KPMG IFRG Limited
15 Canada Square
London E14 5GL
United Kingdom

brian.odonovan@kpmgifrg.com

Mr. Bruce Mackenzie
IFRS Interpretations Committee
Columbus Building
7 Westferry Circus
London
E14 4HD

Our ref BOD/288

9 September 2026

Dear Mr. Mackenzie

Classification of Income and Expenses when an Entity Has a Main Business Activity of Providing Financing to Customers (IFRS 18)

We appreciate the opportunity to comment on the IFRS Interpretations Committee's (the Committee's) tentative agenda decision (TAD) *Classification of Income and Expenses when an Entity Has a Main Business Activity of Providing Financing to Customers*. This letter reflects the views of the KPMG network.

We agree with the Committee's observations on Question 1 in the TAD. However, we are concerned that the TAD does not sufficiently explain the basis for the Committee's observations on Questions 2 and 3 and why the alternative views identified in the submission are not acceptable.

Question 2 concerns

For liabilities that arise from transactions that involve only the raising of finance ('specified liabilities'), we disagree with the Committee's observation that "all such liabilities" in paragraph 66 of IFRS 18 results in a requirement to classify in the operating category income and expenses from all specified liabilities of the entity. We believe that this is one possible reading of "all such liabilities", but not the only one. Neither paragraph BC183 of the Basis for Conclusions nor Figures 3.2-3.3 of the Illustrative Examples on IFRS 18 provide a clear basis to support only that reading.

We believe "all such liabilities" could also be read as referring only to a subset of specified liabilities – i.e. those specified liabilities for which the entity cannot distinguish whether they relate to providing financing to customers, rather than all specified liabilities of the entity.

The TAD does not explain why this alternative reading is not acceptable. If an entity can clearly distinguish a separate population of specified liabilities that is unrelated to providing financing to customers and is not affected by a distinguishability issue elsewhere in its group, it is questionable why income and expenses from that separate population should be classified in the operating category solely because other specified liabilities elsewhere in the group cannot be distinguished. This could also produce counter-intuitive outcomes for groups with multiple business activities that include a main business activity of providing financing to customers.

Question 3 concerns

For cash and cash equivalents, we note that paragraph 57 of IFRS 18 explicitly refers to “all cash and cash equivalents”. However, a similar scope question arises when the distinguishability issue affects only a ringfenced population of cash and cash equivalents (C&CE).

The TAD does not explain whether paragraph 57 of IFRS 18 is intended to apply to all C&CE of the entity, or only to the population of C&CE for which the entity cannot distinguish whether they relate to providing financing to customers.

This is important because it affects the interaction between paragraphs 56(b)(ii), 57 and 65(a)(ii) of IFRS 18. If paragraph 57 of IFRS 18 applies to all C&CE of the entity, then the accounting policy choice in paragraph 56(b)(ii) of IFRS 18 could be deemed effectively made as the operating category, which in turn drives the classification of income and expenses from specified liabilities as set out in the TAD. However, if paragraph 57 of IFRS 18 applies only to the population of C&CE for which the entity cannot distinguish whether they relate to providing financing to customers, then the alternative view on Question 3 in the submission may have merit. However, as with Question 2, the TAD does not explain why the alternative view under Question 3 in the submission is not acceptable.

Recommendation

Although the TAD may drive consistent application by providing definitive outcomes, we are concerned that it does so for Questions 2 and 3 without sufficiently explaining the basis for those outcomes and providing technically compelling arguments for ruling out the alternative views.

In light of the above, we recommend that the TAD is expanded on Questions 2 and 3 to explain whether and why:

- “all such liabilities” in paragraph 66 of IFRS 18 refers to all specified liabilities of the entity, rather than only to the population of specified liabilities for which the entity cannot distinguish whether they relate to providing financing to customers;
- paragraph 57 of IFRS 18 is intended to apply to all C&CE of the entity, or only to the population of C&CE for which the entity cannot distinguish whether they relate to providing financing to customers; and
- the alternative views identified in the submission are not acceptable readings of IFRS 18.

Our more detailed concerns on Questions 2 and 3 are provided in the appendix to this letter.

Please contact Brian O'Donovan at brian.odonovan@kpmgifrg.com or Agnieszka Sekita at agnieszka.sekita@kpmgifrg.com if you wish to discuss any of the issues raised in this letter.

Yours sincerely

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Appendix – Concerns on Questions 2 and 3

As noted in our cover letter, we have concerns about the explanatory material supporting the Committee's observations on Questions 2 and 3. In particular, we believe the TAD does not sufficiently explain the basis for the Committee's observations and why the alternative views identified in the submission are not acceptable under IFRS 18. Our concerns are explained in more detail below.

