FASB FINANCIAL ACCOUNTING STANDARDS BOARD

MEMO

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Issue(s)	**Topic 2: FASB Research - Structure of the Performance Statement**

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Purpose of This Memo

1. The FASB staff was asked to provide an update on the research it has performed in the Financial Performance Reporting (FPR) research project. The scope of the FPR project involves two main areas of research: disaggregation of performance information and structure of the income statement. The purpose of this memo is to share our research on structuring the income statement.

2. In August 2016, the FASB issued an Invitation to Comment (ITC), *Agenda Consultation*. That document comprised four chapters identifying potential major financial reporting areas in need of improvement. Chapter 4, "Reporting Performance and Cash Flows," considered issues relating to structuring the income statement with an operating performance measure. When relevant, this memo includes feedback on the ITC.

The Financial Accounting Standards Board (FASB) is an independent standard-setting body of the Financial Accounting Foundation, a not-for-profit corporation. The FASB is responsible for establishing Generally Accepted Accounting Principles (GAAP), standards of financial accounting that govern the preparation of financial reports by public and private companies and not-for-profit organizations in the United States and other jurisdictions. For more information visit www.fasb.org

Discussions on Structuring the Performance Statement

3. Conversations about the presentation of the performance statement, including other comprehensive income (OCI), are usually very polarized, particularly conversations dealing with the structure and required categories for the performance statement.[1] If there are concerns about the effect of a potential solution, discussions often circle around whether the underlying accounting issue has been appropriately identified and whether addressing that issue is a priority for the Board[2]. This paper sets out the FASB staff's views on the underlying accounting issue in respect of the structure of the performance statement and some alternative solutions that may address that issue.

Sections and Structure of This Paper

4. This memo is organized into the following sections:

Section 1: Background and Previous Standard-Setting Efforts

5. In this section of the memo, we discuss the following matters:

   (a) The underlying accounting issue

   (b) Conceptual Framework

   (c) Previous standard setting attempts

   (d) Current practice

[1] In this memo, performance statement refers to the statement(s) of comprehensive income. Income statement refers to the statement of profit or loss (net income).

[2] Throughout this paper, any references to the "Board" generally refers to the FASB.

Underlying Accounting Issue That Could Be Addressed

6. The cash flow statement and balance sheet are structured statements with information arranged in a highly ordered manner. In contrast, the performance statement is structured into a statement of net income and a statement of other comprehensive income. The income statement further structures performance from discontinued operations and income taxes. However, other types of performance exist and it would be helpful to bring greater transparency to these performance measures. Without a better philosophy for how information is organized in the statement, stakeholders consider the income statement to be of limited relevance, which has led to the increased use of non-GAAP measures. In the United States, many reporting entities voluntarily present an operating performance measure, although there is no requirement to do so.

7. The FASB staff believes that the **underlying accounting issue that could be addressed is that some stakeholders would prefer a required structure to the income statement and standardized categories for performance information with the display of various intermediate performance measures**. Some respondents to the ITC would structure the entire performance statement, including OCI. A structured statement would improve an investor's understanding of both the individual lines and the information as a whole. It also would enhance comparability across entities. Stakeholders suggest creating an overarching set of principles for how to structure the performance statement.

FASB's Conceptual Framework

8. While the FASB's Conceptual Framework considers the purpose of the individual financial statements, it does not directly speak to how information within comprehensive income should be arranged within the performance statement or how the structure of the statement helps to achieve the objective of financial reporting.

9. Paragraphs 74 and 75 of FASB Concepts Statement No. 6, *Elements of Financial Statements,* suggests the performance statement should be structured as follows:

> Comprehensive income of a business enterprise results from (a) exchange transactions and other transfers between the enterprise and other entities that are not its owners, (b) the enterprise's productive efforts, and (c) price changes, casualties, and other effects of interactions between the enterprise and the

> economic, legal, social, political, and physical environment of which it is part. An enterprise's *productive efforts and most of its exchange transactions with other entities are ongoing major activities that constitute the enterprises central operations* by which it attempts to fulfill its basic function in the economy of producing and distributing goods or services at prices that are sufficient to enable it to pay for the goods and services it uses and to provide a satisfactory return to its owners [*Emphasis* added.]
>
> Although an enterprise's ongoing major or central operations are generally intended to be the primary source of comprehensive income, they are not the only source. Most entities occasionally engage in activities that are *peripheral or incidental to their central activities*. Moreover, all entities are affected by the *economic, legal, social, political, and physical environment* of which they are part, and comprehensive income of each enterprise is affected by events and circumstances that may be partly or wholly beyond the control of individual enterprises and their managements.

