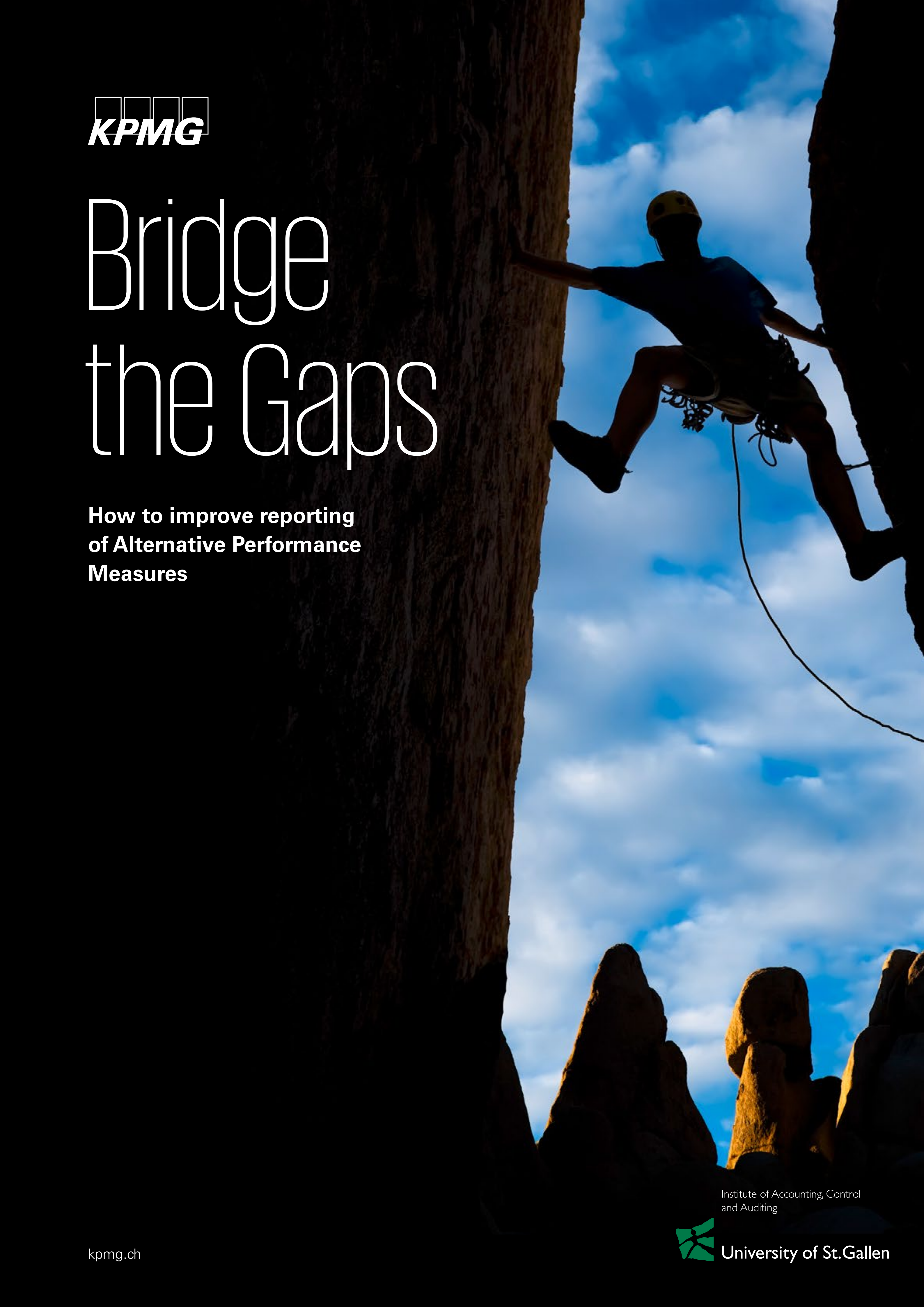

Bridge the Gaps

How to improve reporting of Alternative Performance Measures

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Contents

Executive summary

Alternative Performance Measures (APMs) are a relevant aspect in today's external and internal reporting. Two thirds of Switzerland's 30 largest companies use them to provide an additional view on sustainable performance and bridge the information gap between investors and management. With regulation looming on the horizon, many listed companies will need to think about their external reporting practices, internal policies and processes to be compliant and transparent. But it's more than compliance. Trust is at stake.

Alternative Performance Measures (APMs) have become well established in the communication of Switzerland's 30 largest companies. Two thirds of the companies in the Swiss Leader Index (SLI) reported non-GAAP earnings measures in the financial year 2016. Usually these are placed quite prominently in the 'key highlights' section of financial reports or in the headings of earnings press releases.

The average SLI-listed company reported two non-GAAP measures in financial year 2016 and 2017. In 85% of the investigated cases, the reported APM is higher than the associated GAAP item, on average by 67.5% for absolute non-GAAP figures. This gives rise to suspicions that the company's performance is being embellished or even of investor abuse, especially if the adjustments undertaken are dubious in character or have not been communicated transparently. Trust is at stake.

Against this backdrop, it is not surprising that the Swiss regulator SIX Swiss Exchange (SIX) has taken action. In May 2017, it published a draft of a directive on APMs to encourage their transparent use. The proposed directive focuses primarily on the consistent, comprehensible and transparent use of APMs. In addition, emphasis is put on a balanced presentation of GAAP and non-GAAP numbers as well as on the provision of comparative information.

On the whole, this study shows that the majority of reporting companies are eager to provide transparency in regard to the adjustments made. Indeed, some companies have already fully or partially implemented the directive that is still in the pipeline. They can serve as valuable benchmarks. Nevertheless, many companies still have to rethink their current reporting to create the required transparency and comparability. Thus, there is still room for improvement in communicating and embedding APMs as well as in providing concise definitions and fundamentals for calculations and reconciliations.

> "APMs are an important part of our communication of financial performance. We use only a few KPIs which are purely GAAP defined."
>
> **Harald Kihm, Head Financial Reporting and Planning, Swiss Life**

Behind the curtain, the internal policies, process designs and governance structures appear diverse. As a consequence, increasing transparency will naturally lead to companies having to revise their policies and processes in many cases with respect to their APM reporting. A superficial brush-up of the currently used reporting will not be sufficient to meet the new requirements in the long run. An in-depth review and new conceptualization of the individual corporate reporting would also make sense in view of the forthcoming changes caused by IFRS and US-GAAP (specifically concerning disclosures and the treatment of revenue recognition, leasing contracts and financial instruments). This is therefore an ideal moment to rethink the annual reporting from the ground up.

State of compliance for SLI-listed companies compared to expected SIX regulation

Art. 5: Label and explanation
- Clear and comprehensible definitions must be disclosed for all alternative performance measures used.
- Alternative performance measures must be given a meaningful label. The label should reflect the content and basis of calculation. Misleading labels must be avoided. whether a label (e.g. non-recurring expense) is misleading is determined by the specific circumstances.

Art. 6: References to comparable measures
- For alternative performance measures, reference must be made to a comparable measure in the financial statements prepared according to the recognised accounting standard. This reference can be made, for example, in the form of a reconciliation statement.

Art. 7: Presentation
- Alternative performance measures must not be presented with more prominence than measures defined by recognised accounting standards. Companies must ensure there is a balance between performance measures defined or specified under applicable accounting standards and alternative performance measures used.

Art. 8: Comparatives
- Comparative information for the corresponding previous periods must be disclosed for all alternative performance measures used.

Art. 10: Use of cross-references
- Alternatively, the information required by this directive can be provided by cross-referencing (e.g. footnote, web link) other documents, such as an appendix to the annual report or a central document on a webpage. These documents must be publicly accessible at the time the alternative performance measure is disclosed.

On this study

Overview

Financial statements and key figures in accordance with internationally recognized accounting standards alone are rarely ideal to tell a company's story holistically. This is why so-called Alternative Performance Measures (APMs) are often being additionally used to bridge the gap between companies and investors. For this purpose, GAAP measures (e.g., net profit) are adjusted for certain items (e.g., one-off costs) and translated into APMs (e.g., adjusted net profit).

From a positive point of view, these APMs are designed to better reflect the company's actual performance than the associated GAAP measure. Thus, they are meant to help analysts and investors gain a clearer picture on the company's current and future performance. However, adjusting GAAP KPIs also gives rise to suspicions that the company's performance is being embellished or even of investor abuse, especially if the adjustments undertaken are dubious in character or have not been communicated transparently. Overall, the adjustments are subject to significant professional judgment on the part of Management. Thus, they are often difficult to interpret and/or compare if not explained in detail. Also, they are unaudited. Accordingly, APMs have been controversial for some time now.

This study shows that the way of reporting APMs varies considerably among companies in the Swiss Leader Index (SLI). The SIX Swiss Exchange (SIX) has recognized this divergence. It recently drafted a directive on APMs, which has been aligned with existing international regulations (primarily with ESMA and IOSCO). Companies, associations and analysts have received the draft with much interest. A final version of the directive is expected soon.

Based on quantitative analyses, this study highlights the various types and use of APMs at SLI-listed companies. It shows how far these companies would currently comply with the SIX draft directive if it was to be effective from now on. The study outlines room for improvement and provides good practice examples so that companies can benchmark their own reporting. Moreover, interviews with company representatives and analysts highlight expectations from the different stakeholders involved. Lastly, the study provides specific guidance for companies of how to best comply with the upcoming regulatory requirements.

Focus of the study

The following key questions shall be examined in this study:

- What is the status quo of APM reporting in Switzerland?
- Do listed companies already apply the expected SIX directive?
- What is good practice?
- Which requirements and expectations regarding the use of APMs exist in Switzerland?
- Which aspects should be considered when developing APMs?

The scope of the study and its approach

To examine the status quo of non-GAAP reporting in Switzerland, this study relies on hand-collected data on the use of APMs by SLI-listed companies. The focus is on non-GAAP earnings measures in a narrow sense reported in Financial Year (FY) 2016 and 2017. This has three implications.

1. The study focuses on adjustments to profit figures only, including various ratios related to profit, such as return on equity, return on assets, etc. Adjustments based on cash flows, growth indicators or specific adjustments of balance-sheet numbers are excluded.
2. The study does not scrutinize any of the established 'earnings before' figures, such as EBIT or EBITDA. These APMs in a broader sense are widely accepted and oftentimes included in the audited financial statements. Because of their clear definition and systematic calculation, less managerial judgement is involved. In contrast, APMs in a narrow sense (e.g., adjusted EBIT) are less standardized and allow for a greater degree of managerial judgement.
3. The documents investigated were restricted to annual reports of 2016, quarterly and semi-annual reports 2017 as well as the relevant press releases[1]. Moreover, based on the respective 2017 annual reports and associated press releases, the conclusions and results stated were reviewed to determine whether they are still valid.

To understand the acceptance of and expectations concerning the use of APMs in Switzerland, semi-structured interviews complemented the quantitative analyses. These interviews were conducted with four accounting heads of Swiss listed companies and two financial analysts. In addition, the public feedback to the SIX draft directive on APMs was included in the analysis.

