STAFF PAPER

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Project	**Primary Financial Statements**		
Paper topic	Scope of management performance measures		

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Purpose of this paper

1. This paper explores possible approaches to expanding the scope of the management performance measure requirements to include measures other than subtotals of income and expenses.

2. We plan to address the following aspects of the management performance measure proposals in future papers:

   (a) remaining aspects of the definition of management performance measures including addressing feedback that the following components may require clarification:

      (i) the scope implied by defining management performance measures as measures of performance included in public communications;

      (ii) the need to explicitly state that management performance measures should faithfully represent an aspect of an entity's performance given the general requirement for information in financial statements to provide a faithful representation;

      (iii) whether defining management performance measures by reference to management's view of performance may unintentionally exclude some measures (for example industry measures); and

   (iv) whether additional guidance may be required to help entities apply the requirement for management performance measures to complement subtotals specified in IFRS Standards;

(b) interaction of management performance measures with other requirements including:

   (i) proposals for unusual income and expenses;

   (ii) segment reporting;

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

   (iv) earnings per share measures;

(c) disclosure requirements, including:

   (v) the proposals relating to the reconciliation;

   (vi) the requirement to disclose tax and non-controlling interests;

   (vii) presentation restrictions such as the restriction on the use of columns; and

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

(d) requirements relating to EBITDA.

Summary of staff recommendations in this paper

3. The staff recommends that the Board require that, if a numerator or a denominator of a ratio meets the definition of a management performance measure, that numerator or denominator should be included in the scope of the management performance measure requirements.

4. The staff also recommends that the Board not explore expanding the scope of management performance measures to include:

   (a) measures based on line items presented in the statement(s) of financial performance;

(b) measures based on the cash flow statement;

(c) measures based on the statement of financial position; or

(d) ratios.

Structure of the paper

5. The sections in this paper relate to:

   (a) Background (paragraphs 6–10);

   (b) Staff analysis (paragraphs 11–78):

      (i) revised approach to the analysis (paragraphs 11–13);

      (ii) response to stakeholder concerns arising from management performance measures being a subset of non-GAAP measures (paragraphs 14–17);

      (iii) measures based on the statement(s) of financial performance (paragraphs 18–31);

      (iv) measures based on the cash flow statement (paragraphs 32–45);

      (v) measures based on the statement of financial position (paragraphs 46–59);

      (vi) ratios (paragraphs 60–78); and

   (c) Appendix A—extracts of management performance measure requirements from the Exposure Draft.

Background

6. The Exposure Draft *General Presentation and Disclosures* proposed that an entity disclose ‘management performance measures’ in a single note to the financial statements. The Exposure Draft defined management performance measures as subtotals of income and expenses that:

(a) are used in public communications other than financial statements;

(b) complement totals or subtotals specified by IFRS Standards; and

(c) communicate to users of financial statements management's view of an aspect of an entity's financial performance.

7. At its March 2021 meeting the Board decided to explore expanding the scope of management performance measures to include measures other than subtotals of income and expenses. The Board also discussed factors for evaluating possible approaches to expanding the scope.

8. The staff grouped measures the Board may want to consider including in the scope of management performance measures as follows:

(a) measures based on the statement(s) of financial performance;

(b) measures based on the statement of financial position

(c) measures based on the cash flow statement; and

(d) ratios.

9. To evaluate the balance between the benefits of expanding the scope and the effect of doing so on the project timeline, the staff identified four factors for the Board to consider, namely:

(a) the prevalence of the measures in practice;

(b) the usefulness and complexity of any necessary changes to the disclosure requirements;

(c) the contribution to achieving the project objective; and

(d) the complexity of a new definition of management performance measures.

10. However, some Board members expressed concern about evaluating each group of measures against each factor in detail before having a better understanding of the extent of the work that would be involved.

Staff analysis

Revised approach to the analysis

11. In response to some Board members' concerns about the work involved in the staff's proposed approach, the staff has revised its approach to the analysis. Instead of assessing each of the groups of measures against each factor in paragraph 9, the staff has sought to simplify the analysis focussing on benefits, complexities and risks. We expect this will give the Board an idea of the work that would be involved in including each group of measures in the scope of the requirements, enabling it to decide whether it wants to further explore including each group of measures within the scope of the requirements.

12. Our analysis covers, for each group of measures discussed in paragraph 8:

    (a) the benefits of increased transparency and discipline and contribution to the project objective that can be achieved from expanding the scope of management performance measures to include the measures being evaluated;

    (b) the complexities arising from:

        (i) the need for additional guidance to apply the disclosure requirements to the measures being evaluated;

        (ii) potential changes to the disclosure requirements; or

        (iii) potential changes to the definition of management performance measures; and

    (c) the risks to both the project timeline and other proposals within the project resulting from the need for further outreach and testing of any new proposals and potential stakeholder reaction to any required changes to the requirements.