Question 2 – Lack of persuasive technical arguments supporting only one reading of "all such liabilities" in paragraph 66 of IFRS 18

The TAD refers to paragraph BC183 of the Basis for Conclusions and Figures 3.2-3.3 of the Illustrative Examples on IFRS 18 to support the observation that "all such liabilities" in paragraph 66 of IFRS 18 means all specified liabilities of the entity. However, we do not believe those sources provide clear support for only that reading.

Paragraphs BC183-BC184 explain the intended outcome from applying the accounting policy choice for specified liabilities. However, these paragraphs do not address the gating question of what population of specified liabilities is captured by the phrase "all such liabilities". Similarly, Figures 3.2-3.3 repeat the phrase "all such liabilities" without explaining its scope.

We believe that the Committee's observation is one possible reading of "all such liabilities".

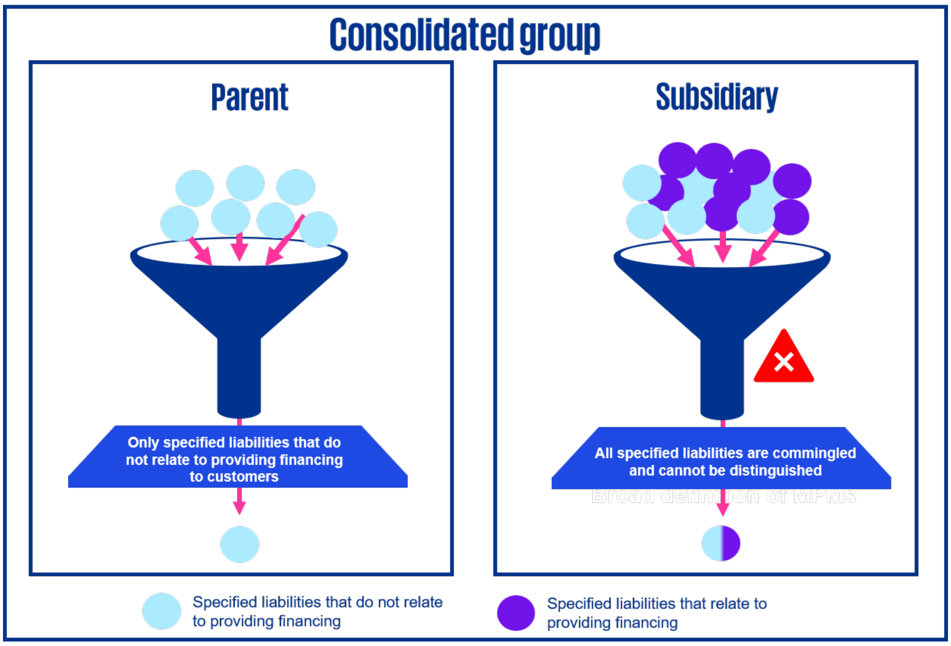
However, we believe "all such liabilities" could also be read as referring only to a subset of specified liabilities – i.e. those specified liabilities for which the entity cannot distinguish whether they relate to providing financing to customers, rather than all specified liabilities of the entity ('alternative reading'). This alternative reading would still give effect to the outcome described in paragraph BC183, which is that income and expenses from specified liabilities that relate to providing financing to customers would be classified in the operating category. The same would be true when those specified liabilities are commingled with specified liabilities that do not relate to providing financing to customers and the entity cannot distinguish between the two (i.e. the entity would, at least, classify income and expenses from specified liabilities that relate to providing financing to customers in the operating category, even if income and expenses from other specified liabilities that cannot be separated from those liabilities are also classified in the operating category as a consequence). Therefore, paragraph BC183 does not appear to support only the reading in the TAD.

In addition, paragraph BC185 suggests that the intention of the International Accounting Standards Board (IASB) was to avoid arbitrary allocations between the operating and financing categories when specified liabilities that relate to providing financing to customers are commingled with specified liabilities that do not. In that situation, if the entity cannot distinguish between the two, paragraph 66 of IFRS 18 avoids an arbitrary allocation by requiring income and expenses from all commingled specified liabilities to be classified in the operating category.

However, that rationale does not appear to apply in the same way to a separate population of specified liabilities that is clearly distinguishable as not relating to providing financing to customers. For that population, there is no commingling and no allocation issue to resolve. Therefore, it is unclear why paragraph 66 of IFRS 18 should be read as requiring income and expenses from those specified liabilities to nevertheless be classified in the operating category solely because distinguishability issues arise for other specified liabilities elsewhere in the group.

Indeed, it would be arbitrary for the classification of income and expenses from a separate population of specified liabilities that is clearly distinguishable to be based on the classification of income and expenses from a separate commingled population, contrary to the IASB's intention as stated in paragraph BC185 to avoid arbitrary allocations.

The concern with the reading in the TAD can be further illustrated by a group that has a main business activity of providing financing to customers and comprises a parent and a subsidiary.



