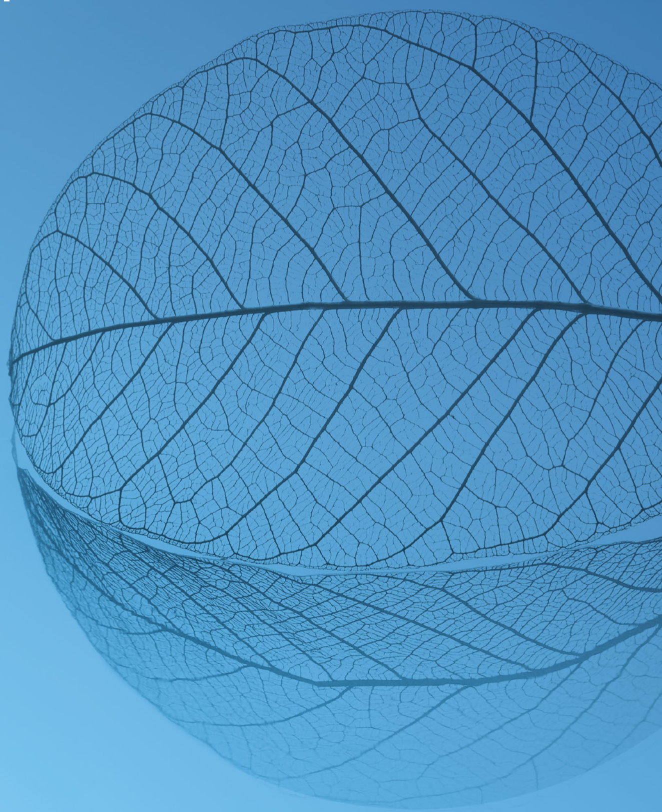
KPMG

Non-IFRS measures & re-shaping financial statement presentation



KPMG's review of non-IFRS disclosures of ASX200 entities and how the exposure draft on general presentation and disclosures could impact current practice

December 2020

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Key highlights

97%

of entities reported at least one non-IFRS measure in the OFR

Only 75%

of entities disclosed a non-IFRS measure as their segment measure of performance

88%

of entities used non-IFRS measures to determine performance incentives awarded to key management personnel

65%

of entities reported Underlying profit as a non-IFRS measure in their OFR

21% ↑

increase in use of non-IFRS segment measures for FY20 over FY19 due to COVID-19 environment

Impacts of proposals in ED compared to existing practice:

Restructured Income statement presentation

Reclassification of dividend and interest cash flows for non-financial entities

Non-IFRS measures to be included in the notes

Purpose of publication

This publication is intended to assist listed entities in assessing their disclosure of non-IFRS measures compared to other entities in the ASX200, as well as raise awareness of the changes that entities may need to implement considering the recent proposals contained in the *General Presentation and Disclosures* Exposure Draft (the ED) issued by the IASB® Board. This publication provides the following insights.

- The common non-IFRS measures and key reconciling items reported by entities.
- The interaction between the OFR, segment disclosures and remuneration reports in relation to non-IFRS measures disclosed.
- How entities currently address several presentation aspects in relation to the Income statement and the Cash flow statement.
- What might change in the financial statements in respect of these items under a new IFRS Standard.

Our publication comprises two key sections.

- Non-IFRS measures: how non-IFRS measures have been disclosed in the OFR, operating segment notes and remuneration reports, with further consideration of the related potential impacts of the ED proposals.
- Other proposals under the ED: possible impact of ED proposals on current disclosure practices in the income and cash flow statements.

Introduction

The topic of non-IFRS measures[1] regularly appears in the financial press. This is understandable given the importance of these measures for directors and management in explaining performance to investors, providing useful insights and telling a story that is unique to their entity. For close to a decade Australia has had regulatory guidance[2] and active surveillance on the presentation of non-IFRS measures in financial reports and other corporate documents. The focus of this guidance is to minimise the possibility of misleading users and to enhance transparency and comparability.

With COVID-19 having a significant financial impact on many entities in 2020, it is not surprising that the prevalence of non-IFRS measures and reconciling items has seen an uptick in the most recent reporting period. This has in turn heightened ASIC's focus on the appropriate use and disclosure of these measures in the directors' report with non-IFRS measures receiving more attention in ASIC's list of financial report surveillance focus areas for 30 June 2020.

