

STAFF PAPER

IASB® Meeting

Project	Primary Financial Statements		
Paper topic	Adjusted earnings per share (EPS)		
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Accounting Standards Advisory Forum, July 2017, Agenda paper 6E

This paper was discussed at the Board meeting in June 2017.

Purpose of paper

1. This Agenda Paper discusses the presentation of management-defined adjusted earnings per share (EPS) in financial statements.¹ This paper only considers the numerator of adjusted EPS calculations and does not propose any changes to the calculation of the denominator.

Summary of staff recommendations

2. The staff recommend the Board require:
 - (a) entities to calculate adjusted EPS and management performance measures consistently when both are presented in the financial statements;
 - (b) entities to reconcile items excluded from the adjusted EPS with items excluded from the management performance measure when both are presented in the financial statements;
 - (c) entities to present adjusted EPS in the financial statements if:

¹ In this Agenda Paper, the term 'adjusted EPS' refers to adjusted basic EPS and/or adjusted diluted EPS, in which an entity has excluded some items (eg infrequently occurring items) from the numerator of basic EPS and/or diluted EPS defined in IAS 33 *Earnings per Share*.

- (i) the entity presents adjusted EPS outside the financial statements²; and
 - (ii) the adjusted EPS is calculated consistently with the management performance measure presented in the statement(s) of financial performance; and
- (d) entities that present an adjusted EPS to present that adjusted EPS in the primary financial statements, rather than just in the notes, if the management performance measure is presented in the primary financial statements.

Structure of paper

3. This paper is structured as follows:
- (a) background: adjusted EPS and the management performance measure (paragraphs 4–9);
 - (b) current IFRS requirements (paragraph 10);
 - (c) what is the problem? (paragraphs 11–16); and
 - (d) staff analysis (paragraphs 17–38).

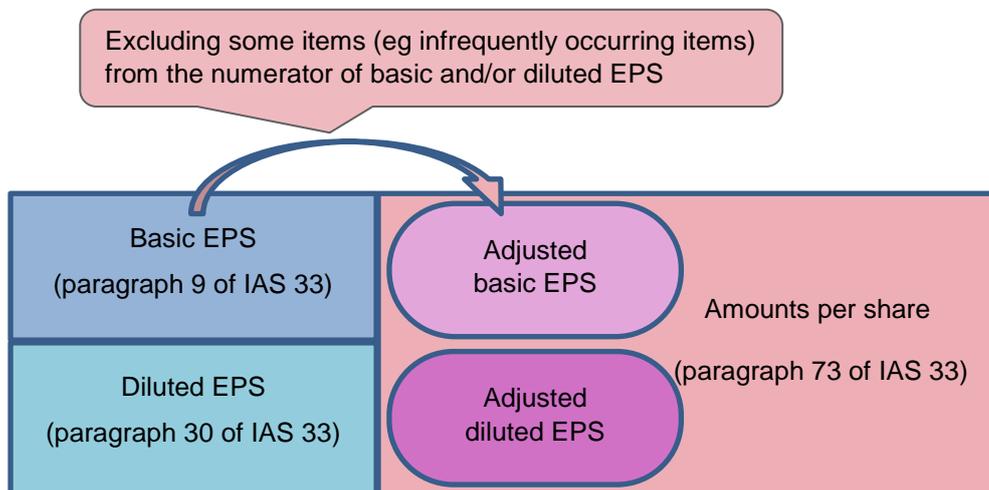
Background

4. IAS 33 *Earnings per Share* requires entities to present basic EPS and diluted EPS in the statement(s) of financial performance. The numerators of basic EPS and diluted EPS are profit or loss attributable to ordinary equity holders of the parent entity. In addition to basic and diluted EPS, paragraph 73 of IAS 33 allows an entity to present amounts per share, using numerators other than those required by IAS 33.
5. Currently, in practice, many entities present one or more management-defined amounts per share either in the financial statements or outside the financial statements, or both. In many cases, entities exclude some items (eg infrequently

² In Agenda Paper 21C, we propose to define ‘outside the financial statements’ as ‘outside the financial statements but within annual report’. Please see further discussion in Agenda Paper 21C.

occurring items) from the numerators of basic EPS and/or diluted EPS to calculate adjusted basic EPS and/or adjusted diluted EPS.

