IFRS™

STAFF PAPER

February 2015

IASB Meeting

Project	**Disclosure Initiative**		
Paper topic	Principles of Disclosure—Alternative Performance Measures		
CONTACT(S)	Eduardo Baldoino	ebaldoino@ifrs.org	+44 (0)20 7246 6462
	Holger Obst	obst@drsc.de	+49 (0)30 2064 1229
	Kristy Robinson	krobinson@ifrs.org	+44 (0)20 7246 6933
	Alan Teixeira	ateixeira@ifrs.org	+44 (0)20 7246 6442

This paper has been prepared by the staff of the IFRS Foundation for discussion at a public meeting of the IASB and does not represent the views of the IASB or any individual member of the IASB. Comments on the application of IFRSs do not purport to set out acceptable or unacceptable application of IFRSs. Technical decisions are made in public and reported in IASB *Update*.

1. Most concerns we hear within the context of non-IFRS information relate to the presentation and disclosure of APMs. In this paper we discuss the definition (description) of an APM and whether some constraints should be written into IFRS about APMs. We also discuss EBIT and EBITDA as examples of additional subtotals that some commentators view as being non-IFRS measures.

2. We make the following recommendations:

   (a) That IFRS should not prohibit the disclosure of APMs in the (primary) financial statements or in the notes (paragraph 31);

   (b) That IFRS should include some qualitative constraints (as set out in paragraph 32) on the use of APMs in the (primary) financial statements and the notes (paragraph 32);

   (c) That IFRS should include additional guidance on the depiction of non-recurring, unusual or infrequently occurring items in the statement of comprehensive income. However, the staff have identified three ways that the guidance could be developed and the IASB is asked to indicate their preferred approach (paragraph 46); and

   (d) That if EBIT or EBITDA are presented as a subtotal in the statement of profit or loss in accordance with paragraphs 85-85B of IAS 1, and that

The IASB is the independent standard-setting body of the IFRS Foundation, a not-for-profit corporation promoting the adoption of IFRSs. For more information visit www.ifrs.org

statement is presented 'by nature', that presentation would be in accordance with IFRS (paragraph 54).

What is an APM?

3. As we have described in Paper 11A, some regulators would treat a subtotal such as gross margin as an APM, because it is not specified or defined in IFRS. Others would treat this as a legitimate subtotal that is an IFRS number.

4. We think the APMs that we should look at are those conveyed by an entity as an alternative (ie competing) measure of performance, to which the entity gives more emphasis than it does to the IFRS measures. These APMs tend to exclude some income or expense items to convey management's view of profit or loss. Common terms used to identify these measures include, among others, 'underlying earnings', 'normalised profit', 'pro forma earnings', 'cash earnings', 'EBITDA', 'adjusted earnings', and 'earnings before non-recurring items'.[1]

5. Before we discuss these concerns further, we think it is important to note that, for the most part, investors find APMs useful for assessing the financial results of an entity.

6. A recent survey of investors conducted by PricewaterhouseCoopers found that, of those interviewed, a substantial majority find 'adjusted performance measures' useful.[2] This view is consistent with Standard and Poors Rating Services' view expressed in its response to ESMA's Consultation Paper on *Guidelines on Alternative Performance Measures*[3]:

> "APMs reported within or outside the financial statements can provide useful information for understanding the financial condition, results of operations and/or cash flows of the business and therefore be relevant to analysis..."[4]

---

[1] IOSCO's Proposed Statement on Non-GAAP Financial Measures, September 2014 (see Agenda Paper 11D)

[2] http://www.pwc.com/en_GX/gx/audit-services/corporate-reporting/publications/investor-view/assets/pwc-investors-survey-apms-july-2014.pdf

[3] http://www.esma.europa.eu/system/files/esma-2014-175_cp_on_the_draft_guidelines_on_apms.pdf

[4] Page 5, http://www.esma.europa.eu/system/files/esma_alternative_performance_measures_14_may_2014.pdf

7. We understand that investors find APMs useful because they can provide information about:

   (a) an entity's performance that may not be apparent from accounts prepared under IFRS (or other accounting standards). There is a view that a single standardised set of metrics can never be sufficient information to understand an entity's position or performance;

   (b) management's view of what is 'underlying' or 'core' to the entity; and

   (c) the nature of management's decisions; eg even APMs that are viewed as being biased can provide information that is useful in assessing management's character.

