Primary Financial Statements
Update on MPMs

Objective

1 The objective of the session is to provide an update to EFRAG FR TEG members on the latest IASB's tentative decisions in January and March 2023 (which have not been discussed by the EFRAG FR TEG and EFRAG User Panel on 10 May 2023) on management performance measures.

Structure of the document

2 In the following sections, for each of the topics listed below, it is provided a summary of the IASB proposal in the Exposure Draft *General Presentation and Disclosures* ("the ED"), EFRAG's position in its final comment letter, the latest IASB discussions and decision and the EFRAG Secretariat analysis.

3 The topics to be discussed are:

(a) Management performance measures:

(i) Rebuttable presumption (IASB AP21B, March 2023);

(ii) Relationship with the requirements of other IFRS Accounting Standards (IASB AP21C, March 2023); and

(iii) Tax disclosure (IASB AP21D, March 2023).

Management performance measures

MPM - Rebuttable presumption

IASB proposal in the ED

4 The ED proposed disclosure requirements for MPM which it defined as subtotals of income and expenses that:

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

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

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

EFRAG Final Comment Letter

5 In its comment letter EFRAG welcomed the IASB's efforts to provide guidance on MPMs leading more transparency and consistency.

6 However, EFRAG suggested to extend the definition of an MPM including also measures related to the statement of financial position and ratios. In addition, EFRAG invited the IASB to consider:

(a) making the definition of public communication narrower;

(b) excluding from the scope the performance measures required by regulators; and

(c) extending the scope to cover possible MPMs presented in the financial statements but not in other public communications.

7 Finally, EFRAG also suggested that the IASB provided an explanation of how MPMs interact with performance measures already presented under IFRS 8.

IASB discussions and tentative decisions

8 At its November 2021 meeting, the IASB discussed some of the concerns expressed by its stakeholders, including the risks of not capturing intended measures and the risk of risk of capturing unintended measures. To address those risks, the IASB tentatively decided:

(a) to establish a rebuttable presumption that a subtotal of income and expenses included in public communications outside financial statements represents management's view of an aspect of the entity's financial performance. The rebuttable presumption is intended to reduce the subjectivity involved in judging whether a subtotal of income and expense represents management's view;

(b) that an entity may rebut this presumption only when it has reasonable and supportable information. Allowing entities to rebut the presumption in specific circumstances is intended to exclude subtotals that do not represent management's view but are required to be included in its public communications; and

(c) to provide high-level application guidance on how to assess whether the entity has reasonable and supportable information. The guidance would include an explanation that the assessment of whether a subtotal of income and expenses is a management performance measure is made for the subtotal as whole.

9 Based on the feedback received during the target outreach, many participants agreed with the aforementioned proposal. However, many said that application guidance explaining when it would be appropriate to rebut the presumption would be needed to make the proposal operational.

10 At its March 2023 meeting, the IASB tentatively decided to develop application guidance to explain that reasonable and supportable information for rebutting the presumption would include management communicating or using a subtotal in a way that is consistent with the assertion that the subtotal does not communicate management's view. The IASB also tentatively decided to include some examples of when this could be the case.

11 It is worth noting that the IASB's agenda paper included some examples such as:

(a) subtotal being included in multiple locations with extensive analysis throughout an entity's public communications would not be consistent with the assertion that it does not communicate management's view, and

(b) a subtotal being used internally by management would not be consistent with the assertion that it does not communicate management's view.

12 The high-level application guidance on how to assess whether the entity has reasonable and supportable information to support the rebuttal is then likely to focus on two aspects:

(a) Information supporting why the subtotal is included in public communications even if not reflecting management's view (e.g., requested by users, an industry body, local regulator or by local GAAP); and

(b) Information supporting why the subtotal does not represent management's view (e.g., circumstances that would support rebutting the presumption could include: whether a subtotal is communicated in a single location in the management commentary without extensive management analysis and commentary or, whether a communicated subtotal is not used internally by management)

EFRAG Secretariat analysis

13 In its *Summary Report and Recommendations*, EFRAG highlighted that many participants welcomed the new rebuttable presumption on MPMs, however, there were questions on whether an entity will have to disclose when it decides to rebut the presumption that a specific subtotal of income and expenses is an MPM.