10. We interpret these paragraphs to suggest that the performance statement should be a structured statement with categories that are very different from those used in practice today. Specifically, there is a strong emphasis that there should be an operating performance category.

11. In FASB's Exposure Draft of proposed Concepts Statement No. 8, *Conceptual Framework for Financial Reporting—Chapter 7: Presentation*, the FASB decided against developing concepts for the structure of the performance statement. Paragraph BC7.9 states:

> The Board considered how to determine the amount of detail to be provided in each financial statement and how the information in a statement might be organized. However, the Board concluded that at a conceptual level no single set of line items, subtotals and totals for the income statement would serve all entities equally well.

12. Consistent with this view, the FASB concluded there is no conceptual basis for the current structure of the performance statement and OCI. That is, there is no basis for excluding items from net income and, therefore, later reclassifying items into net income.

13. Some respondents to the Exposure Draft of proposed Chapter 7: Presentation disagreed with this conclusion and suggested that there is a conceptual basis for the structure of the performance statement and OCI, however this basis was not explained in the letters. Another respondent commented that the FASB could examine what information users derive from categorizing cash flows and develop a coordinated conceptual basis for categorizing the performance statement.

Previous Standard-Setting Efforts

14. Despite limited concepts for how the performance statement should be structured, users and preparers generally agree that there are different types of performance, and it would be helpful for financial statement analysis to bring greater transparency to these different performance measures. Over the years, there have been many attempts to improve the structure of the performance statement. Most efforts sought to, at least, develop a category for operating performance and define terms like *operating activities.*

15. The most significant standard-setting attempts of which we are aware include:

    (a) FASB Reporting Earnings Task Force Discussion Memorandum, *An Analysis of Issues Related to Reporting Earnings* (1979)

    (b) FASB Proposed Exposure Draft of a Concepts Statement, *Reporting Income, Cash Flows, and Financial Position of Business Enterprises* (1981)

    (c) AICPA Special Committee on Financial Reporting[3] *The Jenkins Committee Report: Improving Business Reporting—A Customer Focus* (1994)

    (d) FASB and Other G4+1 members Special Report, *Reporting Financial Performance: Current Developments and Future Directions* (1998)

    (e) UK Accounting Standards Board Exposure Draft, *Reporting Financial Performance* (2000)

    (f) FASB/International Accounting Standards Board (IASB) Discussion Paper, *Preliminary Views on Financial Statement Presentation* (2008)

    (g) FASB/IASB Staff Draft of an Exposure Draft, *Financial Statement Presentation* (2010).

[3] The Jenkin's report was not issued by an accounting standard setter; however, the staff considered it together with the other documents in this list because it was such a substantial document and because Mr. Jenkins later became a FASB Chairman.

16. These documents contain broad proposals for structuring the performance statement and proposed a variety of categories. Appendix A includes a table of the different ways the term *operating activities* (or similar phrases) was defined in those documents. At present, we have not focused on other potential categories within comprehensive income.

The FSP Project – The Joint 2010 Staff Draft Document

17. In 2010, the FASB and IASB posted the Staff Draft on their respective websites. The Boards proposed a highly structured performance statement with multiple sections, categories, and subcategories that included:

Performance Statement	
Business section	
Operating category	XXX
Operating-finance subcategory	XXX
Investing category	XXX
Total business income	**XXX**
Financing section	XXX
Income tax section	XXX
Discontinued operation section	XXX
Multi-category section	XXX
Net income	**XXX**
Other Comprehensive Income section	XXX
Total comprehensive income	**XXX**

18. The term *operating activities* was defined as activities that "generate revenue through a process that requires the interrelated use of the entity's resources. That process also requires the application of employee and management expertise." Assets were classified as part of operating activities if they were "used as part of the entity's day-to-day business," and liabilities if they "arise from the entity's day-to-day business." There likely would have been implementation concerns with these proposals because the definition and classification criteria were not directly linked to one another.

Current Practice - Presenting a Measure of Operating Performance

Public Companies in the United States

19. As part of the FPR project, we researched the current practice in the U.S. using XBRL data on entities presenting an operating income subtotal. The staff observed two main findings.

Percentage of Entities Already Displaying an Operating Income Metric in the Income Statement

20. Of the 2013 XBRL data reviewed, we observed that 69 percent (5,317 out of 7,750 entities) of tagged annual financial statement filings displayed an operating income subtotal. Except for those entities within the financial, insurance, and real estate sectors, most public entities currently display an operating income subtotal.