[1] For 26 of the 30 SLI companies, the financial year equals the calendar year. For the remaining companies the annual report of FY 2016/17 including any corresponding quarterly reports and press releases of the FY 2016/17 and 2017/18 serve as data input.

The current debate

What are Alternative Performance Measures?
In Article 3 of its draft directive on APMs, SIX defines them as follows:
An alternative performance measure is 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 recognized accounting standards.

This is in line with definitions of academic studies[2], which feature two main similarities. First, companies publish APMs on a voluntary basis. Second, APMs are neither required nor defined by any accounting standards such as IFRS, US GAAP and Swiss GAAP FER. Furthermore, they are usually not subject to an audit because they are communicated outside the financial statements.

APMs can be performance, balance sheet or cash flow figures. Usually, operational metrics and physical parameters, such as the number of sales points or number of units, are excluded. This is why SIX also excludes physical parameters or non-financial performance figures from its draft directive.

[2] E.g., Entwistle, G. M., Feltham, G. D., & Mbagwu, C. (2006). Financial Reporting Regulation and the Reporting of Pro Forma Earnings. Accounting Horizons, 20(1), 39–55. Hitz, J.-M. (2010). Information versus adverse Anlegerbeeinflussung: Befund und Implikationen der empirischen Rechnungswesenforschung zur Publizität von Pro-forma-Ergebnisgrößen. Journal für Betriebswirtschaft, 60(2), 127–161.

Examples of APMs	Examples of other metrics
EBIT	Customer retention
EBITDA	Carbon emissions
Adjusted EBITDA	Accident rate
Recurring net income	Market share
Core income	Employee satisfaction
Underlying profit	Number of new products
Adjusted EPS	Client acquisition rates
Operational EPS	Customer acquisition costs
Adjusted revenue	
Free cash flow	
Net debt	
Funds from operation	

● Main focus of this study

The upside of APMs

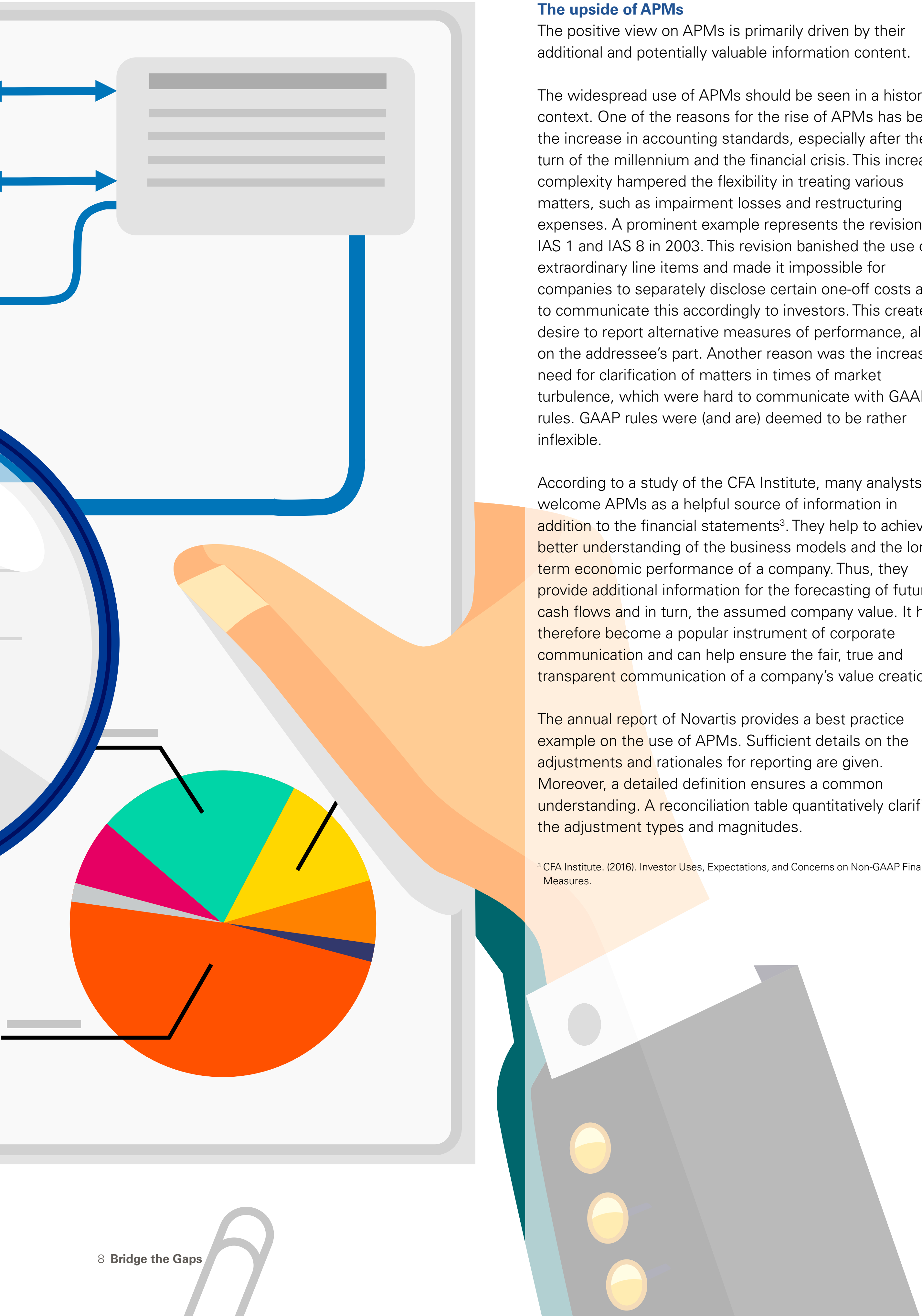
The positive view on APMs is primarily driven by their additional and potentially valuable information content.

The widespread use of APMs should be seen in a historic context. One of the reasons for the rise of APMs has been the increase in accounting standards, especially after the turn of the millennium and the financial crisis. This increased complexity hampered the flexibility in treating various matters, such as impairment losses and restructuring expenses. A prominent example represents the revision of IAS 1 and IAS 8 in 2003. This revision banished the use of extraordinary line items and made it impossible for companies to separately disclose certain one-off costs and to communicate this accordingly to investors. This created a desire to report alternative measures of performance, also on the addressee's part. Another reason was the increased need for clarification of matters in times of market turbulence, which were hard to communicate with GAAP rules. GAAP rules were (and are) deemed to be rather inflexible.

According to a study of the CFA Institute, many analysts welcome APMs as a helpful source of information in addition to the financial statements[3]. They help to achieve a better understanding of the business models and the long-term economic performance of a company. Thus, they provide additional information for the forecasting of future cash flows and in turn, the assumed company value. It has therefore become a popular instrument of corporate communication and can help ensure the fair, true and transparent communication of a company's value creation.

The annual report of Novartis provides a best practice example on the use of APMs. Sufficient details on the adjustments and rationales for reporting are given. Moreover, a detailed definition ensures a common understanding. A reconciliation table quantitatively clarifies the adjustment types and magnitudes.

[3] CFA Institute. (2016). Investor Uses, Expectations, and Concerns on Non-GAAP Financial Measures.



Best practice example: Novartis Annual Report 2017

1 Presentation of the KPIs with equal prominence

Key figures[1]
(in USD millions, unless indicated otherwise)

	2017	2016	% Change USD	% Change Constant currencies
Net sales to third parties	49 109	48 518	1	2
Operating income	8 629	8 268	4	7
Return on net sales (%)	17.6	17.0		
Net income	7 703	6 698	15	12
Basic earnings per share[2] (USD)	3.28	2.82	16	14
Core operating income	12 850	12 987	– 1	0
Core return on net sales (%)	26.2	26.8		
Core net income	11 391	11 314	1	2
Core earnings per share[2] (USD)	4.86	4.75	2	3
Free cash flow	10 428	9 455	10	

2 Explanation on the intentions or reasons for using APMs

[1] This Annual Report includes non-IFRS financial measures such as core results, constant currencies and free cash flow. Novartis believes that investor understanding of the Group's performance is enhanced by disclosing these non-IFRS measures. A definition of non-IFRS measures used by Novartis, and further details, including reconciliation tables, can be found starting on page 179.

3 Definition of "Core results"

Core results

The Group's core results – including core operating income, core net income and core earnings per share – exclude fully the amortization and impairment charges of intangible assets, except software, and certain acquisition-related items. The following items that exceed a threshold of USD 25 million are also excluded: integration and divestment related income and expenses, divestment gains and losses, restructuring charges/releases and related items, legal related items, impairments of property, plant and equipment and financial assets, as well as income and expense items that management deems exceptional and that are or are expected to accumulate within the year to be over a USD 25 million threshold.

Novartis believes that investor understanding of the Group's performance is enhanced by disclosing core measures of performance since they exclude items that can vary significantly from year to year, the core measures enable better comparison of business performance across years. For this same reason, Novartis uses these core measures in addition to IFRS and other measures as important factors in assessing the Group's performance.

The following are examples of how these core measures are utilized:

- In addition to monthly reports containing financial information prepared under IFRS, senior management receives a monthly analysis incorporating these core measures.
- Annual budgets are prepared for both IFRS and core measures.

A limitation of the core measures is that they provide a view of the Group's operations without including all events during a period, such as the effects of an acquisition, divestments, or amortization/impairments of purchased intangible assets and restructurings.

4 Reconciliation table and details on the adjustments

2017 and 2016 reconciliation from IFRS results to core results

	Innovative Medicines		Sandoz		Alcon		Corporate		Group	
(USD millions unless indicated otherwise)	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016
IFRS Operating income	**7 782**	7 426	**1 368**	1 445	**– 190**	– 132	**– 331**	– 471	**8 629**	8 268
Amortization of intangible assets	**2 243**	2 440	**454**	460	**901**	901			**3 598**	3 801
Impairments										
Intangible assets	591	522	61	65	57	4			709	591
Property, plant & equipment related to the Group-wide rationalization of manufacturing sites	7	1	60	– 7					67	– 6
Other property, plant & equipment	77	76	13	8					90	84
Financial assets		18			29		197	99	226	117
Total impairment charges	**675**	617	**134**	66	**86**	4	**197**	99	**1 092**	786
Acquisition or divestment of businesses and related items										
- Income	– 2	– 68					– 115	– 229	– 117	– 297
- Expense	32	41					130	223	162	264
Total acquisition or divestment of businesses and related items, net	**30**	– 27					**15**	– 6	**45**	– 33
Other items										
Divestment gains	– 368	– 608		– 6				– 48	– 368	– 662
Restructuring and related items										
- Income	– 53	– 41	– 7	– 23	– 4	– 4	– 1	– 5	– 65	– 73
- Expense	268	418	134	123	34	33	29	65	465	639
Legal-related items										
- Income	– 21	– 99							– 21	– 99
- Expense	35	205			61				96	205
Additional income	– 534	– 61	– 3		– 51	– 13	– 372	– 22	– 960	– 96
Additional expense	273	84		6	20	61	46	100	339	251
Total other items	**– 400**	– 102	**124**	100	**60**	77	**– 298**	90	**– 514**	165
Total adjustments	**2 548**	2 928	**712**	626	**1 047**	982	**– 86**	183	**4 221**	4 719
Core operating income	**10 330**	10 354	**2 080**	2 071	**857**	850	**– 417**	– 288	**12 850**	12 987
as % of net sales	*31.3%*	*31.8%*	*20.7%*	*20.4%*	*14.2%*	*14.6%*			*26.2%*	*26.8%*
Income from associated companies	– 1		23	6			1 086	697	1 108	703
Core adjustments to income from associated companies, net of tax	1						226	431	227	431
Interest expense									– 777	– 707
Other financial income and expense[1]									39	– 99
Taxes, adjusted for above items (core taxes)									– 2 056	– 2 001
Core net income									**11 391**	11 314
Core net income attributable to shareholders of Novartis AG									**11 391**	11 307
Core basic EPS (USD)[2]									**4.86**	4.75

“Everything but the bad stuff” – controversial use of APMs

Despite the positive perception of the use of APMs, the resulting risks are repeatedly discussed controversially. The most obvious criticisms are:

1. Specifically painting the company’s performance rosier than it is, and;
2. Unclear origin of figures, communication and lack of comparability.