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



6. Preparers use adjusted EPS figures to compare an entity's performance with management's objectives, compare past with current performance or compare an entity with other entities. Such adjusted EPS figures are labelled as adjusted EPS, underlying EPS, core EPS, headline EPS, sustainable EPS or EPS before non-recurring items.
7. Many users rely on these preparers' adjusted EPS as a starting point for their own analysis, but users further adjust preparers' adjusted EPS to make the adjusted EPS suitable for their analysis or to compare it with other entities.
8. In Agenda Paper 21C, the staff propose introducing a management performance measure in the financial statements. When entities calculate the management performance measure, entities exclude some items from EBIT (Earnings before finance income/expenses and tax), to present management's view on performance.

$$\text{Management performance measure} = \text{EBIT} - \text{items excluded}$$

9. An entity may present both adjusted EPS and the management performance measure in its financial statements. The question is whether the exclusion of items should be consistent when calculating the management performance measure and adjusted EPS. This Agenda Paper (paragraphs 18–26) addresses this question.

Current IFRS requirements

10. Paragraph 73 of IAS 33 sets out requirements for entities that choose to disclose amounts per share other than basic and diluted earnings per share:
- (a) if an entity discloses amounts per share using a reported component of the statement of comprehensive income (the statement(s) of financial performance) other than one required by IAS 33, 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 presented in the notes;
 - (c) 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; and
 - (d) 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 reported in the statement of comprehensive income.

What is the problem?

The management performance measure and adjusted EPS may not be consistently calculated and may mislead users

11. Entities could present both the management performance measure and adjusted EPS in financial statements. Agenda Paper 21C proposes some constraints and disclosure requirements for the management performance measure. However, an entity could calculate these performance measures differently and this has the potential to mislead users.

Existing disclosures about adjusted EPS do not provide enough information

12. Some users say that the existing requirements of IAS 33 do not always provide sufficient information about the calculation of adjusted EPS (eg because of lack of information on reasons for the exclusion of items or on the effect of tax and non-controlling interests (NCI) for each item excluded). Many users that we spoke to during outreach expressed some support for exploring improvements to the disclosure of adjusted EPS in IFRS financial statements.
13. 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. 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.

Many entities present adjusted EPS only outside the financial statements and transparency in the items excluded may not be adequate

14. Although IAS 33 permits entities to present adjusted EPS in their financial statements, many entities only present adjusted EPS outside the financial statements. Many users that we spoke to during outreach stated that the adjusted EPS measures reported outside the audited financial statements often are not clearly explained.³ Some users suggested that requiring entities to present a ‘management view’ adjusted EPS in the financial statements would bring transparency to items excluded. Additional transparency about what has been excluded from the adjusted EPS would encourage preparers to be more disciplined about excluding items. In addition, financial statements are audited by an external auditor, which also adds discipline.
15. However, some other users expressed concerns about the presentation of adjusted EPS in financial statements, because they consider adjusted EPS figures to be non-IFRS information that should only be presented outside the financial statements. These users were concerned that including them in the IFRS financial statements (in

³ Refer to paragraph 29 of Agenda Paper 21D in November 2016.

accordance with paragraph 73 of IAS 33) lends spurious legitimacy to the adjusted EPS figures.

Analysis of adjusted EPS in practice

16. We have analysed ten sample entities that presented adjusted EPS in their IFRS financial statements. This analysis is included in Appendix A. Generally, we found:
- (a) entities labelled adjusted EPS differently;
 - (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) most sample entities did not explicitly state the entity's policy for calculating adjusted EPS; instead they merely listed items excluded;
 - (d) all ten entities in the sample presented both adjusted EPS and management performance measure subtotals in the financial statements. In some cases, the entity excluded different amounts from the management performance measure and adjusted EPS. For example, three entities included amortisation of intangible assets when they calculated their management performance measure but excluded the amortisation of intangible assets when they calculated adjusted EPS;
 - (e) in some 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 multiple items excluded; and
 - (f) 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.

Staff analysis

17. We analysed the following questions:
- (a) should the Board require entities to calculate adjusted EPS and management performance measures consistently when both are presented in the financial statements? (paragraphs 18–26);
 - (b) should the Board require, rather than allow, presentation of adjusted EPS in the financial statements if an entity presents adjusted EPS outside the financial statements and the adjusted EPS is calculated consistently with the management performance measure in the statement(s) of financial performance? (paragraphs 27–33); and
 - (c) should the Board require entities that choose to present an adjusted EPS to present that adjusted EPS in the primary financial statements, rather than just in the notes, if the management performance measure is presented in the primary financial statements? (paragraphs 34–38).