21. Only 30 percent of entities within the financial, insurance, and real estate sector present a measure of operating performance. In contrast, for all other industry sectors, 80 percent (4,791 out of 5,976) of public entities reported an operating income subtotal. One of the primary reasons financial entities do not commonly present operating income is that interest expense is considered by those entities to be an operating, rather than financing, expense.

Items Commonly Excluded from Operating Income

22. Within the Standard & Poor's 100 (S&P 100) index, the staff reviewed annual reports for the 2014 financial year to identify the most common items of income and expense that are excluded from operating income when that subtotal is presented.

23. The breakdown of entities within the S&P 100 presenting an operating income subtotal was slightly lower than the overall XBRL population with only 56 of the S&P 100 entities presenting operating income. The staff attributes this to disproportionally more banks, insurers, and large conglomerates represented in the S&P 100 than in the overall XBRL population of 69 percent.

24. Of those 56 entities, the top 5 most excluded items from operating income include:

#	Item presented as nonoperating	No. of entities excluding these items	Percentage of Total*
1	Interest income and expense	56	100%
2	Derivative and foreign currency gains and losses	33	59%
3	Equity income in equity method investees	16	29%
4	Investment gains, losses, and impairments	15	27%
5	Debt extinguishments	8	14%

* *Percentage of total entities presenting operating income subtotals (out of 56).*

FASB Staff View

25. Collectively, these two observations suggest that despite there being no GAAP requirement to present a measure of operating performance, or underlying concept for what is included in that measure, most public entities in the United States already present an operating income subtotal that is management-defined and largely is consistent over time. Entities that typically do not present that measure are concentrated in the financial, insurance, and real estate sectors. This means that if the FASB were to define *operating activities* and standardize the structure of the income statement, it would be moving from a voluntary system in which management self-defines operating performance to a required system that has many challenges when defining operating activities that is relevant to all industries.

Other Jurisdictions – Presenting an Operating Performance Measure or Other Defined Subtotals

26. Aside from the current U.S. practice, we are aware of other jurisdictions that require and define an operating performance measure or define a subtotal, such as earnings before interest, tax, depreciation, and amortization (EBITDA). We briefly describe the approaches taken in Korea, Brazil, and South Africa.

South Korea – Arithmetic Approach

27. When Korean entities were first permitted to apply IFRS in 2009, users were concerned about a loss of information when transitioning to Korean International Financial Reporting

Standards (K-IFRS) because IFRS does not require the presentation of operating profit, unlike Korean Generally Accepted Accounting Principles (K-GAAP) that had required that presentation for many years.

28. In 2012, in response to stakeholders' concerns, the Korean Accounting Standards Board (KASB) reinstated the operating profit definition in K-IFRS, even though that definition was not issued by the IASB. Korean stakeholders strongly supported carrying across the K-GAAP definition of operating profit into K-IFRS, rather than develop a new definition.

29. In K-IFRS, *operating profit* is defined as follows:

Operating profit = Revenue – Cost of goods sold – Selling and administrative expense

30. Two principles underpin the meaning of operating profit:

(a) Income and expense should occur from *major operating activities* to be classified into operating profit regardless of whether they are irregular, infrequent, unusual, or nonrecurring.

(b) Management should consider various factors when judging the *major operating activities,* such as the activities set out as a business objective in the constitution and the materiality of the amount generated from the activities.

31. We understand that the same definition and principles also are used by financial services entities; however, in those cases self-defined meanings of *revenue* and *cost of goods sold* are applied.

32. The FASB staff calls this an arithmetic approach to defining operating activities because of the reductive way in which this definition is applied.

Brazil – Regulation on the Use of EBIT and EBITDA, If Presented

33. In 2012, the Brazilian securities regulator, the Comissão de Valores Mobiliários (CVM), issued Instruction 157, which regulated the composition and labeling of EBITDA and earnings before interest and taxes (EBIT) subtotals for entities that voluntarily report those measures. EBITDA was described to mean strictly earnings before depreciation and amortization, net financial income and expenses, and income tax and social contribution.

EBIT was described to mean earnings before net financial income and expenses and income tax and social contribution. This effort was in response to some entities selectively adjusting the EBITDA and EBIT subtotals for items without properly labeling the measure as such.

