IFRS

STAFF PAPER

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Project	**Disclosure Initiative: Principles of Disclosure**
Paper topic	Comment letter feedback—use of performance measures in the financial statements

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Objective

1. This paper provides a detailed analysis of feedback received from comment letters on Section 5 of the *Disclosure Initiative—Principles of Disclosure* Discussion Paper. Feedback from users of financial statements is summarised separately in Agenda Paper 11B. Section 5 of the Discussion Paper discusses fair presentation of performance measures in the financial statements.

2. This paper is structured as follows:

   (a) Key messages (paragraphs 3-7);

   (b) Background and questions in the Discussion Paper (paragraphs 8-9);

   (c) Presentation of EBIT and EBITDA in the statement(s) of financial performance (paragraphs 10-19);

      (i) Comments on the Board's preliminary views included in the Discussion Paper (paragraphs 10-15);

      (ii) Comments on tentative Board decisions in the Primary Financial Statements project (paragraphs 16-19);

   (d) Depiction of unusual or infrequently occurring items in the statement(s) of financial performance (paragraphs 20-28);

      (i) Definitions and requirements (paragraphs 20-26);

(ii) Prohibiting the use of other terms to describe unusual and infrequently occurring items (paragraphs 27-28);

(e) General requirements for all performance measures in the financial statements (paragraphs 29-35);

(f) Interaction between Better Communication projects (paragraph 36); and

(g) Appendix A—Extract from paragraph 5.34 of the Discussion Paper.

Key messages

3. Respondents expressed mixed views on the Board's preliminary views on the presentation of EBIT (earnings before interest and tax) and EBITDA (earnings before interest, tax, depreciation and amortisation). Many of the respondents who disagreed with the Board's preliminary views said that the existing guidance in paragraphs 85–85B of IAS 1 *Presentation of Financial Statements* is sufficient and does not need clarification (paragraphs 10-15).

4. Respondents also expressed views on whether the Board should define EBIT and/or EBITDA in the Primary Financial Statements project. Many respondents thought the Board should define these measures (paragraphs 16-19).

5. Many respondents thought that developing definitions of, and requirements for, the presentation of unusual or infrequently occurring items in the statement(s) of financial performance would be difficult for the Board. Many respondents agreed that the Board should develop some guidance on this topic, but some said that such guidance should consist of general requirements for the fair presentation and disclosure of unusual or infrequently occurring items (paragraphs 20-26).

6. Many respondents disagreed with prohibiting the use of other terms to describe unusual and infrequently occurring items (paragraphs 27-28).

7. Most respondents supported the Board's preliminary view that a general disclosure standard should describe how performance measures can be fairly presented in financial statements, as described in paragraph 5.34 of the Discussion Paper (paragraphs 29-35).

Background and Questions in the Discussion Paper

8. In Section 5 of the Discussion Paper, the Board observed that many users of financial statements find performance measures[1] useful, both in the primary financial statements and the notes, provided they are not misleading. Consequently, the Board's preliminary view was that a general disclosure standard should not prohibit the use of specific types of performance measures. Nevertheless, the Board observed that it is important to address some concerns about transparency of those measures raised by users of financial statements. Therefore, the Board's preliminary view was that a general disclosure standard should include requirements to ensure all performance measures are fairly presented in the financial statements.

9. The feedback described in this paper includes the responses provided by stakeholders on the following two questions in the Discussion Paper.

[1] In the Discussion Paper the term 'performance measure' refers to any summary financial measure of an entity's financial performance, financial position or cash flows.

Question 8

The Board's preliminary views are that it should:

- clarify that the following subtotals in the statement(s) of financial performance comply with IFRS Standards if such subtotals are presented in accordance with paragraphs 85–85B of IAS 1:
    - the presentation of an EBITDA subtotal if an entity uses the nature of expense method; and
    - the presentation of an EBIT subtotal under both a nature of expense method and a function of expense method.
- develop definitions of, and requirements for, the presentation of unusual or infrequently occurring items in the statement(s) of financial performance, as described in paragraphs 5.26–5.28.

(a) Do you agree with the Board's preliminary views? Why or why not? If you do not agree, what alternative action do you suggest, and why?

(b) Should the Board prohibit the use of other terms to describe unusual and infrequently occurring items, for example, those discussed in paragraph 5.27?

(c) Are there any other issues or requirements that the Board should consider in addition to those stated in paragraph 5.28 when developing requirements for the presentation of unusual or infrequently occurring items in the statement(s) of financial performance?

The feedback on Question 8 will be considered as part of the Board's Primary Financial Statements project.

