MIC 2020
Management International Conference

The 20th Management International Conference

Proceedings of the Joint International Conference
Organised by

- University of Primorska, Faculty of Management, Slovenia
- Lomonosov Moscow State University, Moscow School of Economics, Russian Federation
- Juraj Dobrila University of Pula, Faculty of Economics and Tourism 'Dr. Mijo Mirković,' Croatia

Online Conference • 12–13 November 2020

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Foreword

The MIC organisers, partners, authors and friends celebrated the 20th edition of the conference in 2020. Although our attempts to meet you all in person in Ljubljana did not come true, we hope that our first virtual MIC met your expectations. We surely put a lot of effort in planning and preparing this virtual event, which was organised by University of Primorska, Faculty of Management (Slovenia), Lomonosov Moscow State University, Moscow School of Economics (Russian Federation), and Juraj Dobrila University of Pula, Faculty of Economics and Tourism 'Dr. Mijo Mirković' (Croatia).

We would like to extend a sincere appreciation to all the participants and presenters for their contributions and participation. This year we received 134 submissions, of which approximately 100 were presented at the conference. After the conference, authors were invited to submit their full papers to the MIC 2020 Conference Proceedings. All the received papers have gone through a double-blind peer review process.

We are glad that a substantial number of papers presented at the MIC 2020 conference were published in several of the MIC supporting journals:

- *Academica Turistica – Tourism and Innovation Journal*
- *Economic and Social Changes: Facts, Trends, Forecast*
- *Economic Research/Ekonomska istraživanja*
- *Human Systems Management*
- *International Journal of Computational Economics and Econometrics*
- *Journal of the New Economic Association/Zhournal Novoi Ekonomicheskoi Associacii*
- *Management*
- *Management and Production Review*
- *Managing Global Transitions*
- *Review of Innovation and Competitiveness*

We sincerely thank all the journals' editors for their cooperation in the publication process and for their engagement at the Editors' Panel.

Our deepest gratitude goes to the Keynote Speaker, Dr. Janez Potočnik, Co-Chair of the UN International Resource Panel and Former European Commissioner for Environment.

Last but not least, we extend our sincere thanks to everybody who participated in the programme boards and organisation of the MIC 2020.

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Is "Operating Profit" Set in Stone? A Commentary on the New IASB's Exposure Draft "General Presentation and Disclosures"*

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Abstract. Financial statements are beneficial to users when the underlying economic relationships are presented clearly and concisely, thereby improving the comparability and understandability of financial information. In order to improve these qualitative characteristics, the International Accounting Standards Board (IASB) has published in December 2019, as part of its Primary Financial Statements project, an Exposure Draft "General Presentation and Disclosures" (ED /2019/7) to replace IAS 1 "Presentation of Financial Statements". The aim of this paper is to analyse the main changes proposed by the IASB to the structure of the financial statements, highlight their advantages and disadvantages, and engage with the relevant literature.

Keywords: financial accounting, financial reporting, IFRS, IAS 1, IAS 7, income statement, operating income, cash flow statement

1. Introduction

According to the International Accounting Standards Board's 2018 Framework, the fundamental qualitative characteristics of financial information are relevance and faithful representation (Framework:2.4). Financial information is relevant if it can make a difference to users' decisions. Financial information should also faithfully represent the substance of the phenomena it purports to represent (Framework:2.12). The usefulness of financial information is enhanced by four other qualitative characteristics, which the Framework as comparability, verifiability, timeliness, and understandability (Framework:2.23). Comparability is the qualitative characteristic that enables users to identify and understand similarities in and differences between items (Framework:2.25). Comparability has long been regarded in the accounting literature as an essential characteristic of financial reporting, without which financial reporting would be useless for decision making (Fischer 1989). Comparability can be achieved through equivalent presentation and equivalent measurement (Simmons 1967), or, very similarly, through consistency in classification and measurement and by separating extraordinary income and expenses from other income statement line items (Fanni and Cossar 1998). Empirical definitions of comparability derive from the observation that the accounting system describes economic events in financial statements; therefore, two companies have comparable accounting systems if they produce similar financial statements for the same set of economic events (De Franco, Kothari, and Verdi 2011).
The IASB's Framework states that comparability does not mean uniformity: for information to be comparable, "like things must look alike and different things must look different" (Framework:2.27).