The importance of non-IFRS performance measures to a user of the financial report is further highlighted in the proposed new IFRS® Standard that will replace IAS 1/AASB 101 *Presentation of Financial Statements*. The *General Presentation and Disclosures* Exposure Draft (the ED)[4] seeks to mandate disclosure of non-IFRS performance measures in the notes to the financial statements along with supporting disclosures similar to those currently required by ASIC outside the financial statements[5].

The ED extends beyond non-IFRS performance measures and looks to re-shape the structure of the primary statements, particularly the income statement and provides new guidance on the disclosure of 'unusual items'. The objective of these proposals is to enhance comparability, usefulness and relevance of disclosures in the financial statements.

Given this evolving landscape, KPMG have undertaken a review of 72 ASX200 entities' annual reports for the 2019 reporting period with a focus on the use of non-IFRS measures along with some of the more significant aspects of the ED. We have considered what is happening in practice now and how this may change under the ED proposals. We have supplemented this with an additional 35 ASX200 annual reports for the 2020 reporting period to better understand how these disclosures have been impacted by COVID-19.

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1. Non-IFRS measures are measures presented other than in accordance with all relevant Australian Accounting Standards.
2. ASIC Regulatory Guide 230 *Disclosing non-IFRS information*.
3. Financial report means the directors' report, primary financial statements and notes to the financial statements.
4. Refer to Appendix 2 for more details on the ED.
5. Financial statements means the primary financial statements and the notes to the financial statements as required by Australian Accounting Standards.

Non-IFRS measures

Non-IFRS measures continue to feature prominently in annual reports.

Operating and Financial Review (OFR)

ASIC Regulatory Guide 230 *Disclosing non-IFRS financial information* defines 'Non-IFRS financial information' as financial information that is presented other than in accordance with all relevant accounting standards.[6]

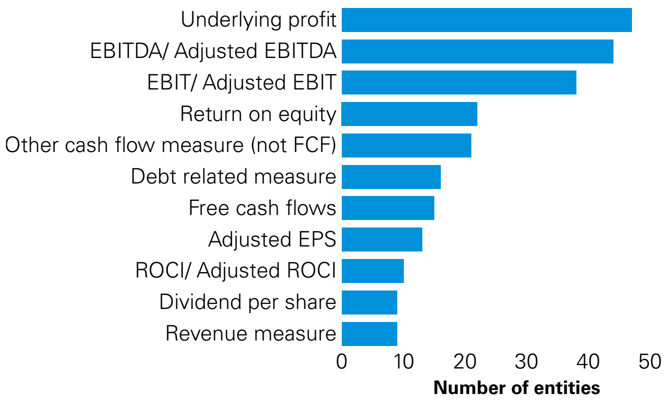
Non-IFRS measures continue to be used by directors in OFRs[7] to contextualise and explain their entity's performance and financial position. In fact, 97% of the entities reviewed reported at least one if not multiple non-IFRS measures to share their financial performance story.

The most common non-IFRS measure used in FY19 was a form of Underlying profit with 65% of entities using this as a relevant measure of underlying performance in their OFRs.

Other popular measures included a form of Earnings before interest, tax, depreciation and amortisation (EBITDA), Earning before interest and tax (EBIT) and Return on equity.

Cash flow measures were utilised by 47% of entities to explain their performance, with Free cash flows (FCF) being the most commonly used. Other cash flow measures included cash earnings, underlying cash flow, funds from operations, cash flow from operating activities and cash flow ratios.

FY19: Non-IFRS measures in OFR

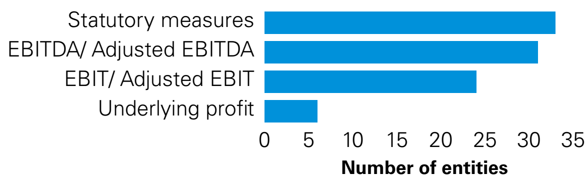


Segment measures of performance

Whilst most entities reported a non-IFRS measure in their OFR, only 75% disclosed a non-IFRS measure as their segment measure of performance in the notes to the financial statements[8]. The lower use of non-IFRS measures in the segment disclosures compared to the OFR was surprising. We would generally expect a Chief Operating Decision Maker (CODM) to focus on the same measures to evaluate segment performance as is used to communicate to users in the OFR.

However, as expected, the most common non-IFRS segment measures aligned with those reported in the OFR i.e. EBITDA, EBIT and Underlying profit.

FY19: Segment measures



+ FY20 observations

All entities reviewed in FY20 included non-IFRS measures in the OFR, including those that had only included statutory measures in FY19. In addition, there was a notable increase in the volume of adjustments to non-IFRS measures in the OFR in FY20. This is not surprising given the impact that COVID-19 has had on the performance and financial position of most entities.