14 In addition, regulators and highly regulated entities, such as banks and insurance companies, raised questions on the effective applicability of the rebuttable presumption for all the significant measures communicated for regulatory purposes which could include measures that are difficult to reconcile with IFRS measures and might lead to additional disclosures related to rebutting the IASB's presumption. There was also the concern that this could lead to a wider scope for MPMs than the IASB intended.

15 Considering this, in its *Summary Report and Recommendations*, EFRAG expressed some concerns on establishing a rebuttable presumption for highly regulated entities as this could increase complexity and may unintendedly enlarge the scope of MPM. This is particularly the case when it involves measures required by regulators, which may be difficult to reconcile with IFRS measures and might lead to additional disclosures related to rebutting the IASB's presumption.

16 Therefore, the EFRAG Secretariat will continue to monitor the future IASB decisions to assess whether the mentioned application guidance and examples, once developed, would improve the balance between costs and benefits.

17 Finally, the EFRAG Secretariat questions whether an entity should explain that it has rebutted some performance measures. If not, users may be confused to not find all alternative performance measures (that are subtotals, related to performance and used in public communications) within the financial statements.

Questions for EFRAG FR TEG

18 Do EFRAG FR TEG members have any comments on the IASB's tentative decisions?

19 Do EFRAG FR TEG members agree with the EFRAG Secretariat analysis?

MPM – Relationship with the requirements of other IFRS Accounting Standards

IASB proposal in the ED

20 Paragraph 106 of the ED proposed that an entity shall disclose information about any MPM in a single note to the financial statements. In addition, for each MPM an entity shall disclose in the notes:

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

(b) a reconciliation between the MPM and the most directly comparable subtotal or total included in paragraph 104 (e.g., operating profit or loss before depreciation and amortisation, profit or loss before income tax);

(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).

21 Paragraph 108 of the ED proposed that if an entity changes the calculation of its MPM, introduces a new MPM or removes a previously disclosed MPM 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.

22 The ED also proposed a consequential amendment to paragraph 16A of IAS 34 *Interim Financial Reporting* to include the disclosure requirements for MPMs in paragraph 106 of the ED.

EFRAG Final Comment Letter

23 In its comment letter EFRAG suggested that the IASB considers whether a change of the formula of an MPM constitutes a change of an accounting policy in accordance with the guidance of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

24 With regard to the proposed amendments to IAS 34 *Interim Financial Reporting*, EFRAG had some concerns about requiring a reconciliation of the MPMs to the most directly comparable subtotal or total specified in IFRS Standards as such reconciliations, including the tax effect and non-controlling interest ('NCI') effect, can be costly, particularly when preparing interim financial statements at consolidated level (e.g., tax includes income tax of different subsidiaries and not transactions).

IASB discussions and tentative decisions

25 Based on the feedback received on the ED, some respondents, mainly users, agreed with the IASB's proposal. However, respondents, mainly preparers, expressed some concerns, including:

(a) Whether the costs related to the restatement of comparative information would outweigh the benefits (e.g., when a MPM has been changed because of changes in business);

(b) whether a change in MPMs is a change in accounting policy according to IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors; and*

(c) Whether the costs related to disclosing the tax effects of reconciling items in interim financial reports would outweigh the benefits. However, in the IASB's agenda paper, the IASB staff noted that considering the IASB proposal to allow an entity to use a simplified approach to calculate such a tax effect, the benefits should outweigh the costs.

26 In order to address stakeholders' concerns, at its March 2023 meeting the IASB decided (in regard to IAS 8):

(a) to confirm the proposal that 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 would be required:

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

   (ii) to disclose the reasons for the change, addition or removal (see paragraphs 108(a) and 108(b) of the ED).

