

IASB® meeting

Project	Primary Financial Statements	
Paper topic	Management performance measures—faithful representation	
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Objective

1. This paper sets out staff analysis and recommendations relating to the proposal in the Exposure Draft *General Presentation and Disclosures* to require management performance measures to faithfully represent aspects of the financial performance of the entity to users of financial statements. This paper should be read in conjunction with Agenda Paper 21B relating to other aspects of the definition of management performance measures.
2. This paper discusses feedback on the requirement for management performance measures to faithfully represent aspects of the financial performance of the entity to users of financial statements, adding detail to the discussion in Agenda Paper 21H of the December 2020 Board meeting.
3. In future papers, we plan to discuss:
 - (a) interaction of management performance measures with other requirements including:
 - (i) proposals for unusual income and expenses;
 - (ii) segment reporting;
 - (iii) subtotals in the statement(s) of financial performance;
 - (iv) earnings per share measures; and

- (v) measures excluded from being management performance measures;
and
- (b) disclosure requirements for management performance measures, including:
 - (i) the proposals relating to the reconciliation;
 - (ii) the requirement to disclose tax and non-controlling interests;
 - (iii) presentation restrictions such as the restriction on the use of columns;
and
 - (iv) whether specific guidance is needed for non-GAAP measures that are not management performance measures.

Summary of staff recommendations in this paper

4. The staff recommend that the Board:
- (a) add application guidance clarifying how an entity applies the requirement to describe a management performance measure in a clear and understandable manner that does not mislead users. An entity would do so by:
 - (i) explaining the basis for determining the income and expenses the measure includes or excludes;
 - (ii) including definitions for terms not defined in IFRS Standards that are needed to understand the aspect of performance being communicated;
and
 - (iii) disclosing whether and how a management performance measure has been calculated using accounting policies that differ from those selected when applying IFRS Standards; and
 - (b) remove the specific requirement for management performance measures to faithfully represent aspects of the entity's financial performance to users of financial statements.

Structure of the paper

5. This paper is structured as follows:
 - (a) basis for including a requirement for faithful representation of management performance measures (paragraphs 6–9);
 - (b) feedback (paragraph 10);
 - (c) staff analysis (paragraphs 11–31); and
 - (d) Appendix A—Extracts of management performance measure requirements from Exposure Draft *General Presentation and Disclosures and Basis for Conclusions*.

Basis for including a requirement for faithful representation of management performance measures

6. Paragraph BC148 of the Basis for Conclusions for the Exposure Draft (see Appendix A) notes that some stakeholders were concerned that management-defined measures could be incomplete or biased and therefore misleading. Paragraph BC149 explains that management performance measures would be subject to the general requirement for information to faithfully represent what it purports to represent. Complying with this requirement would prevent misleading measures.
7. Paragraphs BC159–BC162 (see Appendix A) explain the Board’s consideration of some stakeholders’ concerns over restricting the disclosure of information about management performance measures to situations when those measures faithfully represent an aspect of performance.
8. Some stakeholders argued that such a restriction would be inconsistent with the objective of providing enough information about management performance measures to avoid misleading users, because:
 - (a) entities would not be prevented from presenting potentially misleading measures outside the financial statements;
 - (b) entities would be prevented from disclosing in the financial statements information about the measures most likely to be misleading; and

- (c) entities might avoid the disclosure requirements by not providing a faithful representation of measures.
9. However, as explained in paragraph BC161, in the Board’s view, all information included in the financial statements should provide a faithful representation of what it purports to represent. A management-defined performance measure that does not faithfully represent an aspect of the entity’s performance should not be included in the financial statements as a management performance measure.

Feedback

10. Many respondents did not comment on the requirement for a management performance measure to faithfully represent aspects of the entity’s financial performance. A few respondents agreed with the requirement but did not explain why. Some, mostly standard-setters and accountancy bodies, said they had concerns about the requirement for management performance measures to faithfully represent aspects of the financial performance of the entity because:
- (a) determining whether a measure provided a faithful representation would require judgement and therefore may be costly to apply and audit;
 - (b) requiring faithful representation may exclude many measures intended to be captured by the proposals, because non-GAAP measures that represent management’s view are often not neutral, and neutrality is an aspect of faithful representation set out in the *Conceptual Framework for Financial Reporting*; or
 - (c) specifying faithful representation as a requirement for management performance measures when it is already a general requirement for information in the financial statements could imply that it was less applicable to other IFRS Standards—particularly IFRS 8 *Operating Segments*, which also requires disclosures based on a management view of performance.

Staff analysis and recommendations

11. In responding to stakeholder feedback, the staff has considered:

- (a) how the requirement for faithful representation applies to management performance measures (paragraphs 12–26); and
- (b) whether a requirement for faithful representation specific to management performance measures should be included (paragraphs 27–31).

How does the requirement for faithful representation apply to management performance measures?