* This paper is the result of the joint efforts of the authors. However, paragraphs 3, 4 and 5 can be attributed to M. Bertoni, paragraphs 1 and 2 to B. De Rosa, and paragraphs 6 and 7 to P. Rossi.

Consistent with this view, the IASB has always allowed preparers of financial statements a considerable degree of freedom, particularly concerning the format of the income statement. In the accounting literature, such flexibility granted to preparers of financial statements is often associated with investor-oriented or “strong equity” accounting systems (Nobes 1998). On the other hand, more creditor-oriented or ‘weak equity’ accounting systems prefer uniformity to flexibility (Radebaugh, Gray, and Black 2006), and often require a uniform format for the financial statements, as is the case with national accounting regulations in various European Union countries, all of which stem from EU Directive 2013/34/EU.
The current version of International Accounting Standard (IAS) 1 - Presentation of Financial Statements requires a minimum content of the income statement and allows entities to classify their operating expenses either by nature, or by function (IAS 1.99), resulting in two different income statement formats, which can be referred to as the cost of goods sold format, and the total output format. In addition, IAS 1 prohibits the presentation of any income and expense items as extraordinary items, including in the notes (IAS 1.87).
Although the adoption of International Financial Reporting Standards (IFRS) in the European Union has arguably increased the comparability of financial information, there is less evidence to support the achievement of full cross-country comparability (Yip and Young 2012). Indeed, the flexibility granted by international accounting standards, which do not impose specific requirements on the presentation and calculation of subtotals in the income statement, has led to a variety of reporting practices, even within the same industry. In some cases, subtotals with the same title are often calculated differently by different reporting entities. For example, the IASB reports that in a sample of 100 annual reports in 2017-18 (from different countries and industries), 63 entities included an operating profit in their financial statements that was calculated in nine different ways. This diversity makes it difficult for users of financial statements to understand the information provided and to compare information between entities. Therefore, as a result of its project to revise primary financial statements, the IASB issued a proposal to revise the format and content of the primary financial statements to improve the consistency and comparability of financial information (IASB 2019). In the exposure draft, the Board introduces, among other things, an official definition of operating income, a mandatory classification of income statement line items into four distinct sections, and a different definition of cash flows from operating activities, which removes some of the options contained in IAS 7 Statement of Cash Flows.
This paper proceeds as follows. Section 2 summarizes the main points of the new draft “General presentation of disclosure”, while Section 3 and Section 4 analyse the problem of distinguishing between operating and financial activities in financial reporting and the classification of cash flow. Section 5 and Section 6 present the issue of unusual income and expenses and the use of alternative performance measures in the income statement.

2. Primary financial statements: the IASB’s new draft standard
Given the variety of choices allowed by IFRS in the presentation of the financial statements, and considered the relevance attributed to user-defined measures of performance, the IASB decided to reform its standard on the presentation of financial statements, also by defining and formalizing some of the most important and commonly used alternative measures of performance. The project, currently still in the stage of an exposure draft, aims to improve comparability across preparers by standardizing the format of the income statement and by providing for the first time an official definition for the subtotals that it should report. In addition, the proposed standard aims to make management-defined measures of performance simpler to understand, requiring adequate and easy-to-find disclosure on the calculation basis of such measures. The IASB’s project started in 2014, based on the evidence that the flexibility and the lack of officially defined subtotals that characterizes IAS 1 has led to income statements that differ in content and structure, thus hindering comparability. Research shows that investors attribute the utmost importance to measures of performance based on the operating/financing distinction, such as the operating income and earnings before interest, tax, depreciation and amortization, or EBITDA (Barton, Hansen, and Pownall 2010). Therefore, the need to regulate

management-defined measures of performance, some extremely popular among investors and analysts, such as the operating result of the firm, was also a driving factor in the development of the new standard. The exposure draft of the new standard, intended to replace IAS 1, was issued in December 2019. It revises the format and content of all the main financial statements, with major modifications to the statement of profit or loss (IASB 2019). In the exposure draft, the Board introduces, among other things, an official definition of operating income, a mandatory classification of income statement items in four different areas, and a different definition of cash flow from operations, removing some of the options available under IAS 7 "Statement of cash flows".
The proposal encompasses changes to all the primary financial statements; however, for this article, our analysis will be limited to the income statement and the most relevant improvements to the cash flow statement.
The new standard proposes to classify income and expenses into four defined categories: operating, integral associates and joint ventures, investing, and financing. The names of most of these categories are the same adopted in the statement of cash flow, although they do not have the same meaning. Preparers will also be required to show three new subtotals, between these four categories, thus creating a consistent structure of the income statement, making it easier for investors to compare companies. The new subtotals are:

a) operating profit or loss;
b) operating profit or loss and income and expenses from integral associates and joint ventures;
c) profit or loss before financing and income tax.