13. Our analysis is structured as follows:

    (a) response to stakeholder concerns arising from management performance measures being a subset of non-GAAP measures—these concerns are discussed separately because they relate to all groups of measures in the same way (paragraphs 14–17);

(b) measures based on the statement(s) of financial performance (paragraphs 18–31);

(c) measures based on the cash flow statement (paragraphs 32–45);

(d) measures based on the statement of financial position (paragraphs 46–59); and

(e) ratios (paragraphs 60–78).

Response to stakeholder concerns arising from management performance measures being a subset of non-GAAP measures

14. Some stakeholders that said the scope of management performance measures should be expanded mentioned two concerns arising from management performance measures being a subset of non-GAAP measures, namely that an entity:

    (a) will communicate information that differs between non-GAAP measures—an entity will be required to disclose information about measures in the scope of the requirements and will not be required to disclose this information about other measures; and

    (b) may communicate information about non-GAAP measures in various locations—in the financial statements for measures in the scope of the requirements and outside the financial statements for other measures.

15. In the staff's view, providing improved disclosure requirements for one set of non-GAAP measures would not decrease the usefulness of information already provided for other non-GAAP measures for which there are no requirements in IFRS Standards. Stakeholders that expressed concerns about disclosure requirements differing between non-GAAP measures were mainly preparers and accountancy bodies. These stakeholders were concerned that the variety of requirements may be confusing for users. However, no users raised this particular concern, even though many said that the scope should be expanded.

16. There will always be a need to exclude some non-GAAP information from the financial statements because some non-GAAP information is outside the scope of the financial statements. In the staff's view, management performance measures cannot be defined in a way that will result in one location for all information that all

stakeholders agree is relevant. The proposals should instead provide clarity about where information is located. By requiring a single location for measures within their scope, so information about these measures is easy for users to identify. This requirement is expected to improve the disclosure of this subset of measures, particularly for entities that include information about non-GAAP measures in various communications or in several places in a communication. For entities that include all information about non-GAAP measures in a single location outside the financial statements, the Exposure Draft will require them to disclose the measures in the scope in the financial statements. However, the entity may clarify the location of each set of information by cross-referring to it from other communications.

17. The staff have proceeded with the analysis of whether the scope of the management performance measures requirements should be expanded based on a view that management performance measures being a subset of non-GAAP measures does not cause significant issues for users.

Measures based on the statement(s) of financial performance

18. Measures based on the statement(s) of financial performance that are excluded from the scope of management performance measures include:
    (a) subtotals of income and expenses used in a ratio; and
    (b) measures based on line items presented in the statement(s) of financial performance.

19. This section explores the benefits, complexities, and risk of expanding the scope of proposals to include such subtotals or line items in the scope. This section does not discuss ratios themselves, these are discussed together with other ratios, in paragraphs 60–78.

Benefits

20. Measures based on the statement(s) of financial performance that are excluded from the scope of management performance measures are frequently used in practice. Many respondents to the Exposure Draft with concerns over the scope of management

performance measures used adjusted revenue as an example of a measure that, in their opinion, should be included in the scope. The staff's research[1] of non-GAAP measures used in practice but not included in the definition of management performance measures identified two types of frequently used measures:

(a) measures based on line items presented in the statement(s) of financial performance were used by 15 entities (all 15 were adjusted revenue); and

(b) ratios in which either or both of numerator and denominator are a subtotal of income and expenses:

  (i) margin ratios (such as EBITDA margin[2]) were used 95 times by 66 entities; and

  (ii) ratios of return (such as return on capital employed) were used 130 times by 85 entities.

21. The project objective is to improve how information is communicated in the financial statements, with a focus on information in the statement of profit or loss. Consequently, including in the scope subtotals of income and expense used in ratios and measures based on line items presented in the statement(s) of financial performance can contribute to that objective by providing transparency and discipline over the use of these measures.

Subtotals of income and expenses used in a ratio

22. The definition in the Exposure Draft includes subtotals of income and expenses as management performance measures. Often the subtotals used in a ratio are also used on their own as performance measures and are therefore included in the scope. However, they may be excluded from the scope when they are included **solely** in a ratio (with the exception of adjusted earnings used in adjusted earnings per share, which the Exposure Draft proposed to include in the definition of management

[1] March 2021 Agenda Paper 21B includes the results of staff research on the use of non-GAAP measures excluded from the Exposure Draft scope of management performance measures in 113 non-financial entities and 25 financial entities.

[2] The staff research counted all ratios of margin as non-GAAP measures even if the numerator and denominator consisted of measures specified in the Exposure Draft. For example, an operating margin calculated as operating profit/revenue would have been counted as a non-GAAP measure.

performance measures). Excluding subtotals from the disclosure requirements in these cases may reduce transparency. This was observed in the fieldwork where a few participants excluded some subtotals of income and expenses because they were **solely** used in ratios, for example adjusted EBITDA solely used in an adjusted EBITDA/net debt ratio. Bringing income and expense subtotals into the scope of the management performance measures requirements, even when those are solely used in ratios, would mean users would get benefits of transparency and discipline for all subtotals of income and expenses used in communicating performance.

