

## STAFF PAPER

March 2017

## IASB® Meeting

<b>Project</b>	<b>Primary Financial Statements</b>		
<b>Paper topic</b>	Management operating performance measure		
<b>CONTACT(S)</b>	Koichiro Kuramochi	<a href="mailto:kkuramochi@ifrs.org">kkuramochi@ifrs.org</a>	+44 (0)20 7246 6496

This paper has been prepared for discussion at a public meeting of the International Accounting Standards Board (the Board) and does not represent the views of the Board or any individual member of the Board. Comments on the application of IFRS® Standards do not purport to set out acceptable or unacceptable application of IFRS Standards. Technical decisions are made in public and reported in IASB *Update*.

**Purpose of paper**

1. This Agenda Paper discusses whether entities should be permitted to present an operating performance measure in their statement(s) of financial performance and what constraints should be imposed on the presentation of that measure.

**Summary of staff recommendations**

2. In summary, the staff recommend:
  - (a) allowing the presentation of a management operating performance measure, rather than seeking to define operating profit, in the statement(s) of financial performance;
  - (b) allowing items to be excluded from the management operating performance measure as long as the subtotal meets the requirements in existing paragraphs 85, 85A and 85B of IAS 1; and
  - (c) requiring additional disclosures to provide transparency around presentation of the management operating performance measure, including:
    - (i) appropriate labelling of the subtotal;
    - (ii) a requirement to describe and explain the management operating performance measure;

- (iii) a requirement to disclose whether the entity uses the same management operating performance measure outside of the financial statements; and
- (iv) a historical summary of items excluded from the management operating performance measure.

### **Structure of paper**

3. This paper is structured as follows:
- (a) background: operating performance measure (paragraphs 4–6);
  - (b) current IFRS requirements (paragraphs 7–8);
  - (c) what is the problem? (paragraphs 9–16);
  - (d) operating performance measures used in practice (paragraphs 17–24);
  - (e) staff analysis (paragraphs 25–56); and
  - (f) staff recommendations (paragraphs 57–60).

### **Background: operating performance measure**

4. For the purposes of this Agenda Paper, the term ‘performance measure’ refers to any summary financial measure of an entity’s financial performance. The term ‘operating performance measure’ refers to any performance measure that an entity intends to use to present the results of its operations.
5. Currently, many entities present an operating performance measure as a subtotal in the statement(s) of financial performance and/or outside the financial statements. These operating performance measures are labelled in various ways: as, for example, operating profit, core operating profit, underlying operating profit, trading operating profit, or operating profit before non-recurring items. In many cases, operating performance measures are similar to earnings before interest and tax (EBIT) as discussed in Agenda Paper 21A. However, in other cases, entities exclude some items (eg infrequently occurring items) from their operating performance measures.

6. Operating performance measures are commonly used to compare an entity's performance against management's objectives, to past performance or against other entities. Preparers often use such measures when communicating with users of financial statements, in press releases and analyst presentations, and for the purposes of determining management compensation.

### **Current IFRS requirements**

7. IAS 1 *Presentation of Financial Statements* requires an entity to present additional line items, headings and subtotals in the statement(s) presenting profit or loss and other comprehensive income (the statement(s) of financial performance) when such presentation is relevant to an understanding of the entity's financial performance (paragraph 85 of IAS 1).
8. In December 2014, the Board published amendments to IAS 1, which added the following requirements for subtotals presented in accordance with paragraph 85 of IAS 1 (see paragraphs 85A and 85B of IAS 1):
- (a) those subtotals shall:
    - (i) be comprised of line items made up of amounts recognised and measured in accordance with IFRS Standards;
    - (ii) be presented and labelled in a manner that makes the line items that constitute the subtotal clear and understandable;
    - (iii) be consistent from period to period; and
    - (iv) not be displayed with more prominence than the subtotals and totals specifically required in IFRS Standards for that statement.
  - (b) entities must reconcile any additional subtotals in the statement(s) presenting profit or loss and other comprehensive income with the subtotals or totals required in IFRS Standards for that statement.