The basic structure of the income statement according to the new draft proposal is illustrated in Table 1.
In addition to the new format of the income statement, the standard will require more detailed disaggregation of information in the notes to the financial statements and adequate disclosure on management-defined performance measures.

Table 1: Sample format of the income statement

Revenue	X	Operating
Operating expenses	(X)	
Operating profit or loss	**X**	
Share of profit or loss of integral associates and joint ventures	X	Integral associates and joint ventures
Operating profit or loss and income and expense 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	
Profit or loss before financing and income tax	**X**	
Interest revenue from cash and cash equivalents	X	Financing
Expenses from financing activities	(X)	
Unwinding of discount on pension liabilities and provisions	(X)	
Profit or loss before tax	**X**	

Adapted from IASB (2019)

3. The operating-financing distinction in financial reporting

Users of financial statements typically attempt to analyse the financial performance of the company regardless of how it is financed. This goal is achieved by separating financing revenues and expenses from operating income. The operating-financing distinction is pervasive in the finance literature and can be traced to the seminal work of Modigliani and Miller (1958), whose model, assuming perfect financial markets and fixed capital expenditures in each period, shows how the value of the firm is not affected

by its capital structure. Accounting standards generally require the separate disclosure in financial statements of flows and obligations arising from the provision of finance to the firm from those (broadly defined) as “operating”, arising from all other activities (Barker 2010). However, this residual definition of operating activities in financial reporting is a source of interpretive doubt and divergent practices. International Financial Reporting Standards (IFRS) also acknowledge that the definitional issues are ambiguous; IAS 7 - Statement of Cash Flows defines financing activities as those that result “in changes in the size and composition of the contributed equity and borrowing of the entity”, without providing a definition of borrowing (IAS 7.6). IAS 7 notes that interest paid and received “are usually classified as operating cash flows for a financial institution” but that there is “no consensus on the classification of these cash flows for other entities” (IAS 7.33). In practice, the accounting standards concede that a distinction between operating and financing income and expenses (and cash flows) is important, but they do not explain why, and they do not provide sufficient guidance on how to make such a distinction. The proposed new standard addresses this problem by specifying that the “operating” category includes information about income and expenses arising from an entity’s main business activities, i.e. those not classified as investing, financing, integral associates and joint ventures, income taxes, and discontinued operations (IASB 2019, 46). The proposal expands and clarifies the definitions of IAS 7 by explaining that financing activities are those that involve obtaining the use of a resource from a provider of finance with the expectation that: a) the resource will be returned to the provider of finance; and b) the provider of finance will be compensated by the payment of a finance charge that depends on both the amount of the loan and its duration (IASB 2019, 50). The definition is circular, but at least it helps to distinguish operating liabilities from financing liabilities. Nonetheless, the list of income and expenses included in the financing category does not seem to be entirely consistent with this definition. In fact, in addition to income and expenses from liabilities, this category also includes those from cash and cash equivalents (IASB 2019, 49), considering excess cash and temporary investment of excess cash as part of the entity’s financing (IASB 2019, BC39). Even if it is correct to assume that users of financial information are not typically able to distinguish “operating cash” from “investment cash”, the project does not explain why income and expenses from cash and cash equivalents are not instead included in the “investing”, category, which would seem more appropriate. In fact, this section of the income statement includes the result from investments that are generated individually and are largely independent of other resources held by an entity (IASB 2019, 47). Although it could be argued that the “independence” of cash from other resources is dubious at best, the inclusion of income and expenses derived from cash and cash equivalents in financial activities seems inconsistent with the very definition provided by the project.
It is also important to note that the concept of “investing” in the income statement differs from that of the cash flow statement since the cash flow statement includes investments in operating assets (and thus related to the principal activity of the enterprise) in addition to investments in financial assets.
The investing category excludes income and expenses from “integral associates and joint ventures”, which must be reported separately. This category includes the share of profit of integral associates and joint ventures (to be accounted for using the equity method), impairment losses (and reversals of impairment losses) relating to these assets, and gains and losses from their disposal. The reason for creating this category is the observation that in practice there are significant differences in how income and expenses from equity method investments are reported in the income statement (IASB 2019, BC8). The purpose of separating interests in integral associates from those in non-integral associates is therefore to highlight the different roles of these different categories of investments: integral investments, in combination with other assets, contribute to the principal activity of the entity and create synergies that are not present in non-integral interests. Nevertheless, a significant amount of judgement will likely be required to identify associates and joint ventures that should be classified as “integral”. Indeed, the definition provided in the draft standard is, once again, circular: “associated and joint ventured accounted for using the equity method and that are integral to the main business activities of an entity” (IASB 2019, Appendix A). The standard provides some guidance to help identify integral associates, including some examples of significant interdependencies between an entity and an associate or joint venture, including:

a) integrated operations with the associate or joint venture;
b) a common name or brand so that the entity and the associate or joint venture appear to the outside world as one entity;
c) a supplier or customer relationship with the associate or joint venture that is difficult to replace without causing significant disruption to the business.
Since associates may change status over time, this could lead to potential intertemporal comparability problems in the financial statements of the same entity.
In the finance literature to date, there are two main definitions of financing activity: financial statement items can be classified according to their intrinsic attributes, i.e. by nature (Feltham and Ohlson 1995), or according to the purpose of the financial statement items in the context of the business of the entity, i.e. by function (Penman 2006). The latter definition is often considered less precise because it is inherently entity-specific and so defies a standardised delineation. Barker (2010), analysing the theoretical basis of these concepts, proposes the adoption in financial reporting of the functional definition, because it is more in line with the investors' primary concern of measuring the value of the company by analysing its operating activities. According to these considerations, it seems that the definition of the draft is consistent with the position of Barker (2010), even if the functional approach may hinder consistency and comparability.

4. Classification of cash flows
The IASB proposal also introduces some relevant changes to IAS 7 - Statement of Cash Flows by removing some of the options currently available in separating cash flows between operating, investing, and financing activities. Namely, the current version of IAS 7 allows entities to present cash flows from interest paid, interest received, dividends paid and dividends received in the operating, investing, or financing section of the statement of cash flows (IAS 7.31). Other accounting standards, such as United States Generally Accepted Accounting Principles, or US GAAP (ASC 230), instead impose a more rigid classification of cash flows and require cash flows from interest paid, interest received and dividends received to be reported as operating cash flows. Although the flexibility provided by IFRS contrasts sharply with the uniformity imposed by other accounting standards, particularly US GAAP, the classification of interest and dividends as operating cash flows is the most common choice under IFRS (Baik et al. 2016, Gordon et al. 2017, Bertoni and De Rosa 2018). However, reporting outflows from interest expense in the operating section of the statement of cash flows can lead to several inconsistencies and is generally inconsistent with the finance literature (Nurnberg 1993, Nurnberg and Largay 1998). Furthermore, reporting interest payments as an operating cash outflow can be an obstacle for analysts trying to compare the performance of firms with different financing decisions, considering that dividends paid are instead generally included in the financing section of the statement of cash flows (Weiss and Yang 2007).
The IASB proposal introduces the following mandatory classifications of interest and dividends:

a. dividends and interest paid should be classified as cash flows from financing activities (IASB 2019, 33A-34A)[1];
b. interest and dividend received as cash flows from investing activities (IASB 2019, 34A).

The new requirements resolve one of the main inconsistencies of IAS 7, namely the ability to include dividends paid in the operating section of the cash flow statement. This requirement applies to all entities, including those whose main business is financing customers. The reason why IAS 7 originally allowed such classification of dividends was that investors often want to determine the entity's ability to pay dividends from operating cash flows (IASB 2019, BC192). This rationale is rather weak because

[1] The proposal leaves entities that provide financing to customers as a main business activity, or that invest in assets that generate returns individually and largely independently of other resources as a main business activity, free to classify interest and dividends as operating, investing, or financial activities, as long as the cash flow classification is consistent with the one chosen for income and expenses. See IASB 2019, 34B.

