



Technical Accounting Alert

Subtotals in the Statement of Comprehensive Income

Introduction

This alert covers two areas dealing with presentation in the statement of comprehensive income:

- disclosure of subtotals such as earnings before interest, tax, depreciation and amortisation (EBITDA) on the face of an IFRS income statement; and
- the disclosure of “operating profit” on the face of an IFRS income statement.

This alert also demonstrates examples of both appropriate and inappropriate disclosures regarding the above matters.

Relevant Australian standards

References in this TA alert are made to standards issued by the International Accounting Standards Board. The Australian equivalent to each standard included in this alert is shown below:

International Standard reference	Australian equivalent standard
IAS 1 <i>Presentation of Financial Instruments</i>	AASB 101 <i>Presentation of Financial Statements</i>

Guidance

The IFRS requirements on presentation of the statement of comprehensive income are set out in IAS 1.81-105. These paragraphs set out certain minimum contents for the income statement (IAS 1.82), and other general principles to be followed. However, there is no set format for the statement of comprehensive income and entities therefore need to exercise judgement in determining which headings and subtotals to include and the order in which they are presented.

The most important principle in presenting a statement of comprehensive income is that it should be relevant to, and of assistance in, explaining financial performance (IAS 1.85). The appropriateness of additional sub-totals needs to be judged against those criteria. Subtotals that have the potential to confuse or mislead users of the financial statements should be avoided.

With respect to "operating profit", the Basis for Conclusions to IAS 1 explains that "it would be misleading and would impair the comparability of financial statements if items of an operating nature were to be excluded from the results of operating activities, even if that had been industry practice. For example, it would be inappropriate to exclude items clearly related to operations (such as inventory write-downs and restructuring and relocation expenses)" (IAS 1 BC56).

The financial statements, including the statement of comprehensive income, should be presented consistently from one period to the next unless significant changes in the entity's operations or new IFRS requirements justify or necessitate a change (IAS 1.45).

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(a) Is it permissible to disclose subtotals such as EBITDA on the face of an IFRS statement of comprehensive income?

Yes, but only if the subtotal is consistent with the requirement that an IFRS income statement should be relevant to, and of assistance in, explaining financial performance (IAS 1.85). The following paragraphs provide guidance on how to apply this basic principle.

The only "totals" **required** to be presented on the face of the statement of comprehensive income are profit or loss and amounts related to discontinued operations/assets held for sale (IAS 1.82).

Additional headings, line items and sub-totals should, however, be included to achieve a relevant presentation (IAS 1.85). Some subtotals, such as "gross profit" and "profit before tax" are widely used and are clearly understandable. Other subtotals, including EBITDA, can also be relevant and helpful but only if used in a clear way that does not have the potential to confuse or mislead.

Subtotals that are inherently misleading (or potentially so) should be avoided. Examples of inappropriate subtotals include:

- maintainable earnings;
- core earnings;
- underlying earnings;
- business performance; and
- earnings before volatility.

These are potentially misleading because they suggest that any income and expenditure excluded from the subtotal is not likely to recur or is less relevant to understanding the "true" performance of the business. Any such suggestion is highly subjective and may not be borne out by future events.

Where subtotals are used that are not defined in IFRS and are not necessarily clearly understandable care should be taken to ensure that:

- the subtotal is properly described and includes all income and expenses consistent with that description (eg EBITDA excludes interest, tax, depreciation and amortisation but should not exclude other expense items such as restructuring costs or losses on disposal of non-current assets);
- line items above the sub-total are properly described and include all income and expense appropriate to their description;
- the additional sub-total is defined and that definition is applied consistently from one period to the next. The definition should be given in the notes to the financial statements in cases where it is not obvious (eg it is not a commonly used sub-total or it is commonly used but definitions vary between entities).

IAS 1 gives entities a choice in how expenses are presented in the statement of comprehensive income.

The options are presenting expenses

- (i) **by function** (eg cost of sales, distribution costs, administrative expenses etc); or
 - (ii) **by nature** (eg changes in inventories, raw materials used, depreciation and amortisation etc).
- Generally, only a presentation by nature is compatible with including an EBITDA subtotal. This is because functional expense line items, such as cost of sales and administration expenses, usually include depreciation (and/or amortisation).

