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

Michele Bertoni
University of Trieste, Dept. of Economics, Management, Mathematics and Statistics, Italy
michele.bertoni@deams.units.it

Bruno De Rosa
University of Trieste, Dept. of Economics, Management, Mathematics and Statistics, Italy
bderosa@units.it

Paola Rossi
University of Trieste, Dept. of Economics, Management, Mathematics and Statistics, Italy
prossi@units.it

The operating-financing distinction is pervasive in finance literature, and it can be traced back to the seminal work of Modigliani and Miller (1958), whose model, under the assumption of 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 to separate "financing" items from those called (in a broad sense) "operating", deriving from all the other activities (Barker 2010). However, this residual definition of operating activities in financial reporting has been a source of interpretative doubts and different practices. Consistently with the flexibility expected from a strong equity accounting system (Nobes 1998), IAS 1 "Presentation of financial statements" requires firms to present revenues and profits or losses in their income statement, but does not require any specific subtotals in between. For these reasons, the structure and content of the income statement varies among companies, even within the same industry. Moreover, although most companies present an operating income in their income statements, there is no uniformity in its determination.

The lack of a prescriptive format, and the absence of a definition of subtotals in the income statement, led over the years to the development of several alternative measures of performance, specifically designed by the preparers themselves, known in literature as "non-GAAP" measures of financial performance (Black et al. 2018). 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). However, firms employ a variety of other measures when communicating their performances to investors, mainly 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). It is possible to make a connection between the need of conveying to investors financial information that is not affected by non-recurring items with the fact that IAS 1 prohibits to report extraordinary gains and losses in the income statement.

In December 2019 the IASB issued a proposal to revise the format and content of the main financial statements, as the outcome of its project on the revision of primary financial statements, in order to improve consistency and comparability of financial information (IASB 2019). In the exposure draft, the Board introduces, among other changes, 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 objective of the present paper is to review the theoretical and empirical research that addresses the specific issues of Primary Financial Statements Project. On the basis of this analysis, we discuss the content of the changes introduced by the proposed regulation, highlighting their advantages and

disadvantages. We also explore the impact that the new rules will probably have on the usefulness of financial information for investors, and on the current prevailing financial reporting practices.

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

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