

STAFF PAPER

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Project	Primary Financial Statements		
Paper topic	Unusual items		
CONTACT(S)	Yuki Fujiwara	yfujiwara@ifrs.org	+44 (0) 20 7246 6410
	Aida Vatrenjak	avatrenjak@ifrs.org	+44 (0) 20 7246 6456

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Purpose of this paper

1. At its September 2018 meeting, the Board directed the staff to develop principle-based guidance to help entities identify unusual or infrequent items.
2. This paper seeks the Board's views on a proposed definition of unusual items and guidance to accompany that definition. This paper also discusses disclosure requirements relating to unusual items.

Summary of staff recommendations

3. The staff recommend that the Board:
 - (a) define unusual items as follows:

Unusual items are income or expenses with limited predictive value because it is reasonable to expect that similar items will not arise for several future annual reporting periods.

Similar items are income or expenses that are similar in type and amount.
 - (b) provide the following additional guidance on the assessment of unusual items:
 - (i) information provided about unusual items should be neutral;

- (ii) considering the past occurrence of similar items may help entities assess whether it is reasonable to expect that similar items will arise in the future; and
 - (iii) gains or losses arising from the remeasurement of items required to be measured at current value (including fair value) should not, in general, be classified as unusual items.
- (c) require all entities to attribute unusual expenses to natural expense categories, regardless of their method of analysis of expenses in the statement(s) of financial performance.
 - (d) require all entities to provide a narrative description of the transactions or other events that gave rise to unusual items.
 - (e) not require entities to disclose income or expenses related to unusual items (unless those income or expenses themselves meet the definition of unusual items).

Structure of paper

- 4. This paper is structured as follows:
 - (a) Background (paragraphs 5–8)
 - (b) Definition of unusual items (paragraphs 9–26)
 - (c) Additional guidance (paragraphs 27–36)
 - (d) Should there be additional information disclosed relating to unusual items? (paragraphs 37–46)
 - (e) Appendix A—Example disclosures of unusual items

Background

- 5. At its September 2018 meeting the Board discussed unusual or infrequent items and tentatively decided to:
 - (a) require separate disclosure of information about unusual or infrequent items of income or expense regardless of whether an entity chooses to disclose a management performance measure;

- (b) require separate disclosure of unusual or infrequent items in the notes to the financial statements and require that those items be attributed to line items in the statement(s) of financial performance; and
 - (c) develop principle-based guidance to help entities identify unusual or infrequent items.
6. However, some Board members raised concerns about requiring disclosures without defining unusual or infrequent items and commented that they would like to see a definition before we go further.
7. [Agenda paper 21C](#) from the September 2018 Board meeting analysed the guidance issued by some standard-setters and regulators and identified three attributes that could be used as a basis for developing principle-based guidance:¹
- (a) unusual in nature because the item is unrelated to the entity’s ordinary business activities;
 - (b) infrequent (ie whether similar items will recur in or continue into the future); and
 - (c) unusual in size (ie amount).
8. AP21C also provided analysis of feedback from stakeholders on this topic:
- (a) feedback received on the Board’s preliminary view on unusual and infrequent items included in the [Disclosure Initiative—Principles of Disclosure Discussion Paper](#) published in March 2017. Most users supported the Board developing requirements for the presentation of unusual and infrequently occurring items. However, many of the non-user respondents as well as a few users suggested that it would be difficult for the Board to define unusual and infrequent items.
 - (b) feedback from Capital Markets Advisory Committee members and Global Preparers Forum members at their joint meeting in June 2018. They suggested that the Board should provide principle-based guidance on what items are expected to be disclosed separately, and/or allow entities to develop their own definitions of unusual or infrequent items,

¹ Paragraph 58 in AP21C.

requiring entities to provide sufficient disclosures to enable users to understand the basis for classifying items as unusual or infrequent.

Definition of unusual items

9. The staff propose to define unusual items as follows:

Unusual items are income or expenses with limited predictive value because it is reasonable to expect that similar items will not arise for several future annual reporting periods.

Similar items are income or expenses that are similar in type and amount.

10. The proposed definition means:

- (a) income or expenses can only be classified as unusual if they have limited predictive value;
- (b) income or expenses can be classified as unusual items even if it is not *certain* that similar items will not arise for several future annual reporting periods; and
- (c) income or expenses cannot be classified as unusual items if, for example:
 - (i) it is reasonable to expect that similar items will arise; or
 - (ii) an entity cannot develop any reasonable expectation regarding whether similar items will arise (for example, because of a high level of uncertainty associated with such items).