(b) to amend the proposed disclosure requirement in paragraph 108(c) of the ED to say that an entity need not provide comparative information when the entity changes a management performance measure or introduces a new one, if it is impracticable to do so.

(c) to add a requirement that if an entity does not provide comparative information about a new or changed management performance measure because it is impracticable to do so, the entity shall disclose that fact.

(d) to clarify that the choice of a management performance measure, including how the measure is calculated, is not an accounting policy as defined in IAS 8.

27 In addition, in regard to interim financial reporting, the IASB tentatively decided to:

(a) confirm the proposal to amend IAS 34 to require the disclosure in interim financial reports of the MPM set out in paragraph 106 of the ED; and

(b) expand the proposed amendment to IAS 34 to include the requirements that apply to changes in an entity's MPM (as stated in paragraph 108 of the ED) in the list of 'other disclosures' required by paragraph 16A of IAS 34.

EFRAG Secretariat analysis

28 The EFRAG Secretariat welcomes the IASB's tentative decision to clarify that the choice of a management performance measure, including how the measure is calculated, is not an accounting policy as defined in IAS 8 as it addresses the concern raised by EFRAG in its comment letter.

29 In particular, the EFRAG Secretariat notes as the IASB's tentative decision to require an entity to disclose sufficient explanation for users of financial statements to understand the change of a MPM and the underlying reasons for the change should prevent frequent changes to MPMs and, whether they occurred, an entity shall provide specific explanations leading to a more transparent, effective and useful disclosure.

30 In addition, the EFRAG Secretariat welcomes the IASB tentative decision to not require comparative information on a new or changed MPM when it is impracticable to do so as it is a compromise between costs and benefits.

31 In regard to the proposed amendments to IAS 34, the EFRAG Secretariat continues to express some concerns about requiring a reconciliation of the MPMs to the most directly comparable subtotal or total specified in IFRS Standards as such reconciliations, including the tax effect and non-controlling interest ('NCI') effect, can be costly, particularly when preparing interim financial statements at consolidated level (e.g., taxes include income taxes of different subsidiaries and not transactions).

32 Nonetheless, if the IASB decides to proceed with its initial proposal, the EFRAG Secretariat generally agrees with the IASB's tentative decision in terms of disclosure requirements to be provided in condensed financial statements on changes to an entity's MPMs as it would provide users with transparent information about MPMs and allow them to analyse all aspects of an entity's performance on a timely basis.

Questions for EFRAG FR TEG

33 Do EFRAG FR TEG members have any comments on the IASB's tentative decisions?

34 Do EFRAG FR TEG members agree with the EFRAG Secretariat analysis?

MPM – Tax disclosure

IASB proposal in the ED

35 As stated in paragraph 106 of the ED an entity shall disclose the tax effect (and the effect on non-controlling interests) for each item disclosed in the required reconciliation between a MPM and the most directly comparable subtotal or total specified in IFRS Standards.

36 In addition, paragraph 107 of the ED specified that the income tax effect has to be calculated 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.

EFRAG Final Comment Letter

37 In its comment letter EFRAG questioned the cost/benefit profile of the requirement to present the split of tax and NCI components for all the items when a performance measure is adjusted.

38 Consequently, to reduce cost for preparers, EFRAG suggested that the IASB reconsiders this requirement, such as to limit it to income tax and NCI effects only if an entity presents an adjusted Earnings Per Share (EPS ratio based on the MPM).

39 In addition, with specific reference to the benefits deriving from the potential use of proxies due to the complexity of the calculation, EFRAG questioned whether the resulting information would be reliable without an entity incurring incremental operational efforts to collect the required information and to prepare reliable financial information.

