STAFF PAPER

May 2018

IASB® Meeting

Project	**Primary Financial Statements**
Paper topic	Outstanding issues on management performance measures (MPMs) and adjusted EPS

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 two issues that arose at the April 2018 Board meeting about our proposals for management performance measures (MPMs) and adjusted earnings per share (adjusted EPS):

   (a) whether to further expand the list of subtotals/totals in paragraph 81A of IAS 1 *Presentation of Financial Statements* (see paragraph 5) for the purposes of the MPM disclosure requirements to include other commonly used subtotals, such as profit before tax; and

   (b) whether to provide relief from disclosure of multiple adjusted EPS in any circumstances when an entity has multiple MPMs.

Summary of staff recommendations in this paper

2. At its April 2018 meeting, the Board tentatively decided that all entities shall identify a measure (or measures) of profit or comprehensive income that, in the view of management, communicates to users the financial performance of the entity. It also decided that if this measure is not a subtotal/total required by paragraph 81A of IAS 1 then it would be an MPM and specific MPM disclosure requirements would apply. At this meeting the staff recommend the following:

(a) to further expand the list of subtotals/totals in paragraph 81A of IAS 1 for the purposes of the MPM disclosure requirements to include the following subtotals:

(i) profit before tax;

(ii) profit from continuing operations; and

(iii) gross profit, defined as revenue less cost of sales.

(b) adjusted EPS disclosures would not be required for an MPM if all of the differences between that MPM and the most directly comparable subtotal/total in paragraph 81A of IAS 1 are also all separately disclosed as differences in the MPM reconciliation provided for another MPM (ie another MPM that is determined further down the statement(s) of financial performance).

Overview

3. This paper is structured as follows:

(a) whether to further expand the list of subtotals/totals in paragraph 81A of IAS 1 for the purposes of the MPM disclosure requirements (paragraphs 4-16)

(b) whether to provide relief from disclosure of multiple adjusted EPS (paragraphs 17-24)

(c) appendices

(i) A—supporting disclosure requirements for MPMs (in addition to the paragraph 4(b)(i) and (iii) requirements)

(ii) B—how to calculate adjusted EPS

(iii) C—illustrative disclosure of multiple MPMs that have a single adjusted EPS under the approach described in paragraph 19(a)

Whether to further expand the list of subtotals/totals in paragraph 81A of IAS 1

Background

4. At its April 2018 meeting the Board tentatively decided:

   (a) all entities shall identify a measure (or measures) of profit or comprehensive income that, in the view of management, communicates to users the financial performance of the entity. This measure will

      (i) often be a subtotal or total required by paragraph 81A of IAS 1. If so, an entity shall identify this measure.

      (ii) sometimes be identified by management as a measure that is not a subtotal or total required by paragraph 81A of IAS 1, but would complement those subtotals or totals. Such a measure is a management performance measure (MPM).

   (b) the following disclosure requirements apply to MPMs described in paragraph 4(a)(ii):

      (i) a reconciliation in the notes between that measure and the most directly comparable subtotal or total required by paragraph 81A of IAS 1 (the 'MPM reconciliation');

      (ii) supporting disclosures to explain the MPM as described in Appendix A; and

      (iii) disclosure of an adjusted EPS calculated consistently with that MPM, together with disclosure of the effects of tax and non-controlling interests (NCI) separately for each of the differences between the numerator of adjusted EPS and the numerator of EPS.

5. Paragraph 81A of IAS 1 would include the existing subtotals in that paragraph and the proposed new subtotals developed as part of this project as follows:

   (a) *business profit;*

   (b) *profit before financing, investing and tax;*

   (c) *profit before financing and tax;*

   (d) profit or loss;

   (e) total other comprehensive income; and

(f) comprehensive income for the period.

The proposed new subtotals are shown in italics. The exact labelling of these new subtotals has not yet been decided by the Board.

6. At the April 2018 Board meeting the staff observed that we might want to further expand the list in paragraph 5 to include other commonly used subtotals, such as profit before tax, if we do not think the MPM disclosures in paragraph 4(b) would be useful for these measures. The Board asked the staff to bring a recommendation to a future meeting.