Measures based on individual line items

23. For measures based on line items, the Exposure Draft may already provide transparency and discipline because in many cases the adjusted line items will be included within a subtotal included in the scope of management performance measures. For example, in the staff's research, nearly all entities that used an adjusted revenue measure included that adjusted revenue measure in an adjusted subtotal such as adjusted operating profit. Being included in a subtotal that is subject to the disclosure requirements would indirectly subject the line item to the disclosure requirements, for example adjustments to the line item being included in the reconciliation of the subtotal to the most directly comparable subtotal specified in IFRS Standards. The incremental benefit of including these measures in the scope of the requirements is therefore limited.

Complexities

24. Including measures based on line items presented in the statement(s) of financial performance or subtotals used in ratios in the scope of the management performance measures requirements could create the need for guidance on how to apply the requirements, especially in relation to line items. The staff has identified two such areas that could give rise to complexity, namely:

    (a) the need for additional guidance on reconciling line items to the most directly comparable subtotal or total specified in IFRS Standards; and

    (b) the potential for duplication of disclosures.

25. The Exposure Draft carries forward the list of line items that an entity is required to present in the statement of profit or loss from IAS 1 *Presentation of Financial Statements*. However, many entities present more line items in the statement of profit and loss than those that are required. If an entity uses a non-GAAP measure based on a line item from its statement of profit and loss that is not required, the Board would need to develop guidance to clarify how the entity should reconcile the measure to required information. If the scope of management performance measures were expanded to include measures based on line items presented in the statement(s) of financial performance there is the potential for duplicate disclosures where one measure is included in the calculation of another. For example, if an entity identified adjusted revenue and adjusted operating profit as its management performance measures, the entity might conclude it needs to provide the reconciliation for adjusted revenue twice. The Board may need to provide guidance to help entities avoid duplication.

Risks

26. In the staff's view, expanding the scope of management performance measures to include measures based on the statement(s) of financial performance poses no significant risks to the project timeline. We have not identified complexities in relation to subtotals used in ratios and we think complexities in relation to line items can be resolved efficiently. We think limited additional outreach would be required because measures based on line items presented in the statement(s) of financial performance and margin ratios overlap with subtotals of income and expenses on which we consulted already. This overlap means that feedback on the management performance measures in the Exposure Draft would apply to these measures, and the Board would need to conduct less outreach than it would if the scope were being expanded further.

Staff recommendation

27. The staff recommends the Board require that, if a numerator or a denominator of a ratio meets the definition of a management performance measure, that numerator or

denominator should be included in the scope of the management performance measure requirements.

28. We make this recommendation on the basis of:

(a) the benefits of helping ensure all subtotals of income and expense used in communicating performance of an entity are in the scope of management performance measures; and

(b) there being no significant complexity or risks identified.

29. We make no recommendations in relation to potential additional disclosures relating to ratios themselves, these are discussed in the section on ratios in paragraphs 68–71.

30. The staff does not recommend expanding the scope of management performance measures to include additional measures based on the line items presented in the statement(s) of financial performance.

31. We make this recommendation based on the balance between:

(a) limited benefits, because we think most measures based on line items presented in the statement(s) of financial performance will be included in measures that are subtotals of income and expenses; and

(b) some, although limited, complexity of bringing such measures in the scope of the proposals, in particular in relation to the reconciliation.

Questions 1 and 2

1 Does the Board agree with the staff recommendation that if a numerator or a denominator of a ratio meets the definition of a management performance measure, that numerator or denominator should be included in the scope of the management performance measure requirements?

2 Does the Board agree with the staff recommendation not to explore expanding the scope of management performance measures to include measures based on line items presented in the statement(s) of financial performance?

Measures based on the cash flow statement

32. Measures based on the cash flow statement are excluded from the scope of management performance measures proposed in the Exposure Draft. This section explores the benefits, complexities, and risk of expanding the scope of proposals to include measures based on the cash flow statement. This section does not discuss ratios that include measures based on the cash flow statement, these are discussed together with other ratios, in paragraphs 60–78.

Benefits

33. Including measures based on the cash flow statement in the scope would improve transparency and discipline for a widely used measure— free cash flow. Many respondents to the Exposure Draft with concerns about the scope of management performance measures used free cash flow as an example of a measure that, in their opinion, should be included in the scope. The staff's research showed that free cash flow was one of the most widely used non-GAAP measures: 67 of 113 non-financial entities in the sample used this measure. The staff's research also found other measures based on the cash flow statement.

34. Users commonly view free cash flow as a measure of performance, unlike some other measures based on the cash flow statement, such as capital expenditure. Viewed as a measure of performance, free cash flow could align to the project objective when expressed as providing improved information on a wider view of performance.

Complexities

35. Including measures based on the cash flow statement in the scope of the management performance measure requirements could create the need for guidance on how to apply the requirements. The staff has identified three such areas that could be complex to resolve, namely:

    (a) the various types of information communicated by the cash flow statement, some of which is considered to communicate performance and some not (paragraphs 36–38);

(b) the need for guidance on reconciling to the most directly comparable subtotal or total specified in IFRS Standards (paragraph 39); and

(c) the lack of applicability of the requirement to disclose the tax effects and non-controlling interests on items reconciling a measure to the most directly comparable subtotal or total specified in IFRS Standards (paragraph 40).