11. The following paragraphs discuss:

- (a) the relationship between the proposed definition and the previously identified attributes of unusual/infrequent items (paragraphs 12–13);
- (b) the focus on predictive value (paragraphs 14–18);
- (c) considering the underlying transactions or other events when assessing ‘similar in type’ (paragraphs 19–21);
- (d) the period over which an entity should assess whether a similar item will arise (paragraphs 22–24); and

- (e) use of the term ‘reasonable to expect’ (paragraphs 25–26).

The relationship between the proposed definition and the previously identified attributes of unusual/infrequent items

12. In this paper, we use the term ‘unusual items’ for what we previously called ‘unusual or infrequent items’. This is because we have concluded that items that occur infrequently can be described as ‘unusual’. Hence, we are proposing a definition of unusual items that would include infrequent items.
13. The relationship between the proposed definition and the three possible attributes of unusual items we identified in the September 2018 Board meeting (see paragraph 7) is as follows:
- (a) unusual in amount—this attribute is captured by defining ‘similar items’ as income or expenses that are similar in type and *amount*. Items that are unusual in amount (eg very large litigation costs) would be assessed as unusual items under the proposed definition, if it is reasonable to expect that items of a similar type and amount (eg very large litigation costs) will not arise for several future annual reporting periods. The fact that an entity may expect normal periodic litigation costs (ie items of a similar type) to arise in future periods would not prevent an entity from classifying items such as very large litigation costs as unusual as long as those future costs are not expected to be of a similar amount.
- (b) unusual in frequency—this attribute is captured in the proposed definition by saying that it is reasonable to expect that similar items *will not arise for several future annual reporting periods*. Items that are unusual in frequency (eg a fine from a regulator for non-compliance with a regulation) would be assessed as unusual items under the proposed definition, if it is reasonable to expect that such items (of any amount) will not arise for several future annual reporting periods.
- (c) unusual in nature—this attribute is indirectly captured by defining ‘similar items’ as income or expenses that are similar in *type* and amount. As discussed in paragraphs 19–21, when assessing whether an item of income or expense is similar, it may be helpful to consider the

nature of the transactions or other events that gave rise to the income or expense.

Focus on predictive value

14. Users have told us that they find information about non-recurring, unusual and/or infrequent items useful in assessing the persistence or sustainability of an entity's financial performance. In academic literature, 'persistence' or 'sustainability' is linked to the following notions:
- (a) the extent to which reported earnings will persist or continue into the future. Analysts are interested in the sustainable component of earnings because investors tend to attribute a lower valuation for earnings that are not sustainable.²
 - (b) whether an item can be used to predict future values of similar items. Researchers have found that some 'special items' (eg restructuring charges, merger costs, impairment and write-offs) have 'zero' persistence (ie they are transitory) in terms of predicting future values of similar items.³
15. The *Conceptual Framework for Financial Reporting* states:
- 2.6 Relevant financial information is capable of making a difference in the decisions made by users. ...
 - 2.7 Financial information is capable of making a difference in decisions if it has predictive value, confirmatory value or both.
 - 2.8 Financial information has predictive value if it can be used as an input to processes employed by users to predict future outcomes. ... Financial information with predictive value is employed by users in making their own predictions.
16. The proposed definition defines unusual items as income or expenses with limited predictive value. We think that defining unusual items in this way will:

² Stephen H. Penman, 'Sustainable Earnings and P/E Ratios with Financial Statement Analysis', 2006.

³ D. Jones and K. Smith, 'Comparing the Value Relevance, Predictive Value, and Persistence of Other Comprehensive Income and Special Items', *The Accounting Review*, Vol. 86, No 6, 2011, pp.2047–2073.

- (a) address users' need for information regarding items that are unlikely to persist and hence have limited predictive value (see paragraph 14); and
- (b) help preparers identify unusual items by providing them with a concept that underpins the need to identify unusual items.

17. The staff suggest using the term 'limited predictive value' rather than 'no predictive value', because very few income or expenses recognised in the financial statements could be said to have no predictive value.
18. The proposed definition focuses on income or expenses rather than the transactions or other events that gave rise to those income or expenses. This is because it is the information provided in the financial statements (income or expenses), not the transactions or other events, that has predictive value. However, as discussed in paragraphs 19–21, considering the underlying transactions or other events may help preparers identify unusual items.

