STAFF PAPER

February 2018

IASB® Meeting

Project	**Primary Financial Statements**
Paper topic	Management-defined adjusted earnings per share (EPS) measures

CONTACT(S) Michelle Fisher mfisher@ifrs.org +44 (0)20 7246 6918

Purpose of this paper

1. This Agenda Paper seeks the Board's views on requirements for management-defined adjusted earnings per share measures ('adjusted EPS') in the financial statements.

2. For the purposes of this paper 'adjusted EPS' is an adjusted basic EPS and/or adjusted diluted EPS, ie the numerator of adjusted EPS is always an 'adjusted' profit or loss attributable to ordinary equity holders of the parent entity—further adjusted for dilution in the case of adjusted diluted EPS—and it is a post-tax and non-controlling interests (NCI) measure. Such measures are currently permitted to be disclosed in the notes in accordance with IAS 33 *Earnings per Share*. This paper does not consider:

   (a) other amounts per share that are permitted to be disclosed in accordance with IAS 33, ie where the numerator is not an 'adjusted' profit or loss attributable to ordinary equity holders of the parent entity; and

   (b) EPS measures that make changes to the calculation of the denominator in IAS 33. In our research we have not identified instances of entities making adjustments to the denominator of EPS when presenting adjusted EPS measures and we think such instances would be rare (and are currently not permitted by IAS 33).

Summary of staff recommendations in this paper

3. The staff recommend that:

   (a) all entities should be required to disclose an adjusted EPS that is calculated consistently with the management performance measure (MPM), together with supporting disclosures about:

      (i) differences between the items excluded from the MPM and the items excluded from the adjusted EPS measure; and

      (ii) the effect of tax and NCI for the items excluded.

   At the March 2018 meetings of the Capital Markets Advisory Committee (CMAC) and the Global Preparers Forum (GPF) the staff plan to ask CMAC/GPF members for feedback on the cost and benefits of these supporting disclosures to help the Board to assess the level of detail that should be required and whether to provide guidance on the basis of the allocation of tax and NCI effects.

   (b) if an MPM is presented as a subtotal in the statement(s) of financial performance, entities should be permitted to present an adjusted EPS that is calculated consistently with that MPM in the statement(s) of financial performance. In all other cases, the adjusted EPS should be required to be disclosed in the notes (as is currently required by IAS 33).

   (c) entities should be prohibited from disclosing adjusted EPS measures that are not consistently calculated with the MPM (or MPMs).

Overview

4. This paper is structured as follows:

   (a) whether we should require all entities to provide an adjusted EPS that is consistently calculated with the MPM (paragraphs 5-17)

   (b) whether adjusted EPS measures should be permitted in the statement(s) of financial performance (paragraphs 18-22)

   (c) whether we should prohibit entities from disclosing adjusted EPS measures that are not calculated consistently with the MPM (paragraphs 23-26)

(d) appendices:

(i) A—IAS 33 disclosure requirements for amounts per share disclosed in addition to basic and diluted earnings per share

(ii) B—Analysis of entities disclosing adjusted EPS

(iii) C—Alternative illustration of disclosure of the differences between the items excluded from the MPM and the items excluded from adjusted EPS, including the effect of tax and NCI for each item excluded

We have made reference to the sample of entities in paragraph B3 of Appendix B in our analysis in this paper.

Whether we should require all entities to provide an adjusted EPS that is consistently calculated with the MPM

Background

5. Users have told us they find MPMs useful because they provide information about management's view of performance and because they can help users to assess the persistence or sustainability of an entity's financial performance, for example because MPMs commonly exclude items identified as non-recurring by management. For the same reasons some users find management's adjusted EPS useful for their analysis, because it shows the effect of management's exclusions on the entity's basic or diluted EPS figures.

6. However, some users have expressed the following concerns about adjusted EPS:

(a) many entities only present adjusted EPS outside the financial statements with little or no explanation. Some users would prefer adjusted EPS to be required in the financial statements because the measures would be more transparent and would be subject to audit, which may encourage preparers to be more disciplined over the adjustments they make. However, other users expressed concern about giving adjusted EPS (and other non-IFRS information) undue prominence by including these measures in the financial statements.

(b) in some cases when entities present both an adjusted EPS and an MPM subtotal in the financial statements, these measures are not calculated consistently. Such differences have the potential to mislead users. Some users say it is difficult to see whether an entity's MPM and adjusted EPS are calculated consistently.