34. The CVM's regulations do not preclude entities from presenting an "adjusted" EBITDA or EBIT subtotal provided the following requirements are met: (a) the adjusted EBITDA or EBIT is derived from the EBITDA or EBIT calculation, (b) items that comprise adjusted EBITDA or EBIT are disclosed and derived from the financial statements, (c) the reasons for those adjustments are disclosed, and (d) the measure is labeled using the term *adjusted*. The subtotal should be consistent from period to period, subject to independent audit, and any changes to the composition of the adjusted EBITDA or EBIT calculations are disclosed.[4]

South Africa – Defined Headline Earnings Subtotal

35. Since 2000, the Johannesburg Stock Exchange has required listed entities to present an additional performance metric termed *headline earnings* in the audited financial statements. The requirements for this metric are issued by the South African Institute of Chartered Accountants. The purpose is to provide a consistent basis to calculate price earnings ratios.

36. The calculation starts with IFRS net profit or loss and excludes certain prescribed items to derive headline earnings. The list of prescribed items is extensive and is arranged by each IFRS/IAS, for example, impairments, bargain purchase gains, gains/losses on disposals, and recycled amounts from OCI are specific add-backs. Entities disclose a reconciliation of net profit to headline earnings reporting both nominal and per share amounts.

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[4] The FASB staff based the summary of Instruction 157 from our translation of the document. We are unaware of the CVM producing an English version of that document. Our understanding of this Instruction is that it only regulates EBIT and EBITDA and related "adjustments" to those subtotals. It does not regulate operating profit and related "adjustments" to that subtotal.

37. The approaches used in Brazil and South Africa seek to define the composition of a subtotal such as EBITDA or headline earnings. While there may be similarities, these subtotals are not a measure of an entity's operating performance.

Questions for the IASB—Section 1
1. Do IASB members have comments or questions about the staff's research?

Section 2: Alternatives Identified for the Structure of the Performance Statement

38. If the FASB were to proceed with requiring a measure of operating performance or another defined subtotal, the staff has identified six broad approaches. At present, we have not focused on other potential categories. The alternatives include:

(a) Definitional approach

(b) Descriptional approach

(c) Self-defined approach

(d) Topic-by-topic guidance, if an entity voluntarily categorizes operating activities

(e) Arithmetic approach

(f) Define EBIT, if presented.

Definitional Approach - Define the Meaning of *Operations* or *Operating Activities*

39. When the FASB has structured a financial statement in the past, it has traditionally defined the required categories, for example, the defined categories of the cash flow statement or the definition of discontinued operations. The definitions are used by entities when reporting and classifying their transactions and events. This is a classical approach to standard setting.

40. Previous standard-setting attempts also have tried this classical approach when categorizing the income statement with an operating income category. The challenge is developing a definition of operating activities that applies to activities pertaining to both (a) goods and services outputs and (b) exchanges of financial instruments. That is, the definition needs to

address various activities for financial instruments, such as insurance, banking, securities trading, and conglomerates.

41. A definition of operating activities can be developed in one of three ways:

(a) *Direct approach*—Operating activities and operating performance are defined in terms of what is included in, rather than excluded from, operating activities. Entities would classify earnings into operating income based on that definition. This is the most common approach chosen in previous standard-setting attempts. Within the FPR project, the staff also has attempted to directly define operating activities but has noted the complexity of doing so for activities involved in financial instruments.

(b) *Residual approach*—Operating activities are defined as the residual category of earnings after certain nonoperating components are excluded, such as investing and financing activities. Topic 230, Statement of Cash Flows, defines *operating activities* as "…all transactions and other events that are not defined as investing or financing activities…." Previously, this approach has been tried with limited success by standard setters. The staff has not attempted this approach within the FPR project.

(c) *Broad industry lines*—Operating activities are defined based on broad industry groupings, such as commercial and industrial, insurers, and financial services entities.

Descriptional Approach – Describe the Meaning of *Operating Activities*

42. For the second approach, the FASB could describe, not define, the meaning of operating activities and establish parameters for interpreting the meaning of operations. Management would determine the composition of that measure through an accounting policy. When classification is not clear based on the description of operations, an entity follows its accounting policy. Changes to the accounting policy would require restatement of prior presented periods and a preferability conclusion by the entity's auditor. This approach

follows the ideas recommended in academic papers by Tom Linsmeier, and Roger Marshall and Andrew Lennard.[5]

43. Many comment letter respondents to the ITC supported this type of approach. It was clear, however, that those respondents had different meanings of *operations*. Some noted that operating profit should exclude infrequently occurring items, while others noted that fair value changes should be excluded. Finally, one or two respondents equated operating profit to "core" or "central" income. A description on its own would be insufficient. Many respondents commented that additional guidance would be needed to ensure operability and comparability, such as:

(a) A principle that described the meaning of operations that could allow for application across a multitude of entities

(b) Indicators like the principle versus agent guidance in Topic 606, Revenue from Contracts with Customers, that support the description of operations

(c) Transaction specific guidance or additional guidance for gains or losses on asset disposals, currency gains or losses, and income from equity method investments

(d) Illustrative examples for application guidance, ideally based on industries such as real estate investment trusts (REITs), investment companies, banking, and insurance

(e) Require an accounting policy to explain how the principle is applied and detailed disclosure regarding what components are excluded from that performance measure.