Requiring consistent calculation of adjusted EPS and the management performance measure

18. Requiring entities to consistently calculate the adjusted EPS and the management performance measure could encourage some entities to present management-defined EPS only outside the financial statements, which would be a disadvantage.
19. However, requiring the calculation of the adjusted EPS to be consistent with the calculation of the management performance measure has its advantages.
20. An entity would present misleading information if it excluded different items from the management performance measure and the adjusted EPS. For example, if an entity decides to exclude restructuring expense from its adjusted EPS to present its view of performance, users would expect the entity to exclude the same item from the management performance measure that also presents its view of performance.
21. In addition, if the entity excludes the same items from adjusted EPS and the management performance measure, the proposed constraints on the management performance measure (in existing paragraph 85A of IAS 1 *Presentation of Financial*

Statements and staff proposal in Agenda Paper 21C) would also apply to the items excluded from the adjusted EPS as follows:

- (a) items excluded from the numerator of the adjusted EPS should comprise items recognised and measured in accordance with IFRS Standards;
 - (b) items excluded from the numerator of the adjusted EPS should be consistent from period to period; and
 - (c) entities should apply management-defined constraints to the items excluded.
22. Furthermore, the proposed disclosure of items excluded from the management performance measure would enhance the transparency in the adjusted EPS calculation. In Agenda Paper 21C, we recommend adding disclosures about the management performance measure, including:
- (a) a five-year history of the infrequently occurring items excluded;
 - (b) a description of each item excluded; and
 - (c) an explanation of how the items meet management's definition of 'infrequently occurring'.
23. Consequently, we recommend that if an entity presents the management performance measure and adjusted EPS in its financial statements, the Board should require the calculation of that adjusted EPS to be consistent with the calculation of the management performance measure.
24. Even though we propose requiring consistent calculations of the management performance measure and adjusted EPS, there would be some differences between the items excluded in the calculation of the management performance measure and adjusted EPS because of the nature of the EPS calculation as follows:
- (a) items excluded from adjusted EPS can be wider than items excluded from the management performance measure (eg a one-time finance expense can also be excluded); and
 - (b) items excluded from the management performance measure are gross tax and NCI, but items excluded from adjusted EPS are net of tax and NCI.

25. Paragraph 73 of IAS 33 requires an entity to provide a reconciliation between the component used for the numerator and a line item reported in the statement of comprehensive income. However, the reconciliation required in paragraph 73 of IAS 33 does not provide information whether the management performance measure subtotal in the statement(s) of financial performance and adjusted EPS are consistently calculated (ie whether management's adjustments to the management performance measure subtotal and adjusted EPS are the same). Particularly because of the differences noted in paragraph 24, it is often difficult to understand whether an entity's management performance measure and adjusted EPS are consistently calculated.
26. Accordingly, we think that the Board should require an entity to disclose the reconciliation between items excluded from the management performance measure and items excluded from adjusted EPS to clarify the relationship between the excluded items in the management performance measure and adjusted EPS as follows.

Category	Items excluded	Gross	Tax and NCI	Net
Items excluded from the management performance measure	Restructuring expenses	-300	30	-270
	Impairment of goodwill	-200	20	-180
	Impairment of plant	-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)

Requiring the presentation of adjusted EPS in the financial statements, when an entity presents adjusted EPS outside the financial statements

27. Paragraph 73 of IAS 33 only allows, rather than requires, an entity to present their amounts per share in financial statements. The question is whether the Board should require the presentation of adjusted EPS in financial statements.

28. During our outreach, some users expressed concerns about presenting the adjusted EPS in financial statements because they consider adjusted EPS figures to be non-IFRS information.
29. However, some other users suggested requiring a 'management view' EPS within the financial statements because it would bring transparency to the items excluded and discipline to these EPS measures.
30. When the Board discussed the management performance measure at its March 2017 meeting, some Board members expressed the view that the management performance measure should be required, rather than merely allowed in financial statements, when an entity presents such a measure outside the financial statements. In Agenda Paper 21C, the staff recommend requiring the presentation of the management performance measure in the financial statements when an entity presents such a measure outside the financial statements (see Agenda Paper 21C).