As this study highlights, APMs are primarily used to improve results, i.e., to present a better picture in the APM than in the corresponding GAAP figure. This gives rise to the impression that costs are more likely to be adjusted than income in order to embellish the company’s overall performance. This raises questions as to where the boundaries are in regard to eliminations. For instance, how to differentiate between actual one-off costs and expenses that are strategically motivated? For example, restructuring costs are often recurring operational costs caused by changing market environments, technological changes or intended efficiency gains. In such cases, an adjustment as a one-off cost would not reflect the financial performance adequately. The same is true for M&A-intensive companies, which label cost components related to acquisitions as one-off costs. Financial analysts and investors often question the legitimacy of such adjustments[4].

Secondly, a further criticism concerns the communication of APMs. The adjustments to performance figures should enable a long-term forecast as well as a comparison with industry peers. However, because of the frequent lack of transparency in the adjustments, this often becomes time consuming at best, if not impossible. Difficulty arises in particular regarding the composition of adjustments. Companies may sum up various items in just one adjustment position. This makes it hard to establish comparability across time and peers. These reasons have lead some companies to not disclose APMs at all, as the case of Burckhardt Compression shows.

> “We are determined not to report non-GAAP key figures - there is only one EBIT. From our perspective this is a decision that creates trust and an ultimate degree of transparency”
>
> **Matthias Hugentobler, Group Controller, Burckhardt Compression AG**

The Swiss regulator’s answer

On 30 May 2017, SIX started its consultation process for a draft of a directive on APMs[4]. The purpose of this draft directive is to “promote clear and transparent use of alternative performance measures” (Art. 1).

This directive is not necessarily a novelty but rather an alignment with already existing international guidelines. In response to several cases of abuse, the US put into law APM rules already in 2003 as directed by the Sarbanes-Oxley Act of 2002. In October 2005, the Committee of European Securities Regulators (CESR) also reacted by publishing a recommendation on APMs which was fairly similar to the SEC regulations. Further developments and adjustments followed.

The Swiss draft directive is aligned to already existing regulations, such as those issued by European or US regulators but tries to simplify things in certain areas. For instance, SIX does not require the disclosure of a reason for using APMs. Furthermore, it does not specifically define how an APM has to relate to a comparable GAAP figure. Also, if a company does not continuously apply APMs, it may simply justify this deviation instead of retrospectively adjusting the previous year’s figures (comply or explain).

[4] CFA Institute. (2016). Investor Uses, Expectations, and Concerns on Non-GAAP Financial Measures.

[5] SIX Swiss Exchange. (2017). Preliminary draft of the Directive Alternative Performance Measures.

Overall, SIX focuses on the following areas:

1. APMs should be defined clearly and comprehensibly and have a meaningful label (Art. 5)
2. APMs should reference comparable measures defined by the accounting standards (Art. 6)
3. APMs should not be presented with more prominence than measures defined by the accounting standards (Art. 7)
4. Comparative information for the corresponding previous periods should be disclosed (Art. 8)
5. APMs should be applied consistently over time (Art. 9)
6. Cross-references should reference to more information on APMs (Art. 10)

Article 2 of the draft directive specifies which companies are affected by the new regulations:
This directive applies to all issuers whose equity securities are listed on SIX Swiss Exchange Ltd ("SIX Swiss Exchange") and whose registered office is in Switzerland. Issuers whose registered office is not in Switzerland also fall within the scope of the directive if their equity securities are listed on SIX Swiss Exchange but not in their home country.

The scope of application extends to information which issuers publish periodically or on an event-related basis such as annual reports and press releases (Art. 4). Investor presentations are currently excluded from the scope of the draft directive. Non-listed companies are not affected by this rule. In the current draft version, adherence to the directive would also not be required for prospectus information for initial public offerings.

The use of APMs today – fit for purpose?

Overview of non-GAAP reporting in Switzerland
The following quantitative analysis focuses on non-GAAP earnings measures in a narrow sense reported in FY 2016 and 2017 by all companies listed in the SLI. The SLI consists of the 30 largest and most liquid Swiss companies. It includes companies from various industries, such as industrials (27% of companies), financials (27%), health care (13%) and consumer goods (13%). The majority of companies apply IFRS, five companies apply US GAAP and one company applies Swiss GAAP FER.

The use of APMs is very popular in the SLI, with two thirds of companies reporting non-GAAP earnings measures. The 20 non-GAAP reporters in the sample published 64 non-GAAP earnings measures. On average, this equals three APMs[6] per company, ranging from one to eight adjusted figures.

Out of the 64 APMs published, 54 measures (84%) are reported in the annual report of FY 2016. A review of the annual reports of FY 2017 showed no major changes, with 26 of the 30 SLI-listed companies reporting the same APMs than in FY 2016. 87% and 93% of APMs are included in the half-year and quarterly report, if these reports were published for FY 2017. 86% and 81% of non-GAAP earnings measures were included in the press releases of FY 2016 and HY 2017, respectively. The press releases accompanying the quarterly earnings releases of FY 2017 contain only about half of the APMs in use[7].

The labelling of APMs differs across companies. Most companies identify them as "adjusted". Other popular labels are listed in the table below.

[6] For reasons of simplification and readability, 'non-GAAP earnings measures in a narrow sense' will be labelled 'APMs' in the following.

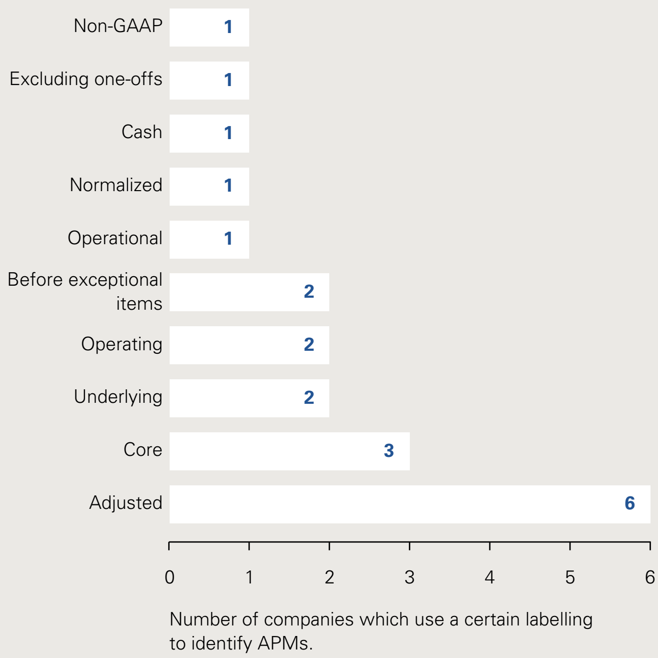
[7] APMs are also reported in other financial communication documents, such as analyst presentations. In line with the specifications in the draft of the SIX draft directive, these have been excluded from this study.

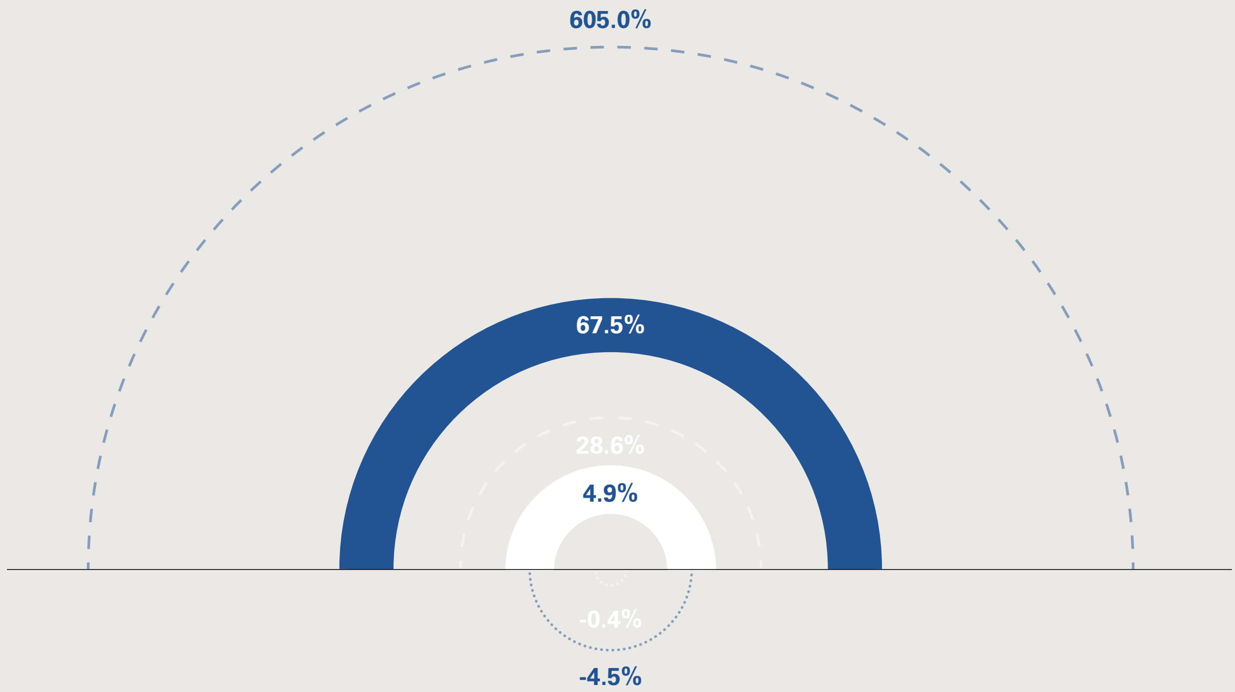
Use of APMs by SLI-listed companies

2/3
Report
non-GAAP measures

1/3
Do not report
non-GAAP measures

Main labelling of non-GAAP earnings





Adjustment magnitude in relation to GAAP figure (for absolute non-GAAP figures)

Average Max Min

- Change in comparison to most directly reconcilable GAAP item; in %
- Adjustment amount in % of revenues

Adjustment direction and magnitude

In the majority of the cases, an adjustment usually means an upward correction of GAAP measures. In total, 85% of the reported APMs are higher than the most directly reconcilable GAAP item. To analyze this in greater detail, the non-GAAP earnings measures were split into absolute earnings measures (e.g. adjusted EBIT), non-GAAP EPS and non-GAAP ratios other than EPS (e.g. adjusted EBITDA margin).