8. Having said that, some investors qualify their comments by saying that APMs need to be presented in a fair manner that is not misleading.[5]

9. The type of research in this area that would be helpful is the examination of metrics that suggest how markets react to APMs, such as share price movements that could give some evidence of 'corrections', trading volume changes and changes in analysts' estimates of forecast earnings. Unfortunately, there is very little research of this type, because it generally requires extensive hand-collection of data from earnings announcements and financial statements. It is also difficult to differentiate between market responses to the APM and market responses to the IFRS measures when they are released at the same time. In the only comprehensive study we are aware of, the practice of separating profit or loss into 'operating profit' and management-classified 'unusual and extraordinary items' was found to be consistently more informative than the aggregate profit or loss.

10. The challenge for us is to anticipate the types of APMs that could potentially mislead investors, or for us to put some constraints upon APMs to protect the credibility of the financial statements.

11. We think it is difficult to draw a hard and fast line between APMs that are non-IFRS and APMs that are not only consistent with IFRS but are actually required by IFRS. In addition, we do not think that it would be particularly helpful or fruitful to do so.

---

[5] CFA UK—Response to IOSCO's Proposed Statement on Non-GAAP Financial Measures, September 2014

However, we think we can identify the circumstances in which an APM starts to undermine IFRS, and we can do that mainly by using the qualitative characteristic of faithful representation.

12. Separately identifying a major expense item that is different in some way from the other activities, such as costs that an entity incurred as a result of a natural disaster, is likely to be required by IAS 1. We suspect that few users would disagree with this view. However, if an entity selectively isolates (presents separately) only *some* such costs, but not others, this would seem to breach the qualitative characteristic of faithful representation, because the selectivity is not neutral.

13. In our view, APMs presented within the financial statements would be a concern if they change the information set available to investors in a way that results in investors being misled into taking actions they would not otherwise have taken. As new information becomes available the investors will become aware that they have been misled.

14. As discussed in paragraph 24 of Paper 11A we think there is a presumption that financial performance measures defined or specified by IFRS provide the best anchor from which to assess an entity's financial performance. Consequently, understanding the relationship between the measure defined or specified in IFRS and the APM enables an investor to fairly assess that APM.

15. Many of the concerns we have heard about APMs relate to difficulties in being able to fairly assess those measures. These concerns include:

    (a) difficulty in understanding APMs because they are not defined by the entity and/or they cannot be easily derived or reconciled back to financial statements;

    (b) difficulty comparing APMs across periods, because even if the APMs are defined, the definition is inconsistently applied, ie it is changed often;

    (c) difficulty comparing APMs between entities because of the lack of standardised definitions that apply across entities;

    (d) presentation of APMs in a way that obscures measures that are defined or specified in IFRS; and

(e) presentation of APMs in a way that presents an excessively optimistic picture of an entity's financial performance.

16. Most examples used to illustrate concerns about the use of APMs in financial statements relate to disclosure on the face of the statement of comprehensive income. These concerns include:

    (a) presentation/disclosure of additional subtotals on the face of the statement of comprehensive income, including EBIT (see Agenda Paper 11D Example 4);

    (b) the depiction of financial effects arising from non-recurring, unusual or infrequently occurring transactions and events (see Agenda Paper 11D Examples 1 and 4); and

    (c) improper early application of IFRS ie disclosure of information prior to the adjustment of a particular Standard (see Agenda Paper 11D Example 3).

Additional subtotals on the face of the statement of comprehensive income and statement of financial position

17. IFRS defines or specifies few of the subtotals commonly observed in practice in the statement of comprehensive income and the statement of financial position. Examples include gross margin, gross profit, operating profit, EBIT and EBITDA. Because of this, some view some of these subtotals as being APMs/non-GAAP measures and view them in a negative light.

