# STAFF PAPER

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## IASB® Meeting

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| **Project** | **Primary Financial Statements** |
| Paper topic | Management performance measures and adjusted earnings per share |


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| CONTACTS | Zhen Xu | zxu@ifrs.org | +44 (0)20 7246 6477 |
| | Aida Vatrenjak | avatrenjak@ifrs.org | +44 (0)20 7246 6456 |




## Purpose of this paper

1. This Agenda Paper discusses whether to amend IAS 33 *Earnings per Share* to restrict what can be used as the numerator in an adjusted earnings per share (EPS), to amounts based on IFRS-defined subtotals or management performance measures (MPMs).

2. In this paper:

   (a) *adjusted EPS* are amounts per share calculated using a component of the statement(s) of financial performance other than one required by IAS 33;

   (b) *IFRS-defined subtotals* are those subtotals that the Board is proposing to require, and the measures listed in paragraph 9; and

   (c) *adjusted EPS based on IFRS-defined subtotals or MPMs* are amounts per share calculated using IFRS-defined subtotals or MPMs attributable to ordinary equity holders of the parent entity.

3. The Board has previously tentatively decided to clarify that adjusted EPS cannot be presented in the statement(s) of financial performance. This paper does not discuss that previous tentative decision.

## Staff recommendation in this paper

4. The staff recommend the Board amend IAS 33 *Earnings per Share* to restrict what can be used as the numerator in an adjusted EPS, to amounts based on IFRS-defined subtotals or management performance measures.

## Structure of the paper

5. This paper is structured as follows:
   (a) what are the current requirements for adjusted EPS and what are the Board's tentative decisions? (paragraphs 6–9)
   (b) what is the issue? (paragraphs 10–12)
   (c) what is current practice? (paragraphs 13–16)
   (d) how can the Board resolve the issue? (paragraphs 17–24)
   (e) Appendix A—Research of current practice

## What are the current requirements for adjusted EPS and what are the Board's tentative decisions?

6. IAS 33 requires entities to present basic and diluted EPS and sets out requirements on how to calculate these measures.

7. Paragraph 73 of IAS 33 sets out requirements for determining and disclosing amounts per share that are not required by the Standard:

> If an entity discloses, in addition to basic and diluted earnings per share, amounts per share using a reported component of the statement of comprehensive income other than one required by this Standard, such amounts shall be calculated using the weighted average number of ordinary shares determined in accordance with this Standard. Basic and diluted amounts per share relating to such a component shall be disclosed with equal prominence and presented in the notes. An entity shall indicate the basis on which the numerator(s) is (are) determined,

including whether amounts per share are before tax or after tax. If a component of the statement of comprehensive income is used that is not reported as a line item in the statement of comprehensive income, a reconciliation shall be provided between the component used and a line item that is reported in the statement of comprehensive income.

8. The Board has tentatively decided to define MPMs as subtotals of income and expenses. Consequently, ratios such as measures expressed as an amount per share cannot be identified as MPMs. The Board considered but tentatively decided against requiring MPM information on a per share basis because it would add complexity to the proposals.

9. The Board tentatively decided that some commonly used subtotals would not be considered MPMs:

(a) profit before tax;

(b) profit from continuing operations;

(c) gross profit, defined as revenue less cost of sales; and

(d) operating profit before depreciation and amortisation.

The reason for this tentative decision is that providing additional information and a separate reconciliation for these measures would be unlikely to provide useful information.[1] Agenda Paper 21B proposes that subtotals similar to gross profit are added to this list.

## What is the issue?

10. Applying the Board's tentative decisions for MPMs (see paragraph 24 of the appendix to AP21), an entity is required to:

(a) describe why an MPM provides management's view of financial performance;

[1] https://www.ifrs.org/news-and-events/updates/iasb-updates/may-2018/#1 and https://www.ifrs.org/news-and-events/updates/iasb-updates/december-2018/#6

(b) explain how it has been calculated;

(c) provide a reconciliation between the MPM and the most directly comparable subtotal or total defined by IFRS Standards;

(d) disclose, for each reconciling item, its income tax effect and effect on non-controlling interests (NCI); and

(e) disclose the reasons for and effect of any change in how an MPM is calculated.

11. IAS 33 requires entities to disclose the basis on which the numerator of an adjusted EPS is calculated and, if the numerator is not reported as a line item in the statement(s) of financial performance, a reconciliation between the numerator and a line item in that statement (see paragraph 7).

12. Apart from the tentative decision to clarify that presentation of adjusted EPS in the statement(s) of financial performance is prohibited (see paragraph 3), the Board is not proposing further amendments to IAS 33. This gives rise to two issues:

(a) because there are fewer disclosure requirements for adjusted EPS compared to MPMs, entities may choose to disclose an adjusted EPS rather than an MPM, avoiding the requirement to disclose additional information that is useful to users.

(b) paragraph 73 of IAS 33 could be interpreted as only allowing adjusted EPS based on income and expenses calculated in accordance with IFRS Standards. This would mean that not all MPMs can be disclosed on a per share basis because MPMs do not have to be calculated in accordance with IFRS Standards. We think this outcome would be counterintuitive as we think there is no reason for the constraints on adjusted EPSs to be different from those on MPMs.

## What is current practice?

13. EPS is one of the most commonly used performance metrics, for example as an input to the price-to earnings (P/E) ratio. The staff researched annual reports of 85 entities from different jurisdictions and industries to identify entities that disclose adjusted

EPS and compare adjusted EPS (if any) with any alternative performance measures expressed as a subtotal of income and expenses (subtotal APMs). We focussed on subtotal APMs as they are the only type of APMs likely to meet the definition of MPMs. Out of 85 entities in our sample, 71 entities disclosed subtotal APMs, and 39 entities disclosed adjusted EPS.