Staff analysis

Can we develop a principle to identify additional subtotals to include in paragraph 5?

7. When identifying a measure in accordance with the requirement in paragraph 4(a), an entity might identify a subtotal (other than one in paragraph 81A of IAS 1—see paragraph 5) that does not include any management adjustments. For example, a profit before tax subtotal is often provided in the normal flow of the statement(s) of financial performance. The staff do not think it would be helpful to identify these subtotals as MPMs if the disclosures in paragraph 4(b) would not provide useful information about these measures to users.

8. The staff think that if we further expand the list in paragraph 5, we should list the additional subtotals rather than try to develop a principle for which subtotals should be included. This is because it would be difficult to describe what we mean by ‘management adjustments’ and/or develop a principle to identify those circumstances when it makes sense from a market perspective to provide the disclosures in paragraph 4(b). Typically, when words such as ‘recurring’, ‘adjusted’, ‘underlying’ and ‘excluding’ are applied to IFRS-defined subtotals, the disclosures in paragraph 4(b) would be useful to users. However, developing a principle to convey this would be challenging. Specifying the additional subtotals would also be consistent with the Board’s decision in April 2018 to provide a specific list of subtotals for the purposes of the MPM requirements rather than trying to describe what we mean by ‘subtotals specifically required by IFRS Standards’ (see paragraphs 10(a) and 13-15 of April 2018 Agenda Paper 21A).

Commonly used subtotals other than those in paragraph 81A of IAS 1

9. The staff have identified the following four commonly used subtotals for which we think the disclosures in paragraph 4(b) would not be useful for users:

   (a) profit before tax—a subtotal before tax. Tax expense is a required line item.[1] Profit is a required subtotal (see paragraph 5).

   (b) profit from continuing operations—a subtotal before discontinued operations. A single amount for the total of discontinued operations is a required line item.[2]

   (c) gross profit—a common subtotal in a by function analysis of expenses. It comprises revenue less cost of sales (COS). Revenue is a required line item and COS is a required item in a by function analysis of expenses.[3] Under our proposals in this project, an entity would be required to present its primary analysis of expenses in the statement(s) of financial performance (Board tentative decision in September 2017). Consequently revenue and COS would both be required line items if an entity uses a by function presentation.

   (d) EBITDA—a common subtotal in a by nature analysis of expenses, often calculated by adding back depreciation and amortisation to EBIT (or profit before financing and tax). Whilst depreciation and amortisation are not required line items, they are required to be disclosed separately.[4]

10. If we add the subtotals in paragraph 9 to the list in paragraph 5 they might be used as the most directly comparable IFRS subtotal/total for the purposes of the MPM reconciliation in 4(b)(i). Consequently, we think they would need to be defined or described in IFRS Standards to ensure consistent application by entities. Otherwise, an entity would be reconciling an MPM to an amount that could vary between entities. The staff have discussed the measures in paragraph 9 in more detail below.

[1] paragraph 82(d) of IAS 1 *Presentation of Financial Statements*.

[2] paragraph 82(ea) of IAS 1.

[3] paragraphs 82(a) and 103 of IAS 1.

[4] for example, see paragraph 73(e)(vii) of IAS 16 *Property, Plant and Equipment* and paragraph 118(e)(vi) of IAS 38 *Intangible Assets*.

11. Profit before tax and profit from continuing operations: The staff do not think the disclosures in paragraph 4(b) should be required for profit before tax and profit from continuing operations. This is because they are defined implicitly in IFRS Standards (because profit or loss, income tax and discontinued operations are defined/described) and so should not include management adjustments. In addition, an adjusted EPS calculated consistently with these subtotals would not be useful to users:

    (a) an adjusted EPS that is consistently calculated with profit before tax would be identical to EPS calculated in accordance with IAS 33; and

    (b) an entity is already required to present EPS from continuing operations if profit from continuing operations is presented.

    Consequently, we think these subtotals should be added to the list in paragraph 5.