18. In December 2014, the IASB published narrow-focus amendments to IAS 1 clarifying the presentation of additional subtotals in the statements of financial position and comprehensive income that are relevant to an understanding of the entity's financial position and financial performance. Paragraphs 55A and 85A of IAS 1 now provide that additional subtotals in those statements shall:

    (a) be comprised of line items made up of amounts recognised and measured in accordance with IFRS;

    (b) be presented and labelled in a manner that makes the line items that constitute the subtotal clear and understandable;

(c) be consistent from period to period; and

(d) not be displayed with more prominence than the subtotals and totals required in IFRS for that statement.

19. In addition, paragraph 85B of IAS 1 provides that entities must reconcile any additional subtotals in the statement of comprehensive income with the subtotals or totals required in IFRS for that statement.

20. We think these amendments adequately address the concerns about APMs raised in paragraphs 8 and 15 above. Subject to our discussion in paragraph 33 on non-recurring items, we do not think any further guidance in IFRS on the presentation of subtotals in these statements is necessary.

Other forms of disclosure of APMs on the face of the financial statements and in the notes

21. So far we have talked about subtotals on the statements of financial position and comprehensive income. Our conclusion was that the recent amendments in paragraphs 55A and 85A-B of IAS 1 would address many of the concerns raised about the fair presentation of APMs presented as additional subtotals in those statements.

22. However, these recent amendments to IAS 1 do not apply to the statement of cash flows or to the statement of changes in equity. In addition, they do not extend to the situations in which the APMs are 'disclosed' on the face of the financial statement. These are situations in which the APMs are not amounts included in the totals for that statement either as a line item or a subtotal, ie they do not form part of the financial statement itself even though they might be presented on the 'same page'. Examples include:

(a) additional columns; for example showing the early application of an IFRS, disaggregating non-recurring items, segments or other adjustments (see Paper 11D, Examples 2 and 3); and

(b) disclosure above the first line item of the statement or below the statement total (see Paper 11D, Examples 1 and 4).

23. The disclosure of additional columns was the basis for a request received from regulators to the IFRS IC to clarify the application of some of the presentation requirements in IAS 1.[6]

24. Those concerns are also echoed by various regulators and they either (i) already prohibit such disclosures from complete set of financial statements, (ii) only permit the disclosure in the notes, or (iii) permit the disclosure only in exceptional circumstances, and then only in the notes.

25. We think that disclosures on the face of the financial statements need special attention. Many constituents we talked to believe there is a need to protect the integrity of IFRS regarding the disclosures in primary financial statements. There are fewer concerns about adding useful information as part of the notes.

26. As discussed with the IASB in October 2014 within the context of the role of the notes and the 'primary' financial statements, information in those financial statements generally attracts more attention by users as compared to the information in the notes.[7] Consequently, concerns exist that any additional information disclosed on the face of those statements may give undue prominence to that information and hence receive excessive attention by users. In short, if that information is placed there, it has a greater ability to mislead.

27. We also believe that the IASB has already expressed similar concerns by its tentative decision in the *Insurance Contracts* project to prohibit volume information that is not consistent with insurance contracts revenue and therefore may confuse investors.

28. As further discussed with the IASB in October 2014, we think that 'primary financial statements' should provide a user of the financial statements with an overview of the financial position and performance that helps the user to identify areas of particular interest within the complete set of financial statements and to compare, at a basic level, the summary information with that of other entities.

---

[6] In its meeting in May 2014 the IFRS IC noted that it would be beneficial if the IASB's Disclosure Initiative were to consider what guidance should be given for the presentation of information beyond what is required in accordance with IFRS. See also discussion Agenda Paper 12, IFRS IC Meeting May 2014 (http://www.ifrs.org/Meetings/MeetingDocs/Interpretations%20Committee/2014/May/AP12%20-%20IAS1%20Application%20of%20IAS%201%28agenda%20decision%29.pdf)

[7] http://www.ifrs.org/Meetings/MeetingDocs/IASB/2014/October/AP11Aa-DI.pdf

29. Because of the summary and signposting role of disclosure on the face of the financial statements in meeting the objective of financial statements, we think that it needs to treated cautiously. This is because there is greater ability to mislead by placing disclosures on the face of the financial statements, because:

    (a) information is highly summarised and concise (eg a label and an amount) and therefore it may not be possible to fully explain:

        (i) how the APMs relate to the amounts specified in IFRS for that statement, ie it might be difficult to make the number understandable;

        (ii) why the number is being presented as an alternative to the IFRS measure ie why is it useful.