## What is the problem?

9. Users of financial statements told us that they need information that allows them to assess the persistence or sustainability of an entity's financial performance and management operating performance measures are useful for that purpose. In particular, users think that exclusion of infrequently occurring items is important to them when they forecast future cash flows.
10. Paragraph 85 of IAS 1 requires entities to present subtotals in the statement(s) of financial performance, when such presentation is relevant to an understanding of the entity's financial performance. Presentation of an operating performance measure could be relevant to an understanding of the entity's financial performance. However, entities often present such operating performance measures only outside of the financial statements, eg in the management commentary accompanying the financial statements. These are sometimes called alternative performance measures.<sup>1</sup> Some preparers told us that unless there are clear requirements and sufficient guidance to present management operating performance measures in the statement(s) of financial performance, they are reluctant to present such measures in the statement(s) of financial performance, because regulators may question and challenge them doing so.
11. Some users would prefer management operating performance measures to be presented in the financial statements because the disclosures required by IFRS Standards for such measures would make them more understandable. In addition, an external audit of the measures would increase their credibility<sup>2</sup>.
12. Despite the additional requirements in paragraph 85A and 85B of IAS 1 (see paragraph 8 of this paper), some users expressed concerns about the lack of transparency in practice. They think that more guidance should be provided to achieve greater transparency when entities present such subtotals in the statement(s) of

---

<sup>1</sup> European Securities and Markets Authority (ESMA) Guidelines on Alternative Performance Measures (APMs) in October 2015 states that *'For the purpose of these guidelines an APM is understood as a financial measure of historical or future financial performance, financial position, or cash flows, other than a financial measure defined or specified in the applicable financial reporting framework.'*

<sup>2</sup> In many jurisdictions auditors have duties only to audit information within the boundary of the financial statements, but in some jurisdictions there are additional duties to read other information accompanying the financial statements to determine whether the other information is consistent with the financial statements and not misleading.

financial performance. For example, some users think that the general requirement to reconcile additional subtotals to subtotals or totals required in IFRS Standards is not that helpful because IFRS standards require only a limited number of mandatory subtotals or totals (ie profit or loss, total other comprehensive income, and comprehensive income) in the statement(s) of financial performance.

13. In addition, users expressed concerns about when entities exclude infrequent items because:
  - (a) transactions identified as ‘infrequent’ may occur too frequently for that label to be justified;
  - (b) such classification is sometimes used inconsistently by entities over time and in comparison with other entities; and
  - (c) although expenses are often classified as infrequent, income is rarely classified this way, so such measures tend to present a biased view of an entity’s financial performance.
  
14. Some entities also exclude items that are *not* infrequently occurring items when they present their operating performance measures in the statement(s) of financial performance. For example, some entities exclude share-based payments expense or amortisation expense of intangible assets from their performance measure, perhaps because they do not see such items as a true part of the entity’s performance or perhaps they believe these are items for which they should not be held accountable. Some users question whether excluding such expenses from operating performance measures is useful or relevant.
  
15. The fact that a variety of different performance measures are used and the varying level of transparency provided by entities is currently the subject of widespread interest and debate. Some regional regulators have issued guidance to increase the discipline and transparency on the use of performance measures. Such regulatory guidance could have some effect, directly or indirectly, on IFRS financial statements in that region. For example, the European Securities and Markets Authority (ESMA) issued Guidelines on Alternative Performance Measures (the ESMA Guidelines) in October 2015. Although the ESMA Guidelines explicitly state that they do not apply

to alternative performance measures disclosed in financial statements,<sup>3</sup> recently published Q&A clarified that the ESMA Guidelines apply to alternative performance measures that are simultaneously presented inside and outside of the financial statements.<sup>4</sup>

16. Although these regulatory guidelines should help to enhance the discipline and transparency around the presentation of performance measures, it may also create an imbalance between the jurisdictions with such guidelines and those without such guidelines.

### **Operating performance measures used in practice**

17. We researched how operating performance measures are used in practice.
- (a) analysis of financial statement presentation (paragraphs 18–23); and
  - (b) data aggregators (paragraph 24).