[5] Linsmeier, T. J 2016. "Revised model for presentation in statement(s) of financial performance: Potential implications for measurement in the conceptual framework." *Accounting Horizons* 30 (4) p485-498

Marshall, R., and A. Lennard. 2016. "The reporting of income and expense and the choice of measurement bases." *Accounting Horizons* 30 (4) p499-510

44. An approach that describes the meaning of operations, yet provides detailed application guidance, would be an extensive undertaking for the FASB. It is not apparent to the FASB staff whether this standard-setting method is any less complex than a definitional approach.

Self-Defined Approach

45. A third standard-setting approach could include a requirement to categorize the income statement and display an intermediate performance measure, but the composition of that measure is mostly self-defined. The staff has identified two variations of this approach:

   (a) *Composition of operating activities is entirely self-defined by the entity*—An operating performance measure would be required but would be entirely self-defined. This largely would affect financial institutions and insurers, that is, entities that currently do not present an operating performance measure. Any change to the calculation of the operating measure would result in a restatement of prior presented periods and a preferability conclusion by the auditor. The FASB staff sees this as not being substantially different from the voluntary system applied in practice today.

   (b) *Composition of the performance measure is based on the measure the entity uses to communicate its performance to internal and external stakeholders*—An intermediate performance measure would be required to be presented in the income statement and would be based on the measure management uses to communicate the operating performance to the entity's board of directors or in external earnings releases. Any change to the basis of calculating the operating measure would result in a restatement of prior presented periods and a preferability conclusion by the auditor. If multiple internal or external performance measures are communicated, those additional measures should also be presented or disclosed. The staff believes this would incorporate non-GAAP performance measures into GAAP income statements.

Topic-by-Topic Guidance, If an Entity Voluntarily Categorizes Operating Activities

46. At present, the FASB uses another standard-setting method that classifies items inside or outside of operating profit but is premised on an entity voluntarily presenting an operating

performance measure. In that case, a certain component is included in or excluded from the operating performance measure, if that subtotal is presented. For example:

(a) Topic 360, Property, Plant, and Equipment, requires that gains and losses on sales or disposals of fixed assets and impairments must be included within operating income if that subtotal is presented.[6]

(b) Subtopic 410-20, Asset Retirement and Environmental Obligations—Asset Retirement Obligations, requires that the accretion expense on an asset retirement obligation must be included within operating income if that subtotal is presented and should not be shown as part of interest expense.[7]

(c) Topic 420, Exit or Disposal Cost Obligations, requires that costs associated with an exit or disposal activity, such as restructuring charges, must be presented within operating income if that subtotal is presented.[8]

(d) Topic 715, Retirement Benefits—In November 2016, the FASB affirmed its initial decision to require the net periodic pension cost or benefit to be separated into the "service cost" component and "other" components. The "other" components should be excluded from the operating income subtotal, if one is presented.

47. This standard-setting approach is a low-cost way of standardizing various components within the structure of the income statement, but it is predicated on entities voluntarily categorizing the income statement in the first instance. The FASB staff do not see this approach as a long-term solution for categorizing the income statement because there is no underlying concept for operating activities.

[6] See paragraphs 360-10-45-4 through 45-5
[7] See paragraphs 410-20-35-5 and 45-1
[8] See paragraph 420-10-45-3

Arithmetic Approach

48. The fifth standard-setting approach could include arithmetically defining operating activities, similarly to that used in South Korea. *Operating income* could be defined as:

Operating profit = Revenue – Cost of goods sold – Selling and administrative expense

49. The Korean approach permits management to consider various factors when judging the *major operating activities*, such as the activities set out as a business objective in the constitution and materiality of the amount generated from activities. This type of descriptor allows for implementation by entities engaged in financial instruments, such as banks, insurers, and conglomerates.

50. Under this approach, reporting entities self-define the composition of items within the calculation, for example, revenue; cost of goods sold; and selling, general, and administration.

51. We think this type of approach also would necessitate transaction specific guidance and illustrative guidance based on industries to enhance consistency. The FASB staff sees this as not being substantially different to the voluntary system applied in practice today.