    (b) a statement is often limited in space (whether digitally or on paper) and therefore disclosure on the face may 'clutter' the statement and obscure IFRS information contained within it; and

    (c) depending on how the APM is presented, it may take more prominence than the subtotals specified in IFRS. Subtotals specified in IFRS, eg profit or loss, are presumed to be the starting point of analysis (see paragraph 17).

30. We have heard little, or at any rate less, concern regarding the disclosure of APMs in the notes to the financial statements.

31. Because of this context, we think it is a valid question whether IFRS should prohibit the disclosure of APMs on the face of the financial statements, eg by prohibiting the disclosure of these measures in additional columns or separate sections. For example, ASIC prohibits the presentation of 'non-IFRS financial information' as additional columns in the financial statements (see Paper 11D). However, we are concerned that prohibiting such disclosures may restrict the disclosure of useful information.

32. We think an alternative would be to build on the guidance on subtotals in paragraphs 55A and 85A-B in IAS 1 and to extend it so it is applicable to the disclosure of APMs in financial statements as a whole (on the face or in the notes). Building on the current requirements of paragraphs 55A and 85A-B of IAS 1 and considering the concerns in paragraph 15 above, possible criteria for the disclosure of APMs on the face and in the notes could be:

(a) be reconciled (where possible) to the most directly comparable measure defined or specified in IFRS and presented in the statement of financial position or performance;

(b) explain why the APM provides relevant information about an entity's financial position or financial performance and why the adjustments to the most directly comparable measure (see paragraph (a) above) have been made;

(c) be presented and labelled in a manner that makes it clear and understandable what the APMs show and how they are constructed;

(d) provide comparatives and be clear and consistent about how the APM is defined from period to period and explain if adjustments have been made (in accordance with paragraph 45 of IAS 1);

(e) not be displayed with more prominence than the subtotals and totals required in IFRS for that statement;[8] and

(f) be clear whether the APM forms part of the financial statements and whether it is audited or validated on the same basis as the IFRS information.

Question 1 to the IASB
Do you agree that IFRS should not prohibit the disclosure of APMs in the (primary) financial statements or in the notes? If yes, do you agree that IFRS should include some qualitative constraints on the use of APMs in the (primary) financial statements and the notes and if yes, do you agree with the criteria in paragraph 32?

Depiction of non-recurring, unusual or infrequently occurring items

33. Line items in the statement of comprehensive income are sometimes labelled as 'non-recurring', exceptional', 'special' or 'one-time'. APMs in the form of the

[8] We are not suggesting that font size, for example, leads to mis-pricing. The emphasis on prominence is intended to protect the integrity of the IFRS-specified requirements as the anchor for the financial statements.

resulting subtotals include 'normalised earnings', 'underlying earnings' and 'adjusted profit'. See Agenda Paper 11D Example 4.

34. We have heard concerns about the presentation of additional subtotals/APMs in the statement of comprehensive income resulting from the inclusion/exclusion of amounts presented as line items when that inclusion or exclusion has been made on the basis of their non-recurring or exceptional nature. The concerns reflect a perception that:

    (a) transactions or events with a negative impact to the entity's financial position and financial performance are often classified as non-recurring or exceptional; and

    (b) many transactions or events classified as non-recurring or exceptional recur too frequently to be classified in that way.

35. Similarly, we also have heard concerns that in some cases not all the financial effects of infrequently occurring or unusual transactions or events are disclosed with equal prominence in the primary financial statements. For example, the financial effects of infrequently occurring or unusual transactions or events are distinguished for operating income, but the distinction is missing for related effects on finance expense and income.

36. However, we understand that information about the frequency of particular transactions and events and related financial effects are highly relevant for predicting future cash flows. Thus, many preparers provide information in the (primary) financial statements and/or the notes on whether transactions are considered to be unusual, infrequently occurring or non-recurring.

