Comments on Tentative Agenda Decision – Classification of Income and Expenses when an Entity Has a Main Business Activity of Providing Financing to Customers (IFRS 18)

The Accounting Standards Board of the Institute of Chartered Accountants of India appreciates the opportunity to comment on the IFRS Interpretations Committee's Tentative Agenda Decision on **"Classification of Income and Expenses when an Entity Has a Main Business Activity of Providing Financing to Customers (IFRS 18)"**.

We acknowledge the Committee's analysis of the requirements in paragraphs 65 and 66 of IFRS 18 and the related requirements concerning the classification of income and expenses from cash and cash equivalents. We appreciate the Committee's efforts to address the practical questions raised by stakeholders regarding the application of these requirements in consolidated financial statements.

We broadly agree with the Committee's conclusion that the principles and requirements in IFRS 18 provide an adequate basis for determining the classification of income and expenses from specified liabilities. However, we believe that certain aspects of the application of these requirements could benefit from further clarification to promote consistent application in practice.

1. Overall view

We support the Committee's conclusion that a separate standard-setting project is not necessary to address the questions raised.

However, the fact pattern considered by the Committee involves an entity that has a main business activity of providing financing to customers and prepares consolidated financial statements comprising entities with different business activities.

In our view, the application of paragraphs 65(a) and 66 in such circumstances may give rise to practical questions, particularly regarding:

- the identification of the reporting entity for purposes of determining whether providing financing to customers is a main business activity;
- the application of the accounting policy choice in paragraph 65(a)(ii) across a consolidated group;
- the meaning and practical application of the expression "all such liabilities" in paragraph 66; and
- the interaction between paragraphs 57 and 65(a)(ii) where the entity is unable to distinguish cash and cash equivalents relating to financing activities but is able to distinguish specified liabilities.

We therefore recommend that the final Agenda Decision provide additional explanation on these matters.

2. Application of paragraph 65(a)(ii) at the consolidated group level

The Committee observes that paragraph 65 of IFRS 18 applies to an entity that provides financing to customers as a main business activity, with that assessment being made for the reporting entity as a whole.

Accordingly, where a reporting entity is a consolidated group and the group concludes that providing financing to customers is a main business activity, the accounting policy choice in paragraph 65(a)(ii) applies to the consolidated group as a whole. Consequently, the choice applies to all specified liabilities of the consolidated group that do not relate to providing financing to customers and not merely to specified liabilities of subsidiaries that themselves have providing financing to customers as a main business activity.

We agree with this conclusion.

In our view, this approach is consistent with assessing specified main business activities at the level of the reporting entity and is also consistent with the objective of consolidated financial statements to present the financial information of the group as a single reporting entity.

However, we believe that the final Agenda Decision could make this principle more explicit. In particular, it would be helpful to clarify that the assessment of whether providing financing to customers is a main business activity is performed at the **consolidated reporting-entity level**, rather than by separately assessing each subsidiary and then aggregating the conclusions.

Such clarification would be particularly useful where:

- only one or some subsidiaries within a group provide financing to customers;
- other subsidiaries undertake manufacturing, trading or other activities;
- specified liabilities are raised by subsidiaries that do not themselves have financing as a main business activity; and
- those liabilities do not relate to the group's financing activities.

We recommend that the final Agenda Decision include an illustrative example demonstrating the application of paragraph 65(a)(ii) in such a group structure.

3. Meaning of "all such liabilities" in paragraph 66

Paragraph 65(a) requires an entity that provides financing to customers as a main business activity to distinguish between specified liabilities that relate to providing financing to customers and those that do not.

Where an entity cannot make that distinction, paragraph 66 requires the entity to classify income and expenses from "all such liabilities" in the operating category by applying the accounting policy choice in paragraph 65(a)(ii). The Committee has observed that the reference to "all such liabilities" means all specified liabilities of the consolidated group in the fact pattern considered.

We agree with the Committee's conclusion in principle.

However, we believe that the practical application of this requirement could benefit from further clarification.

In particular, the fact pattern may be understood as including circumstances in which an entity can distinguish **some**, but not **all**, specified liabilities that relate to providing financing to customers.