Considering the underlying transactions or other events when assessing 'similar in type'

19. When assessing similar items, it may be helpful to consider the nature and frequency of transactions or other events that gave rise to the income or expenses. For example, an entity might assess that:
- (a) it is reasonable to expect that income or expenses (eg impairment losses) arising from transactions or other events that are unusual in nature and/or in frequency (eg a big earthquake) will not arise for several future annual reporting periods and should be classified as unusual items; but
 - (b) it is not reasonable to expect that income or expenses (eg impairment losses) arising from transactions or other events that are usual in nature and/or in frequency (eg a drop in product prices) will not arise for several future annual reporting periods and should not be classified as unusual items.
20. However, although in many cases, unusual items result from transactions or other events that are unusual in nature and/or in frequency, this is not always the case. Transactions or other events that are unusual in nature and/or in frequency can

give rise to 'usual' income or expenses. For example, a large earthquake may give rise to increased costs that are expected to arise for a number of years.

21. Consequently, the staff have not included a reference to unusual transactions or other events in the definition of unusual items. However, the staff recommend explaining in guidance accompanying the definition that it may be helpful to consider the nature and frequency of the transactions or other events giving rise to the income or expenses when assessing whether an item is unusual.

Period over which an entity should assess whether a similar item will arise

22. The proposed definition requires an entity to assess whether it is reasonable to expect that similar items will not arise *for several future annual reporting periods*. The staff proposed the term 'several future annual reporting periods' because:
- (a) items that are reasonably expected to arise in the next few annual reporting periods are unlikely to have limited predictive value (ie they are unlikely to be unusual).
 - (b) stating that a similar item is not expected to arise in the future, without indicating a period over which the entity should make that assessment, could be interpreted as meaning the entity must consider all possible future reporting periods. Considering all possible future reporting periods would be impractical and would be likely to result in few items being treated as unusual.
 - (c) specifying the period over which an entity should consider whether a similar item will arise (for example stating that the entity should reasonably expect that the item will not arise in the next five years) would be arbitrary and may not lead to the identification of all items that have limited predictive value.
23. The staff considered, but rejected, requiring entities to assess whether a similar item will arise *in the foreseeable future*. Some stakeholders interpret the foreseeable future as being virtually all possible future reporting periods. As discussed in the previous paragraph, we do not think this interpretation would work for the definition of unusual items. In addition, stakeholders raised concerns about the term when the Board considered using the term 'foreseeable future' in

IFRS 9 *Financial Instruments* suggesting that it would be unlikely to result in consistent application.⁴

24. We acknowledge that ‘several future annual reporting periods’ is imprecise and will require entities to exercise judgement when deciding the period over which to assess whether a similar item will arise. However, we think this phrase should help preparers appropriately identify items that have limited predictive value.

Use of the term ‘reasonable to expect’

25. The proposed definition requires entities to assess if it is *reasonable to expect* that similar items will not arise for several future annual reporting periods. Some Standards use the term ‘reasonably be expected’ or ‘reasonable expectation’. For example the term is used:
- (a) in the definition of material (paragraph 7 of IAS 1 *Presentation of Financial Statements* as amended in October 2018);
 - (b) in deciding whether a write-off of a financial asset should occur (paragraph 5.4.4 of IFRS 9); and
 - (c) in guidance to help entities determine the measurement of a provision (paragraph 49 of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*).
26. These Standards do not provide guidance on what is meant by ‘reasonably be expected’ or ‘reasonable expectation’. Consequently, the staff do not think it is necessary to develop guidance on the term ‘reasonable to expect’.

Question 1

Does the Board agree with the staff recommendation that the Board define unusual items as follows?

Unusual items are income or expenses with limited predictive value because it is reasonable to expect that similar items will not arise for several future annual reporting periods.

⁴ See paragraphs BC5.100 and BC5.208–BC5.209 in the Basis for Conclusions on IFRS 9.

Similar items are income or expenses that are similar in type and amount.

Additional guidance

Neutrality

27. The proposed definition of unusual items states that unusual items are income *or* expenses with limited predictive value. In other words, unusual items could be items with a positive effect on the entity's financial performance (income) or a negative effect (expenses). However, some research shows that it is more common for entities to identify expenses as unusual than it is for them to identify income as unusual. For example, Standard & Poor's has found that entities generally identify adjusting items that boost their measures of performance more often than items that decrease them.⁵ Research by Curtis et al. finds that approximately one-half of firms with one-time gains do not exclude the gains from their adjusted performance measures.⁶
28. Users have expressed concerns about perceived bias in identifying unusual items. For example, a CFA member survey found that investors are concerned that entities cherry-pick the items they adjust for in the calculation of their adjusted performance measures.⁷
29. Consequently, the staff recommend the Board specify that information provided about unusual items should be neutral.