37. Paragraph 87 of IAS 1 prohibits the entity from labelling line items as 'extraordinary'. However, paragraph 97 of IAS 1 provides that when items of income and expense are material, an entity shall disclose their nature and amount separately in the statement of comprehensive income. The connection between these two paragraphs is clarified by IAS 1 paragraphs BC63-64, in which the IASB states that segregating items by their frequency is not in line with the presentation of income and expenses by their function or nature.

38. Staff have mixed views whether the IASB should provide additional guidance in a general disclosure Standard (eg a replacement of IAS 1) on the depiction of non-recurring, unusual or infrequently occurring items.

39. Some staff are of the view that assessing whether an item is material because of its nature, in accordance with paragraph 97 of IAS 1 should guide an entity's decision to present subtotals or line items in the statement of comprehensive income. Those with this view think that whether something is unusual would be part of its nature and might be relevant for investors for assessing an entity's future cash flows. This materiality assessment might result in its presentation as a separate line item. However, the resulting label or note explaining that line item should be based on its nature or function, not on whether its 'non-recurring' or 'one-time'. The requirements in paragraph 85A-B of IAS 1 would help to ensure a clear use of labelling to achieve a fair presentation in this case.

40. However, other staff think that IFRS should contain additional guidance on how to distinguish recurring transactions versus those that are non-recurring or unusual or that occur only infrequently. This is because many of the concerns regarding the presentation of APMs as subtotals in the statement of comprehensive income result from the inclusion or exclusion of amounts relating to such transactions.

41. For example, in accordance with US SEC guidance regarding the conditions for the use of non-GAAP financial measures, an item must not be identified as non-recurring, infrequent or unusual, when the nature of the charge or gain is such that it is reasonably likely to recur within two years or if there was a similar charge or gain within the previous two years (see Paper 11D).

42. The IASB, together with the FASB, proposed changes to disclosure of unusual or infrequently occurring transactions or events in the Financial Statement Presentation (FSP) project. Paragraphs 155-156 of the FSP Staff Draft of an Exposure Draft *IFRS X Financial Statement Presentation*[9] included guidance as follows:

> An entity shall present separately a material event or transaction that is *unusual* or *occurs infrequently*. An unusual

[9] http://www.ifrs.org/Current-Projects/IASB-Projects/Financial-Statement-Presentation/Phase-B/Documents/FSPStandard.pdf

> or infrequently occurring event or transaction shall be presented separately in the appropriate section, category or subcategory in the statement of comprehensive income. A description of each unusual or infrequently occurring event or transaction and its financial effects shall be disclosed in the statement of comprehensive income or in the notes to financial statements.
>
> An entity shall not describe any item of income or expense as an extraordinary.

43. The terms 'unusual' and 'infrequently occurring' were defined in the FSP Staff Draft as follows:

> *infrequently occurring*: Not reasonably expected to recur in the foreseeable future given the environment in which an entity operates.
>
> *unusual*: Highly abnormal and only incidentally related to the ordinary and typical activities of an entity, given the environment in which the entity operates.

44. Meanwhile, in July 2014 the FASB published a Proposed Accounting Standards Update *Income Statement—Extraordinary and Unusual Items*[10]. The proposed Update would eliminate the concept of extraordinary items from US GAAP and would therefore align US GAAP income statement presentation guidance more closely with IAS 1. However, the FASB has retained the following guidance about the presentation of unusual or infrequently occurring items:

> A material event or transaction that an entity considers to be either of an **unusual nature** or of a type that indicates **infrequency of occurrence** shall be reported as a separate component of income from continuing operations. The nature and financial effects of each event or transaction shall be disclosed on the face of the income statement or, alternatively, in notes to financial statements. Gains or losses of a similar nature that are not individually material shall be aggregated. Such items shall not be reported on the face of the income

[10] https://asc.fasb.org/imageRoot/91/63059291.pdf

statement net of income taxes. Similarly, the EPS effects of those items shall not be presented on the face of the income statement.