12. Gross profit: The staff also think that the disclosures in paragraph 4(b) would not be useful for gross profit because the adjustments needed to arrive at the most directly comparable subtotal listed in paragraph 5 (business profit) would likely just comprise line items presented in the statement(s) of financial performance such as selling, general and administrative expenses (SG&A). Gross profit is not defined in IFRS Standards. However, the staff think it would be straightforward to define it as revenue less COS—consistent with the illustrative example of a by function analysis of expenses in paragraph 103 of IAS 1. Revenue is a defined term in IFRS Standards. COS is a required line item in a by function presentation, but it is not defined in IFRS Standards. The staff acknowledge that it would be difficult for the Board to define COS and for the definition to be applied consistently by entities. At previous meetings, some Board members have observed that allocations of expenses between functions in a by function analysis of expenses (eg between COS and SG&A) involves significant judgement, which limits comparability of COS across companies. Nevertheless, the staff still think that gross profit should be included in the list in paragraph 5 because it is a common subtotal comprised of two required line items in a by function presentation and we do not think the disclosures in paragraph 4(b) would be useful to users in relation to it.

13. EBITDA: The staff also think that the disclosures in paragraph 4(b) would not be useful for EBITDA. This is because depreciation and amortisation (at least for most intangible assets) are generally accepted to be ongoing expenses that users would not

make adjustments for. Nevertheless, some might argue that EBITDA should be disclosed as an MPM because there is diversity in how EBITDA is calculated in practice (such diversity was confirmed by some respondents to the Discussion Paper *Disclosure Initiative—Principles of Disclosure* (POD Discussion Paper)) and because some stakeholders have concerns about EBITDA as a measure of financial performance. The staff think that we should discuss EBITDA separately at a future Board meeting when we discuss the feedback received on the POD Discussion Paper. Consequently, the staff have not considered EBITDA further in this paper and do not seek comments from the Board about EBITDA at this meeting.

Other considerations

14. If we decide to add subtotals to the list in paragraph 5, the staff think we should consider listing them in a separate paragraph of IAS 1, rather than adding them to paragraph 81A of IAS 1, because they would not be subtotals that are specifically required by IFRS Standards. For example, we could refer to subtotals in addition to the subtotals or totals required by paragraphs 81A of IAS 1 in the requirements in paragraphs 4(a) and 4(b)(i). The staff would address this consideration during drafting of any proposed amendments.

Staff recommendation

15. The staff think we should add the following subtotals to the list in paragraph 5 for the purpose of the MPM disclosure requirements:

(a) profit before tax;

(b) profit before continuing operations; and

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

16. This would mean, when applying the requirements in paragraph 4, these three subtotals would be treated the same way as the subtotals required by paragraph 81A of IAS 1 (except we would need to indicate that they are not specifically required subtotals under IFRS Standards). Therefore:

(a) if an entity identifies one of the subtotals in paragraph 15 as a measure of profit or comprehensive income that, in the view of management, communicates to users the financial performance of the entity, that measure would not be a MPM and the disclosures in paragraph 4(b), including the requirement to disclose an adjusted EPS, would not apply.

(b) if an entity identifies an MPM, one of the subtotals in paragraph 15 might be used as the most directly comparable subtotal or total in the MPM reconciliation in paragraph 4(a)(i).

Question 1

Does the Board agree that we should add the following subtotals to those in paragraph 5 for the purposes of the MPM requirements?

- profit before tax;
- profit before continuing operations; and
- gross profit, defined as revenue less costs of sales.

Does the Board think any other subtotals should be added to the list in paragraph 5? (note, we will bring proposals that consider EBITDA to a future Board meeting.)

Whether to provide relief from disclosure of multiple adjusted EPS

Background

17. At its April 2018 meeting the Board tentatively decided that if an entity identifies an MPM, it is required to:

(a) disclose adjusted EPS calculated consistently with that MPM; and

(b) disclose the effects of tax and NCI separately for each of the differences between the numerator of adjusted EPS and the numerator of EPS.

Appendix B explains how adjusted EPS is calculated.

