would give rise to income and expenses resulting from the changes in the expected future cash flows of the instrument as and when expectations regarding the use of the early repayment option are updated but it may not be always clear if it gives rise to:

    a) interest expenses or changes in interest rates (to be classified in 'financing' as '); or,

    b) any other type of income and expense that would be classified in a different category (e.g. 'operating').

34. This identification may also require specific disaggregation of income and expenses of the entire hybrid contract into those relating to the host liability and those relating to the embedded derivative, which would be contrary to the measurement of the hybrid liability as a single unit of account as per IFRS 9.

35. Therefore, at the July 2021 meeting the IASB asked the staff to explore an alternative approach that would classify all income and expenses in the financing category.

Further simplification on the classification of 'specific hybrid contracts'

36. At its March 2023 meeting the IASB decided (emphasis added):

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

[31] Example provided in paragraph 46 of Agenda Paper 21E (March 2023).

Topic 3B: Classification of foreign exchange differences on ‘other liabilities’ that are denominated in a foreign currency

37. At its March 2023 meeting the IASB discussed the classification of FX differences arising from *other liabilities* (i.e. liabilities arising from transactions that involve operating activities in addition to the raising of finance) and tentatively decided to (emphasis added):

- *require an entity **to use its judgement** to determine in which category in the statement of profit or loss to classify foreign exchange differences on a liability that arises from a transaction that involves operating activities in addition to the raising of finance.*

38. The table below provides context around the IASB’s March 2023 tentative decisions.

ED proposal and changes	Rationale for the IASB’s decision
Paragraph 56 of the ED proposed that an entity classifies FX differences included in profit or loss (applying paragraphs 28 and 31 of IAS 21 *The Effects of Changes in Foreign Exchange Rates*) in the same category of the statement of profit or loss as the income and expenses from the items that gave rise to the FX differences[32]. This classification was confirmed by the IASB at its July 2021 meeting, except when doing so would involve undue cost or effort in which case an entity classifies FX differences in the ‘operating category’.	IASB members expressed mixed views on the classification of FX differences. For example, some supported classification in the ‘financing’ category (e.g. for countries with high inflation rates that have access to capital). Some others supported classification in the ‘operating’ category as the default category. The IASB ultimately, decided to require an entity to use its judgement for this classification.

[32] For example, FX differences relating to accounts receivable would be classified in the operating category whereas FX differences on foreign currency denominated loans would be classified in the financing category. Refer to paragraph 6 in Agenda Paper 21C (July 2021).

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Topic 3C: Income and expenses arising from cash and cash equivalents for entities that provide financing to customers as a main financing activity

39. The IASB tentatively decided to retain the accounting policy choice in paragraph 51 of the ED and clarify the interaction with paragraph 52(a) of the ED as follows: (emphasis added):

> a. *to **confirm the accounting policy choice** proposed in paragraph 51 of the Exposure Draft for the classification of income and expenses arising **from cash and cash equivalents** for entities that provide financing to customers as a main business activity; and*
>
> b. *to clarify that **the requirement in paragraph 52(a)** of the Exposure Draft applying to an entity that invests in financial assets as a main business activity would apply **regardless of whether the entity has any other specified main business activity**.*

40. The outcome of these decisions is as follows:

Entity type	Classification of income and expenses from cash and cash equivalents
Entity **does not invest** in financial assets or **does not provide financing to customers as a main business activity**	**Investing category**
Entity **invests in financial assets as a main business activity**	**Operating category**
Entity provides **financing to customers as a main business activity** but **does not invest** in financial assets as a main business activity.	**Accounting policy choice:** Classify in the operating category either all income and expenses arising from cash and cash equivalents or the portion related to providing finance to customers.

41. The table in the next page provides context around the IASB's March 2023 tentative decisions.

Question for the Board–Primary Financial Statements General update
1. Does the Board have any comments on the updates in the paper?