45. The proposed Update retains the existing definitions of ‘unusual nature’ and ‘infrequency of occurrence’ in current US GAAP, which are similar to the defined terms ‘unusual’ and ‘infrequently occurring’ in the FSP Staff Draft.

46. Those staff who think additional guidance in a general disclosure Standard (eg a replacement of IAS 1) on the depiction of non-recurring, unusual or infrequently occurring items would be helpful think there are three alternatives:

   (a) develop guidance on when and how transactions or events should be presented in the primary financial statements as ‘unusual’ or ‘infrequently occurring’, with further details in the notes. Such an approach to standardisation would be similar to the FASB approach. The guidance could also clarify the prohibition on the use of specific terms such as ‘recurring’ or ‘non-recurring’;

   (b) Develop specific guidance to the effect that an entity must not label any item in the primary financial statements by referring to its frequency of occurrence or to whether or not it is unusual. The entity would be allowed to provide such information only in the notes; or

   (c) guidance on the statement of profit or loss and other comprehensive income could be developed as part of a distinct performance reporting project.

Question 2 to the IASB

Do you think IFRS should include additional guidance on the depiction of non-recurring, unusual or infrequently occurring items in the statement of comprehensive income?

If yes, how should IASB staff develop this guidance (see the alternatives in paragraph 46 above)?

EBIT and EBITDA

47. We note that some have suggested that the IASB should define some APMs commonly reported in the statement of comprehensive income, eg EBIT, EBITDA and 'operating income'. We think there may be merit in IFRS defining some commonly reported APMs. As discussed in paragraph 14 above, we think that measures defined or specified in IFRS provide the most appropriate anchor from which to assess an entity's reported financial performance. However, we think that any detailed discussion on this topic is beyond the scope of the Disclosure Initiative and would be more appropriately considered as part of the IASB's project on performance reporting.

48. We do however think, that if IFRS does not define or specify a commonly reported measure of financial performance, IFRS should not reference it. We think including a reference in IFRS without a definition may give it undue credibility.

49. Having said that, we do think we need to discuss EBITDA (earnings before interest, taxes, depreciation and amortisation) specifically in this paper and potentially in a disclosure Standard, because it is often mentioned as a non-IFRS/non-GAAP measure.

50. EBITDA is often used as an indicator for cash that is available to pay debt. Consequently, many preparers present 'adjusted' EBITDA, excluding items such as non-cash stock options and non-recurring expenses etc. This means that there is no standardised way for calculating or presenting EBITDA. This has led to concerns about comparability. Consequently, some regulators prohibit it, while others only allow the reporting of 'plain' EBITDA.

51. As discussed above (paragraph 47), we think it is beyond the scope of the Principles of Disclosure project to define or standardise the way in which entities should report EBITDA. However, we do think we should clarify whether presentation of EBITDA of the face of the statement of comprehensive income is permitted under IFRS.

52. If EBIT and EBITDA are presented as a subtotal in the statement of profit or loss in accordance with paragraphs 85-85B of IAS 1 (see paragraphs 18–19) and that statement is presented 'by nature' (IAS 1.102), we think such presentation would be in accordance with IFRS. For example:

Statement of Income (by nature)	
Revenue	X
Changes in inventories of goods	(X)
Employee benefits expense	(X)
Other expenses	(X)
EBITDA	**X**
Depreciation and amortisation	(X)
EBIT	**X**
Interest	(X)
Profit before tax	**X**

53. In the example above, because the presentation of the subtotals for EBIT and EBITDA would be in accordance with IFRS they would not be non-IFRS information.

54. However, when entities include EBITDA in a statement of comprehensive income that is presented by function (IAS 1 paragraph 103), in our view it would no longer be a subtotal, because it would not be the direct sum of line items presented above it. This is because when the statement of profit or loss is presented by function, line items may exclude certain nature-based expenses (eg amortisation), thereby mixing the concepts and creating confusing information.

Question 3 to the IASB

Do you agree that if EBIT and EBITDA are presented as a subtotal in the statement of profit or loss in accordance with paragraphs 85-85B of IAS 1 and that statement is presented 'by nature', that presentation would be in accordance with IFRS?