In the reported segment measures we observed a 21% increase in the CODM's use of non-IFRS segment measures by entities that had previously reported only statutory measures[9] of segment performance.

6. For more details relating to a description and composition of non-IFRS items and reconciling items identified in the discussion and graphs that follow, refer to the Appendix 1 of this publication.
7. S299A of the *Corporations Act 2001* requires a listed entity's directors' report to include an OFR.
8. Paragraph 23 of AASB 108 *Operating segments* requires an entity to report a measure of profit or loss for each reportable segment.
9. Statutory measures are those presented in accordance with Australian Accounting Standards/ IFRS Standards.

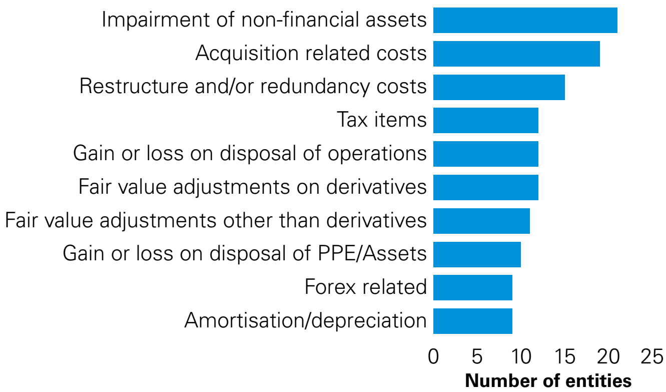
Key reconciling items to statutory measures

Non-IFRS measures in the OFR

In most instances, the nature of the reconciling items between non-IFRS measures disclosed in the OFR and the respective statutory measure highlight what in management's view are items that are not representative of underlying performance.

Impairment of non-financial assets, acquisition related adjustments and restructuring and/or redundancy costs were the three highest occurring reconciling items in FY19. Fair value adjustments – both those relating specifically to derivatives and those relating to other assets – also featured as reconciling items for 32% of entities. Interestingly, the nature of the reconciling items reported by entities has remained relatively consistent since the introduction of RG 230 in 2011.

FY19: Reconciling items in OFR



+ FY20 observations

In FY20 only three entities (8.5%) identified specific reconciling items as arising solely from COVID-19. This aligns with ASIC's observation that it may not be possible to reliably identify and separately quantify the impact of the COVID-19 pandemic[10].

The proportion of entities having impairment of non-financial assets and restructure and/or redundancy costs as reconciling items increased in FY20 compared to FY19, to 51% from 29%, and to 31% from 21%, respectively. This increase is not surprising given COVID-19 was likely one of the contributing factors increasing the prevalence of these items.

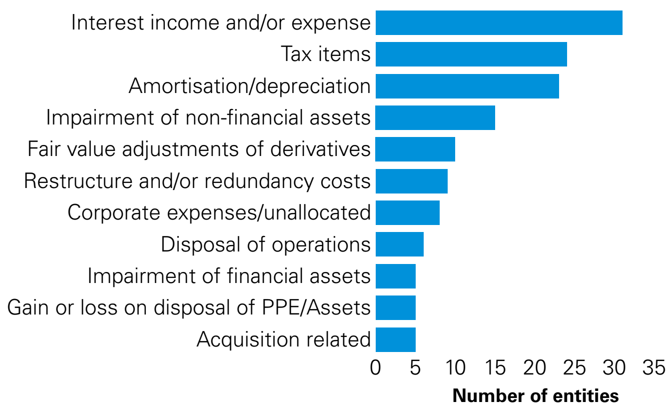
Another reconciling item of note was the profit impact of applying the new leases accounting standard (AASB 16). 11% of entities normalised their non-IFRS measures to remove the impact of the standard from their FY20 result to ensure a like for like comparison with FY19. Whether entities continue to adjust for the impact of AASB 16 in future financial years will be interesting to follow. We expect that once there is familiarity with the new leases standard, and the desire to maintain two sets of records diminishes, this reconciling item will drop away.

Non-IFRS Segment measures

Given 76% of entities reported non-IFRS segment measures excluding the impact of interest and tax (i.e. EBIT and EBITDA) it is not unexpected that these were the two most common reconciling items to statutory measures, along with depreciation and amortisation.

Outside of these items, the nature of reconciling items identified for segment measures was consistent with those identified for non-IFRS measures disclosed in the OFR.