### ***Analysis of financial statement presentation***

18. We have analysed the financial statements of 25 entities that report in accordance with IFRS Standards.<sup>5</sup> Of the 25 entities analysed, 12 entities presented management operating performance measures (eg excluding non-recurring or non-core items from the EBIT-type operating profit subtotal) in the statement(s) of financial performance. Among the 12 entities, 9 entities presented management operating performance measure subtotal(s) in addition to the EBIT-type operating profit subtotal (ie they presented more than one operating profit-type subtotals). The other 3 entities presented management operating performance measures only.
19. Different entities presented their management operating performance measure differently. Some (not all) entities included in our sample stated in their policy that

---

<sup>3</sup> Paragraph 4 of the ESMA Guidelines state that ‘By way of derogation from the aforementioned paragraph these guidelines do not apply to APMs disclosed in financial statements as defined in section II of these guidelines.’

<sup>4</sup> Page 7 of Questions and answers ESMA Guidelines on Alternative Performance Measures (APMs) published in January 2017.

<sup>5</sup> Refer to paragraphs 37–47 of Agenda Paper 21A in November 2016.

they excluded items of the following nature when they calculated management operating performance measure (some entities excluded more than one category):

Entity's policy for excluding items from the management operating performance measure	Number of sample entities
(a) non-recurring income/expense (frequency)	7
(b) non-core income/expense (nature)	1
(c) items beyond the control of management (control)	1
(d) effects of fair value measurement (fair value)	2

20. Entities excluded the following types of income and expense when calculating management operating performance measure in the statement(s) of financial performance:

Items excluded when calculating management operating performance measure	Number of sample entities
disposal of business	7
restructuring	5
impairment of goodwill	5
acquisition related cost in business combination	3
impairment (underlying asset is not clear)	2
disposal of property, plant and equipment	2
disposal of equity investment	2
amortisation expense of intangible assets*	1
reversal of impairment (underlying asset is unknown)	1
change in fair value of investment properties	1
change in fair value of plantation	1
change in fair value of derivative asset	1
hyperinflation	1
share-based payments expense*	1
others	3
total number of entities	12

\*we have further discussions in paragraphs 45–50.

21. Some entities stated their general policy for the items that they exclude, regardless of whether such an item arose in that financial period. However, many entities presented information only about items which they excluded from the management operating performance measure in the current financial period. Thus, it was not necessarily clear whether an entity did not exclude a particular item because:

- (a) the item did not occur (eg no restructuring occurred); or
  - (b) the item occurred but the entity did not exclude it (eg management did not exclude restructuring expense from the management operating performance measure).
22. In some cases, descriptions of excluded items are broad and entities aggregated items with different natures. In addition, some entities describe items as ‘other’ and do not describe the items included.
23. Different entities presented excluded items differently. Some entities presented excluded items in a tabular format that makes clear whether the same items were excluded in previous years. Other entities presented excluded items in narrative format. The level of detail provided in the descriptions for excluded items was also different among different entities.

***Data aggregators***

24. We analysed how some data aggregators calculate and use operating performance measures. These data aggregators presented at least two sets of statement(s) of financial performance as follows:
- (a) As reported format: data aggregators mimic the entity’s reported statement(s) of financial performance. When an entity excludes some items (eg infrequent items) from the operating performance measure, the data aggregators exclude the same items.
  - (b) As adjusted format: data aggregators also present a statement(s) of financial performance that is reformatted to their standardised model or format. In order to present an operating performance measure, data aggregators classify items excluded from the operating performance measure according to their predetermined list of ‘abnormal’ items. Entities name and categorise adjustments differently, but the data aggregators standardise the name and categorisation of the adjustments.<sup>6</sup> Examples:

---

<sup>6</sup> A data aggregator’s classification of adjustments is in **Appendix A** of this paper.

- (i) entity A labels a type of restructuring expense as an integration cost, but a data aggregator might rename it as a restructuring expense.
- (ii) entity B presents restructuring expenses and merger expenses together, but a data aggregator might want to separate these two items when disaggregated information is available, even if it is from outside of the financial statements.

### **Staff analysis**

25. In the light of the problems identified and practice observed, we analysed the following questions:

- (a) should the Board define an operating performance measure or allow management to present their own operating performance measure? (paragraphs 26–35);
- (b) what should be the constraints on the presentation of a management operating performance measure? (paragraphs 36–50); and
- (c) how can transparency of management operating performance measures be improved? (paragraphs 51–56).