36. The cash flow statement provides information that many stakeholders consider relates to performance and information that does not, for example capital expenditure. The Board could decide to expand the scope to include only measures that communicate performance or only free cash flows.

37. However, if the Board decided to include only measures that communicate performance or free cash flows guidance may be needed to help entities identify those cash flow measures. Such guidance may be complex. For example, determining which cash flow measures communicate performance could require a definition of performance. The diversity in how entities calculate free cash flow may make defining it challenging, particularly in cases where entities use similar measures but do not label them as free cash flows.

38. According to the definition in the Exposure Draft, management performance measures are measures that communicate management's view of an aspect of performance. If the Board decided to expand the scope to include all measures based on the cash flow statement, it would need to amend the definition of management performance measures so it no longer refers solely to management's view of performance. This could also be complex.

39. Measures based on the cash flow statement, such as free cash flow, generally have no directly comparable measures specified in IFRS Standards. Many entities reconcile free cash flow to the operating cash flow, but not all entities do so, and they may require further guidance on how to apply this requirement in such cases.

40. The requirement in the Exposure Draft to disclose the tax effects and non-controlling interests on items reconciling a measure to the most directly comparable subtotal or total specified in IFRS Standards cannot apply to measures based on the cash flow statement. As explained in paragraphs BC176–BC177 of the Exposure Draft, the

requirement for this disclosure was included to provide the information required to calculate an adjusted earnings per share based on a management performance measure. Because earnings per share is not based on cash flows, these disclosures would not be relevant, and guidance to exempt measures based on the cash flow statement would be required.

Risks

41. Stakeholders may see a decision to expand the scope of management performance measures to include measures based on the cash flow statement as inconsistent with the decision not to review IAS 7 *Statement of Cash Flows* as part of this project, and could increase their demand for wider changes to the cash flow statement within the project.

42. If cash flow based measures are included in the scope of management performance measures, stakeholders will not have had the opportunity to comment on their inclusion and the changes may affect respondents' views. Even if the scope were limited to cash flow measures that communicate performance, such as free cash flows, which are closer to project objective and to the measures we already consulted on, additional outreach would be needed, in particular to better understand the implications of necessary changes to the management performance measure disclosure requirements. The Board would need to consider the extent of that outreach, including whether the expansion of the scope would require re-exposure.

43. In March 2021 the Board published its *Request for Information—Third Agenda Consultation* which seeks stakeholder views on financial reporting issues that could be added to the work plan. The cash flow statement and related matters is included in the *Request for Information* as one of the financial reporting issues frequently suggested by stakeholders in the Board's outreach in preparation for the *Request for Information*. Should the Board undertake more extensive work on the cash flow statement as a result of the consultation, related non-GAAP measures could be considered in that project.

Staff recommendation

44. Including measures or a subset of measures based on the cash flow statement would provide transparency and discipline over some widely used measures, in particular free cash flow. However, developing guidance to determine any subset of measures that would be included and clarifying the application of the disclosure requirements for such measures would require significant time. Developing guidance on reconciling cash flow-based measures to measures specified in IFRS Standards could be particularly complex. Significant stakeholder outreach on proposed changes would be required.

45. In the staff's view, the time required to resolve the complexities and to consult on the changes required could significantly delay the delivery of the project proposals, including those for management performance measures. There is also opportunity to look at measures related to the cash flow statement in a potential future project. For these reasons the staff recommends not exploring further expanding the scope of the management performance measure requirements to include measures based on the cash flow statement in this project.

Question 3
3 Does the Board agree with the staff recommendation not to explore expanding the scope of management performance measures to include measures based on the cash flow statement?

Measures based on the statement of financial position

46. All measures based on the statement of financial position are excluded from the scope of management performance measures in the Exposure Draft. This section explores the benefits, complexities, and risk of expanding the scope of proposals to include measures based on the statement of financial position. This section does not discuss ratios that include measures based on the statement of financial position, these are discussed together with other ratios, in paragraphs 60–78.

Benefits

47. Including measures based on the statement of financial position would improve transparency and discipline for some widely used measures, in particular net debt. Many respondents to the Exposure Draft with concerns about the scope of management performance measures used net debt as an example of a measure that, in their opinion, should be included in the scope. A few respondents raised concerns over the exclusion of industry-specific measures such as net asset value for investment entities. In the staff's research net debt was one of the most widely used non-GAAP measures: 68 of 113 non-financial entities in the sample used this measure.

48. However, the staff's research found that many entities already disclose information about net debt in the financial statements to meet requirements in IAS 7 to disclose information about changes in liabilities from financing activities or in IAS 1 to disclose information about its capital. This practice may mean the incremental benefits of including such measures as management performance measures are limited. For example, of the 68 entities that presented net debt, 43 disclosed that they either identified net debt as a component of capital or a measure used to manage capital and most of those provided information about its composition as part of meeting the capital disclosure requirements in paragraphs 134 and 135 of IAS 1.

