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Project	**Primary Financial Statements**	
Paper topic	Management performance measures—disclosure of tax and NCI	

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Purpose of this paper

1. This paper sets out staff analysis and recommendations which respond to stakeholder comments relating to the proposed requirement in the Exposure Draft *General Presentation and Disclosure* for an entity to disclose the tax effect and the effect on non-controlling interests for each item disclosed in the reconciliation between a management performance measure and the most directly comparable subtotal specified by IFRS Accounting Standards.

2. In future papers, we plan to discuss:

   (a) whether specific guidance is needed with regards to the timing of public communications (following up on related discussion in Agenda Paper 21A of the September 2021 IASB meeting);

   (b) whether specific guidance is needed for non-GAAP measures that are not management performance measures;

   (c) other disclosure requirements for management performance measures, including:

      (i) presentation restrictions, for example the restriction on the use of columns;

(ii) the location of disclosure, for example cross-referencing;

(iii) other stakeholder comments, for example requirements for changes to management performance measures; and

(d) how management performance measures work with other requirements including:

(i) accounting policies;

(ii) unusual income and expenses;

(iii) segment reporting;

(iv) subtotals in the statement(s) of financial performance; and

(v) earnings per share measures.

Summary of staff recommendations in this paper

3. The staff recommend the IASB:

(a) retain the proposed requirements to disclose

(i) the income tax effects and the effect on non-controlling interests for each item disclosed in a reconciliation between a management performance measure and the most directly comparable IFRS specified subtotal or total; and

(ii) how the entity determined the income tax effect

(b) revise the wording for how to calculate the income tax effect to be:

An entity shall determine the income tax effect required by paragraph 106(c) [of the Exposure Draft] on the basis of a reasonable allocation of the current and deferred tax of the entity.

(c) add application guidance on a reasonable allocation:

(i) in assessing what is a reasonable allocation, an entity shall consider the tax jurisdiction(s) and the individual treatment of the reconciling item in those jurisdictions; but

(ii) a reasonable allocation need not involve complex calculation relating to tax effects that arise at an aggregated level.

(d) include examples to illustrate such application guidance.

Structure of the paper

4. This paper is structured as follows:

   (a) background (paragraphs 5–22):

      (i) proposals in the Exposure Draft (paragraphs 5–11);

      (ii) feedback (paragraphs 12–20);

      (iii) fieldwork findings (paragraphs 21–22).

   (b) staff analysis and recommendations (paragraphs 23–51);

      (i) are changes to the proposal in the Exposure Draft necessary (paragraphs 23–35);

      (ii) possible approaches to resolving stakeholder concerns (paragraphs 36–51).

Background

Proposals in the Exposure Draft

5. The Exposure Draft proposed that an entity would be required to disclose specific information about management performance measures, including (see paragraph 106 of the Exposure Draft):

   (a) a description of why the management performance measure communicates management's view of performance;

   (b) a reconciliation to the most directly comparable total or subtotal specified by IFRS Standards;

(c) the income tax effect and the effect on non-controlling interests for each item disclosed in the reconciliation; and

(d) how the entity determined the income tax effect for each item disclosed in the reconciliation.

6. The Exposure Draft proposed that an entity shall determine the income tax effect stated in paragraph 5(c) on the basis of a reasonable pro rata allocation of the current and deferred tax of the entity in the tax jurisdiction(s) concerned or by another method that achieves a more appropriate allocation in the circumstances (see paragraph 107 of the Exposure Draft).

7. Paragraphs BC146–BC147 of the Basis for Conclusions explains that as part of research undertaken as part of the Primary Financial Statements project, users of financial statements expressed concerns about the quality of disclosures provided about management-defined performance measures. In some cases the disclosures:

(a) lack transparency in how the management-defined performance measures are calculated;

(b) lack clarity regarding why these measures provide management's view of the entity's performance;

(c) create difficulties for users trying to reconcile the measures to the related measures specified by IFRS Standards; and

(d) are reported inconsistently from period to period.