dividends paid need to be reported separately in any case, so investors can easily compare operating cash flow with dividends paid, in addition to calculating other measures, such as free cash flow, which also takes into account capital expenditures.
The decision to classify interest paid as operating cash flows, and interest and dividends received as investing cash flows, aims to provide a more accurate measure of cash flows from operations. As noted above, this is certainly more in line with the way cash flows are determined in the finance literature, so in that sense, it can be seen as a welcome change. Eliminating these options reduces the flexibility provided by IAS 7 and may arguably lead to improved comparability between entities. The current standard also allows managers, given the general lack of disclosures on the statement of cash flows, to make classification decisions that may have a relevant impact on cash flows from operating activities but are typically not explained or mentioned in the notes to the financial statements. In addition, the elimination of these choices provides a more direct link between the operating section of the statement of cash flows and the operating results reported in the income statement. On the other hand, it should be noted that the majority of companies reporting under IFRS will be forced by the new rules to change their current financial reporting practices and that comparability with companies reporting under US GAAP will become even more problematic.
Many studies have examined the impact of different classifications of income statement items on managerial opportunism (Lail, Thomas, and Winterbotham 2014), while few studies have focused on shifting classifications in the statement of cash flows. Lee (2012) shows that managers of US firms increase operating cash flows by shifting items in the statement of cash flows. This result is consistent with Baik et al. (2016). They show that managers have incentives to shift the classification of interest payments in the statement of cash flows to inflate operating cash flows. However, this opportunistic behavior of managers negatively affects the market valuation of firms as investors use this information in their investment decisions. Based on these findings, the draft's new requirement could reduce managers' opportunistic behavior in using IFRS discretion to inflate operating cash flows.

5. Unusual income and expenses

In the accounting literature, reporting extraordinary items separately in the income statements has long been considered one of the prerequisites of financial statements comparability (Fanni and Cossar 1998). When used appropriately, this classification of income and expenses can supposedly improve financial reporting, by providing users of financial information with data that is not distorted by underlying anomalies (Gamble et al. 2012). However, this section of the income statement has often been considered as a grey area, an elusive concept that can be exploited opportunistically, especially for earnings management (Hoyle, Paik, and Shi 2017, Bavagnoli 2002, Massoud, Raiborn, and Humphrey 2007). The current version of IAS 1 does not allow to classify any component as "extraordinary", including the notes to the financial statements (IAS 1:87). This decision dates back to 2002, when the IASB revised its standard, following a similar debate originated by the United States Financial Accounting Standards Board (FASB) in 2001, when not even the loss generated by the World Trade Center attack was considered extraordinary[2], largely for pragmatic reasons (Hoyle, Paik, and Shi 2017). Before 2002, IAS 1 defined extraordinary items as "income and expense that arise from events or transactions that are clearly distinct from the ordinary activities of the enterprise and therefore not expected to recur frequently or regularly" (IAS 1: BC60). The clear tautology included in the IASB's definition left ample judgment to preparers when deciding which items to include in this section of the income statement. However, the definition of "ordinary activities" provided by international accounting standards (in the formulation of IAS 8 at the time) was so broad that the possibility to use this classification was limited to few residual cases, such as the consequences of natural catastrophes, or the losses arising from an expropriation (Bavagnoli 2002). The IASB justifies its choice of eliminating this section of the income statement by stating that items treated as extraordinary stem from the normal business risk faced by an entity and do not warrant a separate presentation in the income statement (IAS

[2] See FASB News Release of October 1, 2001: https://www.fasb.org/eitf/eitf91101.shtml.