49. The staff also found that the most useful information for users regarding net debt is the detail of what contributed to the period-to-period movement in the measure. The disclosure requirements for management performance measures proposed in the Exposure Draft were developed with income and expenses in mind and focussed on their composition. Unless the Board required a period-to-period reconciliation as part of the disclosure requirements, the incremental benefits of expanding the scope to include these measures may be limited.

Complexities

50. Including measures based on the statement of financial position in the scope of the management performance measure requirements create the need for guidance on how

to apply the requirements. The staff has identified four areas that may be complex to resolve, namely:

(a) the need for guidance on reconciling measures based on the statement of financial position (paragraphs 51–52);

(b) the need to revise the definition of management performance measures from ‘management’s view of an aspect of performance’ (paragraph 53);

(c) the potential for duplication of disclosures (paragraph 54);

(d) the lack of applicability of the requirement to disclose the tax effects and non-controlling interests on items reconciling a measure to the most directly comparable subtotal or total specified in IFRS Standards (paragraph 55).

51. Including measures based on the statement of financial position would require guidance for reconciling such measures to a directly comparable measure specified in IFRS Standards. Such guidance would be required because the statement of financial position specifies few subtotals that can be used as anchors in a reconciliation. For example, the most frequently identified measure, net debt, is not defined or specified in IFRS Standards. In the staff’s research, some entities reconciled net debt to liabilities from financing activities, and explained in which items in the statement of financial position they were included. However, entities do not always reconcile net debt to liabilities from financing activities. As with measures based on the cash flow statement, the Board would need to develop guidance to include such measures within the scope of the management performance measures requirements, including potentially specifying directly comparable measures within IFRS Standards.

52. Alternatively, the Board could develop different reconciliation requirements for measures based on the statement of financial position. For example, requiring an explanation of the composition of the subtotal and providing a reconciliation from opening to closing balances.

53. Measures based on the statement of financial position are generally not considered performance measures. Including such measures in the scope of the management performance measures requirements would require incorporating ‘management’s view of an aspect of financial position’ in the definition. As with measures based on the

cash flow statement, doing so may have broader implications—for example, re-evaluating the aim of management performance measures and whether the aim is transparency generally or improved reporting of performance, and the consequences of the conclusion.

54. The use of net debt to meet aspects of the disclosure requirements in IAS 1 and IAS 7 could result in the duplication of disclosure requirements if such measures were also included in the scope of the management performance measures requirements. Guidance may need to be developed to avoid:

(a) duplication of disclosures, which may add to complexity or clutter in the financial statements; and

(b) confusion over how the information is used to comply with the disclosure requirements of different IFRS Standards.

55. The requirement in the Exposure Draft to disclose the tax effects and non-controlling interests on items reconciling a measure to the most directly comparable subtotal or total specified in IFRS Standards would not apply to measures based on the statement of financial position for the reasons explained in paragraph 40. The Board would need to develop guidance to exempt these measures.

Risks

56. Measures based on the statement of financial position are generally not considered to be measures of performance. Such measures are therefore furthest from the project objective. Stakeholders that agreed with the management performance measure requirements for the reasons in the Exposure Draft may not agree with expanding the scope of the proposals to meet different objectives. To mitigate this risk, additional outreach would be needed, in particular to understand the implications of necessary changes to the management performance measure disclosure requirements. The Board would need to consider the extent of that outreach, including whether the expansion of the scope would require re-exposure.

57. Stakeholders providing feedback on the Exposure Draft did not specifically request wider changes to the statement of financial position. However, if the scope of the management performance measure proposals were extended to include measures

based on this statement, stakeholders could demand a wider review of the statement within the project.

Staff recommendation

58. Including measures based on the statement of financial position would provide transparency and discipline over some widely used measures, in particular net debt. However, the incremental benefits of including net debt in the scope, may be limited due to its inclusion in existing disclosures in the financial statements by many entities. Additionally, such measures would not contribute to the project objective and would require the definition of management performance measures to be revised. Clarifying or amending the application of the disclosure requirements for such measures would require significant time, in particular in relation to reconciliations. Significant stakeholder outreach would be required on the expansion of the scope beyond the project objective and to test whether the effects of the revised proposals are as expected.

59. In the staff's view, the time required to resolve the complexities and to consult on the changes required could significantly delay the delivery of the project proposals, including those for management performance measures and, in our view, is not justified by the expected benefits. The staff therefore recommends not exploring further the possibility of expanding the scope of the management performance measure requirements to include measures based on the statement of financial position.

Question 4
4 Does the Board agree with the staff recommendation not to explore expanding the scope of management performance measures to include measures based on the statement of financial position?