### ***Should the Board define an operating performance measure or allow management to present their own operating performance measure?***

26. During our outreach, many stakeholders supported introducing the concept of an operating performance measure in the statement(s) of financial performance. We think there are two broad approaches to introducing such an operating performance measure:

- (a) defining in IFRS Standards the operating performance measure to be presented (paragraphs 27–29); or
- (b) allowing management to define their own operating performance measure (paragraphs 30–35).

*Defining in IFRS Standards the operating performance measure to be presented*

27. The Board could require the presentation of an operating performance measure (ie operating profit) subtotal and prescribe in a Standard what is included and excluded in arriving at that subtotal. There are advantages to the Board defining the operating performance measure to be presented by entities. Such an operating performance measure would be highly comparable across entities, which would help users of financial statements perform screening or ratio analysis. In addition, the operating performance measure would become widely understood because it would have standard definition. Defining an operating performance measure in IFRS Standards would also help to prevent preparers from providing potentially misleading information about their financial performance (for example it would prevent preparers from excluding expenses but including related income in their measure of performance).
28. Despite the benefits discussed in paragraph 27, defining an operating performance measure would also involve significant challenges. Previous standard-setting initiatives have tried various approaches to define operating activities or operating profit but they were not successful. One of the major challenges was to define a performance measure that is applicable to entities in all industries. In October 2008 the IASB and US Financial Accounting Standards Board (FASB) published the Discussion Paper *Preliminary Views on Financial Statement Presentation* and proposed to define operating activities as ‘...primary revenue and expense-generating activities’. However, many respondents to the Discussion Paper indicated that the proposed definition was too broad and should be more specific.
29. In addition, entities often use their own performance measures for good reasons, for example, to communicate progress toward managements’ business objective or strategy. Hence, even if an operating performance measure is defined in IFRS Standards and presented in the statement(s) of financial performance, it is likely that entities will further adjust the measure outside of the financial statements and use that adjusted figure in communication with users of financial statements, thereby undermining the usefulness of the performance measure included in the financial statements.

*Allowing management to define their own operating performance measure*

30. Alternatively, we could allow management to define their own operating performance measure in the statement(s) of financial performance. This approach would allow an entity to tell its own story. Many entities already present their operating performance measures in the statement(s) of financial performance in accordance with paragraph 85 of IAS 1 and our research has shown that users find such measures useful.
31. We think that we should *allow*, rather than *require*, entities to present management operating performance measures, because some entities do not use these management operating performance measure even outside of the financial statements.
32. The important information for users is arguably the difference between a comparable IFRS standardised measure (anchor) and management operating performance measure. As we discussed in Agenda Paper 21 and 21A, we recommend introducing an EBIT subtotal. The staff think that the combination of the EBIT subtotal and a management operating performance measure could provide the following benefits to users:
  - (a) The EBIT subtotal will provide a comparable starting point among different entities and can be used for screening or ratio analysis.
  - (b) Management operating performance measures, by contrast, would provide a measure management uses to assess its progress toward its objective or indicate the key drivers of its performance.
  - (c) Items in-between the management operating performance measure and EBIT would provide transparency about which items are excluded from management operating performance measures compared with EBIT. This information helps users to understand how management operating performance measures are different across different entities and allows users to reconcile those different performance measures. In addition, transparency about the items excluded from management operating performance measure could help users assess whether reported earnings are persistent.
33. There are nevertheless downsides to allowing management to define their own operating performance measure. The operating performance measure used would be

different, even among entities in the same industry thereby reducing comparability. In addition, there is a risk of misleading performance measures being included in IFRS financial statements, which might negatively affect stakeholders' confidence in IFRS financial statements. Sophisticated users may also, at least to some extent, ignore management measures because they use their own "model" adjusted performance measures.

34. Nonetheless, most users of financial statements agree that entities should be allowed some flexibility in presenting performance measures provided that they are not misleading and are a faithful representation of the entity's performance. Some users also think that a management performance measure can be useful in assessing management's stewardship of the entity's resources particularly when such performance measures are linked to the entity's objectives or strategy.
35. However, if we take this approach, we should carefully consider whether there should be the constraints attached to the presentation of the management operating performance measure in the statement(s) of financial performance. The following section discusses the need for constraints on the presentation of a management operating performance measure.