18. An entity might identify more than one MPM. If the requirements in paragraph 17 apply to each MPM, an entity would have multiple EPS, which could be confusing for users. The Board asked the staff to bring proposals to a future meeting that consider ways to provide relief from disclosure of multiple adjusted EPS.

Staff analysis and recommendation

19. The staff have identified the following two alternatives to avoid or reduce the need for entities to disclose multiple adjusted EPS:

    (a) the staff expect that if an entity has more than one MPM, the MPMs would often be consistent with each other. This means that adjustments made in determining the MPMs would be identical except that additional adjustments might be made to one MPM compared to another MPM because one MPM is determined further down the statement(s) of financial performance. For example, an entity might disclose both an adjusted EBIT MPM and an adjusted profit before tax MPM. These two MPMs would be consistent with each other if adjustments are identical except for further adjustments made below the EBIT MPM to arrive at the adjusted profit before tax MPM, ie adjustments that relate to tax or financing items. The staff think in this case we could permit or require the entity to provide the adjusted EPS disclosures in paragraph 17 for the adjusted profit before tax MPM only. This is because this disclosure would provide the information in paragraph 17(b) for the adjusted EBIT MPM.

    (b) instead of requiring adjusted EPS for each MPM, we could just require disclosure of the effects of tax and NCI separately for each of the differences between the MPM and the most directly comparable subtotal/total in paragraph 81A of IAS 1. This would provide relief from a full adjusted EPS calculation and avoid the need for entities to disclose adjusted EPS for its MPMs.

Staff analysis and recommendation

20. The staff think that both of the alternatives in paragraph 19 would provide sufficient information to allow users to calculate their own adjusted EPS for the purposes of their analysis of the MPMs and for comparison with other entities. However, the staff think any reduction in cost or complexity for entities would be minimal under both alternatives. This is because we think most of the cost and complexity arises from determining the effects of tax and NCI separately for each of the differences between the MPM and the most directly comparable subtotal/total in paragraph 81A of IAS 1.

Nevertheless, both methods would achieve our objective of reducing the disclosure of multiple adjusted EPS for MPMs.

21. The approach in paragraph 19(b) would avoid the need for adjusted EPS to be disclosed altogether. Nevertheless the staff support the approach in paragraph 19(a) for the following reasons:

    (a) we think that users would prefer to see adjusted EPS in the financial statements rather than calculate it themselves. For example, some users would use adjusted EPS without further adjustments.

    (b) some preparers already provide an adjusted EPS that is consistent with measures likely be identified as MPMs under our proposals.

    (c) we do not think disclosure of adjusted EPS would be an additional burden on top of separate disclosure of the effects of tax and NCI for each of the differences between the MPM and the most directly comparable subtotal/total in paragraph 81A of IAS 1.

    (d) our aim is to reduce instances of multiple adjusted EPS when this might be confusing. We think if adjustments made to the MPMs are identical, except because one MPM is determined further down the statement(s) of financial performance (ie MPMs are consistent with each other as explained in paragraph 19(a)), users would expect a single adjusted EPS. However, if MPMs are not consistent with each other, we think it would make sense to have different adjusted EPS for the MPMs.

    (e) an entity could apply the approach in paragraph 19(a) by providing its MPMs and the single adjusted EPS in a combined reconciliation as illustrated in Appendix C. The staff think this layout would provide users with clear and easily understandable information.

22. The staff think the only disadvantage of choosing the approach in paragraph 19(a) is it might be challenging to describe in IFRS Standards what we mean by MPMs that are consistent with each other. However, we think this wording can be addressed during drafting of any proposed amendments.

23. The staff think we should permit an entity to apply the approach in paragraph 19(a) rather than require it. This is because there is nothing in IFRS Standards that

specifically prohibits an entity from providing additional disclosures or additional adjusted EPS. Nevertheless, the staff observe the additional disclosures would result in some information being duplicated.

24. The staff considered whether we should allow entities to choose between the two approaches in paragraph 19. However, the staff rejected this because we think that users would benefit from consistent disclosures across entities.