(c) even when adjusted EPS is disclosed in the financial statements, some users say that IAS 33 does not require sufficient information about the reasons for the exclusion of items and the effect of tax and NCI for each item excluded (see Appendix A for the relevant disclosure requirements in IAS 33).

7. Many users include management's adjusted EPS measures in their analysis. However, users often want to make further adjustments to make adjusted EPS suitable for their analysis and for comparison with other entities. Some users have told us information about the effect of tax and NCI for each item excluded from adjusted EPS is important for them to do this. For example, management might exclude both restructuring and share-based payment expenses from adjusted EPS (and its MPM). For the purposes of developing an EPS figure for its analysis, a user might want to keep management's adjustment to exclude restructuring expenses, but want to add back share-based payment expenses. If users are given information about the effect of tax and NCI on the share-based payment expense, they can adjust management's adjusted EPS to calculate their own EPS measure.

8. To facilitate this analysis, we think entities should be required to provide an adjusted EPS in the financial statements that is calculated consistently with the MPM, together with supporting disclosures about the effect of tax and NCI for the excluded items. We note that if an entity reports more than one MPM this may mean that the entity would be required to disclose multiple adjusted EPS.

What do we mean by calculated consistently?

9. The staff think an adjusted EPS is calculated consistently with an MPM if:

(a) the numerator of the adjusted EPS is an MPM; or

(b) the numerator of the adjusted EPS only differs from an MPM because it is a measure of profit presented at a different level of the statement(s) of financial performance (the numerator of adjusted EPS is usually further down the statement(s) than the MPM).

10. To illustrate paragraph 9(b), based on our research we found most entities communicate an operating profit or adjusted operating profit figure as their MPM (this is a pre-tax and pre-NCI measure) and communicate a management-defined EPS measure whose numerator is an 'adjusted' profit or loss attributable to ordinary equity holders of the parent entity—ie it meets our definition of adjusted EPS in paragraph 2 (this is a post-tax and NCI measure). The staff think an MPM and adjusted EPS are calculated consistently if the items excluded from these measures are identical. However, the following differences would be permitted:

    (a) if an entity excludes non-recurring items from its MPM that is an 'operating' profit measure, a non-recurring finance cost might be excluded from adjusted EPS even if it is not excluded from the MPM; and.

    (b) items would be excluded from the MPM on a gross tax and NCI basis. However, the same items would be excluded from the numerator of adjusted EPS on a net tax and NCI basis.

Staff analysis

11. We have heard that requiring all entities to provide an adjusted EPS that is calculated consistently with the MPM would be useful to users. However, the staff understand this requirement might have limited benefits for users unless accompanied by:

    (a) an explanation of the differences between the items excluded from the MPM and the items excluded from the adjusted EPS measure; and

    (b) the effect of tax and NCI for each item excluded.

    We have considered what these disclosures might look like below.

Explanation of the differences between the items excluded from the MPM and the items excluded from adjusted EPS

12. The following disclosure shows the items excluded from the MPM together with additional items excluded from adjusted EPS and the aggregated NCI and tax effects of all the excluded items. We think an entity would need to determine all of this information in order to calculate an adjusted EPS that is consistent with the MPM.

Therefore this disclosure would not be an additional burden on top of requiring entities to provide such an adjusted EPS measure. However, this disclosure only provides the effect of tax and NCI in aggregate for the items excluded. Therefore, it would not help users to make their own adjustments to adjusted EPS (as discussed in paragraph 7):

Category	Items excluded	Gross
Items excluded from the MPM	Restructuring expenses	(300)
	Amortisation of intangibles	(200)
	Share-based payment	(400)
	Total of items excluded from MPM	**(900)**
Additional items excluded from the numerator of adjusted EPS	Early redemption of debt	**(50)**
	Total of items excluded from the numerator of adjusted EPS	**(950)**
Tax and NCI effect of all amounts excluded from adjusted EPS		**95**
Items excluded from the numerator of adjusted EPS		**(855)**

Enhanced disclosure showing effect of tax and NCI for each item excluded

13. An alternative to the disclosure in paragraph 12 would be to also show the effect of tax and NCI for each item excluded from adjusted EPS. One way to do this is illustrated below:

Category	Items excluded	Gross	Tax and NCI	Net
Items excluded from the management performance measure	Restructuring expenses	-300	30	-270
	Amortisation of intangibles	-200	20	-180
	Share-based payment	-400	40	-360
	subtotal	**-900**	**90**	**-810**
Items excluded from finance income/expenses	Early redemption of debt	-50	5	-45
	subtotal	**-50**	**5**	**-45**
Items excluded from the adjusted EPS		**-950**	**95**	**-855**

'Items excluded' from the management performance measure

'Items excluded' from adjusted EPS
(all adjustments, net of tax and NCI)

<u>An alternative and more detailed illustrative disclosure is presented in appendix C</u>.