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ED proposal and changes	Rationale for the IASB's decision	Consistency with UKEB proposals
Paragraph 51 of the ED proposed the following accounting policy choice: If an entity provides financing to customers as a main business activity, it should make an accounting policy choice to not classify in the financing category 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. Such income and expenses are instead classified in the operating category. In addition, paragraph 52(a) of the ED proposed that if an entity invests in financial assets as a main business activity, the entity is required to classify	The IASB retained the accounting policy in paragraph 51 of the ED because during targeted outreach some participants observed that some entities that provide financing to customers as a main business activity do not invest in financial assets as a main business activity. Retaining this policy would also allow entities that provide financing to customers as a main business activity to report their income and expenses arising from cash and cash equivalents as part of their 'net interest income' (a subtotal similar to gross profit) within the operating category.	This issue was not covered in the FCL. AFIAG expressed similar concerns during the IASB's targeted outreach and also proposed retaining this choice.[33]

[33] Refer to UKEB Agenda Paper 8 IASB General Update (17 November 2022) page 56.

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ED proposal and changes	Rationale for the IASB's decision	Consistency with UKEB proposals
income and expenses from cash and cash equivalents in the operating category. In July 2022 the IASB tentatively decided to explore withdrawing the accounting policy choice proposed in paragraph 51 of the ED because: a) many entities that provide financing to customers <u>also</u> invest in financial assets as a main business activity (e.g. banks), and therefore, b) the classification of all income and expenses from cash and cash equivalents in the operating category for the entities in (a) would be triggered by paragraph 52(a) of the ED (making the choice in paragraph 51 unnecessary).		

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Appendix A: Example illustrating the disclosure of some of the required operating expenses by nature

Assumptions

A1. Entity X provides an analysis of operating expenses using the function of expense method (Table 1) and is required to provide a further analysis of specific operating expenses by nature (Table 2). Entity X provides an explanation that part of the amounts disclosed has been included in the carrying amount of property, plant and equipment.[1] The disclosure of employee benefits and amortisation is <u>not</u> illustrated.

Table 1: Statement of profit or loss	CU
Revenue	3000
Cost of goods sold	(600)
Gross profit	**2400**
Other income	500
Selling expenses	(400)
General and administrative expenses	(300)
Research and development expenses	(200)
Other operating expenses	(80)
Operating profit (loss)	**1920**

Table 2: Notes disclosure (1) Operating expenses by nature	CU
Depreciation	**205**
Cost of goods sold	100
Selling expenses	30
General and administrative expenses	25
Research and development expenses	50
Impairment	**60**
Research and development expenses	60
Write-downs of inventory	30
Cost of goods sold	30

(2) Reconciliation of the carrying amount of property, plant and equipment (CU) [2]			
Opening balance	**Impairment losses**	**Depreciation**	**End of the period**
1000	**60**	**205**	735

[1] This example is based on our interpretation of Appendix B of IASB staff Agenda Paper 21D (March 2023).
[2] Required disclosure in accordance with paragraph 73(e) of IAS 16 *Property, Plant and Equipment.*

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Appendix B: Example illustrating the simplified approach for calculating the tax effects of MPMs

Assumptions

B1. Entity Y uses three measures in its financial communications with users of financial statements. The three measures are 'adjusted operating profit', 'adjusted net profit' and 'adjusted equity holders' profit of parent'. All these measures provide management's view of an aspect of performance.

B2. Entity Y undertakes a restructuring resulting in CU1200 of restructuring expenses. Entity Y calculates the tax effects arising directly from the underlying transactions in Jurisdictions A and B[1] as follows:

Jurisdiction	Restructuring expenses	Tax rate applicable	Tax effects
Jurisdiction A	CU800	25%	CU200
Jurisdiction B	CU400	30%	CU120
Total	CU1200		**CU320**

B3. The non-controlling interest (NCI) attributable to the restructuring is CU80.

	MPM	Restructuring effects	IFRS Standards specified measures*
Revenue			
Cost of goods sold		(1200)	
Adjusted operating profit/operating profit	6200	(1200)	*5000**
Income tax		**320**	
Adjusted profit/profit	6080	(880)	*5200**
Profit attributable to NCI		(80)	
Adjusted profit to holders of claims against the parent classified as equity /Profit to holders of claims against the parent classified as equity	4960	(800)	*4160**

* We are assuming that the statement of profit or loss of Entity Y presents these figures.

[1] This example is illustrating the application of the first option described in the March 2023 tentative decision (see paragraph 25 in this paper). It is based on our interpretation of Appendix A of IASB staff Agenda Paper 21A (May 2022) and Note 2 of General Presentation and Disclosures ED/2019/7–Illustrative Examples (pages 12–13).