Question 9

The Board's preliminary view is that a general disclosure standard should describe how performance measures can be fairly presented in financial statements, as described in paragraph 5.34[2].

Do you agree with the Board's preliminary view? Why or why not? If you do not agree, what alternative action do you suggest, and why?

[2] See Appendix A of this agenda paper.

Presentation of EBIT and EBITDA in the statement(s) of financial performance

Comments on the Board's preliminary views included in the Discussion Paper

10. The Board's preliminary views were that:

    (a) presentation of an EBITDA subtotal in the statement(s) of financial performance only complies with IFRS Standards if an entity uses the nature of expense method;

    (b) presentation of an EBIT subtotal complies with IFRS Standards under both the nature of expense method and the function of expense method; and

    (c) the Board should clarify these views in IFRS Standards.

11. Many respondents did not explicitly state whether they agreed with the Board's preliminary views. Those that did respond expressed mixed views: some agreed with the Board's preliminary views, including most regulators; however, some others disagreed.

12. Many respondents agreed with the Board's preliminary view in paragraph 10(a) that an EBITDA subtotal would not fit into the statement(s) of financial performance under the function of expense method. Some of these respondents would like the Board to clarify that EBITDA can be presented adjacent to the statement(s) of financial performance or in the notes if an entity uses the function of expense method.

13. Some respondents said that, while they agreed with the Board's preliminary views in paragraphs 10(a) and 10(b), the Board should not add or amend requirements in IFRS Standards to reflect these views. This was for the following reasons:

    (a) some respondents said the existing requirements in IAS 1 are sufficiently clear.

    (b) a few respondents said such amendments would be piecemeal and rule-based.

    (c) a few respondents cautioned the Board against focusing on EBIT and EBITDA. This was because, in their view, focussing on these two specific subtotals could imply that they are mandatory or that other subtotals are not allowed.

    (d) a few respondents said they would prefer the Board to develop illustrative examples to clarify the views in paragraphs 10(a) and 10(b).

14. Some respondents thought the Board should take a more holistic, principle-based approach to the use of performance measures. For example, some of these respondents

suggested such an approach should also cover other commonly reported measures in addition to EBIT and EBITDA. Most of these respondents thought such an approach should be developed in the Primary Financial Statements project.

15. A few respondents disagreed with the Board's preliminary view in paragraph 10(a) because they thought that entities should be allowed to present an EBITDA subtotal in the statement(s) of financial performance when using the function of expense method.

Comments on tentative Board decisions in the Primary Financial Statements project

16. Some respondents also commented on the Board's recent tentative decision in the Primary Financial Statements project to require and define a subtotal similar to EBIT[3] in the statement(s) of financial performance. This was not discussed in the Discussion Paper because the Board discussions took place after the Discussion Paper had been published.

17. Many of those respondents supported the Board defining EBIT (and EBITDA) because they said such measures are useful to users and need to be comparable across entities. A few added that there is diversity in how these measures are currently calculated and provided some examples of such diversity.

18. However, some other respondents—including many large accounting firms—disagreed with the Board defining and requiring EBIT (and EBITDA). These respondents expressed the following concerns:

    (a) a few said that it would be difficult to reach a consensus on the definition.

    (b) a few said they objected to rule-based definitions, because such definitions cannot address all circumstances.

    (c) some respondents—including many of the Japanese respondents—suggested the Board should focus on requiring and defining an 'operating profit' subtotal instead. A few of these respondents said that such a measure should represent a

[3] This subtotal is tentatively labelled 'Profit before financing and income tax' in the Primary Financial Statements project.

‘sustainable income arising from operating activities’, which they said would be more helpful to users than EBIT or EBITDA.

19. Some respondents said the Board should not require EBIT (and EBITDA) for *all* entities, because such subtotals are not appropriate for financial institutions or investment entities.

Depiction of unusual or infrequently occurring items in the statement(s) of financial performance

Definitions and requirements

20. The Board’s preliminary view was that it should develop definitions of, and requirements for, the presentation of unusual or infrequently occurring items. Respondents expressed mixed views: some agreed with the Board’s preliminary view (including most users—see Agenda Paper 11B) and some disagreed.

21. A few of the respondents that agreed with the Board’s preliminary view did so because they said:

    (a) the separate presentation or disclosure of unusual or infrequently occurring items is important to help users in making forecasts about future cash flows; and

    (b) definitions and requirements developed by the Board could make such items more transparent and comparable across entities and could reduce opportunistic adjustments.