14. The disclosure in paragraph 12 would require entities to allocate tax and NCI to the items excluded from adjusted EPS in aggregate. The disclosure in paragraph 13 would require entities to allocate tax and NCI to each of the items excluded from adjusted EPS. The following points provide some support for us introducing the more detailed disclosure in paragraph 13:

    (a) there is a similar requirement in paragraph 90 of IAS 1, where entities are required to disclose the amount of income tax relating to each item of other comprehensive income; and

    (b) nearly half the entities in our sample provided information about the effects of tax and NCI separately for each item excluded from adjusted EPS.

15. Nevertheless the staff think it might be difficult and time consuming for some preparers to allocate tax and NCI to the items excluded from adjusted EPS, particularly if we require this for each item excluded. However, the Board could consider allowing a simplified allocation approach for determining adjusted EPS, for example use of an average effective tax rate. Furthermore, whilst we had some feedback from users that these disclosures would be useful, others have told us they do not use adjusted EPS information. Considering the extra burden for preparers, the staff think we should perform further outreach, to assess the cost and benefits of requiring entities to provide an adjusted EPS that is calculated consistently with the MPM, together with the disclosures in paragraph 12 and/or 13. This outreach would also help the Board determine what kind of guidance it should provide on the allocation of tax and NCI effects in determining adjusted EPS.

Staff recommendation

16. The staff recommend requiring all entities to disclose an adjusted EPS that is calculated consistently with the MPM, together with supporting disclosures. Given that paragraph 73 of IAS 33 requires both basic and diluted amounts per share to be provided for all amounts per share disclosed in the financial statements (see Appendix A), the staff think entities would be required to disclose both an adjusted basic EPS and an adjusted diluted EPS.

17. The staff think as a minimum we should require the disclosures in paragraph 12 because we do not think these disclosures would constitute an additional burden on

top of requiring the adjusted EPS measure. However, we think the disclosures in paragraph 13 would be more useful to users. Therefore, for the reasons in paragraph 15 we think we should perform further research by asking for feedback at the March 2018 CMAC and GPF meetings before taking a decision on:

(a) which supporting disclosures we should require; and

(b) whether the Board should provide guidance on, or simplifications for, the basis of the allocation of tax and NCI effects.

Question 1

Does the Board agree we should require all entities to disclose an adjusted EPS that is calculated consistently with an entity's MPM together with supporting disclosures about:

- differences between the items excluded from the MPM and the items excluded from the adjusted EPS measure; and
- the effect of tax and NCI for the items excluded?

If so, does the Board agree that before taking a decision on which supporting disclosures we should require, the staff should ask CMAC/GPF members for feedback on the cost and benefits of these disclosures to help the Board to assess the level of detail that should be required and whether to provide guidance on the basis of the allocation of tax and NCI effects?

Whether adjusted EPS measures should be permitted in the statement(s) of financial performance

Background

18. In December 2017[1] the Board decided that entities should present an MPM as a subtotal in the statement(s) of financial performance if it fits in the Board's proposed structure for the statement(s) and satisfies the requirements in IAS 1 for subtotals.

19. IAS 33 requires an entity to present basic and diluted EPS in the statement(s) of financial performance but requires any additional amounts per share, for example an adjusted EPS, to be disclosed in the notes. We think the Board should consider if there

[1] See December 2017 IASB *Update*.

are any circumstances when an adjusted EPS should be permitted in the statement(s) of financial performance.

Staff analysis

20. The staff think the only circumstance we may want to consider including an adjusted EPS in the statement(s) of financial performance is when it is consistently calculated with an MPM subtotal presented in the statement(s) of financial performance. Otherwise we think the adjusted EPS could potentially mislead users of financial statements, because it will be unclear how it has been calculated.