FY19: Key reconciling items in segment note



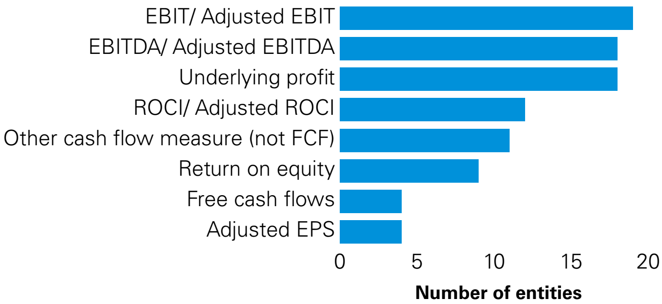
10. ASIC COVID-19 implications for financial reporting and audit: Frequently asked questions (FAQs), FAQ #5.

Remuneration report

Non-IFRS measures continue to be prevalent key performance indicators used in remuneration policies and as a result feature heavily in remuneration report disclosures. Non-IFRS measures of financial performance are more typically used as remuneration hurdles in short-term incentive plans.

88% of entities reviewed used non-IFRS measures to determine performance incentives awarded to key management personnel in FY19, with a form of EBIT (26%), Underlying profit before tax (25%) and EBITDA (25%) being the most common. As would be expected, the nature of measures used in performance incentive plans was generally consistent with those used in the OFR and/or segment disclosures.

FY19: Non-IFRS measure in Remuneration report



Impact of the ED on reporting of non-IFRS measures

Management performance measures (MPMs)

MPMs are subtotals of income and expenses used in public communications, complementing totals or subtotals specified by IFRS Standards and communicate management's view of an entity's financial performance. [ED paragraph 103]

In acknowledgement of the prevalence and usefulness of non-IFRS measures, the IASB Board is proposing to mandate the disclosure of specific non-IFRS measures (referred to as MPMs) in the notes to the financial statements along with supporting disclosures. These requirements closely align to those currently existing under RG 230[11] outside the financial statements and aim to increase the transparency and discipline with which they are prepared.

Although MPMs appear to align with our understanding of non-IFRS measures there is one notable exception. The ED proposes to limit MPMs to subtotals of income and expenses.

Other financial measures that are based on assets, liabilities and cash flows are not MPMs and are therefore not subject to the proposed disclosure requirements.

In practice, it is common for Australian entities to use financial measures such as Free cash flows and Return on equity to communicate their financial performance outside the financial statements. We believe it would be beneficial for investors, if the ED requirements included these as well, particularly where they represent subtotals or ratios derived directly from any of the primary financial statements.

+ Key proposed disclosure requirements

- Information about MPMs to be disclosed in one note.
- A description of why the MPM communicates management's view of performance, including how the measure is calculated and how it provides useful information about the entity's performance.
- A reconciliation to the most directly comparable IFRS subtotal or total.

11. RG 230 paragraph 56 sets out guidelines for presenting non-IFRS financial information including prominence of presentation, appropriate labelling, clear explanation on basis of calculation, reconciliation to statutory financial information, consistency between periods, unbiased and whether it is audited or reviewed.

Unusual income and expense items

Unusual income and expenses are those with limited predictive value.

Income and expenses have limited predictive value when it is reasonable to expect that income or expenses that are similar in type and amount will not arise for several future annual reporting periods. [ED Paragraph 100]

It is not unusual for entities to specifically call out or identify significant or material income and expense items in the notes to the financial statements, whether through reconciling items in the segment note or as a separate note to the financial statements. In fact, we identified that in addition to the segment note disclosures, 21% of entities specifically included a material or significant item note in their financial statements in FY19.

The ED proposes to define unusual items and require entities to make specific disclosures in the financial statements in an effort to achieve greater clarity, consistency and transparency.

Under the proposals, some of the more commonly disclosed significant or unusual items such as impairment and restructuring costs may no longer qualify as unusual. The proposed definition is solely based on expectations about the future: entities would not consider whether similar income or expenses have occurred in the past when identifying unusual items. This would likely be a significant change in practice for some entities.

+ Key proposed disclosure requirements

- Information about unusual items to be contained in one note.
- A narrative description of the transactions or other events that gave rise to that item and why income or expenses that are similar in type and amount are not expected to arise for several future annual financial reporting periods.
- The line item(s) in the statement(s) of financial performance in which each item of unusual income or expense is included.

Impact of the ED on primary financial statements

Income statement structure

In addition to mandating disclosures on MPMs and unusual income and expenses in the financial statements, the ED proposes to re-shape the income statement structure. The intention of these proposals is to reduce the diversity that exists in practice and enhance transparency. The income statement pictured illustrates the proposed general structure that would apply for non-financial entities[12].