22. A few of the respondents that agreed with the Board’s preliminary view said that the definitions for unusual or infrequently occurring items should be principle-based, allowing entities some flexibility in determining what they consider to be ‘unusual’ or ‘infrequently occurring’.

23. Those respondents that did not agree with the Board developing definitions of unusual or infrequently occurring items provided the following views:

    (a) many said that developing such definitions would be difficult for the Board. Many of these respondents thought that assessing whether items are unusual or infrequently occurring requires significant judgement and depends on entity-specific circumstances. Consequently, they thought it would be difficult to develop a definition that is applicable to all entities, in all industries. A few respondents referred to failed past attempts by the Board and other standard-setters to develop such definitions.

(b) a few said any definition of 'unusual' or 'infrequently occurring' would be difficult to audit. However, the International Auditing and Assurance Standards Board said that the Board developing definitions and requirements for the presentation of unusual or infrequently occurring items would provide further clarity and enhance the auditability of such items.

24. Some respondents suggested that the Board should consider developing more general requirements for the fair presentation and disclosure of unusual, infrequently occurring or similar items than those described in paragraphs 5.26-5.28 of the Discussion Paper. These respondents suggested requirements that were similar to the proposed requirements for fair presentation of *all* performance measures in the financial statements in paragraph 5.34 of the Discussion Paper (see Appendix A). For example, respondents suggested requiring such items to be:

(a) classified and presented consistently over time; and

(b) labelled in a clear and non-misleading way.

25. Some respondents asked the Board to clarify:

(a) how the separate presentation of unusual or infrequently occurring items is different in principle from the presentation of extraordinary items, which is prohibited by paragraph 87 of IAS 1.

(b) how the separate presentation of unusual or infrequently occurring items would interact with the requirement in IAS 1, paragraph 99 to present expenses either by nature or by function. Some of these respondents referred to the Board's view expressed in IAS 1, paragraph BC63 that:

> The nature or function of a transaction or other event, rather than its frequency, should determine its presentation within the income statement.

26. A few respondents said that, in addition to providing guidance for the presentation of unusual or infrequently occurring items in the statement(s) of financial performance, the Board should also consider:

    (a) developing guidance for other types of adjustments that entities make to performance measures, such as constant-currency adjustments; and

    (b) the presentation of unusual or infrequently occurring items in the other primary financial statements—specifically the statement of cash flows and statement of financial position—and segment reporting.

Prohibiting the use of other terms to describe unusual and infrequently occurring items

27. The Discussion Paper asked respondents whether the Board should prohibit the use of other terms to describe unusual and infrequently occurring items. Many respondents—including most accountancy bodies and most preparers—disagreed with prohibiting the use of other terms. This was because, in their view:

    (a) entities should have flexibility in selecting the terms they use to describe such items.

    (b) entities would bypass such a prohibition by using other terms. Respondents said this is what happened when the Board prohibited the presentation of extraordinary items.

    (c) such a prohibition would not be in line with the principle-based nature of the Standards.

    (d) such a prohibition would be difficult to implement from a translations perspective.

28. Some respondents—including most regulators—held the opposite view and supported prohibiting the use of other terms such as ‘non-recurring’ to describe unusual and infrequently occurring items. A few of these respondents said that a variety of different terms may confuse users.

General requirements for all performance measures in the financial statements

29. Most respondents—across all stakeholder groups—agreed with the Board's preliminary view that a general disclosure standard should describe how performance measures can be fairly presented in financial statements, as described in paragraph 5.34 of the Discussion Paper (see Appendix A).

30. Some respondents said that the scope of the requirements (ie the definition of 'performance measures' in the Discussion Paper) was too broad. The Discussion Paper defined performance measures as 'any summary financial measure of an entity's financial performance, financial position or cash flows'. Some respondents said that this definition would include measures that are commonly reported and well understood—such as gross profit. For these measures, respondents thought the disclosures described in the Discussion Paper would not be useful and would clutter the financial statements. A few respondents also suggested the Board should use the term 'financial performance measures' instead of 'performance measures' to clarify that non-financial measures are excluded from the scope.

31. A few respondents asked the Board to clarify the relationship between 'non-IFRS information' discussed in Section 4 of the Discussion Paper and 'performance measures' discussed in Section 5 (see Agenda Paper 11H). More specifically, a few respondents asked the Board to provide a better link between the requirements proposed for 'Category C information'[4] in paragraph 4.38 of the Discussion Paper and those proposed for performance measures in paragraph 5.34.