21. At previous meetings we have discussed the advantages and disadvantages of presenting MPMs in the primary financial statements (for example see paragraphs 17-18 of January 2018 Agenda Paper 21A). We think these also apply to presenting adjusted EPS in the primary financial statements and are summarised below:

    (a) Advantages:

        (i) measures could be reported prominently by preparers and would be more likely to be seen and considered by users;

        (ii) information in the primary financial statements is published earlier than some of the information in the notes, for example in earnings announcements and press releases, and is more often included in information collected by data aggregators; and

        (iii) regulators may require more detailed tagging of information in the primary financial statements than the notes for structured electronic reporting.

    (b) Disadvantages:

        (i) some Board members have concerns about giving undue prominence to management-defined measures that are not subject to any constraints;

        (ii) presentation of an adjusted EPS in the statement(s) of financial performance might be seen as a significant change and meet resistance; and

        (iii) there would be less room for explanation and the supporting disclosure about differences between items excluded from the

MPM and the adjusted EPS would only be available in the notes.

Staff recommendation

22. The staff think if the MPM is presented as a subtotal in the statement(s) of financial performance, we should permit entities to present an adjusted EPS that is calculated consistently with the MPM in the statement(s) of financial performance. We do not think an adjusted EPS would be misleading provided it is labelled as an adjusted EPS and it is clear that it is calculated consistently with the MPM subtotal.

Question 2

Does the Board agree that:

- if an MPM is presented as a subtotal in the statement(s) of financial performance, we should permit entities to present an adjusted EPS that is calculated consistently with that MPM in the statement(s) of financial performance; and
- in all other cases, the adjusted EPS should be required to be disclosed in the notes (as is currently required by IAS 33)?

Whether we should prohibit entities from disclosing adjusted EPS measures that are not calculated consistently with the MPM

Background

23. In many cases entities calculate their adjusted EPS consistently with their MPM. However, our research showed that sometimes they do not. For example, three entities in our sample included amortisation of intangible assets in their MPM subtotal (which was an operating profit subtotal) but excluded amortisation of intangible assets from their adjusted EPS. Such differences have the potential to mislead users. Therefore, we think the Board should consider whether to prohibit the disclosure of other adjusted EPS measures in the financial statements (ie prohibit adjusted EPS measures that are not calculated consistently with the MPM).

Staff analysis

24. Prohibiting entities from providing other adjusted EPS measures has the following advantages:

    (a) if an adjusted EPS is calculated on a different basis from the MPM this could be confusing for users without adequate explanation;

    (b) if the Board decides to require an adjusted EPS that is consistent with the MPM, it would be confusing to have other adjusted EPS measures calculated on a different basis in the financial statements; and

    (c) if an entity wishes to report an adjusted EPS in the financial statements, we might assume it is one of the entity's key performance measures. We also think the entity would effectively be reporting a corresponding key financial measure of profit (ie an MPM), for example the numerator of the adjusted EPS ('adjusted' profit or loss attributable to ordinary equity holders of the parent entity) could be considered an MPM.

25. Nevertheless, if we prohibit entities from providing other adjusted EPS measures this has the disadvantage that entities may continue to communicate other adjusted EPS measures only outside the financial statements, meaning these measures may be subject to less transparency and would not be subject to audit.

Staff recommendation

26. The staff think we should prohibit entities from disclosing adjusted EPS figures that are not consistently calculated with the MPM.

Question 3
Does the Board agree that we should prohibit entities disclosing adjusted EPS measures that are not consistently calculated with the MPM (or MPMs)?

Appendix A—IAS 33 disclosure requirements for amounts per share disclosed in addition to basic and diluted earnings per share

A1. IAS 33 requires entities to present both basic and diluted EPS in the statement(s) of financial performance. Both basic and diluted EPS use profit or loss attributable to ordinary equity holders of the parent entity (the numerator) and the weighted average number of ordinary shares outstanding (the denominator) during the period. However, diluted EPS adjusts these amounts for the effects of all dilutive potential ordinary shares. In addition to basic and diluted EPS, paragraph 73 of IAS 33 allows an entity to disclose amounts per share using numerators other than those required by IAS 33.

A2. Paragraph 73 of IAS 33 requires that if an entity discloses, in addition to basic and diluted EPS, amounts per share using a reported component of the statement(s) of financial performance other than one required by IAS 33:

(a) such amounts shall be calculated using the weighted average number of ordinary shares determined in accordance with IAS 33;

(b) basic and diluted amounts per share relating to such a component shall be disclosed with equal prominence and disclosed in the notes;

(c) an entity shall indicate the basis on which the numerator is determined, including whether amounts per share are before tax or after tax; and

(d) if a component of the statement(s) of financial performance is used that is not reported as a line item in the statement(s) of financial performance, a reconciliation shall be provided between the component used and a line item reported in the statement(s) of financial performance.