The key proposals related to income statement presentation include:

- Classification of income and expenses into four defined categories.
- Three new mandatory subtotals (marked with an * in the example below).
- Distinguishing between integral and non-integral investment in associates and joint ventures (JVs) with separate presentation of the share of profits for each.
- Present expenses on the face of the income statement either by nature or by function, with a mixed presentation being prohibited.
- Discouraging aggregation of unrelated expenses into large, single numbers.

Example income statement

	20XX	
Revenue	X	Operating
Operating expenses (analysed by nature or by function as appropriate)	(X)	Operating
Operating profit*	X	
Share of profit or loss of integral associates and joint ventures	X	Integral associates and JVs
Operating profit and income and expenses from integral associates and joint ventures*	X	
Share of profit or loss of non-integral associates and joint ventures	X	Investing
Income from investments	X	Investing
Profit or loss before financing and income tax*	X	
Interest income from cash and cash equivalents	X	Financing
Expenses from financing activities	(X)	Financing
Profit before tax	**X**	
Income tax	X	
Profit for the year	**X**	

New required subtotals (*)

Four categories to classify income and expenses:

- **Operating**
- **Integral associates and JVs**
- **Investing**
- **Financing**

12. Entities such as banks, insurers and investment entities would classify income and expenses in the categories differently, with certain income and expenses classified in the operating category that would otherwise be classified in the investing or financing category for non-financial entities.

Defined categories and profit subtotals on the face of the income statement

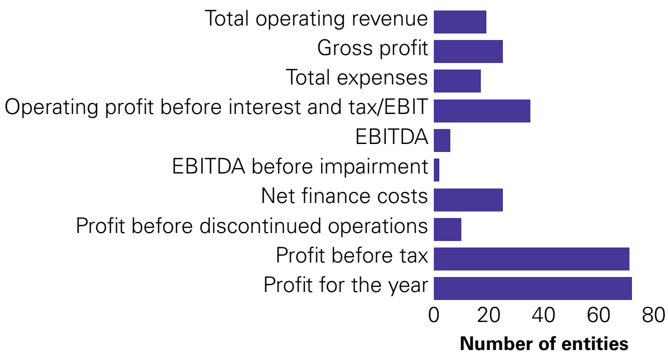
Our review identified that entities are currently tailoring the structure of the income statement and using various subtotals to present their results. These findings are not surprising, given there is no set structure or required subtotals under existing IFRS Standards for the income statement.

Operating profit before interest and tax or EBIT was disclosed as a subtotal by 49% of entities. This most closely resembles the "Profit before financing and income tax" mandatory subtotal proposed by the ED. However, there currently is a lack of consistency and comparability in what comprises operating profit and EBIT, so the current use of similarly termed subtotals do not nicely align with those in the ED. The ED defines what an Operating profit subtotal should include and this coupled with the new requirements related to integral and non-integral associates and JVs (discussed below) will result in some significant changes to income statement presentation for many entities.

Under the proposals, entities will also need to allocate income and expenses between four major categories being Operating, Investing, Financing and Integral associates and JVs. Classification between categories will depend on the nature of the entity's 'main business activity', which is not defined, and will require judgement. Although three income statement categories may initially sound familiar, their definitions do not align to the similarly labelled categories used in the cash flow statement which may cause some initial confusion for users and preparers.

Entities will continue to have the option to present additional subtotals in the income statement if they are relevant to an understanding of entities' financial performance and do not disrupt the presentation of the operating expense analysis as discussed below.

FY19: Subtotals disclosed in Income statement

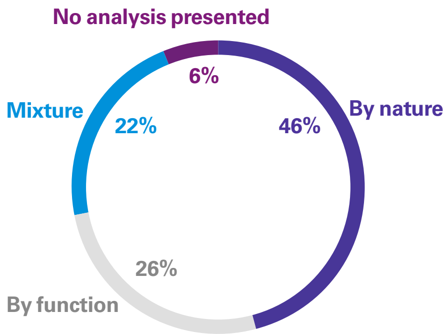


Analysis of operating expenses on the face of income statement

Although the current accounting standard AASB 101 *Presentation of Financial Statements* requires the disclosure of operating expenses on the face of the income statement either by nature or by function, 22% of the entities reviewed presented this analysis using a mixture of nature and function in FY19. A further 6% presented no breakdown on the face of the income statement, instead opting to aggregate all expenses together into one line item with further information provided in the notes.