Absolute non-GAAP numbers are larger than their GAAP counterpart in 86% of the cases. Only a few companies included in the study (Schindler, LafargeHolcim und Zurich Insurance) report absolute non-GAAP numbers over a certain period that are lower than their GAAP counterpart. The average SLI-listed non-GAAP reporter adjusts the GAAP number by 67.5%. This translates into a positive adjustment amount of 4.9% of sales.

APMs in relation to their GAAP counterpart

- Percentage of APMs where non-GAAP > GAAP

Except for one 'Recurring EPS', all other non-GAAP EPS ratios are larger than the respective GAAP EPS (91%). On average, the non-GAAP EPS is 34.4% higher than the GAAP counterpart.

Non-GAAP earnings ratios other than EPS are higher than their GAAP counterpart in 87% of the cases. Only Zurich Insurance (BOPAT ROE) and Schindler (EBIT margin before exceptional items) report non-GAAP earnings ratio that are lower than the GAAP counterpart. On average, companies improve the GAAP item by 2.3 percentage points.

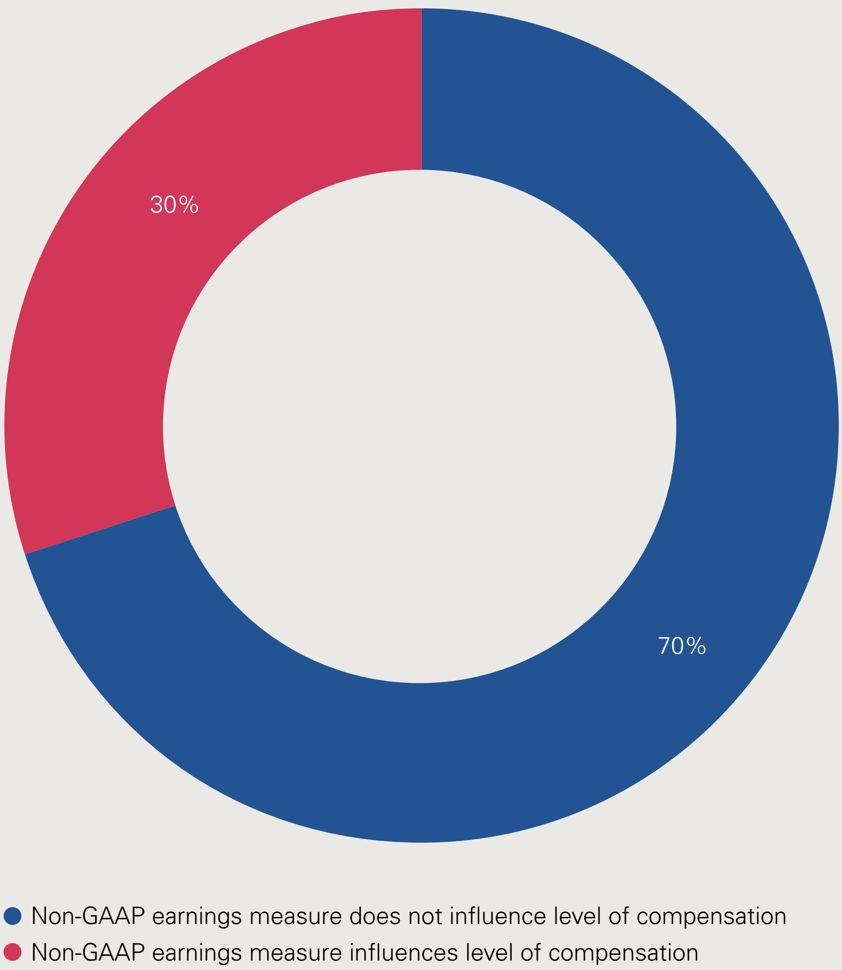
APMs and management compensation

These observations are especially sensitive taking into consideration that every third APM influences the level of management compensation. Put differently, 30% of SLI-listed companies have at least one APM that influences the level of compensation[8]. A need for governance obviously exists. The search for transparency and adequate controls is therefore not only of relevance to investors but also to shareholders and board members.

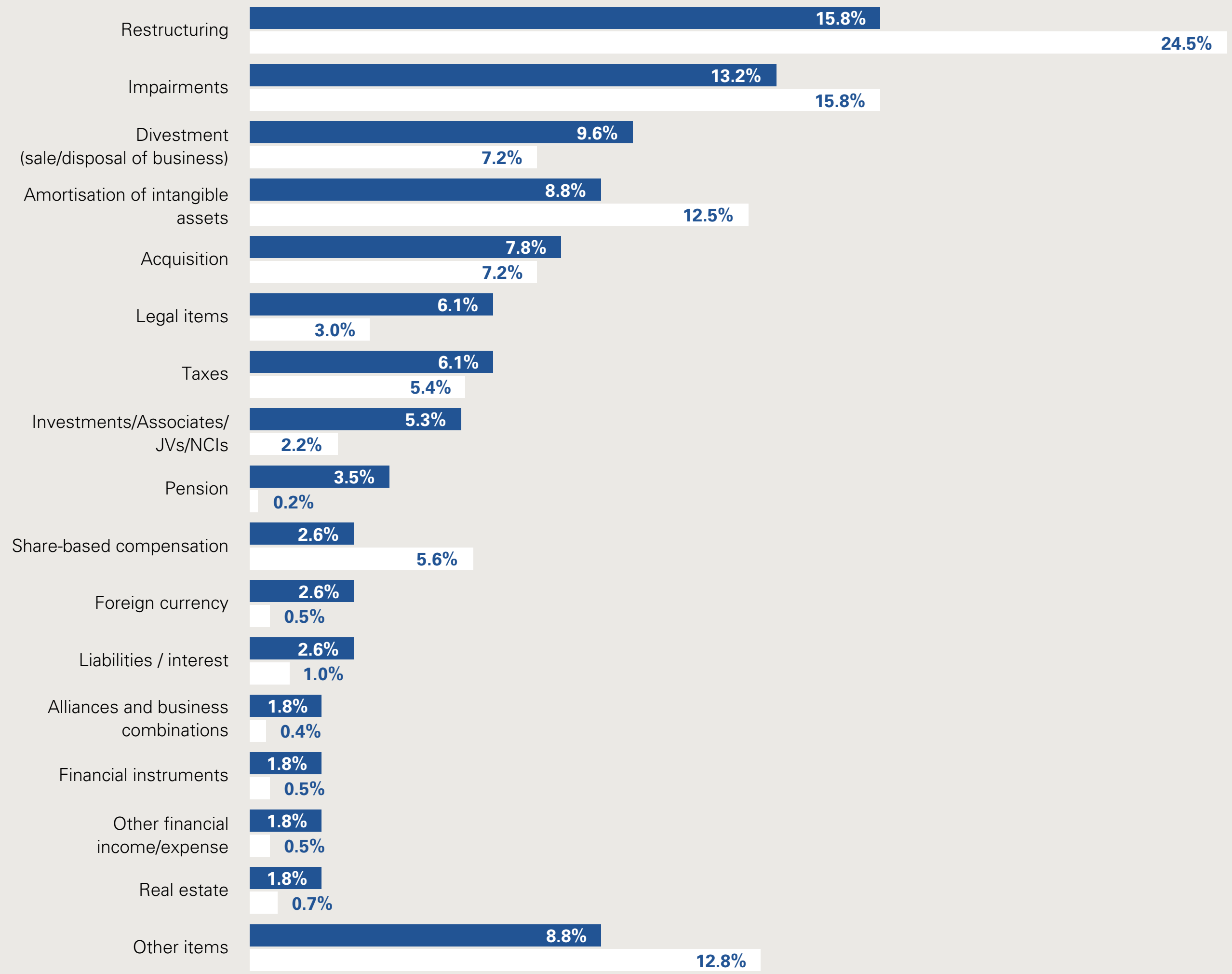
Adjustment types

An analysis of the adjusted corrections shows that the most frequently used adjustment types include restructurings (16% of all adjustments) and impairments (13%). These two are also the most significant types in percent of total adjustments with 24.5% and 15.8%, respectively.

[8] These results have to be interpreted with caution since the completeness of the information given in the Corporate Governance section cannot be guaranteed.



Adjustment types



● Adjustment type used in % of all adjustment types (average across APMs)
○ Adjustment type in % of the total adjustment amount (average across APMs)

Compliance with the SIX draft directive

In view of the SIX regulations to be expected for issuers in Switzerland, this study analyzes to what degree the requirements of the directive have already been implemented by Switzerland's 30 largest companies in their financial communication of 2016 and 2017, and where there is room for improvement.

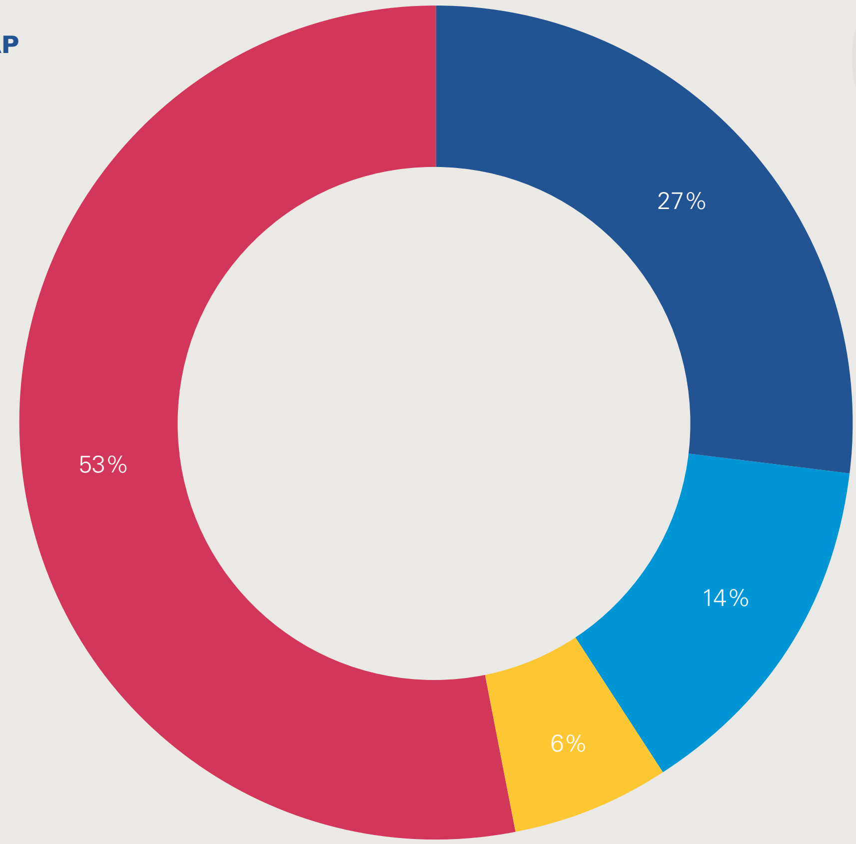
Articles 1 to 4 of the draft directive focus on the use, applicability, definition and scope of APMs, and will not be analyzed further. Article 9 (consistency) will also not be analyzed due to the fact that this information is currently not yet required. The main focus on the next pages will therefore be on Articles 5 to 10 that include specific reporting requirements that would be mandatory for the companies in question[9].