Ratios

60. The scope of management performance measures in the Exposure Draft excludes all measures that are ratios. This section explores the benefits, complexities, and risk of expanding the scope of proposals to include ratios themselves. This section does not explore including the numerator or the denominator in a ratio in the scope of the management performance measure requirements because:

    (a) we think these components would already be in the scope if the Board:

        (i) decides to consider expanding the scope of management performance measures to include measures based on statements of cash flows or financial position; and

        (ii) agrees with the staff recommendation in question 1 that the numerator or denominator in a ratio could be a management performance measure on their own,

    (b) we do not think the Board should consider bringing components of a ratio in the scope of the management performance measures if those components were not in the scope as individual measures. For example, in the ratio adjusted EBITDA/net debt we would not expect the Board to consider bringing net debt in the scope of the management performance measures if the Board decides that net debt on its own should not be in the scope. However, in such circumstances, we think the Board could still consider specific disclosure requirements to achieve full transparency, as discussed in paragraphs 68–71.

Benefits

61. Ratios are frequently used non-GAAP measures. Many respondents to the Exposure Draft with concerns about the scope of management performance measures used ratios of return as examples of measures that, in their opinion, should be included in the scope of the requirements. The staff's research on non-GAAP measures used in practice but not included in the definition of management performance measures showed that entities used two main types of ratios, namely:

(a) ratios of return (such as return on capital employed)—used 130 times by 85 entities; and

(b) liquidity and solvency ratios (such as debt to equity)—used 65 times by 60 entities.

62. Ratios of return are generally considered to communicate performance. Including such measures in the scope of the requirements, at least for this subset of ratios, would contribute to the project objective. However, other ratios, for example ratios of liquidity and solvency, are generally not considered to communicate performance and we think would not contribute to the project objective.

63. Overall, we think the incremental benefits of bringing ratios in the scope are limited because, as discussed in paragraph 60, we expect most components of ratios would be management performance measures on their own. However, there are some benefits which include:

(a) transparency about the components of ratios that do not meet the definition of a management performance measure (see discussion in paragraph 69); and

(b) transparency and discipline for a ratio as a whole.

Complexities

64. Including ratios in the scope of the management performance measure requirements would create the need for guidance on how to apply the requirements. The staff has identified three such areas that could be complex to resolve, namely:

(a) the various types of information communicated by ratios, some of which is considered to communicate performance and some which is not (paragraphs 65–67);

(b) the need for guidance to clarify which disclosure requirements should apply, specifically to any components of ratios which are not management performance measures on their own (paragraphs 68–71); and

(c) the need for guidance on faithfully representing a ratio with respect to the relationship between its numerator and denominator (paragraph 72).

Information communicated by ratios

65. Similar to measures based on the cash flow statement, some ratios provide information that stakeholders consider relates to performance, and some ratios provide information that does not.

66. If the Board decided to expand the scope to include only measures that communicate performance, guidance may be needed to help entities identify which ratios communicate performance. Such guidance may be complex. For example, a definition of performance may be required.

67. If the Board decided to expand the scope without limiting it to the measures that communicate performance, defining what that scope is would also be complex due to the diversity of information that ratios can be used to communicate. For example, ratios can combine components of different financial statements to communicate information about not only the content of the financial statements, but also the relationships between those components.

How should disclosure requirements apply?

68. The Exposure Draft requires an entity to disclose information about why a management performance measure communicates management's view of performance, including how it is calculated and how it provides information about the entity's performance (see Appendix A). This information can be provided for ratios as a whole. However, the requirement to reconcile to the most directly comparable subtotal or total specified by IFRS Standards can only apply to the individual subtotal or line item which, in the case of ratio, is its numerator or denominator. We expect that, if the Board agrees with recommendation in Question 1 in this paper, for many ratios the numerator and the denominator would be in the scope of the requirements, and as such a reconciliation would be provided. This would not always be the case though.

69. To provide transparency in the cases when a ratio includes a measure that is not in the scope of management performance measures, the Board could consider providing limited disclosure requirements. For example, if the Board agrees with the staff recommendations in Questions 1 and 3, in the ratio adjusted EBITDA/net debt, the

subtotal adjusted EBITDA could be a management performance measure but net debt could not. If the Board decided that adjusted EBITDA/net debt ratio is in the scope, the Board could for example consider requiring an explanation of how net debt is calculated.

70. However, developing requirements that could apply in all cases may be complex. For example, there may be ratios where the numerator or denominator is:

    (a) a physical measure (for example, store surface measured in square feet);

    (b) an average (for example, weighted average capital employed during the period); or

    (c) a measure not generally used on its own outside of a ratio (for example, capital employed).

71. It may be complex to provide additional disclosure requirements that would ensure such measures are transparent, can be related to the financial statements and can be made subject to audit.

Faithful representation

72. Including ratios in the scope of the management performance measure requirements may also require guidance on ratios faithfully representing what they purport to represent. Being comprised of a numerator and denominator presents the possibility for each to be prepared using different assumptions. For example, a measure of return on assets might include revenues generated from a particular asset in the numerator but exclude that asset from the denominator. Inconsistent assumptions raise the question whether the information communicated by the ratio is faithfully represented. To aid consistent application and auditability of ratios, guidance or requirements on maintaining consistency may be required.