14. Our research of current practice suggests that entities generally calculate adjusted EPS using numerators that are based on subtotal APMs, with only a few exceptions. Assuming those subtotal APMs meet the definition of MPMs, then entities would be required to provide our proposed MPM disclosures for these APMs.

15. Details of our research are set out in Appendix A of this Agenda Paper.

16. Whilst current practice suggests that the issue described in paragraph 12(a) may not arise, we think the Board's proposals may result in changes in practice as entities will have an incentive to present an adjusted EPS rather than an MPM.

## How can the Board resolve the issues?

17. To resolve the issues described in paragraph 12, we think that the Board should:

    (a) ensure that users receive the same information about adjusted EPS as for MPMs; and

    (b) clarify whether all MPMs can be used as a basis for the numerator used in the calculation of an adjusted EPS.

18. We have considered but rejected two approaches to achieve the objective in paragraph 17(a), which are to either:

    (a) require the same disclosures for adjusted EPS as for MPMs; or

    (b) require a reconciliation and explanation of the relationship between the numerator of the adjusted EPS and the entity's MPM.

19. We rejected these approaches because we think they would:

    (a) introduce unnecessary complexity.

(b) allow entities to disclose adjusted EPS and MPMs that are calculated on different bases. We think this would be potentially confusing.

20. Instead, we think the Board should amend IAS 33 to restrict what can be used as the numerator in an adjusted EPS, to amounts based on IFRS-defined subtotals or MPMs.

21. This approach:

(a) achieves both objectives identified in paragraph 17.

(b) narrows down possible numerators in adjusted EPS to measures that communicate performance, that is IFRS-defined subtotals and MPMs. We think this is an improvement to IAS 33.

22. Applying this approach, the disclosure requirements included in paragraph 73 of IAS 33 relating to the numerator of an adjusted EPS would be unnecessary and could be deleted.

23. This approach may have implications for entities that disclose adjusted EPS based on a regulatory definition or requirement such as the two entities in our sample discussed in paragraph A2(b) of Appendix A. We think that there are two possible outcomes for such entities:

(a) they might conclude that the numerator used in the calculation of adjusted EPS does not complement the IFRS subtotals or total in communicating their performance and is thus not an MPM. Such entities would not be permitted to disclose their adjusted EPS inside the financial statements but are likely to be permitted to present them outside the financial statements—for example in management commentary.

(b) they might conclude that the numerator used in the calculation of adjusted EPS complements the IFRS subtotals or total in communicating performance, and identify it as an MPM, and disclose adjusted EPS within the financial statements.

Consequently, we think that such entities would still be able to disclose adjusted EPS amounts required by regulators.

24. The staff therefore recommend this approach as it addresses the objectives in paragraph 17 without adding complexity to the proposals.

| Question |
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| Does the Board agree with the staff recommendation to amend IAS 33 to restrict what can be used as the numerator in an adjusted EPS, to amounts based on IFRS-defined subtotals or MPMs? |

## Appendix A—Research of current practice

A1. Out of 39 entities that disclosed adjusted EPS in the sample of 85 entities, 33 entities disclosed a single adjusted EPS while six entities each disclosed two adjusted EPSs.[2] We observed more than one adjusted EPS in two scenarios:

(a) when a regulatory defined adjusted EPS is different from management defined adjusted EPS (see paragraph A2(b)); or

(b) when one adjusted EPS excludes items of income/expenses and another adjusted EPS is based on tailor-made accounting policies and excludes items of income/expenses (see paragraph A3(b)).

A2. Out of 39 entities that disclosed adjusted EPS, 38 entities disclosed both subtotal APMs and adjusted EPS. One entity disclosed an adjusted EPS but no subtotal APM. The staff analysed these 38 entities as follows:

(a) 34 out of 38 entities calculated adjusted EPS consistently with their subtotal APMs:

(i) 24 entities disclosed subtotal APMs representing adjusted profit or loss attributable to ordinary equity holders of the parent entity, which was the same as the numerator of the adjusted EPS.

(ii) nine entities disclosed subtotal APMs (typically a measure of operating profit) further up in the statement(s) of financial performance than the profit or loss attributable to ordinary equity holders of the parent entity (the numerator typically used in adjusted EPS). However, the basis for adjustments seemed consistent, with adjusted EPS mostly including additional adjustments for the income tax effects and effects on NCI plus any non-recurring expenses.

(iii) one entity disclosed EBITDA per share and EBITDA as its subtotal APM.

[2] If an entity disclosed both basic and diluted adjusted EPS, we regarded it as disclosing a single adjusted EPS.

(b) two out of 38 entities disclosed subtotal APMs that were inconsistent with their adjusted EPS because, in their jurisdiction, the regulatory body requires pre-defined adjusted EPS named 'headline EPS' to be disclosed.

(c) in the case of two entities, we could not establish if adjusted EPS and the subtotal APM were consistent.

A3. We analysed the 38 entities who disclosed both subtotal APMs and adjusted EPS by types of adjustments to the numerators of the adjusted EPSs as follows:

(a) 32 out of 38 entities excluded particular items of income/expenses when calculating the numerators of the adjusted EPSs, for example, restructuring expenses.

(b) four out of 38 entities excluded certain items of income/expenses together with application of tailor-made accounting policies, for example, replacement cost accounting of inventory. Three entities out of four also disclosed exclusion-only adjusted EPSs.

(c) one out of 38 entities only applied tailor-made accounting policies.

(d) for one entity, the type of adjustments made was unclear.