8. Paragraph BC148 explains that including disclosures about management performance measures in the financial statements could help to address some of the concerns about these measures expressed by users of financial statements.

9. Paragraph BC176 explains the IASB considered whether an adjusted earnings per share that is based on the entity's management performance measures should be required. It rejected this approach because it would introduce complexity when entities have more than one management performance measure, if these measures are not calculated consistently.

10. Paragraph BC177 explains the IASB considered feedback that earnings per share information was important to users of financial statements and that one of the benefits of management performance to users is the detailed information that can be used to calculate a related earnings per share figure. To calculate such an earnings per share figure, users need information about the earnings adjustments attributable to the parent and the tax effects of those adjustments. Therefore, the IASB proposed an entity should disclose separately the effect of income tax and the amount attributable to non-controlling interest for each reconciling item between a management performance measure and the most directly comparable total or subtotal specified by IFRS Accounting Standards. The IASB decided to propose this disclosure at the level of individual adjustments made in calculating a management performance measure rather than at the level of the total adjustment because it gives users information needed to select which adjustments they want to consider in arriving at an adjusted earnings per share measure used in their analysis.

11. Paragraph BC178 explains the IASB noted that some preparers of financial statements have said the disclosure of the tax and non-controlling interest effects for individual adjustments may be complex and costly. To alleviate the costs of preparing disclosures about the tax effect of management performance measure adjustments, the IASB proposed a simplified approach for calculating the income tax effect of the reconciling items. The IASB concluded that this simplified approach would provide users of financial statements with a reasonable estimate of the income tax effect of adjustments, making it clear when the tax effect of an adjustment is materially different to the effect calculated applying the entity's effective tax rate. The IASB noted that this approach is similar to the approach for determining the income tax effect on items of other comprehensive income set out in IAS 12 *Income Taxes*.

Feedback

12. Respondents provided mixed feedback on the requirement to disclose the income tax effect and the effect of the non-controlling interests for each item disclosed in the reconciliation between a management performance measure and the most directly comparable total or subtotal specified in IFRS Accounting Standards. While some

respondents, including many users, agreed with the proposed disclosure requirements, some—mostly preparers—did not agree.

13. Respondents that agreed with the requirement said that it would provide useful information. In particular:

(a) some users explicitly stated that the tax and non-controlling interest information would be useful. For example, one user said that the tax effects of the reconciling items can be materially different from the amount calculated using the effective tax rate and therefore information about those different effects is important to forecasting future cash flows. Another user said that information about the income tax effect and the effect of the non-controlling interests is needed to calculate adjusted earnings per share excluding some of the reconciling items.

(b) one securities regulator said that in their jurisdiction a defined adjusted earnings per share measure is required and entities have been required to disclose the income tax effect and effect on non-controlling interest on reconciling items for a decade. For this reason, the regulator said they failed to see the concerns raised by preparers over providing the proposed disclosures.

14. In contrast, two users said they were not particularly concerned whether that information was given. One user said this was because as a credit analyst they would not usually use this information. The other said it was because in their view users were able to make reasonable estimates without specific disclosure and therefore the costs to preparers may not justify the benefits.

15. Most of the respondents that disagreed with providing the tax and non-controlling interest information said it was because it would be too costly to provide. A few of these respondents also said that the proposed simplified approach to determining the tax effect did not sufficiently reduce these costs, for example because they would still need to determine effective tax rates in different tax jurisdictions.

16. Some of the respondents that disagreed also said that the tax and non-controlling interest information may require arbitrary allocations that could be misleading.

17. A few respondents disagreed with the requirements because they would result in disclosure that was beyond the equivalent requirements for the line items included in the totals or subtotals specified by IFRS Accounting Standards.

18. A few respondents said that providing information on tax and non-controlling interest was inconsistent with management performance measures communicating a management view because this information was not always used by management.