In this group, the parent only has specified liabilities that are clearly distinguishable as not relating to providing financing to customers. Those specified liabilities are not managed or used interchangeably with the specified liabilities from the subsidiary. The subsidiary has specified liabilities that relate to providing financing to customers and specified liabilities that do not. However, within the subsidiary, all of its specified liabilities are managed together and cannot be distinguished. The distinguishability issue is therefore ringfenced to specified liabilities arising from the subsidiary.

Under the reading in the TAD, the distinguishability issue in the subsidiary would require income and expenses from all specified liabilities of the group to be classified in the operating category of the consolidated income statement. This would include income and expenses from the specified liabilities of the parent, even though they are clearly distinguishable and do not relate to providing financing to customers.

By contrast, under the alternative reading, in the consolidated financial statements, paragraph 66 of IFRS 18 would apply only to the commingled specified liabilities from the subsidiary, because those are the liabilities that cannot be distinguished whether they relate to providing financing to customers. The clearly distinguishable specified liabilities of the parent would remain subject to the accounting policy choice in paragraph 65(a)(ii) of IFRS 18 for purposes of classifying the related income and expenses in the consolidated income statement.

The distinguishability issue may not always be ringfenced to a single legal entity as illustrated above. There may be circumstances where a particular entity that provides financing to customers as a main business activity can clearly distinguish a population of specified liabilities that does not relate to providing financing to customers separately from other sets of specified liabilities that have distinguishability issues.

In those circumstances, applying the reading in the TAD could result in counter-intuitive outcomes. It would cause a distinguishability issue affecting other sets of specified liabilities to determine the classification of another population that is clearly distinguishable and does not relate to providing financing to customers. In our view, this risks undermining the usefulness of the new income statement categories by making classification dependent on group dynamics and distinguishability issues in one part of the business, rather than on whether the specified liabilities relate to providing financing to customers or not.

Question 3 – Lack of explanatory material on the interaction between paragraphs 56(b)(ii), 57 and 65(a)(ii)

We acknowledge that paragraph 57 of IFRS 18 is worded more clearly than paragraph 66 of IFRS 18 because it explicitly refers to “all cash and cash equivalents” (C&CE).

However, as with Question 2, a question still arises in circumstances in which an entity can clearly distinguish a population of C&CE that does not relate to providing financing to customers separately from other sets of C&CE that have distinguishability issues. In those circumstances, it is unclear from the TAD whether paragraph 57 of IFRS 18 is intended to apply to all C&CE of the entity, or only to the population of C&CE for which the entity cannot distinguish whether they relate to providing financing to customers.

If paragraph 57 of IFRS 18 is read as applying to all C&CE of the entity, then the Committee’s observations in the TAD on Question 3 would appear to follow from that reading. In this case:

- the basis for the Committee’s observation would appear to be that, because income and expenses from all C&CE would be classified in the operating category, the accounting policy choice in paragraph 56(b)(ii) of IFRS 18 – which otherwise applies to C&CE that do not relate to providing financing to customers – would effectively have been made as the operating category. Because paragraph 65(a)(ii) of IFRS 18 requires the accounting policy choice for specified liabilities that do not relate to providing financing to customers to be consistent with the accounting policy choice for C&CE that do not relate to providing financing to customers in paragraph 56(b)(ii) of IFRS 18, income and expenses from those specified liabilities would also be classified in the operating category.

- the alternative view in the submission would not be acceptable. Since income and expenses from all C&CE – including those that do not relate to providing financing to customers – are classified in the operating category, applying a different accounting policy choice to specified liabilities that do not relate to providing financing to customers could result in an inconsistency between the classification of income and expenses from C&CE and specified liabilities in the consolidated income statement. For example, such an inconsistency would arise if income and expenses from specified liabilities that do not relate to providing financing to customers were to be classified in the financing category.

However, if paragraph 57 of IFRS 18 is read as applying only to the population of C&CE for which the entity cannot distinguish whether they relate to providing financing to customers, then the alternative view in the submission would appear to have merit. In this case, the accounting policy choice in paragraph 56(b)(ii) of IFRS 18 would remain available for the population of C&CE that is clearly distinguishable as not relating to providing financing to customers. That choice – operating or investing – could then be applied consistently with the related accounting policy choice in paragraph 65(a)(ii) of IFRS 18 for specified liabilities that do not relate to providing financing to customers – operating or financing.

Paragraph BC140 of IFRS 18 explains that the IASB developed the accounting policy choice for C&CE for similar reasons to those for specified liabilities. Therefore, notwithstanding that paragraph 57 of IFRS 18 does not use the phrase “all such”, it is not immediately clear that paragraphs 57 and 66 of IFRS 18 should necessarily be interpreted differently in circumstances whereby the distinguishability issue affects only a ringfenced population of C&CE and specified liabilities.

We believe the TAD has not sufficiently explained the interaction between paragraphs 56(b)(ii), 57 and 65(a)(ii) of IFRS 18. Without this explanation, there is a risk that the limited explanatory material in the TAD does not provide clear guidance to support stakeholders’ understanding of the interaction between different requirements and consistent application of these requirements.