Faithful representation in the context of management performance measures

- 12. Paragraph 15 of IAS 1 *Presentation of Financial Statements* contains a requirement for fair presentation. This paragraph requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expense set out in the *Conceptual Framework*. The paragraph also states that the application of IFRS Standards, with additional disclosure when necessary, is presumed to result in financial statements that achieve a fair presentation.
- 13. The management performance measure requirements do not include restrictions on the calculation of measures within their scope. Thus, management performance measures may include measures that apply definitions or recognition criteria that differ from those set out in the *Conceptual Framework*. When a management performance measure applies definitions or recognition criteria that differ from those set out in the *Conceptual Framework*, judgement may be required to determine whether a management performance measure is faithfully represented (see paragraph 10(a)).
- 14. In the staff's view, an entity could achieve faithful representation for management performance measures even when they are based on definitions or recognition criteria that differ from those in the *Conceptual Framework*. The definition of faithful representation in the *Conceptual Framework* requires information to be complete, neutral and free from error. To achieve faithful representation for management performance measures, an entity would need to first describe in a clear and understandable manner the aspect of performance it is communicating, including the definitions and recognition criteria used. The entity would then need to apply those

definitions and recognition criteria in a way that is complete, neutral and free from error.

15. For example, a measure of ‘non-recurring profit’ could be faithfully represented by disclosing a clear and understandable definition of ‘non-recurring’ and then applying the characteristics of completeness, neutrality and freedom from error. These characteristics could be applied by including all non-recurring items within that definition (complete), excluding equally income and expenses (neutral) and being based on information selected and applied with no errors in the process (free from error).
16. Faithful representation does not by itself convey other information about the measure. It does not, for example, provide information about whether a measure is a ‘good’ or a ‘bad’ measure.
17. A management performance measure is faithfully represented with respect to the aspect of performance being communicated. The aspect of performance that a management performance measure communicates is entity-specific, because it is management’s view of that aspect. Faithful representation cannot be evaluated in relation to other measures either communicated by the entity or communicated by other entities.
18. Applying the disclosure requirements in the Exposure Draft (see Appendix A) helps an entity to faithfully represent its management performance measures. The requirement to explain how the measure is calculated helps users to understand how a measure is constructed. The requirement to explain how the measure provides useful information about the entity’s performance provides context to help users understand the aspect of performance being communicated. The required reconciliation to the most directly comparable measure specified in IFRS Standards helps users to understand how the measure differs from measures calculated applying IFRS Standards.
19. The Exposure Draft contains a requirement for an entity to describe a management performance measure in a clear and understandable manner that does not mislead users. However, given the importance of this requirement to faithful representation,

application guidance could improve consistent application and help address the stakeholder concerns explained in paragraph 10(a).

20. In the staff's view, a clear and understandable description would help a user understand what the measure includes or excludes and the basis for determining those items. Such a description would require definitions of any terms used that are not defined in IFRS Standards and are needed to understand the aspect of performance being communicated. When a measure is calculated using accounting policies that differ from those selected when applying IFRS Standards, a clear and understandable description would inform a user of this fact and explain how that accounting policy is applied.
21. The staff therefore recommends the Board add guidance about the application of the requirement to describe a management performance measure in a clear and understandable manner that does not mislead users. This guidance would clarify that such application would require explanation of the basis for determining which income and expenses are included or excluded and definitions of any terms used that are not defined in IFRS Standards and are needed to understand the aspect of performance being communicated. The guidance would also clarify that application of the requirement would require disclosure of when and how a management performance measure has been calculated using accounting policies that differ from those selected when applying IFRS Standards.

Can a requirement for faithful representation exclude useful measures?

22. Some respondents were concerned that the faithful representation requirement would prevent useful non-GAAP measures from being included in the scope of the management performance measure requirements (see paragraph 10(b)).
23. In the staff's view, a measure that does not faithfully represent what it purports to represent cannot provide useful information. The *Conceptual Framework* includes faithful representation as one of the two fundamental characteristics of useful information, along with relevance. By definition, a measure that did not faithfully represent what it purports represent would not be complete, not be neutral or not be free from error.
24. Further, paragraph 2.22 of the *Conceptual Framework* states:

In some cases, a trade-off between the fundamental qualitative characteristics may need to be made in order to meet the objective of financial reporting, which is to provide useful information about economic phenomenon. For example, the most relevant information about a phenomenon may be a highly uncertain estimate. In some cases, the level of measurement uncertainty involved in making that estimate may be so high that it may be questionable whether the estimate would provide a sufficiently faithful representation of that phenomenon. In some such cases, the most useful information may be the highly uncertain estimate, accompanied by a description of the estimate and an explanation of the uncertainties that affect it. In other such cases, if that information would not provide a sufficiently faithful representation of that phenomenon, the most useful information may include an estimate of another type that is slightly less relevant but is subject to lower measurement uncertainty. In limited circumstances, there may be no estimate that provides useful information. In those limited circumstances, it may be necessary to provide information that does not rely on an estimate.