19. Some respondents suggested that the requirements for tax and non-controlling interest should be restricted to management performance measures that are disclosed on a post-tax basis because, in their opinion, the information was not relevant for pre-tax measures such as EBITDA.

20. Some respondents suggested the requirement should be restricted to the reconciling items in total instead of individual adjustments saying this would be consistent with how tax and non-controlling interest effects are often disclosed today.

Fieldwork findings

21. Many participants that reported management performance measures disclosed the income tax effect for items disclosed in the reconciliation. However, a few of these entities presented a net tax impact for all adjusting items and did not disclose the tax impact for each adjusting item. A few of the participants that disclosed the tax impact did not disclose the effect on non-controlling interests for each item disclosed in the reconciliation. One of these participants said they were unable to calculate the amount using current systems and others said the amounts were immaterial.

22. Some participants said that the calculation of tax and non-controlling interests for each item disclosed in the required reconciliation between a management performance measure and the most directly comparable subtotal specified by IFRS Accounting Standards were challenging due to system limitations. For example, one participant said that an adjustment to remove restructuring costs would be made at the group level but could involve expenses arising in numerous different tax jurisdictions and the existing systems were not designed to calculate the tax effects of these individual expenses in the subsidiary entities. One participant said that although the requirement

for tax and non-controlling interest was similar to that for items of other comprehensive income, it was more difficult to apply to management performance measures. This is because there are more types of reconciling items and they change more frequently than items included in other comprehensive income.

Staff analysis

Costs and benefits of the proposals

Benefits

23. As explained in the Basis for Conclusions (see paragraphs 7–11) of this paper, the proposals to disclose the income tax effects and effect on non-controlling interests for each reconciling item satisfy two objectives:

    (a) for management performance measures calculated on a post-tax basis or used in a per share measure, the disclosures improve the transparency of the management performance measure; and

    (b) for all management performance measures, the disclosures enable users to calculate an adjusted earnings per share figure that takes into account some or all adjustments.

24. The feedback described in paragraph 13 suggests that disclosing the income tax effects and effect on non-controlling interests for each reconciling item would provide users with useful information in relation to both objectives. In response to the specific concerns about the disclosures described in paragraphs 17–20 of this paper, the staff:

    (a) continue to think the objectives of the disclosures justify disclosure of income tax effects and effects of non-controlling interests beyond the equivalent requirements for the line items included in the totals or subtotals specified by IFRS Accounting Standards.

    (b) do not agree that disclosing information on tax and non-controlling interests would be inconsistent with the requirement for a management performance measure to communicate management's view of an aspect of performance. Such additional information would not change how a management performance measure is calculated or the reasons it provides useful information in management's view.

(c) do not agree *in principle* that the requirements for tax and non-controlling interest should be restricted to management performance measures that are disclosed on a post-tax basis.[1] The Board has already provided relief from disclosing the tax effects of depreciation, amortisation and specified impairments by designating as a specified subtotal 'operating profit or loss before depreciation, amortisation, and specified impairments'. For other items excluded from a pre-tax management performance measure, feedback from users indicates the disclosures are useful in enabling them to determine adjusted earnings per share figures.

(d) do not agree that the requirement should be restricted to the reconciling items in total instead of individual adjustments. The IASB considered such an approach when developing the proposals in the Exposure Draft and rejected such an approach because it would not enable users of financial statements to calculate earnings per share figures using only some rather than all of the reconciling items.[2]

Costs

25. This section focuses on costs associated with the calculation of the tax effects, which is the focus of the feedback. Only a few comment letters mentioned non-controlling interests specifically and they gave no explanation of the costs involved.

26. In developing the Exposure Draft, the IASB acknowledged that it may be complex and costly to determine the tax effect of individual income and expenses recognised in the financial statements when there are aspects of tax legislation that apply on an aggregated basis (such as the ability to offset prior year's losses carried forward

[1] Paragraphs 45–50 of this paper explore an approach that limits the scope of the disclosures to post-tax management performance measures for cost relief reasons.