The ED introduces explicit new requirements for entities to provide an analysis of operating expenses on the face of the income statement – either by nature or function – selecting the method that provides the 'most useful' information. The proposals explicitly prohibit mixed presentation of operating expenses. The proposals also remove the current option in AASB 101 to present analysis in the notes only. This would result in a significant change in presentation for certain entities and could be viewed by some as reducing the usefulness of information provided on the face of the income statement.

FY19: Analysis of operating expenses on the face of Income statement



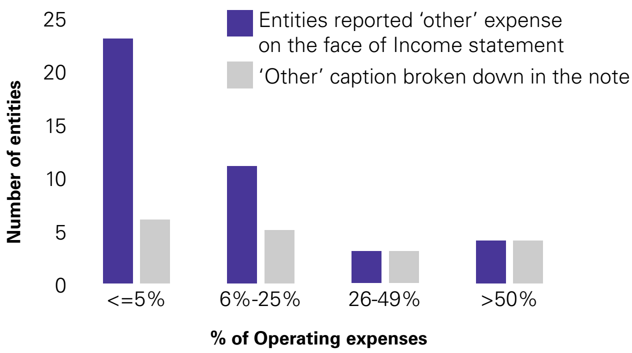
Aggregation and disaggregation of operating expenses on the face of income statement

To further enhance comparability and improve the relevance of information disclosed, the ED also proposes new guidance on the aggregation and disaggregation of income and expense items in the income statement based on 'shared characteristics', with specific rules for immaterial items. However, with no clear definition of 'shared characteristics', judgement will be required in considering the nature of such characteristics when aggregating items in the primary financial statements. The ED acknowledges that a residual expense category may remain for immaterial items lacking shared characteristics. In these instances, entities may be required to provide further disclosure on these items in the notes.

Our review showed that aggregation of certain operating expenses is commonly used by entities when presenting expenses. Of the 41 entities that disclosed an aggregated "other expenses" line item in their income statement, in 44% of instances the value of this aggregated line item exceeded 6% of the entity's total expenses.

What was pleasing to see was that in the majority of these instances, further disaggregation of these expenses was provided in the notes. The aggregation and disaggregation proposals also apply to assets, liabilities, income, equity and cash flows.

FY19: Entities reported 'other' expense line on the face of Income statement



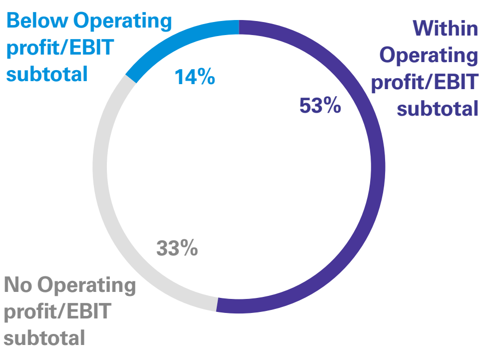
Integral and non-integral associates and joint ventures

There is currently diversity in practice with where the share of profit or loss of associates and JVs is presented in the income statement. Of the 42 entities that disclosed a share of profit or loss from equity accounted investments in the their FY19 income statement, 14% reported the share of profit/losses below an Operating profit/EBIT subtotal.

The ED specifies the location of the share of results of associates and JVs – split between those associates and JVs that are integral to the entity's business activities and those that are not. Specifically, the share of results from integral investees would be presented below an operating profit subtotal but still within operating activities. The rationale for this split is that some equity-accounted investees are more closely related to an entity's main business activities, operating in combination with the entity's other assets and in essence forming part of their operating activities. Those investees that are not integral would be presented within investing activities.

Although we believe many entities, particularly in the Energy and Natural Resource sector are likely to be supportive of these proposals, determining whether an associate or JV is integral to the entity's business activities will involve significant judgement. The current ED proposals would benefit from more expansive guidance and examples to assist entity's in making this judgement.