[8] SIX Swiss Exchange. (2017). Preliminary draft of the Directive Alternative Performance Measures.

Article 5
Clear and comprehensible definition

Is a clear and comprehensible definition provided for the non-GAAP earnings measure?

- Definition provided in a clear and comprehensible manner
- Definition provided, but not in a clear and comprehensible manner
- Definition provided indirectly[10]
- No definition provided



Draft requirements

Art. 5 Label and explanation

[1] Clear and comprehensible definitions must be disclosed for all alternative performance measures used.

[2] Alternative performance measures must be given a meaningful label. The label should reflect the content and basis of calculation. Misleading labels must be avoided. Whether a label (e.g. non-recurring expense) is misleading is determined by the specific circumstances.

Current implementation by the SLI companies

Only 27% of APMs are accompanied by a clear and comprehensible definition. 20% of APMs are accompanied by a rather vague definition. For 53% of APMs, no definition is provided at all.

Considerations

A clear definition of the APMs used creates a calculation base, which is why it is crucial to investors' and financial analysts' assessment. Additional explanations can help to get Management's view across, help investors understand the reason for adjustments and assess the reasonability of adjustments made. The adjustments and according definitions should be very clear and not mislead the reader. Further, they should also contain indications on the hypotheses and assumptions used to allow investors an assessment of the material judgmental areas.

[10] Definition provided indirectly refers to ratios where the ratio itself is not defined, but the underlying earnings figure.

Good practice example

LafargeHolcim 2017

Clear labeling and cross-referencing to definitions in the Notes to the annual report help readers to find relevant content easily. A clear and concise presentation of all APM definitions is available on the referenced pages.

KEY GROUP FIGURES

FINANCIAL HIGHLIGHTS	SALES
6.1 RECURRING EBITDA GROWTH % 2016: 8.7	**4.7** NET SALES GROWTH % 2016: –1.7
5,990 RECURRING EBITDA CHF M 2016: 5,950	**209.5** SALES OF CEMENT MILLION TONNES 2016: 233.2
1,685 FREE CASH FLOW CHF M 2016: 1,660	**278.7** SALES OF AGGREGATES MILLION TONNES 2016: 282.7
5.8 RETURN ON INVESTED CAPITAL % 2016: 5.2	**50.6** SALES OF READY-MIX CONCRETE MILLION M^3 2016: 55.0

Notes:
Recurring EBITDA replaces the former Operating EBITDA Adjusted. Recurring EBITDA excludes restructuring, litigation, implementation and other non-recurring costs. Free cash flow is defined as cash flow from operating activities less net maintenance and expansion Capex. Recurring EBITDA growth and Net Sales growth are both presented on a like-for-like basis. Return On Invested Capital is defined as Net Operating Profit After Tax (NOPAT) divided by the average Invested Capital. The average is calculated by adding the Invested Capital at the beginning of the period to that at the end of the period and dividing the sum by 2 (based on a rolling 12 month calculation).

The non-GAAP measures used in this report are defined on page 251.

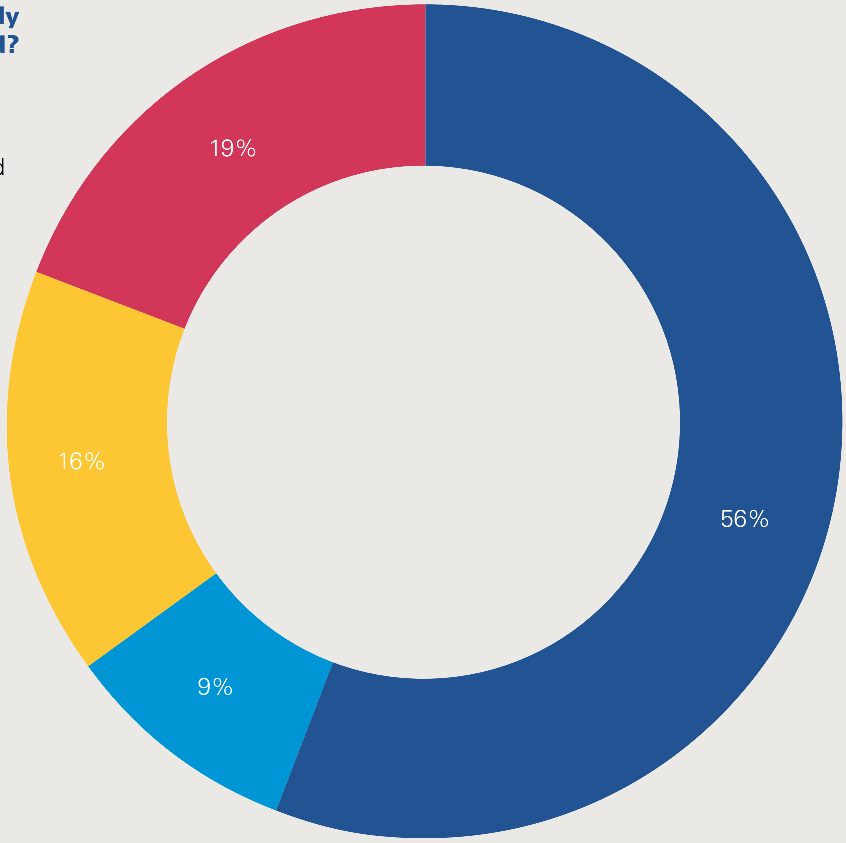
Definition of Non-GAAP Measures used in this report

Like-for-like	Like-for-like information is information factoring out changes in the scope of consolidation (such as divestments and acquisitions occurring in 2017 and 2016) and currency translation effects (2017 figures are converted with 2016 exchange rates in order to calculate the currency effects).
Restructuring, litigation, implementation and other non recurring costs	Restructuring, litigation, implementation and other non recurring costs comprise significant items that, because of their exceptional nature, cannot be viewed as inherent to the Group's ongoing performance, such as strategic restructuring, major items relating to antitrust fines and other business related litigation cases. In 2017 and 2016, they also included costs directly related to the merger such as legal, banking fees and advisory costs, employee costs related to redundancy plans and IT implementation costs.
Profit/Loss on disposals and other non-operating items	Profit/Loss on disposals and non-operating items comprise capital gains or losses on the sale of Group companies and of property, plant and equipment and other non-operating items that are not directly related to the Group's normal operating activities such as revaluation gains or losses on previously held equity interests, disputes with non-controlling interests and other major lawsuits.
Recurring EBITDA (previously named "Operating EBITDA adjusted")	The recurring EBITDA is an indicator to measure the performance of the Group excluding the impacts of non recurring items. It is defined as: +/– Operating profit; – depreciation, amortization and impairment of operating assets; and – restructuring, litigation, implementation and other non recurring costs.
Recurring EBITDA margin (previously named "Operating EBITDA margin adjusted")	The recurring EBITDA margin is an indicator to measure the profitability of the Group excluding the impacts of non recurring items. It is defined as the recurrring EBITDA divided by the net sales.
Net income before impairment and divestments	Net income before impairment and divestments excludes impairment charges and capital gains and losses arising on disposals of investments which, because of their exceptional nature, cannot be viewed as inherent to the Group's ongoing activities. It is defined as: +/– Net income (loss) – gains/ losses on disposals of Group companies; and – impairments of goodwill and assets.
Earnings Per Share (EPS) before impairment and divestments	The Earnings Per Share (EPS) before impairment and divestments is a indicator that measures the theoretical profitability per share of stock outstanding based on a net income before impairment and divestments. It is defined as: – net income before impairment and divestments attributable to the shareholders of LafargeHolcim Ltd divided by the weighted average number of shares outstanding.
Net Maintenance and Expansion Capex ("Capex" or "Capex Net")	The Net Maintenance and Expansion Capex ("Capex" or "Capex Net") is an indicator to measure the cash spent to maintain or expand its asset base. It is defined as: + Expenditure to increase existing or create additional capacity to produce, distribute or provide services for existing products (expansion) or to diversify into new products or markets (diversification); + Expenditure to sustain the functional capacity of a particular component, assembly, equipment, production line or the whole plant, which may or may not generate a change of the resulting cash flow; and – Proceeds from sale of property, plant and equipment.
Free Cash Flow (previously named "Operating Free Cash Flow")	The Free Cash Flow is an indicator to measure the level of cash generated by the Group after spending cash to maintain or expand its asset base. It is defined as: +/– Cash flow from operating activities; and – Net Maintenance and expansion Capex
Net financial debt ("Net debt")	The Net financial debt ("Net debt") is an indicator to measure the financial debt of the Group after deduction of the cash. It is defined as: + Financial liabilities (long-term & short-term) including derivative liabilities; – Cash and cash equivalents; and – Derivative assets.

Article 6
Reference to comparable measures

Is a reconciliation to the most directly reconcilable GAAP measure reported?

- Disclosure of a reconciliation table between non-GAAP and GAAP measure
- Disclosure of both the adjustment types and magnitudes
- Disclosure of adjustment types without magnitudes
- No disclosure of adjustment types and magnitudes



Draft requirements

Art. 6 Reference to comparable measures
For alternative performance measures, reference must be made to a comparable measure in the financial statements prepared according to the recognised accounting standard. This reference can be made, for example, in the form of a reconciliation statement.

Current implementation by the SLI companies
81% of the APMs investigated provide at least a rudimentary form of reconciliation. For 56% of APMs, a detailed reconciliation table is being disclosed, specifying the nature and extent of the adjustments.

Considerations
Being able to clearly understand the connection between the APM and the GAAP counterpart creates clarity and comparability. Therefore, it is ideal to have a meaningful reconciliation. Apart from enabling a comparison with peers, it also allows the reader to assess the adjustments made by Management in view of the actually audited figures. A clear presentation of the facts and the extent of the reconciliation helps inspire confidence in the APMs. It also allows analysts or investors to challenge the robustness of Management's ideas and to form their own opinion.

Good practice example

Novartis 2017

A good example of a detailed reconciliation may be found on page 181 of the 2017 Novartis annual report. By adding additional information on affected financial positions or segments, readers gain valuable additional information, which ultimately generates trust.