[2] See Agenda Paper 21B for the April 2018 IASB meeting AP21B: Management-defined adjusted earnings per share (adjusted EPS) (ifrs.org)

against the current year's taxable profit, or graduated rates of income tax). To mitigate the complexity and costs, the Exposure Draft proposed a simplified approach for calculating the income tax effect of the reconciling items—a pro rata allocation of the total tax in the tax jurisdiction(s) concerned.

27. The concern expressed by some respondents that disclosure would be too costly (see paragraph 15) suggests that the disclosure might be more costly than initially anticipated. This concern is supported by the fieldwork findings that for some entities disclosure would require system enhancements to calculate the tax effects of each individual reconciling item (see paragraph 22). Such system enhancements may be costly.

28. In particular, a few respondents said the simplified approach for calculating the income tax effect would not be an effective cost relief. One fieldwork participant explained that even though the same simplified approach is effective for items of other comprehensive income, it would not be effective for management performance measures because the items used in management performance measures are more varied and change more frequently than items of other comprehensive income.

29. Nonetheless, the staff observe that many fieldwork participants were able to give the tax and non-controlling interest amounts. This puts the concerns about costs about these disclosures in perspective compared with the concerns raised about the cost of the analysis of operating expenses by nature when they are analysed by function in the statement of profit or loss. For that disclosure, most fieldwork participants were not able to give the proposed disclosure.[3] In addition, as noted in paragraph 13(b) of this paper, the securities regulator in a jurisdiction where entities have been required to disclose the income tax effect and effect on non-controlling interest on reconciling items does not share the concerns raised by preparers over providing the proposed disclosures.

[3] See paragraphs 20–23 of Agenda Paper 21C of the October 2021 IASB meeting. [AP21C Analysis of operating expenses-disclosure in the notes]

30. The costs involved in determining the tax effect of the reconciling items can be analysed into two types:

    (a) the costs of collecting the necessary information; and

    (b) the costs of processing the information and calculating the tax effect.

31. In relation to the costs of collecting the necessary information (paragraph 30(a)), the staff would not necessarily expect the tax amounts to be produced by the general reporting systems. Rather, they are likely to be determined by additional calculations at a reporting date, because the reconciling items (for example non-recurring items) are likely to vary from period to period. There will be a limited number of reconciling items, so the staff does not think the collection of the information is likely to be unduly costly. The staff thinks this is the case even when reconciling items arise in several tax jurisdictions.

32. Further, if the entity decided to amend the general reporting systems to generate the information necessary, there would be initial set-up costs, as often happens with new accounting standards, but the future ongoing cost should not be excessive.

33. In contrast, in relation to the costs of processing the information and calculating the tax effect (paragraph 30(b)), the staff accepts the process can be complex, and hence costly. Without the simplified methodology proposed in the Exposure Draft, the process would involve assessing the tax consequences of hypothetical transactions. This becomes particularly complex and potentially arbitrary when the total tax expense in a tax jurisdiction is determined not only by individual transactions, but also by tax effects determined at the tax entity level, for example the tax rate in a graduated tax system or the use of tax losses carried forward. Additional complexity might be added if there are interactions between different tax jurisdictions, for example consolidated tax regimes or foreign tax credits.

34. The simplified approach proposed in the Exposure Draft was intended to provide an entity with a relatively straightforward methodology to avoid such complexity, whilst still providing information about the different tax characteristics of the individual reconciling items. Paragraphs 29 and 30 of Agenda Paper 21C for the June 2019 IASB meeting explain the approach was intended:

(a) to allow an entity to apply a simple allocation approach, rather than requiring the entity to prepare complex calculations of the income tax effects of the reconciling items; but

(b) to provide information about the different tax characteristics of reconciling items by:

    (i) using an allocation of the tax of the entity in the tax jurisdiction(s) concerned, rather than applying the average effective tax rate of the entity as a whole; and

    (ii) in making the allocation, considering the tax treatment of the individual reconciling items so that, for example, allocation of the tax effect of non-deductible expenses would be zero.