1:BC63). Eliminating this section, therefore, eliminates "arbitrary" segregation of the effects of external events (IAS 1:BC64).
The draft standard introduces the concept of unusual income and expense, defined as those with limited predictive value, namely when it is reasonable to expect that income and expense that are similar in type and amount will not arise for several future annual reporting periods (IASB 2019, 100). In this sense, the definition seems close to the old designation of extraordinary items, especially in the part where it referred to items that are not expected to appear regularly or frequently in the income statement. However, the reference to the predictive value of unusual items, although it does not eliminate the unavoidable judgment required to identify them, introduces an explicit "forward-looking" approach, aimed at assessing the persistence of the unusual items (and not their appearance in the past financial statements) that was missing from the definition of extraordinary items. It is interesting to observe that the definition of unusual items differs from that of extraordinary items also because it does not make any reference to the nature of the item, but only to its predictive value: for example, an unusual event such as an earthquake could give rise to "usual" expenses if costs are expected to arise for several years (IASB 2019, BC134).
The new proposed standard, however, does not reintroduce a separate section of the income statement for unusual items; instead, it requires adequate disclosure in the notes to the financial statements of unusual income and expenses, including, besides their amount, a narrative description of the events that gave rise to these items, and, interestingly, the specification of the line items in the income statements in which each item of unusual income and expense is included (IASB 2019, 101). This provision will allow users of financial statements to recalculate each item in the income statement excluding the effect of income and expense with limited predictive value, effectively helping in calculating the "normalization adjustments", widely required by the business valuation literature (Ballas 1999, Damodaran 2006, Damodaran 2012, 243). The decision not to prescribe a separate subtotal in the income statement, such as an "operating profit before unusual items", can be ascribed to the fact that this solution could lead to mixing different classification of expenses (by nature and by function) in the same statement, thus misleading the users (IASB 2019, BC126).
According to some commentators, labelling some income statement items as unusual, since it is not forbidden by the current version of IAS 1, should be already necessary (even before the revised version of IAS 1 becomes effective), as a consequence of the coronavirus (COVID-19) pandemic that hit the world in 2020 (Kegalj 2020). Indeed, to highlight the effects of the pandemic in the income statements, practitioners suggest labelling income (such as insurance recoveries from COVID-19 related claims) and expenses (such as hazard pay to employees, cleaning and sanitation costs…) related to the pandemic as "unusual", or "exceptional". It is a sign that the isolation of unusual and non-recurring, items has always been considered a necessity by users of financial information, to ensure comparability of financial statements. The elimination of extraordinary items from financial statements was first taken, as noted, by the FASB, following a cost-benefit analysis aimed at simplifying financial reporting and reducing its costs. It appears that both the FASB's and the 2002 IASB's decisions were not soundly based on theoretical reasons.

6. Alternative measures of performance

Alternative measures of performance, specifically designed by the preparers themselves, are known in the literature as "non-GAAP" measures of financial performance (Black et al. 2018). The European Security and Market Authority (ESMA) prefers to call them Alternative Performance Measures (APM). They are defined by the Authority as " a financial measure of historical or future financial performance, financial position, or cash flows, other than a financial measure defined or specified in the applicable financial reporting framework" (ESMA 2015, 45). The most important, and widely used, measures of performance not regulated by any accounting standards are the operating profit and the earnings before interest, tax, depreciation, and amortization (EBITDA), but companies may include many more APMs in their financial statements. Table 2 reports examples of alternative measures of performance, not to be confused with other metrics or key performance indicators (such as average revenue per customer, or customer retention) that are outside the scope of the definition provided above.

Table 2: Examples of alternative measures of performance vs. other metrics

Alternative Performance Measures	Other Metrics
Adjusted revenue	Same-store sales
Adjusted net income	Average revenue per customer or user
EBITDA	Revenue per available room
Adjusted EBITDA	Sales per square meter
EBITDAR	Customer retention
EBIT	
Adjusted EPS	
Free cash flow	
Funds from operations	
Net debt	
Unbilled deferred revenue	
Book to bill ratio	
Orders and order backlog	
Return on capital employed (adjusted)	

Adapted from CFA (2016)

ESMA requires attributing meaningful labels to each APM reported in the financial statements, along with adequate disclosures of their basis of calculation and their definition (ESMA 2015, 46).
In general, subtotals near the “centre” of the income statement, such as operating income, seem to have the highest association with stock returns, a measure of value relevance of accounting information (Barton, Hansen, and Pownall 2010). According to some surveys, “non-GAAP”, or alternative, measures of performance represent an answer to certain shortcomings of accounting information, including interpretation complexity, stakeholders disagreements with specific accounting requirements, failure to represent adequately the economics of particular transactions or contracts, and conservatism bias (CFA Institute 2016). Moreover, APMs often are designed with the intent of separating effects of transitory gains and losses from that of transactions that have instead a recurring impact on the firm’s financial performance (Kolev, Marquardt, and McVay 2008). This latter aspect may be interpreted as a response to the requirement of IAS 1 not to classify any revenue or expense as “extraordinary”, including in the notes to the financial statements, as discussed previously.
The IASB proposal defines “management performance measures” and requires companies to include such measures in a single note to the financial statements, accompanied by adequate disclosure. Management performance measures are subtotals of income and expense that:

a) are used in public communication outside financial statements;
b) complement totals or subtotals specified by IFRS standards; and
c) communicate to users of financial statements management’s view of an aspect of an entity’s financial performance (IASB 2019, 103).