FY19: Presentation of share of profit/loss of associates and JVs



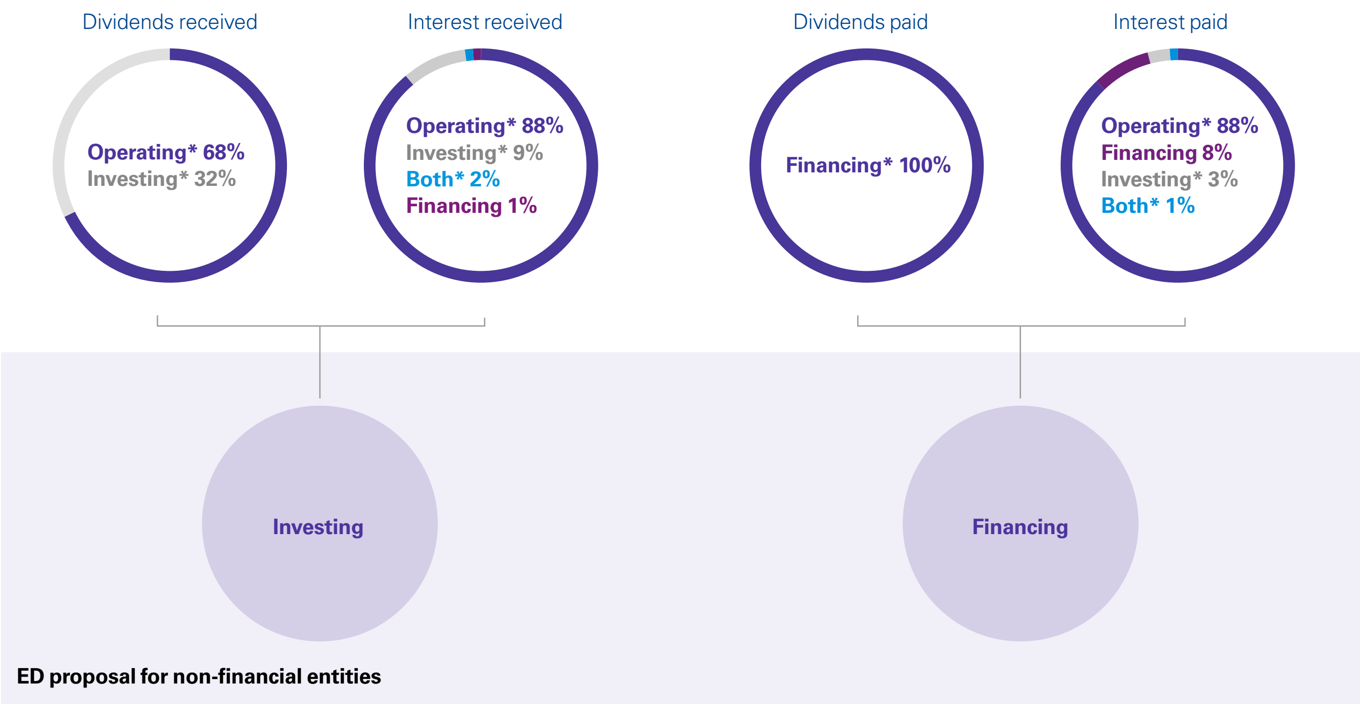
Cash flow structure – removing options for classification of dividends and interest

Under the current requirements contained in AASB 107 *Statement of Cash Flows*, entities have a choice to present interest and dividends received as operating or investing cash flows and interest and dividends paid as operating or financing cash flows. There is presently diversity in the market on the classification of these cashflow.

To reduce this diversity and improve comparability between entities, the ED proposes to eliminate the options for the classification of interest and dividend cash flows. The ED provides specific classification requirements for non-financial entities and requires financial entities[13] to classify interest and dividend cash flows consistently with their classification in the income statement.

We have analysed the current practice under AASB 107 and compared it to the ED proposals. It appears the proposals in the ED will result in significant changes for non-financial entities compared to existing practice. Changes in the cash flows classification may also impact cash earning measures used by entities in their communications, in particular, changes to the classification of interest cash flows will likely result in increases to operating cash ratios for more highly geared non-financial entities. For financial entities changes from the proposals are not expected to be that noticeable[14].

Current practice disclosure under AASB 107



* Accounting policy choice under existing AASB 107

13. Entities such as banks, insurers and investment entities.
14. Financial entities would classify interest paid, interest and dividends received each in a single category of the statement of cash flow depending on how the related income or expenses are classified in the income statement. Dividends paid would be classified as financing cash flows.

Methodology

To provide observations relevant across a broader cross section of entities, we focused this review on the Annual Reports of 72 entities across ASX200 for FY19. These 72 entities were randomly selected from a list of ASX200 entities (based on their market capitalisation) as at 1 January 2020.