Staff view

31. The Board should require entities to present adjusted EPS in the financial statements if:
 - (a) the entity presents adjusted EPS outside the financial statements; and
 - (b) the adjusted EPS is calculated consistently with the management performance measure presented in the statement(s) of financial performance.
32. Requiring the presentation of the adjusted EPS in financial statements achieves greater transparency in the items excluded and discipline around the measure because we propose requiring the calculation of adjusted EPS to be consistent with the calculation of the management performance measure. We think our decision on whether to require the presentation of the adjusted EPS should be consistent with our decision on the management performance measure, because these performance measures are similar in nature and both management-defined.
33. We think the adjusted EPS should be presented in the financial statements, only if the calculation of that adjusted EPS is consistent with the calculation of the management performance measure, if presented. If the entity does not consistently calculate the

adjusted EPS and the management performance measure, presentation in the financial statements would be misleading to the users. In that case, the adjusted EPS should be presented only outside the financial statements.

Requiring the presentation of adjusted EPS in the primary financial statements, rather than just in the notes

34. As discussed in paragraph 10(b) of this paper, IAS 33 requires an entity to present basic and diluted EPS in the primary financial statements but additional amounts per share in the notes to the financial statements. The question is whether the entity should present an adjusted EPS that is consistently calculated with the management performance measure, in the notes or on the primary financial statements.
35. We think that the existing paragraph 73 of IAS 33 requires the amounts per share to be presented in the notes because amounts per share are different from the Board-defined per share measures and could potentially mislead users of financial statements.
36. However, in this Agenda Paper, we propose requiring entities to consistently calculate adjusted EPS and the management performance measure, when entities present adjusted EPS. Because the Board-defined basic and diluted EPS and management performance measure are presented in the statement(s) of financial performance, the adjusted EPS may also be best presented in the primary financial statements, if the measures are clearly labelled as adjusted EPS. By presenting adjusted EPS in the primary financial statements, users will clearly see any differences between the Board-defined EPS and adjusted EPS. In addition, items between the management performance measure and EBIT in the statement(s) of financial performance mostly explain the source of differences between the Board-defined EPS and the adjusted EPS.
37. We think that adjusted EPS in this Agenda Paper is different from other amounts per share that might be disclosed under paragraph 73 of IAS 33, because the adjusted EPS is calculated consistently with the management performance measure and there are disclosures around that measure. Consequently, it is less likely to be misleading than other amounts per share.

Staff view

38. The Board should require entities that present an adjusted EPS in the financial statements to present that adjusted EPS in the primary financial statements, rather than just in the notes, if the management performance measure is presented in the primary financial statements for the reasons stated in paragraphs 36 and 37.

Questions for the Board

1. Does the Board agree with the staff recommendation that the Board should require entities to calculate adjusted EPS and management performance measures consistently when both are presented in the financial statements (paragraphs 18–23)?
2. Does the Board agree with the staff recommendation that the Board should require entities to reconcile items excluded from the adjusted EPS with items excluded from the management performance measure when both are presented in the financial statements (paragraphs 24–26)?
3. Does the Board agree with the staff recommendation that the Board should require entities to present adjusted EPS in the financial statements if:
 - (i) the entity presents adjusted EPS outside the financial statements; and
 - (ii) the adjusted EPS is calculated consistently with the management performance measure presented in the statement(s) of financial performance (paragraphs 27–33)?
4. Does the Board agree with the staff recommendation that the Board should require entities that present an adjusted EPS to present that adjusted EPS in the primary financial statements, rather than just in the notes, if the management performance measure is presented in the primary financial statements (paragraphs 34–38)?

Appendix A— analysis of adjusted EPS in practice

- A1. We have analysed ten sample entities that presented adjusted EPS in their financial statements, in accordance with paragraph 73 of IAS 33. These entities are the largest IFRS reporting entities in their industries in terms of market capitalisation.⁴
- A2. All sample entities calculated adjusted EPS based on their ‘adjusted profit’ (ie excluding some items from their profit). No sample entities presented adjusted EPS 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.
- A3. Different entities labelled adjusted EPS differently (for example, adjusted, underlying, core, before non-recurring). Sample entities’ labelling of the adjusted EPS was as follows:

Entities’ label for adjusted EPS	Number of sample entities
adjusted EPS	4
underlying EPS	3
core EPS	1
headline EPS	1
basic EPS before non-recurring items	1
Total	10

- A4. 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. One entity explicitly stated that their adjusted EPS is used to determine management remuneration.