Past occurrence

30. The proposed definition of unusual items requires an entity to assess if similar items will arise in future reporting periods. The proposed definition does not refer to the past occurrence of such items. We did not propose referring to the past occurrence of similar items in the definition because we think that classifying as

⁵ Standard and Poor's, 'Why inconsistent reporting of exceptional items can cloud underlying profitability at non-financial FTSE100 companies', 2014, www.standardandpoors.com/ratingsdirect.

⁶ A. Curtis, S. McVay, and B. Whipple, 'The Disclosure of Non-GAAP Earnings Information In The Presence of Transitory Gains', *The Accounting Review*, Vol. 89, No. 3, 2014, pp. 933–958.

⁷ CFA Institute, 'Uses, Expectations and Concerns on Non-GAAP Financial Measures', 2016, <https://www.cfainstitute.org/-/media/documents/support/advocacy/investor-uses-expectations-concerns-on-non-gaap.ashx>

unusual an item that is similar to an item reported in previous reporting period(s) may in some cases provide useful information. For example, an entity may incur an impairment loss resulting from a fire at one of its factories in one period. At the end of that period the entity classifies the impairment as an unusual item because it has a reasonable expectation that it will not suffer an impairment loss for several future annual reporting periods. In the next period, the entity once again incurs an impairment loss resulting from a fire at one of its factories. If the two fires in close succession are not indicative of a developing pattern of fires and impairments (ie the entity has just been very unlucky), it may be possible for the entity to have a reasonable expectation at the end of the second reporting period that similar items will not arise for several annual reporting periods. If this is the case, classifying the second impairment as unusual may provide useful information to the users of the entity's financial statements.

31. However, we think that considering whether similar items of income or expense arose in the past may help an entity assess whether it is reasonable to expect that similar items will recur. For example, if similar income or expenses have arisen regularly in the past, it may indicate that it is reasonable to expect that similar items will arise in future reporting periods. Hence the entity would not classify those items as unusual.
32. The staff therefore recommend that the guidance on unusual items states that considering the past occurrence of similar items may help entities assess whether it is reasonable to expect that similar items will arise in the future.

How to apply the proposed definition of unusual items to current value gains/losses

33. The staff acknowledge that some users are of the view that gains or losses arising from changes in current value (including fair value) measurements have limited predictive value. This is because they typically assign a value of zero to their expectations of the current value change in any single period.
34. However, the staff do not think that gains or losses arising from the remeasurement of items required to be measured at current value (including fair value) should, in general, be treated as unusual items:

- (a) current values are likely to change each reporting period and therefore gains or losses from remeasurement are expected to arise in each reporting period. Thus, we think such gains or losses are likely to be similar in type to gains or losses expected in future reporting periods.
- (b) although gains or losses from remeasurement will vary from period to period, these variations in amount are expected for such items.
Classifying these items as ‘unusual’ would be misleading.

35. Consequently, the staff recommend clarifying that gains or losses arising from the remeasurement of items required to be measured at current value (including fair value) should not, in general, be classified as unusual items.
36. The staff acknowledge there may be situations where a change in a current value measurement is an unusual item because it represents a particularly large change in value. However, we think such situations would not be common.

Question 2

Does the Board agree with the staff recommendation to provide the following additional guidance on the assessment of unusual items:

- (a) information provided about unusual items should be neutral;
- (b) considering the past occurrence of similar items may help entities assess whether it is reasonable to expect that similar items will arise in the future; and
- (c) gains or losses arising from the remeasurement of items required to be measured at current value (including fair value) should not, in general, be classified as unusual items?

Should there be additional information disclosed relating to unusual items?

37. As discussed in paragraph 5, the Board’s discussion in September 2018 focussed on whether to require disclosure of unusual items and where in the financial statements such information would be included. In this section, we discuss whether the Board should require entities to:

- (a) attribute unusual expenses to natural expense categories (paragraphs 38–41);
- (b) provide information about the transactions or other events that gave rise to the unusual items (paragraphs 42–43); and
- (c) provide information about income and expenses related to unusual items (paragraphs 44–46).

Attributing unusual expenses to natural expense categories

38. The Board has tentatively decided to require separate disclosure of unusual items in the notes and require those items be attributed to line items in the statement(s) of financial performance. Applying the Board’s tentative decisions, entities will be required to analyse operating expenses in the statement(s) of financial performance either by function or by nature, depending on which method provides more useful information. In addition, entities will be required to provide additional information about the nature of their expenses when they provide an analysis of expenses by function in the statement(s) of financial performance.
39. In practice, many entities analyse expenses by function—in our analysis of a sample of financial statements for 85 entities, we found that 61 entities provide functional expense line items in the statement(s) of financial performance.
40. The staff expect that some unusual items will be identified by reference to their nature (eg impairment losses) and some will not (eg restructuring costs which could include several different natural expense items). In the cases when unusual items are not described by reference to their nature, users may want information about how unusual expenses affect the natural expense categories. Applying the Board’s tentative decisions, this information would not be required from entities that provide an analysis of expenses by function in the statement(s) of financial performance.
41. Therefore, the staff recommend requiring all entities to attribute unusual expenses to natural expense categories, regardless of their method of analysis of expenses in the statement(s) of financial performance.