Risks

73. Some ratios, such as ratios of return, are generally considered measures of performance, but others, such as liquidity ratios, are not. If measures outside the project objective are included in the scope of management performance measures, respondents to the Exposure Draft would not have had the opportunity to comment on

them and the changes may have affected respondents' views. The Board would need to conduct outreach to mitigate these risks. The Board would need to consider the extent of that outreach, including whether the expansion of the scope would require re-exposure.

74. As discussed in paragraph 71, resolving some of the complexities of applying the disclosure requirements may give rise to other risks. Agenda Paper 21B from the March 2021 Board meeting discussed stakeholders' concerns about the audit of management performance measures and application of the requirement for a management performance measure to faithfully represent aspects of performance. That paper explained that suggestions from respondents provided evidence that these concerns could be resolved with additional disclosure requirements.

75. The risks arising from including physical measures and requiring consistency between the numerator and denominator increase the risk that additional disclosure requirements will not fully address stakeholder concerns over the audit of management performance measures and the application of the requirement to faithfully represent an aspect of performance.

Staff recommendations

76. Including ratios in the scope of the proposals would bring transparency and discipline to some widely used measures, some of which contribute to the project objective, because they communicate performance. However, the benefits would generally be limited to information about measures as a whole, because we expect that in most cases components of ratios would be management performance measures on their own. There would be significant risks with this approach, in particular relating to measures which are usually not included in the financial statements, such as physical measures and possible additional audit concerns.

77. In the staff's view, the benefits of bringing ratios in the scope do not justify managing these risks, which we expect to cause significant delay to the project. The staff therefore recommends not to further explore expanding the scope of the management performance measures to include ratios.

78. If the Board agrees with this and the other recommendations in the paper, we would have an outcome where a management performance measure used in a ratio is in the scope of the requirements but the ratio itself and the other measure in the ratio are not. To provide full transparency relating to use of management performance measures, the Board could require specific disclosures relating to measures otherwise outside the scope of the requirements, when used in communicating management performance measures. However, complexities arising from providing such disclosure requirements are similar to the complexities involved with bringing ratios and other measures in the scope of requirements. For the same reasons that we recommend not expanding the scope to include these measures, we do not recommend that the Board considers this approach.

Question 5
5 Does the Board agree with the staff recommendation not to explore expanding the scope of management performance measures to include ratios?

Appendix A—Extracts of management performance measure requirements from Exposure Draft

Management performance measures

103 ***Management performance measures*** **are subtotals of income and expenses that (see paragraphs B76–B81):**

(a) are used in public communications outside financial statements;

(b) complement totals or subtotals specified by IFRS Standards; and

(c) communicate to users of financial statements management's view of an aspect of an entity's financial performance.

104 Subtotals specified by IFRS Standards that are not management performance measures include:

(a) a total or subtotal required by paragraphs 60 and 73;

(b) gross profit or loss (revenue less cost of sales) and similar subtotals (see paragraph B78);

(c) operating profit or loss before depreciation and amortisation;

(d) profit or loss from continuing operations; and

(e) profit or loss before income tax.

105 Management performance measures shall:

(a) faithfully represent aspects of the financial performance of the entity to users of financial statements; and

(b) be described in a clear and understandable manner that does not mislead users.

106 An entity shall disclose information about any management performance measures in a single note to the financial statements. That note shall include a statement that the management performance measures provide management's view of an aspect of the entity's financial performance and are not necessarily

comparable with measures sharing similar descriptions provided by other entities. In addition, for each management performance measure an entity shall disclose in the notes (see paragraphs B82–B85):

(a) a description of why the management performance measure communicates management's view of performance, including an explanation of:

(i) how the management performance measure is calculated; and

(ii) how the measure provides useful information about the entity's performance;

(b) a reconciliation between the management performance measure and the most directly comparable subtotal or total included in paragraph 104;

(c) the income tax effect and the effect on non-controlling interests for each item disclosed in the reconciliation required by paragraph 106(b); and

(d) how the entity determined the income tax effect required by paragraph 106(c).

107 An entity shall determine the income tax effect required by paragraph 106(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.

108 If an entity changes the calculation of its management performance measures, introduces a new management performance measure or removes a previously disclosed management performance measure from its financial statements, it shall:

(a) disclose sufficient explanation for users of financial statements to understand the change, addition or removal and its effects;

(b) disclose the reasons for the change, addition or removal; and

(c) restate its comparative information, including in the required note disclosures, to reflect the change, addition or removal.

109 A subtotal included in the statement(s) of financial performance applying paragraph 42 may be a management performance measure (see paragraph B81).

110 An entity shall not use columns to present management performance measures in the statement(s) of financial performance.

Management performance measures

Identifying management performance measures

B76 Paragraph 103 defines management performance measures. Some entities may have more than one management performance measure. However, not all entities will have management performance measures. For example, if an entity publicly communicates its financial performance to users of its financial statements, using only totals and subtotals specified by IFRS Standards, it will not have a management performance measure.

B77 Paragraph 104 specifies subtotals that are not management performance measures. An entity is not required to provide the disclosures specified in paragraph 106 for these subtotals.