(b) Is it permissible to disclose an "operating profit" or similar subtotal on the face of an IFRS statement of comprehensive income? What items can be excluded from operating profit?

It is permissible to disclose an operating profit or similar subtotal (eg "results from operations"). However, the guidance given under (a) above applies equally here. In particular, in this case the amount disclosed as operating profit must include all income and expenses that are operating in nature. Expenses should not be excluded from operating profit solely on the grounds that they are unusual, infrequent or significant. Items such as inventory write-downs, restructuring costs, gains or losses on disposal of non-current assets and litigation costs are all operating in nature and should not therefore be excluded, even if they are considered by the entity to be exceptional.

Operating profit will in most cases be presented before (ie excluding):

- finance costs (although these are "operating" items for many financial services entities);
- share of profits or losses of associates; and
- income taxes.

If an entity wishes to disclose a subtotal for profit that excludes certain other items, such as items considered to be exceptional, this sub-total should be properly described. Depending on the circumstances, a description such as "operating profit before exceptional items" or "trading profit" might be appropriate.

Examples

Example 1 - acceptable disclosure of EBITDA

	20X2	20X1
Revenue	x	x
Changes in inventory and work-in progress	x	x
Raw materials consumed	(x)	(x)
Employee benefits expense	(x)	(x)
Other operating income	x	x
Earnings before interest, tax depreciation and amortisation	x	x
Deprecation and amortisation expense	(x)	(x)
Finance costs	(x)	(x)
Share of profits of associates	x	x
Profit before tax	x	x

Note: this is an example of presenting expenses by nature.

Example 2 - unacceptable disclosure of EBITDA

	20X2	20X1
Revenue	x	x
Costs of sales	(x)	(x)
Gross profit	x	x
Distribution costs	(x)	(x)
Administration expenses	(x)	(x)
Earnings before interest, tax depreciation and amortisation	x	x
Depreciation and amortisation expense	(x)	(x)
Finance costs	(x)	(x)
Share of profits of associates	x	x
Profit before tax	x	x

Note: this is an example of presenting expenses by function. It is unacceptable because costs of sales, distribution costs and administrative expenses are disclosed but do not include depreciation and amortisation expenses. Typically in a functional presentation the expenses by function (costs of sales, distribution costs etc) include an allocation of depreciation and amortisation.

Example 3 - acceptable disclosure of operating profit

	20X2	20X1
Revenue	x	x
Cost of sales	(x)	(x)
Gross profit	x	x
Distribution costs	(x)	(x)
Administration expenses, excluding restructuring costs	(x)	(x)
Restructuring costs	(x)	(x)
Operating profit	x	x
Finance costs	(x)	(x)
Share of profits of associates	x	x
Profit before tax	x	x

Note: this format is acceptable because operating profit includes all items of an operating nature, including restructuring costs. In the example, a line item is also described as "administration costs, excluding restructuring costs". This is because restructuring costs might in many cases also comprise administration costs. It could therefore be misleading to show a line item "administration costs" if that line item in fact excludes the administrative component of restructuring costs.

Example 4 -unacceptable disclosure of operating profit

	20X2	20X1
Revenue	x	x
Cost of sales	(x)	(x)
Gross profit	x	x
Distribution costs	(x)	(x)
Administration expenses	(x)	(x)
Operating profit	x	x
Restructuring costs	(x)	(x)
Finance costs	(x)	(x)
Share of profits of associates	x	x
Profit before tax	x	x

Note: this format is unacceptable because operating profit excludes restructuring costs, which are operating in nature. The line item "administration costs" would also be misleading if there is an administrative component within restructuring costs.

Example 5 -acceptable disclosure of alternative sub-total

	20X2	20X1
Revenue	x	x
Cost of sales	(x)	(x)
Gross profit	x	x
Distribution costs	(x)	(x)
Administration expenses, excluding restructuring costs	(x)	(x)
Operating profit before restructuring costs	x	x
Restructuring costs	(x)	(x)
Operating profit	x	x
Finance costs	(x)	(x)
Share of profits of associates	x	x
Profit before tax	x	x

Note: this format is acceptable because "operating profit before restructuring costs" is an accurate description of the amounts shown against that subtotal.

Further information

For further information on any of the information included in this TA alert, please contact your local Grant Thornton Australia contact or a member of the National Audit Support team at NAS@grantthornton.com.au.