35. The staff continue to think such an approach strikes the right balance between the benefits of providing useful information and the costs of doing so. However, the staff acknowledge that the wording of the requirement could be revised to better indicate how this balance is intended to be achieved. Such a revision is discussed in paragraphs 38–44 of this paper.

36. An important aspect of the simplified approach is that it is accompanied by a requirement for the entity to disclose how it determined the income tax effect. That requirement did not attract any feedback, so the staff recommend the IASB proceed with that disclosure.

Possible approaches to resolving stakeholder concerns

37. Given the analysis in paragraphs 23–35, the staff have considered two possible approaches to resolving the concerns raised by stakeholders:

    (a) Approach 1—continue with the proposed disclosures, but revise the wording of how the tax effects should be determined; and

    (b) Approach 2—require the proposed disclosures only for management performance measures calculated on a post-tax basis or used in a per share measure.

38. The key difference between the two approaches is that approach 1 continues with both the objectives for the disclosures, ie (i) transparency of information about management performance measures and (ii) enabling users to calculate related earnings per share figures (see paragraph 23 of this paper). Approach 2 focuses solely on the first objective.

Approach 1—continue with proposed disclosures

39. Paragraph 107 of the Exposure Draft requires an entity to determine the tax effects of reconciling items on the basis of a reasonable pro rata allocation of the current and deferred tax of the entity in the tax jurisdiction(s) concerned or by another method that achieves a more appropriate allocation in the circumstances.

40. The staff observe this wording places heavy weight on what is a reasonable pro rata allocation and treats differently tax characteristics of reconciling items arising from:

    (a) different tax jurisdictions, for example different tax rates in different jurisdictions—they cannot be included in the determination of the tax effect using a reasonable pro rata allocation because the allocation must be done for each tax jurisdiction concerned; and

    (b) specific tax treatments in a tax jurisdiction, for example non-deductible expenses—they can be included in the determination of the tax effect using a reasonable pro rata allocation.

41. The staff think that a simpler articulation that treats tax characteristics in the same way, with supporting application guidance, would be more robust and also respond to the concerns expressed about the costs of the requirement.

42. Accordingly, the staff have developed the following revised wording for paragraph 107:

> An entity shall determine the income tax effect required by paragraph 106(c) [of the Exposure Draft] on the basis of a reasonable ~~pro rata~~ allocation of the current and deferred tax of the entity ~~in the tax jurisdiction(s) concerned or by another method that achieves a more appropriate allocation in the circumstances~~.

43. The staff acknowledge that the wording proposed in the Exposure Draft was derived from the wording in paragraph 63 of IAS 12 *Income Taxes* on the allocation of tax effects to items of income and expenses recognised in other comprehensive income or equity. However, that requirement is placed in the context of the requirements of IAS 12 as a whole, and applies only when 'in exceptional circumstances it may be difficult to determine the amount of current and deferred tax that relates to items'. The requirement in paragraph 107 is intended to be a cost relief that allows an entity to avoid the complexity of applying IAS 12 as a whole. Accordingly, different wording from that in paragraph 63 of IAS 12 is appropriate.

44. The staff would also add application guidance that:

    (a) in assessing what is a reasonable allocation, an entity shall consider both the tax jurisdiction(s) and the individual treatment of the reconciling item in those jurisdictions; but

    (b) a reasonable allocation need not involve complex calculation relating to tax effects that arise at an aggregated level.