2017 and 2016 reconciliation from IFRS results to core results

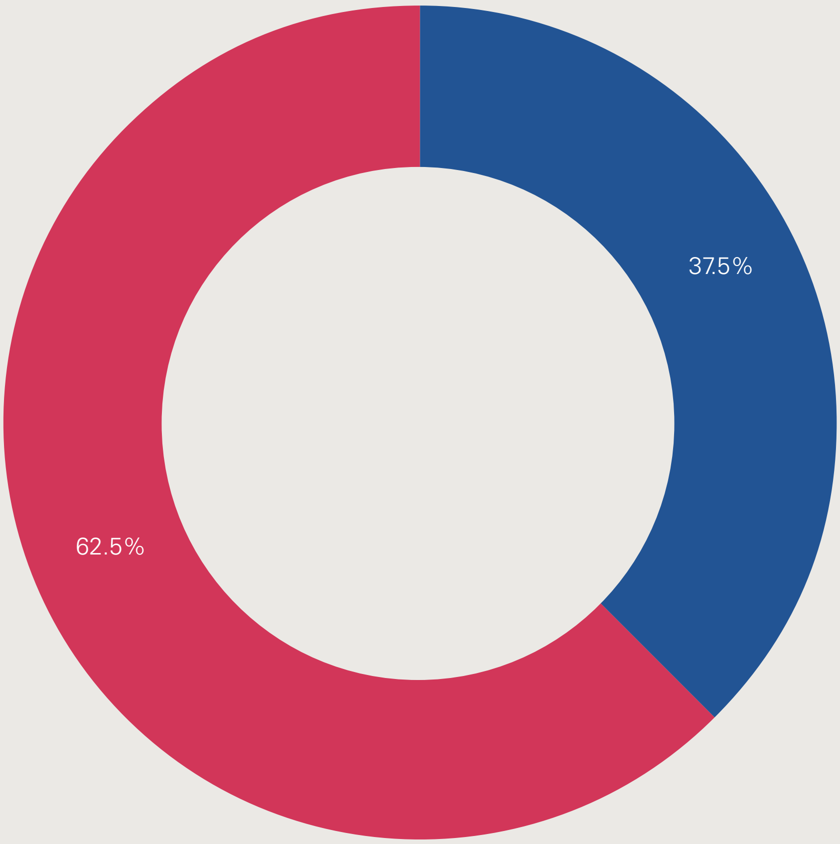
	Innovative Medicines		Sandoz		Alcon		Corporate		Group	
(USD millions unless indicated otherwise)	**2017**	2016	**2017**	2016	**2017**	2016	**2017**	2016	**2017**	2016
IFRS Operating income	**7 782**	7 426	**1 368**	1 445	**– 190**	– 132	**– 331**	– 471	**8 629**	8 268
Amortization of intangible assets	**2 243**	2 440	**454**	460	**901**	901			**3 598**	3 801
Impairments										
Intangible assets	591	522	61	65	57	4			709	591
Property, plant & equipment related to the Group-wide rationalization of manufacturing sites	7	1	60	– 7					67	– 6
Other property, plant & equipment	77	76	13	8					90	84
Financial assets		18			29		197	99	226	117
Total impairment charges	**675**	617	**134**	66	**86**	4	**197**	99	**1 092**	786
Acquisition or divestment of businesses and related items										
- Income	– 2	– 68					– 115	– 229	– 117	– 297
- Expense	32	41					130	223	162	264
Total acquisition or divestment of businesses and related items, net	**30**	– 27					**15**	– 6	**45**	– 33
Other items										
Divestment gains	– 368	– 608		– 6				– 48	– 368	– 662
Restructuring and related items										
- Income	– 53	– 41	– 7	– 23	– 4	– 4	– 1	– 5	– 65	– 73
- Expense	268	418	134	123	34	33	29	65	465	639
Legal-related items										
- Income	– 21	– 99							– 21	– 99
- Expense	35	205			61				96	205
Additional income	– 534	– 61	– 3		– 51	– 13	– 372	– 22	– 960	– 96
Additional expense	273	84		6	20	61	46	100	339	251
Total other items	**– 400**	– 102	**124**	100	**60**	77	**– 298**	90	**– 514**	165
Total adjustments	**2 548**	2 928	**712**	626	**1 047**	982	**– 86**	183	**4 221**	4 719
Core operating income	**10 330**	10 354	**2 080**	2 071	**857**	850	**– 417**	– 288	**12 850**	12 987
as % of net sales	*31.3%*	*31.8%*	*20.7%*	*20.4%*	*14.2%*	*14.6%*			*26.2%*	*26.8%*
Income from associated companies	– 1		23	6			1 086	697	1 108	703
Core adjustments to income from associated companies, net of tax	1						226	431	227	431
Interest expense									– 777	– 707
Other financial income and expense [1]									39	– 99
Taxes, adjusted for above items (core taxes)									– 2 056	– 2 001
Core net income									**11 391**	11 314
Core net income attributable to shareholders of Novartis AG									**11 391**	11 307
Core basic EPS (USD) [2]									**4.86**	4.75

[1] Adjusted for charges of USD 0.3 billion in 2016 related mainly to devaluation losses in Venezuela.
[2] Earnings per share (EPS) is calculated on the amount of net income attributable to shareholders of Novartis AG.

Article 7
Presentation

Is the non-GAAP earnings measure displayed with more prominence?

- Non-GAAP measure not displayed with more prominence
- Non-GAAP measure displayed with more prominence



Draft requirements

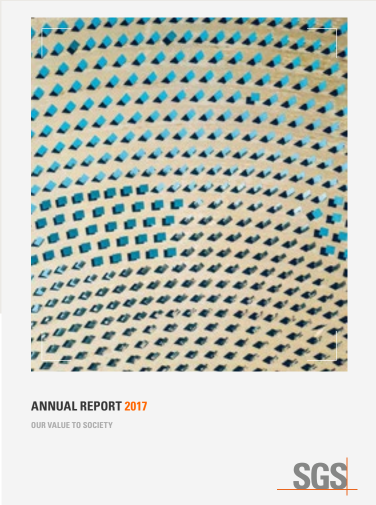
Art. 7 Presentation
Alternative performance measures must not be presented with more prominence than measures defined by recognised accounting standards. Companies must ensure there is a balance between performance measures defined or specified under applicable accounting standards and alternative performance measures used.

Current implementation by the SLI companies
In 62.5% of the APMs studied, the APMs were presented in a more prominent manner than the corresponding GAAP figure[11]. This would no longer be possible under the directive.

Considerations
By giving all key figures, whether non-GAAP or GAAP, equal weight in their presentation allows the reader to form their own opinion. A well-balanced (i.e., similar) presentation of non-GAAP and GAAP key figures should restrain managers from embellishing company performance.

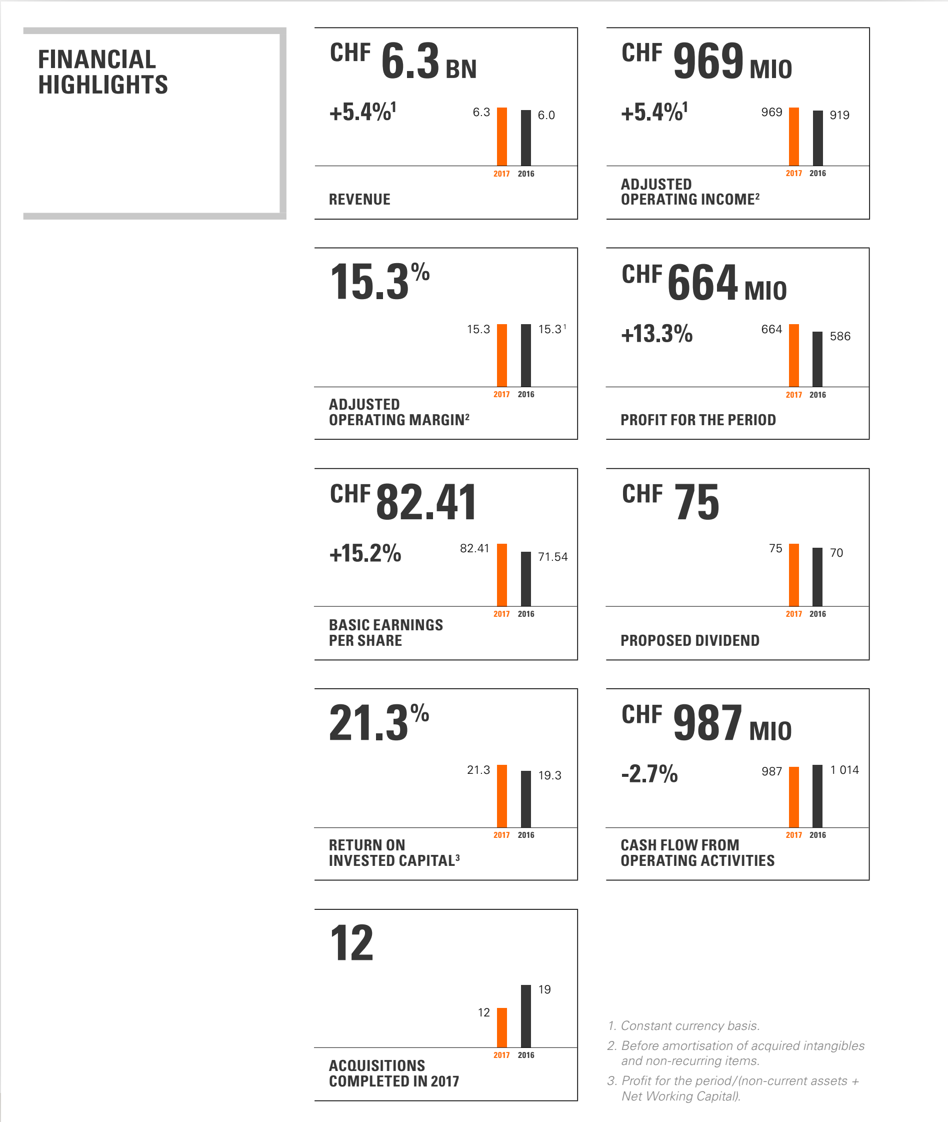
[11] For the purpose of this data collection, this question has been analyzed by investigating the financial summary of each annual report (usually labelled "financial highlights" or "key figures") and press releases (both for FY 2016).

Good practice example



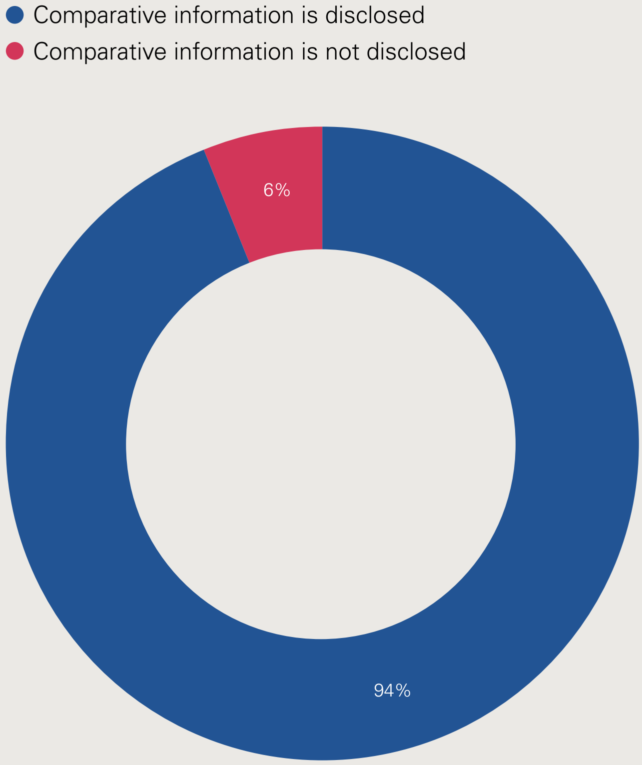
SGS 2017

APMs and GAAP measures are presented with equal prominence. Readers are informed in a neutral way, supporting the equal relevance of GAAP figures.