A3. The requirements in paragraph A2 also apply if the entity discloses, in addition to basic and diluted earnings per share, amounts per share using a reported item of profit or loss, other than one required by IAS 33

Appendix B—Analysis of entities disclosing adjusted EPS

B1. Based on our research we have found that many entities communicate an adjusted EPS (an adjusted basic EPS and/or adjusted diluted EPS) in the financial statements and/or outside the financial statements that excludes some items (for example, non-recurring items) from the numerators of basic EPS and/or diluted EPS as follows:

$$Adjusted\ basic\ EPS = \frac{\text{Profit attributable to ordinary equity holders of the parent} - items\ excluded}{\text{Weighted average number of ordinary shares outstanding}}$$

B2. We have found that management often uses adjusted EPS measures to compare the entity's performance with management's objectives, between reporting periods and with other entities. Many users rely on these adjusted EPS measures as a starting point for their own analysis, but users often further adjust management's adjusted EPS to make it suitable for their analysis or to compare it with other entities.

B3. We analysed ten entities that presented adjusted EPS in their IFRS financial statements. The following is a summary of the analysis in Appendix A of June 2017 Agenda Paper 21D. Generally, we found:

(a) entities labelled adjusted EPS differently, for example as adjusted EPS, underlying EPS, core EPS, headline EPS, sustainable EPS or EPS before non-recurring items.

(b) most sample entities did not specifically state why they present adjusted EPS. Some entities included a generic objective such as to present the entity's financial performance or underlying performance.

(c) all sample entities calculated adjusted EPS based on their 'adjusted profit', ie entities exclude some items, such as non-recurring items, from the numerators of basic EPS and/or diluted EPS to calculate adjusted basic EPS and/or adjusted diluted EPS (see paragraph B1). No sample entities presented amounts per share on the basis of other line-items, subtotals or totals in the statement(s) of financial performance, such as operating profit per share or comprehensive income per share

(d) most sample entities did not explicitly state the entity's policy for calculating adjusted EPS; instead they merely listed items excluded.

(e) all ten entities in the sample presented both adjusted EPS and also an MPM subtotal (an operating /adjusted operating profit subtotal) in the financial statements. In some cases, the entity excluded different amounts from the MPM and adjusted EPS. For example, three entities included amortisation of intangible assets when they calculated their MPM but excluded the amortisation of intangible assets when they calculated adjusted EPS.

(f) in nearly half of the cases, entities provided information about the effects of tax and NCI separately for each adjustment. This enables users to make their own adjustments to adjusted EPS. However, five entities presented the effects of tax and NCI on an aggregated basis for all the items excluded.

(g) six entities' adjusted basic EPS exceeded basic EPS— the average difference was 32 per cent. Four entities' basic EPS exceeded adjusted basic EPS and their average difference was 5 per cent.

B2. The US Securities and Exchange Commission (SEC) staff have analysed IFRS financial statements of 183 companies and found diversity in practice in presentation of adjusted EPS.[2] In particular the SEC found that, in most cases, it was not clear how entities had calculated adjusted EPS or, if the entity defined the measure, the SEC staff could not easily recalculate the adjusted EPS from the information provided.

[2] Securities and Exchange Commission (SEC). 2011. Work plan for the consideration of incorporating IFRS into the financial reporting system for US issuers: An Analysis of IFRS in Practice, page 22. Washington D.C.

Appendix C—Alternative illustration of disclosure of the differences between the items excluded from the MPM and the items excluded from adjusted EPS, including the effect of tax and NCI for each item excluded

	IFRS-defined measure	Items excluded from the MPM			Further items excluded from adjusted EPS	MPM
	Profit before investing, financing and tax	Restructuring changes	Amortisation of intangibles	Share-based payment expenses	Early redemption of debt	Adjusted operating profit
Profit before investing, financing and tax/ Adjusted operating profit	1,000	300	200	400		1,900
Income/expenses from investments	100					100
Finance income/expenses	(100)				50	(50)
Income tax	(160)	(24)	(16)	(32)	(5)	(237)
NCI	(40)	(6)	(4)	(8)	(1)	(59)
Profit/Adjusted profit attributable to ordinary equity holders of the parent entity	800	270	180	360	44	1,654
EPS/adjusted EPS	0.080	0.027	0.018	0.036	0.004	0.165