It would therefore be helpful for the final Agenda Decision to explicitly state whether the inability to distinguish even a portion of specified liabilities results in income and expenses from **all specified liabilities** being classified in the operating category, or whether the requirement applies only where the entity is unable to distinguish any of its specified liabilities.

Based on the Committee's analysis, we understand that the former is intended. We recommend that this conclusion be stated explicitly in the final Agenda Decision.

This clarification is important because a different interpretation could result in significant diversity in practice.

4. Distinguishability of specified liabilities

We note that the Committee's analysis places significant emphasis on whether an entity can distinguish specified liabilities that relate to providing financing to customers from those that do not.

We believe that the final Agenda Decision should clarify the nature of the assessment required to establish whether such liabilities can be distinguished.

For example, it would be useful to clarify whether an entity is expected to establish a direct contractual or legal linkage between a specified liability and a particular financing transaction, or whether other reasonable evidence may be considered.

In practice, financing may be raised at a group or subsidiary level and subsequently used for multiple purposes. Accordingly, it may not always be possible to establish a direct one-to-one relationship between a liability and a particular financing transaction.

We therefore suggest that the final Agenda Decision clarify that the assessment of whether specified liabilities can be distinguished should be based on reasonable and supportable evidence available to the entity and should not necessarily require a direct tracing of each liability to an individual customer financing transaction.

5. Interaction between paragraphs 57 and 65(a)(ii)

Question 3 considered by the Committee addresses an important interaction between the requirements applicable to cash and cash equivalents and those applicable to specified liabilities.

Paragraphs 56(b)(ii) and 65(a)(ii) require the entity's accounting policy choices for classifying income and expenses from cash and cash equivalents and specified liabilities to be consistent.
Further, paragraph 57 requires an entity applying paragraph 56(b) to classify income and expenses from cash and cash equivalents in the operating category if it cannot distinguish between cash and cash equivalents that relate to providing financing to customers and those that do not.

The Committee has concluded that, where an entity classifies income and expenses from cash and cash equivalents in the operating category under paragraph 57 because it cannot make that distinction, the entity is required to apply the same classification to income and expenses from specified liabilities, **even if the entity is able to distinguish specified liabilities relating to financing customers from those that do not**.

We agree with this conclusion.

Nevertheless, we believe that this consequence may not be immediately apparent from reading paragraphs 57 and 65(a)(ii) in isolation.

We therefore recommend that the final Agenda Decision clearly articulate the principle that the accounting policy choices concerning cash and cash equivalents and specified liabilities are required to be consistent and that the inability to distinguish cash and cash equivalents can consequently determine the classification applied to specified liabilities.

An illustrative example would be particularly useful in this regard.

6. Consistency of accounting policy choices

We support the Committee's observation that paragraphs 56(b)(ii) and 65(a)(ii) require consistency between the accounting policy choices for cash and cash equivalents and specified liabilities.

In our view, this consistency requirement is important in ensuring that the presentation of financing-related income and expenses is coherent.

However, it may be useful for the final Agenda Decision to explain whether the consistency requirement is intended to operate as:

(a) a requirement to make the same accounting policy election for both categories of items; or

(b) a requirement that the resulting classification of income and expenses from the two categories of items must be consistent in all circumstances.

The latter appears to be the intended outcome based on the Committee's analysis of Question 3. However, stating this explicitly would enhance clarity for preparers.

7. Consolidated financial statements and intra-group arrangements

We believe that further clarification would also be useful where specified liabilities arise at different levels within a consolidated group.

For example, a group may have:

- a parent entity that undertakes treasury activities;
- a subsidiary whose principal activity is providing financing to customers; and
- other subsidiaries undertaking non-financing activities.

In such circumstances, the classification assessment may involve specified liabilities raised by entities that have different business activities.

Since the Committee has concluded that the assessment under paragraph 65 is made for the reporting entity as a whole, it would be useful for the final Agenda Decision to explain how the requirement to distinguish specified liabilities should be applied when liabilities are raised centrally and subsequently allocated or used across different entities or business activities within the group.