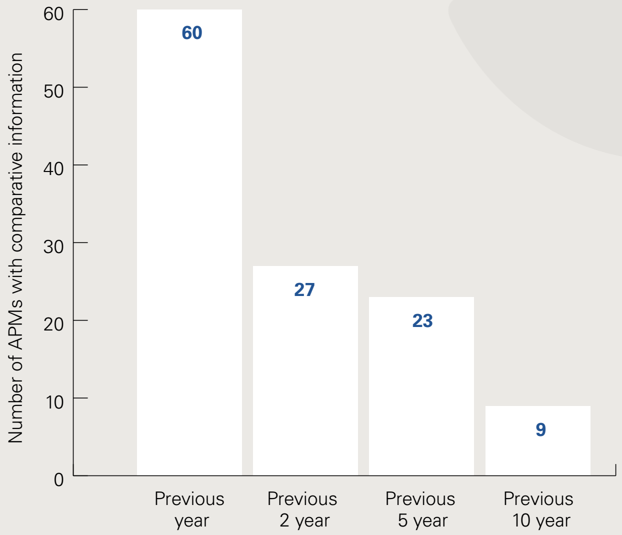


Article 8
Comparative information

Is comparative information for previous periods disclosed?



For how many previous years is compartive information available?



Draft requirements

Art. 8 Comparatives
Comparative information for the corresponding previous periods must be disclosed for all alternative performance measures used.

Current implementation by the SLI companies
SIX is rather vague concerning the period for which comparative numbers have to be disclosed. Assuming that a comparison with the previous year is sufficient, 94% of the APMs investigated would already meet this requirement. A majority (55%) of the APMs are compared to previous year's figures. In some cases, they even disclose figures that go further back than the previous year. For 6% of the APMs, comparative yearly information is not disclosed at all.

Considerations
The possibility of comparing APMs over time is an important aspect for the analysis of the long-term performance of the company. In the best case, the comparative information also includes the adjustments made in every year. This would provide information on the relationship to the associated GAAP figure and help understand the adjustments made. Consistency in the disclosure of the previous periods with the corresponding GAAP figures is therefore desirable.

Good practice example

Adecco 2016

Adecco presents its key figures over a relative long period, allowing readers to understand the long-term developments and trends, which might lead to a better informed prediction of future performance.

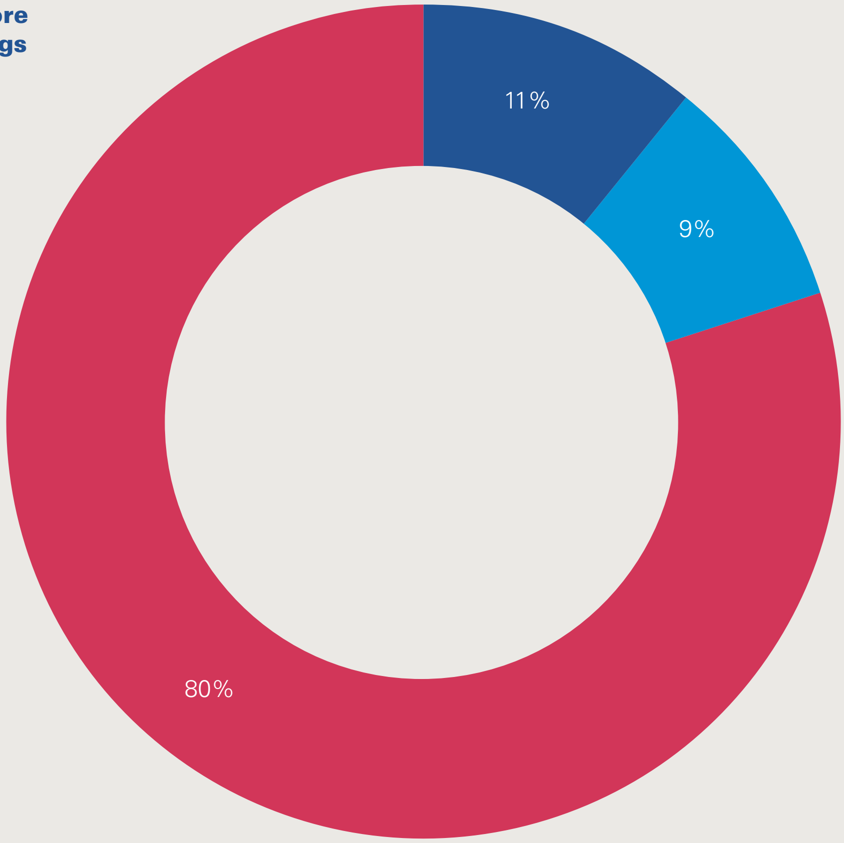
Key figures

In EUR millions unless stated	2016	2015	2014	2013	2012	2011	2010	2009	2008	2007
Revenues	**22,708**	22,010	20,000	19,503	20,536	20,545	18,656	14,797	19,965	21,090
Gross profit	**4,276**	4,179	3,703	3,560	3,674	3,566	3,329	2,649	3,673	3,927
EBITA excluding one-offs	**1,132**	1,147	965	854	813	834	755	402	896	940
EBITA	**1,096**	1,081	928	821	725	814	722	299	908	1,081
Net income attributable to Adecco Group shareholders	**723**	8	638	557	377	519	423	8	495	735
Basic EPS (EUR)	**4.24**	0.05	3.62	3.09	2.00	2.72	2.20	0.04	2.82	3.97
Diluted EPS (EUR)	**4.24**	0.05	3.61	3.08	2.00	2.72	2.17	0.04	2.71	3.80
Dividend per share (CHF)	**2.40**[1]	2.40	2.10	2.00	1.80	1.80	1.10	0.75	1.50	1.50
EBITDA excluding one-offs	**1,217**	1,241	1,057	955	916	927	842	483	980	1,029
EBITDA	**1,181**	1,175	1,020	922	828	907	809	380	992	1,170
Cash flow from operating activities	**687**	799	785	520	579	524	455	477	1,054	1,062
Free cash flow before interest and tax paid	**934**	995	1,013	684	813	651	543	503	1,267	1,302
Free cash flow	**611**	702	705	439	491	415	350	385	948	971
Net debt[2]	**887**	1,039	971	1,091	967	889	748	107	615	864
Shareholders' equity	**3,722**	3,346	3,839	3,557	3,699	3,811	3,567	3,114	2,798	2,880

Article 10
Adequate cross-referencing

Is there a footnote referencing to more information on the non-GAAP earnings measure?

- Footnote provided
- Footnote provided indirectly[12]
- No footnote provided



Draft requirements

Art. 10 Use of cross-references
Alternatively, the information required by this directive can be provided by cross-referencing (e.g. footnote, web link) other documents, such as an appendix to the annual report or a central document on a webpage. These documents must be publicly accessible at the time the alternative performance measure is disclosed.

Current implementation by the SLI companies

In many cases (80% of APMs) there is not even a footnote or a cross-reference which would help find further information on the disclosed adjustments. In some cases (9%), a footnote is at least provided indirectly.

Considerations

Footnotes and cross-references help the reader to find the respective definitions, adjustments made and further useful information. They also signal a willingness to be transparent and to provide the reader with the full information. Currently no uniform approach as to where further information is to be published exists. Thus, references to additional information would be helpful.

In view of the often missing detailed definitions and reconciliation statements, this requirement should be addressed in a holistic approach. A reporting concept should be drawn-up which considers the connection and consistency between relevant reporting parts. This might even be a part of a larger project to improve reporting as a whole. Footnotes are a means to guide a reader through the oftentimes vast amount of documents. The trend towards a more digital corporate reporting might help to better connect such parts in the future.

[12] 'Footnote provided indirectly' refers to ratios, like income margins, where the ratio itself is not footnoted, but the underlying earnings figure.

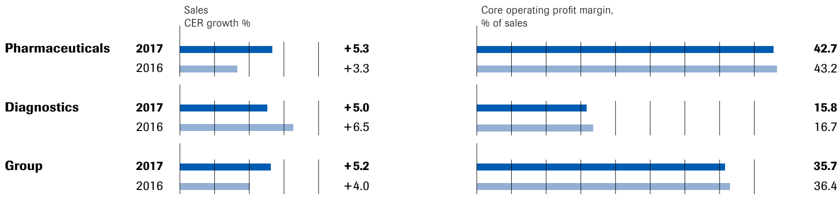
Good practice example

Roche 2017

Roche's financial summary not only includes an overview of both GAAP and non-GAAP results, but also some first information on APMs and references to more details in the footnotes.

Finance in Brief

Key results



	2017 (CHF m)	2016 (CHF m)	% change (CHF)	% change (CER)	% of sales 2017	% of sales 2016
IFRS results						
Sales	53,299	50,576	+5	+5		
Operating profit	13,003	14,069	–8	–8	24.4	27.8
Net income	8,825	9,733	–9	–9	16.6	19.2
Net income attributable to Roche shareholders	8,633	9,576	–10	–10	16.2	18.9
Diluted EPS (CHF)	10.04	11.13	–10	–10		
Dividend per share (CHF)	8.30[1]	8.20	+1			
Core results						
Research and development	10,392	9,915	+5	+5	19.5	19.6
Core operating profit	19,012	18,420	+3	+3	35.7	36.4
Core EPS (CHF)	15.34	14.53	+6	+5		
Free cash flow						
Operating free cash flow	17,827	14,086	+27	+26	33.4	27.9
Free cash flow	13,420	9,130	+47	+47	25.2	18.1

	2017 (CHF m)	2016 (CHF m)	% change (CHF)	% change (CER)
Net debt	(6,963)	(13,248)	–47	–45
Capitalisation	47,967	48,757	–2	–1
– Debt	18,960	22,355	–15	–14
– Equity	29,007	26,402	+10	+10

1) Proposed by the Board of Directors.

CER (Constant Exchange Rates): The percentage changes at constant exchange rates are calculated using simulations by reconsolidating both the 2017 and 2016 results at constant exchange rates (the average rates for the year ended 31 December 2016). For the definition of CER see page 148.

Core results and Core EPS (earnings per share): These exclude non-core items such as global restructuring plans and amortisation and impairment of goodwill and intangible assets. This allows an assessment of both the actual results and the underlying performance of the business. A full income statement for the Group and the operating results of the divisions are shown on both an IFRS and core basis. The core concept is fully described on pages 141–144 and reconciliations between the IFRS and core results are given there.

Free cash flow is used to assess the Group's ability to generate the cash required to conduct and maintain its operations. It also indicates the Group's ability to generate cash to finance dividend payments, repay debt and to undertake merger and acquisition activities. The free cash flow concept is used in the internal management of the business. The free cash flow concept is fully described on pages 144–146 and reconciliations between the IFRS cash flow and free cash flow are given there.