45. We could also add examples of allocations we think would be reasonable, illustrating paragraphs 43(a) and 43(b).

46. The advantage of approach 1 is that it maintains the objectives set in the Exposure Draft, which are supported by some respondents, particularly users of financial statements. The staff also think the revisions to the wording of the requirement, while not changing the IASB's intentions, are responsive to the concerns expressed about the costs of the requirement.

Approach 2—require disclosures only when a measure includes a tax calculation

47. Approach 2 would require an entity to disclose the income tax effects and the effects on non-controlling interests for each reconciling item only for those management performance measures calculated on a post-tax basis or used in a per share measure, as suggested by some respondents (see paragraph 19). For example, disclosure would be required for each reconciling item for measures such as adjusted profit that include an income tax expense or for an adjusted operating profit that is used in an adjusted

operating profit per share measure. However, disclosure would not be required for any measure that does not include income tax, for example an adjusted operating profit or an EBITDA measure not used in a per share measure.

48. The advantage of this approach is that it addresses some of the concerns about the costs of the disclosures more directly than approach 1, by requiring the disclosures only for management performance measures that already include income tax effects in their calculation. As a result:

    (a) entities with only pre-tax management performance measures would not need to disclose the tax effects of their reconciling items. For example, in the staff's combined research sample of 138 IFRS reporters and fieldwork participants 70 entities reported only pre-tax non-GAAP measures; and

    (b) for management performance measures that already include income tax effects in their calculation, the additional calculations required for the disclosures are limited to those necessary to allocate these tax effects to the individual reconciling items. The revisions to the simplified method discussed in approach 1 would apply to these calculations.

49. The disadvantage of this approach is that it discards one of the objectives set in the Exposure Draft for the disclosures—providing information to enable users of financial statements to calculate an adjusted earnings per share figure. However, it could be argued that objective is secondary to the main objective of the overall package of disclosures for management performance measures, which is to provide discipline and transparency over such measures. Disclosures about tax do not provide discipline or transparency about a pre-tax management performance measure, they provide information that is additional to information about that measure.

50. In addition, the second objective set in the Exposure Draft—helping users of financial statements to calculate the adjusted earnings per share number—could be regarded as closer to financial analysis than financial reporting. This is because the determination of the tax effects of reconciling items could also be regarded as requiring the calculation of the outcome of a hypothetical tax situation—what tax would the entity have incurred had the reconciling items not happened. The more complex the

determination of the tax effect, the more hypothetical it becomes. Hence, perhaps discarding the second objective set out in the Exposure Draft might be justifiable.

51. However, another disadvantage of approach 2 is that having different disclosure requirements for different types of management performance measures adds a layer of complexity. It may also incentivise entities not to extend adjusted pre-tax measures to a post-tax measure. For example, an adjusted operating profit measure may not be extended to adjusted profit to avoid presenting detailed disclosure on income tax and non-controlling interests.

Staff recommendation

52. The staff recommend approach 1—retaining the proposed disclosures. Doing so provides disclosures that users indicated would be helpful, and the revisions to the simplified approach for determining the tax effect provide clarity about the cost mitigation it was intended to provide.

Questions for the IASB

Q1 Does the IASB agree with retaining the proposed requirements to disclose:

(a) the tax effects and the effect on non-controlling interests for each item disclosed in a reconciliation between a management performance measure and the most directly comparable IFRS subtotal or total; and

(b) how the entity determined the income tax effect?

Q2 Does the IASB agree with the revised wording for how to calculate the tax effect:

> An entity shall determine the income tax effect required by paragraph 106(c) [of the Exposure Draft] on the basis of a reasonable allocation of the current and deferred tax of the entity.

Q3 Does the IASB agree to add application guidance on a reasonable allocation:

(c) in assessing what is a reasonable allocation, an entity shall consider the tax jurisdiction(s) and the individual treatment of the reconciling item in those jurisdictions; but

(d) a reasonable allocation need not involve complex calculation relating to tax effects that arise at an aggregated level.

Q4 Does the IASB agree to include examples to illustrate such application guidance?