***What should be the constraints on the presentation of a management operating performance measure?***

36. As discussed in paragraph 8 of this paper, the Board amended IAS 1 in 2014 to add requirements when presenting subtotals in accordance with paragraph 85 of IAS 1 (paragraphs 85A and 85B of IAS 1):
  - (a) those subtotals shall:
    - (i) be comprised of line items made up of amounts recognised and measured in accordance with IFRS Standards;
    - (ii) be presented and labelled in a manner that makes the line items that constitute the subtotal clear and understandable;
    - (iii) be consistent from period to period; and

- (iv) not be displayed with more prominence than the subtotals and totals specifically required in IFRS Standards for that statement.
  - (b) entities must reconcile any additional subtotals in the statement(s) presenting profit or loss and other comprehensive income with the subtotals or totals required in IFRS Standards for that statement.
37. These paragraphs already put some constraints on when entities present management operating performance measures in the statement(s) of financial performance. We think that these constraints are helpful for users and should be kept.
38. In particular, paragraph 85A(a) of IAS 1 requires an entity to present subtotals that consist of line items made up of amounts recognised and measured in accordance with IFRS Standards. This paragraph would, for example, prohibit the following types of management performance measures from being presented in the statement(s) of financial performance because they are not recognised and measured in accordance with IFRS Standards:
- (a) performance measures that exclude the effect of changes in currency exchange rates, sometimes called constant currency reporting.
  - (b) performance measures that include the effects of pensions plans measured on a basis different from that required by IAS 19 *Employee Benefits*. For example, an entity provides information about pension plans based on how the local pensions regulator computes the entity's pension obligation.
39. We acknowledge that this constraint may result in entities presenting their own performance measures outside the financial statements, potentially undermining the usefulness of the performance measure included in the financial statements. Nonetheless, the staff think that financial measures recognised or measured on a different basis from IFRS Standards should not be included in the statement(s) of financial performance, because these measures could be extremely misleading to users, particularly if they affect several lines in the statement(s) of financial performance.
40. The question is whether additional constraints should be imposed to supplement the existing constraints discussed in paragraph 36–39. In accordance with the *Conceptual*

*Framework*, if financial information is to be useful, it must be relevant and faithfully represent what it purports to represent (QC4). Paragraphs 41–50 discuss whether excluding the following items from management’s operating performance measure could result in useful information:

- (a) infrequently occurring items (paragraphs 41–44); and
- (b) frequently occurring items (paragraphs 45–50).

*Excluding infrequently occurring items*

41. From our analysis of a sample of financial statements of 25 entities (see paragraph 18), we observed that entities’ operating performance measures often exclude infrequently occurring items. Users of financial statements have told the Board that information about infrequently occurring items is important because it helps them in making forecasts about future cash flows. Accordingly, we think excluding infrequently occurring items or providing information that enables users to exclude infrequently occurring items is relevant to an understanding of the entity’s financial performance.
42. However, the question is whether a management operating performance measure that excludes infrequently occurring items would faithfully represent an entity’s financial performance. We acknowledge that some users of financial statements raised concerns about how some entities exclude infrequently occurring items as discussed in paragraph 13 of this paper, on the grounds that the items are described as infrequently occurring but actually recur quite frequently. The meaning of ‘infrequently occurring’ was discussed by the Board in its previous Financial Statement Presentation project.<sup>7</sup> More recently, this term was also discussed in regulatory guidelines produced by ESMA.<sup>8</sup> We note that the Discussion Paper on *Principles of Disclosure* will seek

---

<sup>7</sup> The description of the term ‘infrequently occurring’ on paragraph 42 of this paper is from a draft Standard, prepared by IASB staff with the US Financial Accounting Standards Board (FASB) staff, which was published on the IFRS Foundation website in July 2010 for outreach.

<sup>8</sup> The ESMA Guidelines for Alternative Performance Measures state that ‘items that affected past periods and will affect future periods will rarely be considered as non-recurring, infrequent or unusual (such as restructuring costs or impairment losses).’

feedback from stakeholders on the use of the term infrequently occurring and the following definition:

Infrequently occurring: Not reasonably expected to recur in the foreseeable future given the environment in which an entity operates.