Information about transactions or other events that gave rise to unusual items

42. As discussed in paragraphs 19–21, it may be helpful to consider the nature and frequency of transactions or other events that gave rise to the income or expense when assessing whether those income or expenses are unusual. We think users would find information about the underlying transactions or other events that gave rise to unusual items useful because such information would enable users to:
- (a) understand the context in which an unusual item arose; and
 - (b) form a judgement on the entities' classification of an item as unusual, allowing them to adjust their analysis accordingly.
43. Therefore, the staff recommended the Board require entities to provide a narrative description of the transactions or other events that gave rise to unusual items.

Information about income and expenses related to unusual items

44. In some cases, transactions or other events that give rise to usual items may also give rise to other items of income or expense that do not meet the proposed definition of unusual items. For example, a sale may give rise to an unusual revenue item. In earning that revenue, an entity may incur several related costs, including staff costs, inventory cost and taxes, which do not meet the definition of unusual items. Users may find information about these related items useful even though they do not meet the definition of unusual items.
45. The staff however do not recommend requiring entities to disclose information about income or expenses related to unusual items (unless those income or expenses themselves meet the definition of unusual items). This is because we do not think the benefits of such disclosure would exceed the costs. This is mainly because we think that:
- (a) it may be difficult for preparers to identify which items are related to unusual items;
 - (b) difficulties in identifying related items may lead to inconsistent application of the requirement making the resulting information less useful to users of financial statements; and

- (c) it may be costly for preparers to require them to identify income and expenses related unusual items, as identification may require system and process changes to track such items.

46. Appendix A illustrates the proposed required disclosures for unusual items.

Question 3

Does the Board agree with the staff recommendation to:

- (a) require all entities to attribute unusual expenses to natural expense categories, regardless of their method of analysis of expenses in the statement(s) of financial performance;
- (b) require all entities to provide a narrative description of the transactions or other events that gave rise to unusual items; and
- (c) not require entities to disclose income or expenses related to unusual items (unless those income or expenses themselves meet the definition of unusual items)?

Appendix A—Example disclosures of unusual items

An entity that analyses expenses by nature

Line items in statement of financial performance that include unusual items	Total amount presented for the line item	Unusual Items included in the line item			Total unusual items included in the line item
		Restructuring of subsidiary A	Litigation costs arising from Case X	Bargain purchase of entity Y	
Employee benefits expense	(4,000)	(300)			(300)
Impairment of non-financial assets	(500)	(150)			(150)
Litigation expenses	(300)		(50)		(50)
Other income	500			450	450
Expenses from financing activities	(200)	(50)			(50)

Notes:

Restructuring of subsidiary A relates to head office move in response to uncertainty caused by Brexit. Restructuring costs incurred include redundancy payment to 578 staff in London and impairment of right to use an office building in London.

Litigation costs arose from Court Case X in which we paid damages to a customer due to consequences of incomplete labelling of one of our products. We have since taken measures to remedy labelling procedures.

Bargain purchase gain arose from acquisition of entity Y in country Z.

An entity that analyses expenses by function

Line items in statement of financial performance that include unusual items	Total amount presented for the line item	Unusual Items included in the line item			Total unusual items included in the line item
		Restructuring of subsidiary A	Litigation costs arising from Case X	Bargain purchase of entity Y	
Cost of goods sold	(3,000)	(100)			(100)
SG&A	(1,500)	(350)	(50)		(400)
Other income	500			450	450
Expenses from financing activities	(200)	(50)			(50)

Notes:

Restructuring of subsidiary A relates to head office move in response to uncertainty caused by Brexit. Restructuring costs incurred include redundancy payment to 578 staff in London (CU300 included in employee benefits expenses) and impairment of right to use office building in London (CU150 included in impairment of non-financial assets).

Litigation costs arose from Court Case X in which we paid damages to a customer due to incomplete labelling of our products. We have since taken measures to remedy labelling procedures. These costs were included in litigation expenses.

Bargain purchase gain arose from acquisition of entity Y in country Z.