⁴ Industry was determined by Global Industry Classification Standard (GICS®) industry classification code. GICS® was developed by MSCI and S&P Global. The sample entities belong to Industrial Conglomerates, Multiline Retail, Beverage, Food Products and Tobacco.

Entities' objective of calculating adjusted EPS	Number of sample entities
no specific statement why an entity presents adjusted EPS	9
adjusted EPS is used to determine management remuneration	1
Total	10

- A5. Most sample entities did not explicitly state what the entity's policy for calculating adjusted EPS was. Two entities explicitly stated that their adjusted EPS excluded infrequently occurring items. Other entities simply listed excluded items for that period and it was not clear whether the same items were consistently excluded or based on the same criteria (eg infrequent) over time.

Entities' policy for calculating adjusted EPS	Number of sample entities
not clear (eg an entity simply listed excluded items for that period)	8
explicitly stated adjusted EPS excluded infrequently occurring items	2
Total	10

- A6. In addition to the two entities that explicitly stated that adjusted EPS excluded infrequently occurring items (paragraph A5), three entities appeared to exclude only infrequently occurring items. However, this was not explicitly stated in their financial statements. Another five sample entities excluded infrequently occurring items and amortisation of intangible assets (frequently occurring item). When entities excluded amortisation of intangible assets, the exclusion tended to have a significant effect on adjusted EPS.

Nature of items excluded	Number of sample entities
Entities seemed to exclude infrequently occurring items only	5
Entities seemed to exclude infrequently occurring items and amortisation of intangible assets	5
Total	10

- A7. All ten entities in the sample presented not only adjusted EPS but also the management performance measure (ie excluding some items from their EBIT-type operating profit) subtotal in the financial statements. In some cases, entities' exclusion of items was inconsistent between their management performance measure and adjusted EPS. For example, three entities did not exclude amortisation of intangible assets when they calculated their management performance measure but they excluded the amortisation of intangible assets when they calculated adjusted EPS.

Amortisation of intangible assets	Number of sample entities
both the management performance measure and adjusted EPS did not exclude amortisation of intangible assets	5
the management performance measure did not exclude amortisation of intangible assets but adjusted EPS excluded it	3
both the management performance measure and adjusted EPS excluded amortisation of intangible assets	2
Total	10

- A8. When an entity calculates adjusted EPS, the entity has to exclude the effects of tax and NCI for each adjustment. In some 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 multiple items excluded.

Effects of tax and NCI are aggregated/separately presented for each adjustment	Number of sample entities
effects of tax and NCI are aggregated to all or some items excluded	5
effects of tax and NCI are allocated to each item excluded	4
No tax and NCI effect was presented	1
Total	10

A9. We also analysed which was higher in value: basic EPS or adjusted basic EPS.

Which EPS was higher	Number of sample entities
Adjusted basic EPS was higher than basic EPS	6
Basic EPS was higher than adjusted basic EPS	4
Total	10

A10. Six entities' adjusted basic EPS exceeded basic EPS and their average difference was 32 per cent. Four entities' basic EPS exceeded adjusted basic EPS and their average difference was 5 per cent. In our sample, when adjusted basic EPS exceeded basic EPS, the difference tended to be greater.

A11. We also analysed the use of basic EPS and adjusted basic EPS outside the financial statements. We analysed how the same sample of entities presented basic EPS and adjusted basic EPS in the financial summary section of their annual reports (at the beginning of the annual report that is outside the financial statements).

Whether basic EPS and adjusted basic EPS are presented in financial summary section of annual report (outside the financial statements)	Number of sample entities
Entities presented both basic EPS and adjusted basic EPS in equal prominence in financial summary section of annual report	6
Entities only presented adjusted basic EPS and did not present basic EPS in financial summary section of annual report	3
Entity did not present either basic EPS or adjusted basic EPS in financial summary section of annual report	1
Total	10

A12. Different entities presented the excluded items differently. Some entities presented excluded items in a tabular format. Other entities presented excluded items in narrative format. The level of detail provided in the descriptions for excluded items also varied among different entities.