43. We will consider the feedback that will be received on the Discussion Paper on *Principles of Disclosure* in this project. However, it may prove difficult to define non-recurring, unusual or infrequently occurring items<sup>9</sup> as stakeholders have different views regarding which items fall into these categories. If it is difficult to define non-recurring, unusual or infrequently occurring items, it will be difficult to restrict entities from labelling items as infrequent or unusual and excluding these items from management operating performance measure.
44. Some users of financial statements told us that enhancing transparency about the entity's historical record of infrequently occurring items is more important than defining what is infrequently occurring. Disclosures about what has been classified as infrequently occurring enables users to make their own judgement about whether the items are appropriately classified. We agree that requiring additional disclosure would help to ensure that the management operating performance measure is understandable to users of financial statements. Paragraphs 55–56 of this paper discuss additional disclosures designed to enhance the transparency of adjustments made to the management operating performance measure.

*Excluding frequently occurring items*

45. In our analysis of financial statements, we have observed that, in addition to excluding infrequently occurring items from performance measures, entities also exclude some types of frequently occurring items (for example, amortisation of intangible assets, share based payment expenses and fair value gains and losses). A recently published report by Morgan Stanley (the Morgan Stanley report)<sup>10</sup> observed an increase in the number of entities excluding what it described as non-traditional items (ie frequently occurring expenses) from performance measures.

---

<sup>9</sup> The Discussion Paper on *Principles of Disclosure* also seeks feedback on the use of the term 'unusual' and whether the Board should prohibit use of other terms to describe unusual and infrequently occurring items, for example non-recurring items.

<sup>10</sup> Morgan Stanley, 'The GAAP Gap—Does It Matter?' (2016)

46. It is more difficult to justify excluding frequently occurring items from a performance measure than it is to justify excluding infrequently occurring items. Excluding such items does not necessarily provide useful information about persistence of earnings. In addition, such items can be viewed as part of an entity’s ongoing activities and hence performance. Indeed survey results in a recently-published report by the CFA Institute (the CFA Institute report)<sup>11</sup> showed that many users consider that excluding share-based payments expense is usually inappropriate, regardless of whether it arises from a cash-settled or equity-settled scheme.
47. However, if entities were to be prohibited from excluding particular types of frequently occurring income or expense from management operating performance measure, it is very likely that management will seek to present their own performance measure outside of the financial statements so as to, in their view, better reflect their performance. This would be likely to result in entities either choosing not to present a management operating performance measure in the financial statements or viewing the performance measure in the financial statements as a compliance exercise.
48. We would like to emphasise that, even when management excludes some items from their management operating performance measure, that item would continue to be reflected in the statement(s) of financial performance. For example, if share-based payment expense is excluded from the management operating performance measure, that expense would still be reflected in the EBIT subtotal, profit and equity of the entity. If we make sure that the management operating performance measure is clearly labelled as a management-defined measure and the difference between the management operating performance measure and EBIT is clearly presented, the information could provide additional insight to the entity’s financial performance.
49. On balance, we think that allowing management to exclude frequently occurring items from management operating performance measure would provide more relevant information, than prohibiting the exclusion of such items.
50. However, we think it is important that, if entities are given the flexibility to decide what to exclude from the management operating profit measure, there should be

---

<sup>11</sup> CFA Institute, ‘Investor uses, expectations, and concerns on non-GAAP financial measures’ (2016)

adequate disclosure of what is excluded. The following section discusses those disclosures.

***How can transparency of management operating performance measures be improved?***

51. If we allow entities to present a management operating performance measure, it is important to ensure that it would not mislead users. This could be achieved by requiring sufficient transparency around the management operating performance measure. We think that additional transparency could be achieved by:
- (a) appropriate labelling of the subtotal (paragraph 52);
  - (b) a description and explanation of the management operating performance measure (paragraph 53);
  - (c) requiring disclosure of whether the entity uses the same management operating performance measure outside of the financial statements (paragraph 54); and
  - (d) an historical summary of items excluded from the management operating performance measure (paragraphs 55–56).

*Appropriate labelling of the subtotal*

52. We consider that the label of the subtotal should clearly communicate the meaning of the subtotal to users of financial statements. A management operating performance measure is an entity-specific performance measure. Hence the label used to describe the measure should indicate that the subtotal may not be comparable with those of other entities and may exclude items that users may not agree with. We tentatively think the subtotal should be called ‘management operating performance measure’. If the same label is used for the subtotal by different entities, it will be more understandable by users.