B78 In accordance with paragraph 104(b) subtotals similar to gross profit are not management performance measures. A subtotal is similar to gross profit when it represents the difference between a type of revenue and directly related expenses incurred in generating that revenue. Examples include:

(a) net interest income;

(b) net fee and commission income;

(c) insurance service result;

(d) net financial result (investment income minus insurance finance expenses); and

(e) net rental income.

B79 Only subtotals that management uses in public communications outside financial statements, for example, in management commentary, press releases or in investor presentations, meet the definition of management performance measures.

B80 A management performance measure is a subtotal of income and expenses. Examples of measures that are not management performance measures include:

(a) individual items or subtotals of only income or expenses (for example, adjusted revenue as a stand-alone measure);

(b) assets, liabilities, equity or combinations of these elements;

(c) financial ratios (for example, return on assets);

(d) measures of growth;

(e) measures of liquidity or cash flows (for example, free cash flow); or

(f) non-financial performance measures.

B81 A subtotal presented in the statement(s) of financial performance to comply with paragraph 42 may meet the definition of a management performance measure. When such a subtotal meets that definition, an entity shall disclose all the information required by paragraph 106.

Management performance measures note disclosure

B82 All information required to be disclosed about management performance measures shall be included in a single note.

B83 In some cases, one or more of an entity's management performance measures may be the same as part of the operating segment information disclosed by the entity in applying IFRS 8. In such cases, the entity may disclose the required information about those management performance measures in the same note that it uses to disclose information about its operating segments provided the entity either:

(a) includes in that note all of the information required by paragraph 106 for management performance measures; or

(b) provides a separate note that includes all of the information required for management performance measures.

B84 Paragraph 106(a)(i) requires an explanation of how a management performance measure is calculated. To comply with this requirement an entity shall explain the specific principles, bases, conventions, rules and practices it applies in calculating its management performance measures.

B85 Paragraph 106(b) requires an entity to reconcile its management performance measure(s) to the most directly comparable subtotal or total specified by IFRS Standards. For example, an entity that discloses in the notes adjusted operating profit or loss as a management performance measure would reconcile to operating profit or loss as the most directly comparable subtotal. In aggregating or disaggregating the reconciling items disclosed an entity shall apply the requirements in paragraphs 25–28.

Management performance measures (Basis for Conclusions)

BC145 When an entity provides one or more performance measures that meet the definition of management performance measures, the Board proposes to require entities to disclose information about such measures in their financial statements.

BC146 Research undertaken as part of the Primary Financial Statements project, feedback received on the 2017 Discussion Paper *Disclosure Initiative—Principles of Disclosure* and the 2015 Agenda Consultation indicated that:

(a) many entities disclose financial information outside the financial statements by providing management-defined performance measures in communications with users of financial statements; and

(b) users consider that information provided by such measures can be useful because it provides insight into:

  (i) how management views the entity's financial performance;

  (ii) how a business is managed; and

  (iii) the persistence or sustainability of an entity's financial performance.

BC147 However, users of financial statements expressed concerns about the quality of disclosures provided about these measures. According to users, 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.

BC148 Including disclosures about these measures in the financial statements could help address some of the concerns expressed by users of financial statements. However, some stakeholders raised concerns about including management-defined performance measures in financial statements prepared applying IFRS Standards, which were that:

(a) management-defined performance measures may be incomplete or biased and therefore including them in the financial statements may be misleading to users of financial statements;

(b) management-defined performance measures may be given undue prominence or legitimacy by including them in the financial statements; and

(c) some adjustments made in calculating management-defined performance measures may be difficult to audit—for example, adjustments made when an entity calculates its performance measures using accounting policies that do not comply with IFRS Standards.

BC149 The Board considered the concerns raised, noting that management-defined performance measures that meet the definition of management performance measures, and would thus be included in the financial statements:

(a) would be subject to the general requirement for information to faithfully represent what it purports to represent, which would not be met if measures were misleading (see paragraph BC158).

(b) would rarely be presented in the statement(s) of financial performance (see paragraphs BC163–BC166).

(c) are similar to segment measures of profit or loss in that they are based on management's view. Segment measures of performance are included in the financial statements and are audited.

B150 Some stakeholders also expressed concerns that management performance measures may proliferate if they are included in the financial statements. The Board noted that it is difficult to predict the effect of the proposals on the number of management performance measures an entity would use. While it is possible that the use of such measures would increase as a result of the Board's proposals, it is also possible that the use of management performance measures would decline if entities choose to use the proposed new subtotals to communicate their performance instead. Paragraphs BC304–BC307 include further discussion of the expected effects of the proposals for management performance measures on the use of performance measures defined by management.

BC151 The Board acknowledges the concerns of some stakeholders, but concluded that management performance measures can complement measures specified by IFRS Standards, providing users of financial statements with useful insight into management's view of performance and its management of the business. Including these measures in the financial statements would make them subject to the same requirements regardless of the entity's jurisdiction and would improve the discipline with which they are prepared and improve their transparency.