Define EBIT, If presented

52. A final standard-setting approach would define common non-GAAP subtotals, such as EBIT or EBITDA, if that subtotal is presented. This idea was suggested by a couple of comment letter respondents to the ITC and raised at several of the FASB's advisory group meetings.

53. To be clear, we believe that EBIT or EBITDA is not the same measure as operating performance. However, this approach may be one of the easier ways to define a subtotal. It is not conceptual and would be predicated on entities voluntarily presenting this measure. It mostly would avoid entities whose activities are concentrated in financial instruments, such as banks, insurers, and conglomerates, because they typically do not present this measure.

54. Under this alternative, the FASB would define the composition of (a) the interest income and interest expense lines and (b) the income tax expense line for entities that voluntarily

present an EBIT subtotal. This has its own set of challenges. GAAP currently deals with the classification of items as interest in four ways.

(a) GAAP occasionally specifies what must be classified as interest. For example, the amortization of a debt discount or premium from liabilities not reported at fair value must be classified as interest expense. Recent changes also require the amortization of debt issuance cost to be classified as interest expense.[9]

(b) GAAP occasionally implies what items should not be included within interest expense. For example, the fact that accretion expense on an asset retirement obligation is required to be classified as an operating item if an operating income subtotal is reported means that it should not be combined with other types of finance expenses.[10]

(c) GAAP occasionally is explicit in allowing for an accounting policy choice. For example, an entity may choose whether interest recognized on an its tax liabilities is classified as interest expense or income taxes.[11]

(d) Finally, GAAP often is silent on the classification of an item as interest.

55. To define the composition of interest income or interest expense within an EBIT subtotal, principles would be needed to distinguish between two types of interest expense—*operating finance* interest expense and *debt finance* interest expense. In this sense, broader issues related to the categorization items as either operating and financing activities arise when discerning the components of *debt finance* interest expense.

IASB's Primary Financial Statements Project

56. In March 2017, the IASB issued a Discussion Paper on the Disclosure Initiative – Principles of Disclosure, where it discusses the presentation of EBIT and/or EBITDA subtotals and

[9] Paragraph 835-30-45-3
[10] Paragraph 410-20-45-1
[11] Paragraph 740-10-45-25

when those subtotals can be considered fair presentation in accordance with IFRS standards. The IASB's preliminary view is that it should clarify that EBITDA can provide fair presentation of performance if an entity presents an analysis of expenses based on nature. However, this is not the case if the entity presents an analysis of expenses based on function. The IASB is also of the view that it should clarify that EBIT can provide fair presentation of performance when both nature or function of expense methods are used.

57. We further understand from the IASB's March 2017 Board meeting that the IASB is exploring a requirement to present an EBIT subtotal. We are interested to understand how an EBIT measure will apply to entities whose activities are concentrated in financial instruments, such as banks, insurers, and conglomerates, and how the IASB will distinguish *debt finance* interest expense. We also understand that the IASB is exploring permitting or requiring a self-defined operating income subtotal. If the IASB decides to *require* an operating performance measure, we would be interested to understand what kind of parameters the IASB would put around this measure or how it would enhance the consistency of this measure across entities.

Questions for the IASB—Section 2
1. Do IASB members have comments on or questions about this section?

Section 3: Feedback from the ITC

58. In this section of the memo, we discuss:

(a) Broad messages received from stakeholders to the ITC

(b) Summary of the February FASB meeting

Broad Messages Received from Stakeholders to the ITC

59. Many stakeholders commented that performance reporting is a priority area and supported improving the income statement; however, the type of improvements was very mixed.

60. *Holistic structural improvements to the performance statement*—Some respondents would prefer to holistically recalibrate the structure of the performance statement. Those

stakeholders believe there should be various required categories and subtotals. Reasons for this view include:

(a) An articulated set of principles underlying the structure and subtotals presented in the performance statement would be beneficial and currently is lacking in GAAP.

(b) A structured statement would improve understandability across statements and lessen the need to resort to non-GAAP measures.

(c) If structured, it could lead to the harmonization of the operating activities category with the cash flow statement.

61. These stakeholders appear to desire an overarching philosophy for organizing the performance statement that potentially aligns to the structure of the cash flow statement. If a full alignment is unachievable, many supported at least aligning operating activities between those two statements. Many of these stakeholders would minimize OCI and recycling.

62. *Focused structural improvements only to the income statement*—Other respondents would prefer that the FASB focus on one or two major areas of the income statement, but there is little desire to restructure the entire performance statement. Reasons for this view include:

(a) For all of its shortcomings, items that are classified in OCI and recycled from accumulated OCI are transparent. The income statement is most in need of improvement.