40 Finally, EFRAG questioned the auditability of this information, in particular when proxies are used.

IASB discussions and tentative decisions

41 At its May 2022 meeting the IASB tentatively decided to revise the requirement in paragraph 107 of the ED providing for a simplified calculation method. In particular, the new proposal would allow an entity to either:

(a) calculate the tax effects of the underlying transaction(s) at the statutory tax rate(s) applicable to the transaction(s) in the relevant jurisdiction(s); or

(b) calculate the tax effects as described in (a) and then allocate any other income tax effects related to the underlying transaction(s) based on a reasonable pro rata allocation of current and deferred tax, or another method that achieves a more appropriate allocation.

42 Based on the feedback received during the targeted outreaches, many participants agreed with the aforementioned simplified tax calculation method. However, some participants challenged the usefulness of the information that would be provided by such a simplified calculation and some participants still had concerns that the disclosure may be costly to provide.

43 To address these concerns, the IASB discussed whether a wider range of approaches to calculating the income tax effect would improve the balance between costs and benefits and whether it should require specific disclosure requirements for the approach(es) an entity uses to calculate the income tax effect.

44 At its March 2023 meeting, <u>the IASB tentatively decided to:</u>

(a) <u>to retain the option of calculating the tax effects of the reconciling items at the statutory tax rate(s) applicable to the underlying transaction(s) in the relevant jurisdiction(s);</u>

(b) <u>to replace the alternative option of adding an allocation of other income tax effects to the tax effects described in (a), with options:</u>

(i) <u>to calculate the tax effects of the reconciling items on the basis of a reasonable pro rata allocation of the current and deferred tax of the entity in the tax jurisdiction(s) concerned; or</u>

(ii) to calculate the tax effects of the reconciling items by another method that achieves a more appropriate allocation in the circumstances;

(c) to confirm the requirement in paragraph 106(d) of the ED for an entity to disclose how it has determined the income tax effects for items reconciling a management performance measure to the most directly comparable subtotal or total specified by IFRS Accounting Standards;

(d) to provide application guidance requiring the disclosure in (c) for each reconciling item if more than one method is used to calculate the tax effect; and

(e) to revise the requirements in paragraph 108 of the ED for disclosures relating to changes in management performance measures so that they apply to changes to the calculation of the tax effects of reconciling items.

45 With this tentative decision, the IASB provides a wider range of approaches to preparers, applicable on an item-by-item basis:

(a) Use a simplified calculation method as defined in paragraph 41(a) above;

(b) calculate the tax effects of the reconciling items on the basis of a reasonable pro rata allocation of the current and deferred tax of the entity in the tax jurisdiction(s) concerned; or

(c) calculate the tax effects of the reconciling items by another method that achieves a more appropriate allocation in the circumstances.

EFRAG Secretariat analysis

46 During its outreaches EFRAG received mixed views on the mentioned simplified approach. Some participants welcomed the proposed simplified solution for the income tax effects for each reconciling item as it would remove large part of operational complexity; however, it was noted that such a method can lead to oversimplifications and the disclosed amounts can be very different to the actual effects. Others were not convinced that such an approach actually resulted in a simplification for reporting entities, particularly for international groups.

47 The EFRAG Secretariat is of the view that the simplified approach is a practical compromise that reduces the costs without removing the usefulness of the information provided. Furthermore, allowing an entity to apply any other tax calculation method which achieves a more appropriate and useful information should improve the balance between costs and benefits.

48 In this context, the EFRAG Secretariat considers the disclosure requirements in paragraph 106(d) of the ED (i.e., disclosing how the income tax effect has been determined) extremely important providing users with relevant information to understand the entity's performance and to assess comparability across entities. At the same time, the revised requirements in paragraph 108 of the ED are also important for users to understand when those tax calculation methods differ between reconciling items and when they are changed.

Questions for EFRAG FR TEG

49 Do EFRAG FR TEG members have any comments on the IASB's tentative decisions?

50 Do EFRAG FR TEG members agree with the EFRAG Secretariat analysis?