25. This paragraph applies to information in general purpose financial reports, and the staff think management will generally apply the same ideas to measures communicated in public communications. Accordingly, we expect management will:
- (a) give sufficient descriptions and explanations of a measure to give a faithful representation, applying the requirements and application guidance described in paragraphs 14–21; or
 - (b) if it is not possible to achieve a faithful representation applying (a), choose another measure to communicate its performance, which is capable of being a faithful representation.
26. The staff think it will be rare for management not to apply the process set out in paragraphs 25(a) and 25(b) of this paper and instead to choose to use a measure for public communications that cannot be faithfully represented, because the measure would be misleading, and most regulators have guidance prohibiting the use of misleading measures. Hence, the staff do not think the requirement for faithful representation would prevent useful measures from being management performance measures.

Question for the Board

Q1 Does the Board agree with the staff's recommendations to add application guidance clarifying an entity applies the requirement to describe a management performance measure in a clear and understandable manner that does not mislead users by:

- (a) explaining the basis for determining the income and expenses the measure includes or excludes;
- (b) including definitions for terms that are not defined in IFRS Standards and are needed to understand the aspect of performance being communicated; and
- (c) disclosing whether and how a management performance measure has been calculated using accounting policies that differ from those selected when applying IFRS Standards.

Should there be a requirement for faithful representation specific to management performance measures?

27. A few respondents said that including a specific requirement for faithful representation of management performance measures, separate from the general requirement, may raise questions over its applicability to other Standards (see paragraph 10(c)). Some of these respondents said that a specific disclosure requirement is inconsistent with IFRS 8, which also includes measures based on management's view but does not include a specific requirement for faithful representation.
28. In the staff's view, faithful representation is a general requirement that will be applicable to management performance measures regardless of whether the specific requirement is retained.
29. The feedback indicates that having a specific requirement may cause confusion over the applicability of faithful representation both to management performance measures and to other IFRS Standards.

30. Not including a specific requirement in an IFRS Standard when a general requirement exists is consistent with the Board's approach to other general requirements, particularly materiality. Materiality and other general requirements are not usually specified, to avoid the impression that such general requirements are more or less applicable to any IFRS Standard.
31. To avoid any confusion with the application of the general requirements to other IFRS Standards, the staff recommends the Board remove the specific requirement for management performance measures to faithfully represent aspects of the financial performance of the entity to users of financial statements.

Question for the Board

Q2 Does the Board agree with the staff's recommendations to remove the specific requirement for management performance measures to faithfully represent aspects of the financial performance of the entity to users of financial statements?

Appendix A—Extracts of management performance measure requirements from the Exposure Draft *General Presentation and Disclosures and Basis for Conclusions*

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.

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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.

Basis for Conclusions on Exposure Draft *General Presentation and Disclosures*

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Management performance measures

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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 are audited.

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Definition and restrictions (paragraphs 103–105 and B76–B81)

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BC158 The Board noted that management performance measures disclosed in the notes to the financial statements would need to comply with the general requirements for information included in financial statements. That is:

- (a) the management performance measure must faithfully represent the aspect of financial performance of the entity it purports to represent;
- (b) the disclosures supporting the management performance measure must comply with the proposed guidance on aggregation and disaggregation, for example, when disclosing reconciling items;
- (c) comparative information should be provided for the management performance measure and related disclosures; and
- (d) the management performance measure should be calculated consistently from one period to the next and be subject to change only if the new measure provides more useful information.

BC159 Some stakeholders argue that there should be no restriction on when an entity can disclose information about its management performance measures. In their view, one of the main objectives of the management performance measure proposals is to provide users of financial statements with enough information to prevent them from being misled by these measures. They argue that restricting the disclosure of information about management performance measures to situations when those measures faithfully represent an aspect of an entity’s performance is inconsistent with that objective because:

- (a) the requirements of IFRS Standards cannot prevent disclosure of potentially misleading measures outside the financial statements. While in some

jurisdictions local law or regulation may prevent the disclosure of such measures, this is not always the case.

- (b) the requirement that a management performance measure must faithfully represent an aspect of an entity's performance would prevent the disclosure of useful information about such measures in circumstances when users are most likely to be misled.
- (c) entities wishing to avoid the proposed disclosure requirements could do so by disclosing performance measures outside the financial statements that they believe would be assessed by their auditors or regulators as not providing a faithful representation.

BC160 These stakeholders also note that IFRS 8 does not place a similar explicit restriction on the disclosure of segment information which reflects the views of management.

BC161 The Board acknowledges that including information about such measures in the financial statements may increase transparency about these measures. However, the Board thinks that all information included in the financial statements should provide a faithful representation of what it purports to represent. A management-defined performance measure that does not faithfully represent an aspect of an entity's performance should not be included in the financial statements as a management performance measure.

B162 The Board also considered whether it should specifically state that management performance measures should not be misleading. The Board rejected such a proposal as unnecessary because misleading measures would not provide a faithful representation of the financial performance of the entity.