32. Respondents also commented on specific aspects of the proposed requirements in paragraph 5.34 of the Discussion Paper (see Appendix A):

    (a) a few respondents said they did not object to an entity's performance measures being displayed with more prominence than the line items, subtotals and totals in the primary financial statements required by IFRS Standards.

    (b) a few respondents said the Board needed to provide more guidance on how to assess prominence.

[4] The Discussion Paper defines 'Category C information' as information in financial statements that is not specifically required by IFRS Standards, nor necessary to comply with IFRS Standards. This includes information that is inconsistent with IFRS Standards and some non-financial information.

(c) a few respondents expressed concerns that the proposed requirements in paragraph 5.34(c) of the Discussion Paper for an entity to provide explanatory information about performance measures may lead to boilerplate disclosures.

(d) a few respondents said a reconciliation to measures specified in IFRS Standards should always be required. Furthermore, they thought the Board should only permit performance measures that can be reconciled to measures specified in IFRS Standards in the financial statements. Consequently, these respondents thought the proposed requirement in paragraph 5.34(c)(iii) of the Discussion Paper should be deleted.

(e) a few respondents did not support the proposed requirement in paragraph 5.34(g) of the Discussion Paper for entities to indicate whether their performance measures have been audited, because they thought:

   (i) requirements related to the audit of financial statements are outside the Board's remit; and

   (ii) such a requirement may implicitly encourage entities to include unaudited information in their financial statements.

(f) some respondents expressed concerns about the proposed requirement in paragraph 5.34(g) of the Discussion Paper for an entity to make clear whether a performance measure forms part of the financial statements. These respondents thought the Board should clarify whether all performance measures included in the body of the financial statements should 'form part of the financial statements'.

33. Respondents also suggested some additional requirements for fair presentation of performance measures that they thought the Board should consider. Some of the suggestions are similar to feedback provided about non-IFRS information in the financial statements in Section 4 of the Discussion Paper (see Agenda Paper 11H):

(a) a few respondents said that the Board should require entities to explain any changes made in the calculation of their performance measures over time and the reasons why these changes result in reliable and more relevant information. Respondents added that this is similar to ESMA guidance on alternative performance measures.

(b) a few respondents said the Board should require all performance measures in financial statements to be made up of amounts recognised and measured in accordance with IFRS Standards—similar to the requirements for subtotals in IAS 1, paragraph 85A(a).

34. A few respondents said management-defined measures should not be allowed in financial statements, but should be presented elsewhere, for example in management commentary.

35. A few respondents would prefer the Board to issue some or all of the requirements for the fair presentation of performance measures in paragraph 5.34 of the Discussion Paper as non-mandatory guidance, rather than including them in a general disclosure standard.

Interaction between Better Communication projects

36. In their responses to questions 8 and 9, many respondents questioned why the Discussion Paper included a section on performance measures and said this discussion would fit better in the Primary Financial Statements project. A few respondents said the topic of performance measures was unrelated to the main objective of the Discussion Paper (see Agenda Paper 11D).

Appendix A—Extract from paragraph 5.34 of the Discussion Paper

5.34 […] the Board recommends introducing requirements for all performance measures in the financial statements to respond to concerns set out in paragraph 5.11. The Board's preliminary view is that these requirements should require a performance measure to be:

(a) displayed with equal or less prominence than the line items, subtotals and totals in the primary financial statements required by IFRS Standards;

(b) reconciled to the most directly comparable measure specified in IFRS Standards to enable users of financial statements to see how the performance measure has been calculated;

(c) accompanied by an explanation in the notes to the financial statements of:

(i) how the performance measure provides relevant information about an entity's financial position, financial performance or cash flows;

(ii) why the adjustments to the most directly comparable measure specified in IFRS Standards in (b) have been made;

(iii) if the reconciliation in (b) is not possible, why not; and

(iv) any other information necessary to aid understanding of the measure (ie the information should provide a complete depiction).[5]

(d) neutral, free from error and clearly labelled so it is not misleading;

(e) accompanied by comparative information for all prior periods presented in the financial statements;

(f) classified, measured and presented consistently to enable comparisons to be made over time, except when IFRS Standards require a change in presentation, as stated in paragraph 45 of IAS 1;[6] and

(g) presented in a way that makes it clear whether the performance measure forms part of the financial statements and whether it has been audited.

[5] Such an explanation would mean that entities would have to provide their rationale for making adjustments as well as a list of all adjustments.

[6] Paragraph 45 of IAS 1 requires an entity to retain the presentation and classification of items from one period to the next unless another presentation or classification would be more appropriate, having regard to the criteria in IAS 8, or if an IFRS Standard requires a change in presentation.