*Description and explanation of the management operating performance measure*

53. In our review of financial statements, we noted that many entities did not adequately describe their performance measures or explain why they believe the measure used

appropriately reflects their performance. We think that a clear description of the performance measure, including an explanation of why any items have been excluded from the management operating performance measure, and an explanation of why management believe it reflects their performance should enable users to determine whether the performance measure is relevant and faithfully represents the entity's financial performance.

*Requiring disclosure of whether the entity uses the same management operating performance measure outside of the financial statements*

54. It would be beneficial for users to know whether the entity uses the same management operating performance measure in the statement(s) of financial performance and outside of the financial statements (eg in the management commentary, analyst presentations or press releases). This would enable users of financial statements to discuss with management why the performance measures used are different and the reasons for those differences.

*Historical summary of items excluded from the management operating performance measure*

55. We think that an historical summary of items excluded from the management operating performance measure (ie items in-between management operating performance measure and the EBIT subtotal) would provide useful information to users of financial statements. Such a summary would allow users to:
- (a) understand the persistence or sustainability of an entity's financial performance over time through an analysis of items that are excluded from operating profit because they occur infrequently;
  - (b) make their own adjustments if they disagree with items excluded from the management operating profit measure (eg share-based payments expense).
56. During our outreach users told us that they would like any historical summary of items excluded from the management operating performance measure to cover a period longer than the usual two or three years. A five-year summary was suggested by some users. In addition, users stated that they would like the summary to be

comparable over time. Hence, when an entity changes its approach to the management performance measures, prior periods would need to be updated.

### **Staff recommendations**

57. The staff recommend allowing the presentation of a management operating performance measure, rather than seeking to define operating profit. As discussed in Agenda Paper 21A, we separately recommend introducing a comparable subtotal of EBIT.
58. The staff do not recommend defining the operating performance measure; rather we recommend that management should be permitted to define their own operating performance measure. An operating performance measure defined by the Board would be comparable between entities. However, it is likely that management would further adjust that measure to present their own view of performance outside the financial statements. In that case, the presentation of the Board-defined operating performance measure would merely be a compliance exercise and may not provide meaningful information to users of financial statements. We instead recommend the presentation of an EBIT subtotal to provide a comparable starting point for users' analysis of financial statements (see Agenda Paper 21A).
59. The staff also recommend allowing any item to be excluded from the management performance measure as long as the subtotal meets the requirements in existing paragraph 85, 85A and 85B of IAS 1 (as discussed in paragraphs 7–8 of this paper). The staff considered whether additional constraints should be imposed (eg only allowing exclusion of infrequently occurring items). However, as discussed in paragraphs 36–50, we think it would be difficult to define what could be excluded. In addition, if constraints are put on what can be excluded it is likely that management would continue to provide their own measures of operating performance outside the financial statements.
60. However, we acknowledge that the presentation of management operating performance measure could be misleading. The measure is entity specific and the measure may exclude items which users think should be included in operating performance. Consequently, the staff think that to provide transparency about the

calculation and presentation of the management operating performance measure, the following should be considered:

- (a) appropriate labelling of the subtotal so that it clearly states that it is a management measure of performance;
- (b) a requirement to describe and explain the management operating performance measure;
- (c) a requirement to disclose whether the entity uses the same management operating performance measure outside of the financial statements when communicating the entity's performance; and
- (d) a historical summary of items excluded from the management operating performance measure.

**Question for the Board**

Does the Board agree with the staff recommendations in paragraphs 57–60?

## Appendix A—An example of a data aggregator’s classification of adjustments

A1. When entities present performance measures, entities make a range of adjustments. Entities may label similar adjustments differently and that hinders comparability of performance measures presented by different entities. A data aggregator determines common adjustments made by entities and presents entities’ adjustments using, for example, the following classifications:

- Acquired In-Process R&D
- Merger Expense
- Restructuring Expense
- Asset Write-Downs
- Impairment of Goodwill
- Impairment of Intangibles
- Gain/Loss on Sale of Business
- Gain/Loss of Sale of Assets
- Gain/Loss on Sale of Investments
- Gain/Loss on Unrealised Investments
- Early Extinguishment of Debt
- Debt Valuation Adjustment
- Credit Valuation Adjustment
- Insurance Settlement
- Legal Settlement
- Abnormal Derivatives Gain/Loss