This would help prevent diversity in practice in determining whether a specified liability relates to providing financing to customers.

8. Relevance of management information and treasury arrangements

We believe that the assessment of whether specified liabilities relate to providing financing to customers may, in practice, require consideration of the manner in which an entity manages its financing arrangements.

Where an entity maintains detailed treasury records, financing arrangements, internal reporting or other information that demonstrates the relationship between specified liabilities and financing activities, such information may provide useful evidence for the assessment.

Accordingly, we suggest that the final Agenda Decision clarify that an entity may consider relevant internal information and the manner in which financing arrangements are managed when determining whether specified liabilities relate to providing financing to customers.

Such an approach would also be consistent with the principles-based nature of IFRS 18 and would avoid imposing an unnecessarily prescriptive tracing requirement.

9. Need for illustrative guidance
Although we agree with the Committee that the principles and requirements in IFRS 18 provide an adequate basis for addressing the questions raised, we believe that the interaction among paragraphs 57, 65 and 66 is sufficiently nuanced that an illustrative example would provide significant practical benefit.

We recommend that the Committee consider including an example covering the following circumstances:

Scenario 1 – Group-level assessment
A consolidated group has a main business activity of providing financing to customers, although only one subsidiary conducts financing activities.

Scenario 2 – Partial distinguishability
The group can distinguish specified liabilities relating to financing customers from certain other specified liabilities, but cannot distinguish all such liabilities.

Scenario 3 – Cash cannot be distinguished
The group cannot distinguish cash and cash equivalents relating to providing financing to customers from other cash and cash equivalents, but can distinguish its specified liabilities.

Scenario 4 – Both cash and liabilities cannot be distinguished
The group cannot distinguish either cash and cash equivalents or specified liabilities between those relating to financing activities and those relating to other activities.
Such examples would demonstrate the practical consequences of paragraphs 57, 65(a)(ii) and 66 and would substantially assist preparers and auditors in applying the requirements consistently.

Conclusion
We appreciate the Committee's consideration of this matter and broadly agree with its tentative conclusion that the principles and requirements in IFRS 18 provide an adequate basis for determining the classification of income and expenses from specified liabilities.

We do not believe that a separate standard-setting project is necessary at this stage. However, considering the potential for diversity in applying the requirements, we recommend that the final Agenda Decision provide additional clarification on the following matters:

1. **Group-level assessment:** The assessment of whether providing financing to customers is a main business activity is made for the reporting entity as a whole, including a consolidated group.

2. **Scope of the accounting policy choice:** Where the consolidated group has a main business activity of providing financing to customers, the accounting policy choice in paragraph 65(a)(ii) applies to the specified liabilities of the consolidated group that do not relate to providing financing to customers, irrespective of which subsidiary incurred those liabilities.
3. **Meaning of "all such liabilities":** Where an entity cannot distinguish specified liabilities that relate to providing financing to customers from those that do not, income and expenses from all specified liabilities should be classified consistently in accordance with paragraph 66.
4. **Partial distinguishability:** The final Agenda Decision should explicitly clarify the outcome where an entity can distinguish some, but not all, specified liabilities.
5. **Consistency with cash and cash equivalents:** Where an entity is required to classify income and expenses from cash and cash equivalents in the operating category under paragraph 57 because it cannot distinguish those relating to financing customers from those that do not, the same classification is required for specified liabilities, even where those liabilities can be distinguished.
6. **Practical evidence:** The final Agenda Decision should clarify the nature of evidence an entity may consider in determining whether specified liabilities relate to providing financing to customers, including relevant treasury and internal management information.
7. **Illustrative guidance:** An illustrative example addressing consolidated groups, partially distinguishable liabilities and the interaction between cash and cash equivalents and specified liabilities would significantly enhance consistent application.

Subject to the above clarifications, we support the Committee's tentative conclusion that the existing requirements of IFRS 18 provide an adequate basis for addressing the matter and that a standard-setting project is not required.

We thank the Committee for providing stakeholders with the opportunity to comment on this important matter.