It is important to observe that, according to the IASB’s proposal, the definition of management performance measures includes only *subtotals* of income and expense, i.e. any other measure calculated with balance sheet or cash flow information would be considered outside the scope of the definition. Interestingly, since the IASB does not include EBITDA in the new income statement, this common measure of performance meets the definition of management performance measures. The reason for the exclusion of this subtotal from the income statement lies mainly in the fact that “users have no consensus about what EBITDA represents, other than being a useful starting point for various analyses” (IASB 2019, BC172). Although we understand the IASB’s concern about reaching a consensus on a subtotal whose determination can be subject to different interpretations, providing a clear and unambiguous

definition of commonly employed measures of performance is precisely what one would expect from a standard setter.
Considered the definition of management performance measures, the proposed rules would apply to income statement subtotals not prescribed by the standard (such as EBITDA, as noted above), but not to other common alternative measures of performance, such as return on investments, return on equity, free cash flow, growth rates, etc. For each management performance measure identified by the draft standard, the entity should disclose in a single note, among others, a reconciliation between the management performance measure and the most directly comparable subtotal or total specified in the income statement, and a description of why each measure communicates management's view of performance and how it is calculated (IASB 2019, 106). While introducing such disclosure requirements is certainly a welcome change, the definition provided seems to be overly restrictive, since it is limited to subtotals of income and expense. On the other hand, the reference to the fact that these measures must be used in "public communication" seems too broad, and could generate some interpretation issues. If the purpose of the new rules is to enhance comparability and shed some light on performance measures that are commonly used, but seldom explained in detail, then the requirements should extend to measures other than those defined by the draft standard. In our opinion, the ESMA definition of Alternative Performance Measures seems more in line with current reporting practices and would allow, if introduced in an IFRS standard, better disclosure than the one deriving from the application of the IASB proposal.
The importance of alternative performance measures is also confirmed by the value relevance studies that prove the explanatory power of EBITDA, followed by that of total revenues (Habib 2010). The research of Graham et al. (2005) shows that earnings per share (EPS) is a key and simple metric to compare the firm's performances.

7. Conclusions
The draft standard addresses key issues in financial reporting and it is expected to have a significant impact on preparers and users of financial statements. It also constitutes a new orientation in the IASB's approach to regulation of financial reporting: indeed, imposing standardized subtotals in the income statement is an important deviation from the flexibility typically granted to prepares by strong equity accounting systems (Nobes, 1998). Providing official guidance on the operating-financing distinction in financial reporting and on the calculation of widely used measures of performance, such as the operating profit, is certainly useful. It would have been preferable, however, if the IASB's efforts were extended to the definition of EBITDA, given its widespread adoption as an alternative measure of performance. Conversely, the distinction between operating, financing, and investing activities in the income statement, and the consequent definition of operating profit, presents some theoretical and practical problems. We highlighted some issues regarding the circularity of the definition of financial activities. We also observed that including interest revenue from cash and cash equivalents in the financing activity section of the income statement is an internal inconsistency that does not find an adequate explanation in the draft standard.
The newly introduced concept of integral associated and joint ventures, whose share of result must be reported separately in the income statement, can potentially shed more light on strategic assets that today are not always adequately disclosed in financial statements. Distinguishing between integral and non-integral associates will certainly require considerable judgement, with potentially relevant consequences on the portrayal of financial performance in the income statement. Judgement, however, is unavoidable in all areas of financial reporting, including the measurement and the classification of financial statement items.
We believe that the new provisions regarding the classification of cash flows and the disclosure of unusual items in the income statements will improve the usefulness of financial reporting, addressing some of the inconsistencies observed in the accounting literature, and contributing to the comparability and understandability of financial information. For example, the definition of unusual income and expenses shifts the perspective from their exclusion from the "ordinary" activities to their predictive

value. In this sense, despite the difficulties that the practical application of this definition may have, the IASB aims at improving the usefulness of financial information. When extraordinary items were originally eliminated, instead, the decision was not entirely based on theoretical considerations regarding the purpose of financial reporting, but rather on the practical goal of reducing managerial discretion in the classification of income statement items.

In this paper, by analysing the content of the IASB's draft proposal and engaging with the relevant literature in the field, we conclude that several of the new requirements could reduce the opportunity for opportunistic behaviours by managers and increase the value relevance of financial information. More research is needed to assess the effects of the new provisions, once they become effective, on the qualitative characteristics of financial information.

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