ASX ranking	Year end		GIS Industry Group			
ASX50:	June	15	Consumer Discretionary	1	Industrials	2
21 entities	September	2	Consumer Staples	2	Materials	1
	December	4	Energy	2	Real Estate	4
			Financials	5	Telecommunication Services	1
			Health Care	2	Utilities	1
ASX51-100:	March	1	Consumer Discretionary	3	Information Technology	3
18 entities	June	12	Energy	1	Materials	5
	September	2	Financials	2	Utilities	1
	December	3	Industrials	3		
ASX101-150:	March	1	Consumer Discretionary	2	Industrials	2
16 entities	April	1	Consumer Staples	1	Information Technology	1
	June	9	Energy	1	Materials	4
	July	2	Financials	3	Real Estate	2
	August	1				
	September	1				
	December	1				
ASX151-200:	April	1	Consumer Discretionary	4	Health Care	1
17 entities	June	10	Consumer Staples	3	Industrials	1
	September	1	Energy	1	Materials	4
	December	5	Financials	1	Real Estate	2

To provide more relevant insights considering COVID-19, we reviewed the Annual Reports of an additional 35 entities across ASX200 for FY20. These 35 entities were randomly selected from a list of ASX200 entities (based on their market capitalisation) as at 1 January 2020.

ASX ranking	Year end		GIS Industry Group			
ASX50:	June	9	Consumer Staples	2	Real Estate	1
9 entities			Financials	1	Telecommunication Services	1
			Health Care	1	Utilities	1
			Industrials	2		
ASX51-100:	March	1	Consumer Discretionary	2	Information Technology	1
9 entities	June	8	Financials	1	Materials	2
			Industrials	2	Utilities	1
ASX101-150:	March	1	Consumer Discretionary	1	Industrials	1
9 entities	June	8	Consumer Staples	1	Materials	2
			Energy	1	Real Estate	1
			Financials	2		
ASX151-200:	May	1	Consumer Discretionary	1	Financials	1
8 entities	June	7	Consumer Staples	2	Health Care	1
			Energy	1	Materials	2

Appendix 1

Details of non-IFRS measures and reconciling items

Details of the types of non-IFRS measures and reconciling items discussed in the publication above.

Item	Description
Underlying profit	Adjusted profit before tax or adjusted profit after tax
ROCI	Return on capital invested
Operating profit before interest and tax/EBIT	Earnings before interest and tax or an equivalent subtotal such as Profit before interest and tax or Profit before financing and tax
EBITDA	Earnings before interest, tax, depreciation and amortisation or an equivalent subtotal such as Profit before interest, tax, depreciation and amortisation
Other cash flow measure (not FCF)	Various cash earnings and adjusted cash earnings measures, such as underlying cash flow, funds from operations, cash flow from operating activities
Debt related measure	Net debt, Net debt to equity, Net debt to EBITDA or similar measures
Tax items	Tax on significant/adjusting items; recognition of deferred tax assets; or total tax expense/benefit for the period
Fair value adjustments other than derivatives	Fair value adjustments on revaluation of investment property, listed investments, land and buildings, financial instruments through profit and loss, self-generating and regenerating assets
Amortisation/ depreciation	Adjustments relate to excluding specific items of amortisation or depreciation such as amortisation on acquired intangibles as well as excluding total amount of amortisation/ depreciation when reconciling from EBITDA to Profit measures
Forex related	Adjustments relate to excluding foreign exchange gain/loss and other adjustments to remove impact of exchange movements from results
Interest income and/or expense	Interest income on deposits and/or interest expense on borrowings and the unwind of discounts on provisions
Corporate expenses/ unallocated	Amounts not attributable to a reportable segment, this may have been from other operating segments or corporate operations

Appendix 2

Exposure Draft *General Presentation and Disclosures*

The Exposure Draft ED/2019/7 *General Presentation and Disclosures* ('the ED') was published in December 2019 by the IASB Board, and the respective Australian Accounting Standards Board Exposure Draft ED 298 *General Presentation and Disclosures* was published in January 2020. Submissions were initially due to the IASB Board by 30 June 2020, however, were extended to 30 September 2020 due to the impacts of the coronavirus pandemic.

This publication covers some of the key potential impacts of the ED. However, there are other proposals that are not discussed, including:

- Prohibiting columnar presentation of management performance measures.
- Changes to the balance sheet presentation with new line items introduced for goodwill and integral and non-integral associates and JVs.
- Changes to the cash flow statement by mandating operating profit to be a starting point under the indirect method.
- Introducing additional permitted earnings per share (EPS) disclosures.
- Amending AASB 134 *Interim financial reporting* to conform to the proposals for annual financial statements.

Our New on the Horizon publication provides more details and discussion on the potential impacts of the ED and offers illustrative examples showing how financial statements might be prepared and presented under this future standard.

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