(b) Holistic changes to the performance statement that include OCI would introduce volatility into net income and would create confusion.

63. *Do not standardize the structure of the income statement*—Some comment letter respondents did not support recalibrating the performance statement. Reasons for this view include:

(a) Despite the conceptual shortcomings, the voluntary system of presenting a measure of operating performance is accepted in practice and users can analyze financial statements.

(b) A single model that describes operating activities or requires a standardized structure will add significant complexity. Previous standard-setting efforts have been unsuccessful.

(c) A holistic or focused project that defines operating activities across both the performance statement and cash flow statement is likely to have substantial resistance from many parties.

FASB Advisory Groups

64. Most members of the FASB's Financial Accounting Standards Advisory Council (FASAC) oppose defining or describing operating or nonoperating activities. Those with this view commented that:

    (a) Differences across industries are so great such that a single definition to classify earnings components would not suit different business models. Determining what is or is not included in operating income generally is driven by what industry the entity is in. Entities tend to report items in a comparable way within their industry

    (b) Others commented that requiring an operating performance measure may not necessarily improve financial reporting because users almost always will recalculate their own operating performance measure differently. Instead, it is important that users have sufficient granularity to see the components of net income to enable them to perform their own calculations.

Roundtable

65. During the roundtable discussion, several of the attendees acknowledged that the FASB has attempted holistic projects before that restructured the income statement, with limited success. Those attendees recommended that the FASB first address the structure of the performance statement through the Conceptual Framework project and develop concepts for intermediate performance measures. Focusing on the concepts first would help derive the structure in a standards-level project and potential alignment to the cash flow statement.

66. Several attendees raised cross-cutting issues about the liabilities and equity topic as a reason for holistically approaching the structure of the performance statement. One of the most contentious aspects of liabilities and equity is *where* in the performance statement to recognize the changes in carrying value of the liabilities. These attendees recommended introducing a new performance category for changes in "non-owners" equity. However, those attendees also stressed that there needs to be some greater thought process to the structure of the performance statement beyond using OCI for volatile performance items.

Summary of the February FASB meeting

67. In February 2017, the Board discussed the comment letter and feedback summary received from the ITC. The opinions expressed by FASB members were preliminary views and no decisions were made during this meeting. During the meeting, Board members acknowledged that respondent's views were very mixed. Thus, FASB members expressed different expectations for how to proceed with to this issue.

68. A couple of FASB members potentially support implementing one of the self-defined approaches to defining operating activities and requiring the presentation of an operating performance measure in the income statement. Those with this view noted that the practice of presenting an operating performance measure in the United States is fairly developed and already is self-defined by management. Making this a GAAP requirement would add discipline to the process through the audit function and require restatement of prior presented periods if there is a change in the composition of that performance measure.

69. Other FASB members observed that the Board has struggled in the past to agree on the structure of the performance statement because the Conceptual Framework currently does not establish concepts necessary to do so. These FASB members would respond to this issue by first developing concepts for the structure of the statement. A standards-level project is unlikely to be successful without first addressing the underlying concepts.

70. Some FASB members appear not to support defining operating activities or structuring the income statement. Those with this view also maintain that in the United States the voluntary practice of presenting operating performance is fairly developed. It is unclear that there is abuse or information loss when this performance measure is changed. Practice has

coalesced on the types of items that generally are excluded from operating income. It is unclear that there is a significant improvement to be made through standard setting.

Immediate Next Steps

71. The FASB staff plans to discuss the various paths forward on this issue and interdependencies with the Conceptual Framework project at our next Board meeting.

Questions for the IASB—Section 3
1. Do IASB members have comments on or questions about this section?

Appendix A: Previous Standard-Setting Attempts to Describe and Classify Items within Operating Activities

The purpose of this table is to present a side-by-side of each main standard-setting document that considered the display of an intermediate operating income metric. We have briefly discussed a summary of the document, the proposed definition, and classification criteria.