Question 2

Does the Board support the approach in paragraph 19(a)? Under this approach, the adjusted EPS disclosures in paragraph 17 would not be required for an MPM if all of the differences between that MPM and the most directly comparable subtotal/total in paragraphs 81A of IAS 1 are also all separately disclosed as differences in the MPM reconciliation provided for another MPM (ie another MPM that is determined further down the statement(s) of financial performance)?

Appendix A—supporting disclosure requirements for MPMs (in addition to paragraph 4(b)(i) and (iii) requirements)

A1. At its January and April 2018 meeting, the Board tentatively decided that an MPM must be labelled in a clear and understandable way so as not to mislead users and the following disclosures would be required (in addition to the MPM reconciliation and requirements for adjusted EPS described in paragraph 4(b)(i) and (iii) of this paper):

(a) a description of why the MPM provides management's view of financial performance, including an explanation of:

  (i) how the measure provides useful information about an entity's financial performance; and

  (ii) how the MPM has been calculated and why.

(b) sufficient explanation, if there is a change in how the MPM is calculated during the year, to help users understand the reasons for and effect of the change.

(c) a statement that the measure provides management's view of the entity's financial performance and is not necessarily comparable with measures provided by other entities.

A2. The Board also tentatively decided that the MPM reconciliation should be provided separately from the operating segment information disclosed in accordance with IFRS 8 *Operating Segments*. However, entities would not be prohibited from also including MPMs within the operating segment information. Furthermore, the following disclosures would be required:

(a) an explanation of how the MPM differs from the total of the measures of profit or loss for the reportable segments; and

(b) if the MPM does not fit into the operating segment information, an explanation of why this is the case.

Appendix B—how to calculate adjusted EPS

B1. At its April 2018 meeting, the Board tentatively decided that to calculate the numerator of adjusted EPS, an entity shall make the following adjustments, and no other, to the MPM:

(a) add or deduct all income or expenses between the most directly comparable subtotal or total required by paragraph 81A of IAS 1 (ie the subtotal or total used for the MPM reconciliation) and profit or loss attributable to ordinary equity holders of the parent entity (ie the numerator of EPS); and

(b) if the MPM is a pre-tax and/or pre-NCI measure, make further adjustments for the effects of tax and/or NCI on the differences between the MPM and the most directly comparable subtotal or total required by paragraph 81A of IAS 1.

B2. Our aim in paragraph B1 is for the differences between the MPM and the most directly comparable subtotal/total required by paragraph 81A of IAS 1 to also be differences between the numerator of adjusted EPS and the numerator of EPS, except:

(a) the differences between the numerator of adjusted EPS and the numerator of EPS would always be post-tax and post-NCI (ie ‘net’ differences); and

(b) the differences between the MPM and the most directly comparable subtotal or total required by paragraph 81A of IAS 1 will often be pre-tax and-pre NCI (ie are often ‘gross’ differences).

Appendix C—illustrative disclosure of multiple MPMs that have a single adjusted EPS under the approach described in paragraph 19(a)

Entity identifies three MPMs, eg adjusted gross profit, adjusted EBIT and adjusted profit

		Adjustments to determine MPMs				
	IFRS	Foreign currency effects	Restructuring charges	Amortisation of intangibles	Share-based payment expenses	Adjusted measures (MPMs and adjusted EPS in bold)
Revenue	4,000	50				4,050
COS	(2,000)				200	(1,800)
Gross profit	*2,000*	*50*			*200*	***2,250***
SG&A	(1,000)		250	200	200	(350)
Profit before investing, financing and tax (EBIT)	*1000*	*50*	*250*	*200*	*400*	***1900***
Income/expenses from investments	100					100
Finance income/expenses	(100)	50				(50)
Income tax	(160)	(15)	(22)	(0)	(40)	(237)
Profit for the year	840	85	228	200	360	**1,713**
NCI	(40)	(1)	(0)	(10)	(8)	(59)
Profit attributable to ordinary equity holders of the parent entity	*800*	*84*	*228*	*190*	*352*	*1654*
EPS	0.080	0.008	0.023	0.019	0.035	**0.165**