FASB Reporting Earnings Task Force (1979)	FASB Conceptual Framework (1981)	The Jenkins Committee (1994)	FASB and G4+1 Special Report (1998)	UK Accounting Standards Board ED (2000)	FSP Preliminary Views Paper (2008)	FSP Staff Draft (2010)	NFP Financial Statements (2015)
Summary of the document	Summary of the document	Summary of the document	Summary of the document	Summary of the document	Summary of the document	Summary of the document	Summary of the document
The 1979 Discussion Memorandum focused on separating regular earnings from irregular earnings. A secondary focus included presented operating earnings from nonoperating earnings.	The 1981 Concepts ED focused on the need for more information about the components of comprehensive income and suggested that operating performance would be useful to users.	The Jenkins Report (1994) proposed a split along core and noncore activities as a means of distinguishing between the earning components.	The 1998 Special Report considered four different ways to separate the earnings components. A majority of G4+1 members supported a three-category model of operating, financing, and other gains and losses sections.	In 2000, the UK Accounting Standards Board issued an ED that proposed an all-inclusive model. All items should be part of operating activities, unless a specific item was required to be reported in another category.	The 2008 Preliminary Views Discussion Paper focused on business activities (comprising operating and investing) and financing activities.	The 2010 Staff Draft continued to focus on an operating, investing, and financing split. However, the definition and classification of operating items differed from those of the 2008 paper.	In proposed Update 2015-230, the Board considered improvements to presentation of financial statements of not-for-profit entities. One proposal required an intermediate measure of current operations.

FASB Reporting Earnings Task Force (1979)	**FASB Conceptual Framework (1981)**	**The Jenkins Committee (1994)**	**FASB and G4+1 Special Report (1998)**	**UK Accounting Standards Board ED (2000)**	**FSP Preliminary Views Paper (2008)**	**FSP Staff Draft (2010)**	**NFP Financial Statements (2015)**
Description of operating activities	Description of operating activities	Description of operating activities	Description of operating activities	Description of operating activities	Description of operating activities	Description of operating activities	Description of operating activities
Operating earnings were defined as *revenues from the main activities of the enterprise less related expenses*. Gains and losses would be excluded along with revenues from unusual and incidental activities.	The ED stated that “no definition of the term *operations* is likely to produce a clear identification of the activities concerned in all types of business.” Operations normally comprise the provision of outputs that make up the main business and other activities that must be undertaken jointly with the provision of goods and services.	Core activities were defined as *the usual and recurring operations and recurring nonoperating gains and losses, excluding interest*. *Usual* meant that the activity is *ordinary and typical for a company*. *Recurring* meant that *the activity, transaction, or event is expected to occur again after an interval*.	The Working Group members could not agree on how the operating category should be defined. Although operating activities were considered, the *primary value-adding activities*.	Operating activities were described as *what a reporting entity earns for its output (revenue) and what it sacrifices to obtain that output (expenses) in its dealings with its customers*.	Business activities were described as those *conducted with the intention of creating value and normally include assets and liabilities that are related to transactions with customers, suppliers, and employees (in their capacities as such) because such transactions usually are related directly to an entity’s value-creating activities*.	Operating activities were defined as activities that *generate revenue through a process that requires the interrelated use of the entity’s resources. That process also requires the application of employee and management expertise*.	Operations are defined by two dimensions: mission and availability. Operations are described as *activities and resources that are from or directed at carrying out a not-for-profit’s purpose for existence.* The availability dimension is irrelevant for for-profit entities.

FASB Reporting Earnings Task Force (1979)	**FASB Conceptual Framework (1981)**	**The Jenkins Committee (1994)**	**FASB and G4+1 Special Report (1998)**	**UK Accounting Standards Board ED (2000)**	**FSP Preliminary Views Paper (2008)**	**FSP Staff Draft (2010)**	**NFP Financial Statements (2015)**
How items were classified as operating	How items were classified as operating	How items were classified as operating	How items were classified as operating	How items were classified as operating	How items were classified as operating	How items were classified as operating	How items were classified as operating
Classification criteria were not specifically described.	No classification criteria were proposed.	The Jenkins Report recommended classifying items based on management judgment. All operations were core activities unless considered otherwise by management. The report recommended disclosure *surrounding management's rationale used to distinguish core earnings and noncore activities, transactions, or events*.	No classification criteria were proposed.	The UK Accounting Standards Board proposed that all items should be classified within operating activities, unless a specific item was required to be reported in another category. Finance and treasury transactions, revaluation gains and losses on fixed assets, and actuarial gains and losses on defined benefits plans were excluded from operating.	The Board proposed that *an entity should classify its assets and liabilities…in a manner that best reflects the way the asset or liability is used within the entity*. The operating category included *assets and liabilities that management views as related to the central purpose(s) for which the entity is in business. An entity uses its operating assets and liabilities in its primary revenue-and-expense generating activities*.	The Board proposed classifying items into the sections and categories based on how those items relate to the activities. Assets should be classified as part of operating activities when they are *used as part of the entity's day-to-day business* and liabilities when they *arise from the entity's day-to-day business.*	The Board proposed classifying items within operations based on a designation from the not-for-profit's governing board.