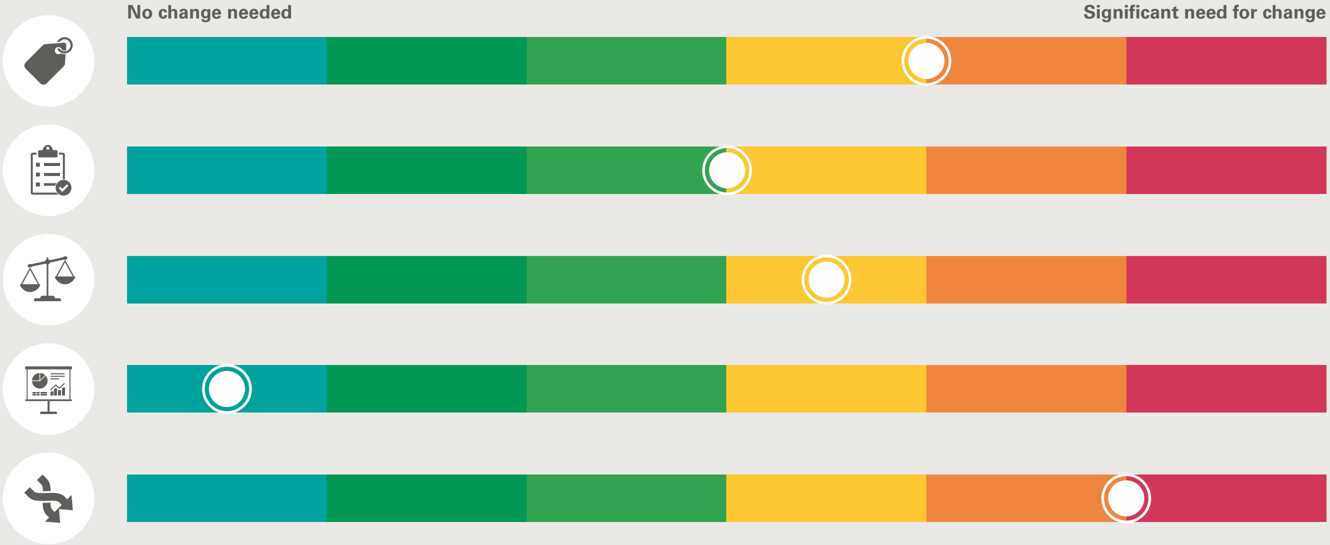
Ready for regulation?

In summary, the following picture emerges from the analysis of the current implementation of the SIX draft directive by all SLI-listed companies.

The action that should have the highest priority is transparent communication itself. Only 27% of the investigated APMs are reported with a clear definition of the adjustments performed. This makes it difficult to put the disclosed performance into a meaningful context. Moreover, most companies present their APMs with more prominence than the corresponding GAAP measures. This is an aspect that has repercussions not only on the formal aspects of such a report but also on its graphic design and presentation. Most importantly, only half of APMs are accompanied by a clear reconciliation from the GAAP to the non-GAAP result. This compromises not only comparability but also the confidence in these adjustments.
To conclude, only very few SLI-listed companies currently fully comply with the requirements of the proposed directive. In comparison to companies abroad (especially in the US and the EU), they will have to work hard to catch up.

> "As our transformation and large cost-reduction programs have resulted in significant restructuring charges to the income statement over the recent past, APMs have become more meaningful to both management and investors, due to the fact that these measures presented a view of our performance with these expenses stripped out. Additionally, APMs generally align more closely with the way Management and the Board of Directors judge the performance of the business for compensation purposes."
>
> **Sandra Schreiner, Head External & Regulatory Reporting, UBS Group**

State of compliance for SLI-listed companies compared to expected SIX regulation



Art. 5: Label and explanation

- Clear and comprehensible definitions must be disclosed for all alternative performance measures used.
- Alternative performance measures must be given a meaningful label. The label should reflect the content and basis of calculation. Misleading labels must be avoided. whether a label (e.g. non-recurring expense) is misleading is determined by the specific circumstances.

Art. 6: References to comparable measures

- For alternative performance measures, reference must be made to a comparable measure in the financial statements prepared according to the recognised accounting standard. This reference can be made, for example, in the form of a reconciliation statement.

Art. 7: Presentation

- Alternative performance measures must not be presented with more prominence than measures defined by recognised accounting standards. Companies must ensure there is a balance between performance measures defined or specified under applicable accounting standards and alternative performance measures used.

Art. 8: Comparatives

- Comparative information for the corresponding previous periods must be disclosed for all alternative performance measures used.

Art. 10: Use of cross-references

- Alternatively, the information required by this directive can be provided by cross-referencing (e.g. footnote, web link) other documents, such as an appendix to the annual report or a central document on a webpage. These documents must be publicly accessible at the time the alternative performance measure is disclosed.

From the perspective of the most affected stakeholders

The previous section has shown that Switzerland's largest companies have substantial room for improvement regarding their non-GAAP reporting. To optimize the use and reporting of APMs, this section analyzes the needs and expectations of the major stakeholders involved. This analysis is based on semi-structured interviews with four accounting heads of Swiss listed companies and two financial analysts. In addition, the public feedback to the SIX draft directive was included.

What investors want – an analyst's perspective
Not surprisingly, financial analysts are in favor of increased transparency through stricter regulatory requirements for APMs. Already the answer of the CFA Society Switzerland to the consultation draft of the SIX directive shows how much importance analysts place on APMs:
"Many Investors, Portfolio Managers and Analysts heavily rely on Alternative Performance Measures and we have recognized a global trend to regulate these measures to enhance the quality, the reliability and the comparability of Alternative Performance Measures."

The interviews conducted with financial analysts confirmed this view. Analysts base themselves heavily on non-GAAP data. GAAP statements contain many volatile performance figures and one-off effects which are frowned upon. Therefore, they should be adjusted wherever possible. Where no APMs are calculated, analysts perform their own non-GAAP calculations.

> "I hope for a strong improvement of transparency of Non-GAAP reporting in the future - most importantly, a detailed reconciliation should be a central part of communication around APMs."
>
> **Daniel Regli, Vice President Equity Research, Banks, Mainfirst Schweiz AG**

Analysts place especially high importance on the multi-year comparability: They prefer key figures that can be compared over a period of time. Transparency regarding the adjustments made is an important aspect for inspiring confidence in the comparability. However, the quantitative analysis has shown that clear definitions and detailed reconciliation tables are not normal practice. Manually collecting the information necessary to understand the adjustments made drives up the costs of the analysis. Therefore, a clear reconciliation of GAAP to non-GAAP key figures is welcomed.

> "At times APMs are not reported transparently and consistently over time. This creates a need for additional analysis and interaction."
>
> **Andreas Venditti, CFA, Senior Analyst Banks/Asset Managers, Vontobel**

The CFA Society shares this view:
"Although investors consider APMs to be useful and necessary, they also have a variety of concerns related to the reporting of these measures. These concerns include the lack of comparability across similar companies, inconsistent period to period reporting, questionable APM calculations (e.g. adjustments of recurring business expenses), and inadequate transparency around the calculation of APMs . We believe that a disclosure based regulation approach is expedient."

A consistent and transparent presentation of APMs, including clear definitions and detailed reconciliation tables, would also facilitate comparisons across peers and within industries.

All interview partners as well as the CFA Society welcomed the new draft directive on APMs. Everyone expects higher consistency and transparency. This would lead to more efficiency and higher quality estimates. Nevertheless, financial analysts deem the SIX draft directive as rather tame in comparison to international regulations. They tend to have higher expectations in regard to companies' financial reporting than the draft seems to address.

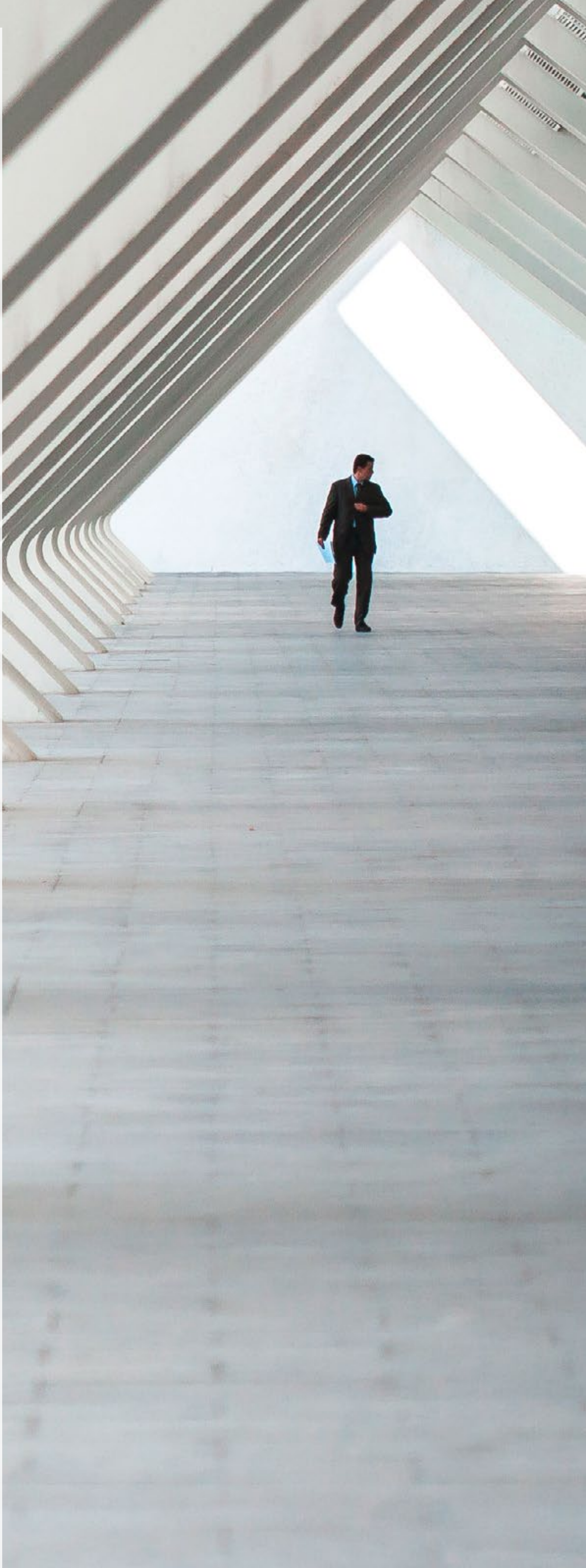
APMs as a temporary solution – companies' perspective
Interestingly, the majority of companies also seem to be in favor of adjusting the directive to international norms. For example, Swiss Holdings writes in its response: *"The directive in the core areas "reconciliation", "transparency" and "consistency" should be closer to ESMA and IOSCO."*

> "The SIX draft is a first step towards the right direction."
>
> **Daniel Geiger, Vice President Corporate Accounting & Controlling, SCHMOLZ + BICKENBACH AG**

Swiss Holdings as well as most of the companies interviewed for this study underline on several occasions the significance of APMs in the communication with analysts and investors. However, this does not mean that GAAP financial statements as a whole are called into question. Quite to the contrary: Many of the interviewed parties stress that, for them, APMs and the associated adjustments are more of a temporary solution. By definition, the adjustments would also have an end within a certain timeframe, i.e., when the underlying cost has vanished.

Several interview partners confirmed that APMs are used to react to deficits in the accounting standards. These are quite inflexible when it comes to showing one-off effects. In certain cases, accounting treatment in line with applicable GAAP is simply perceived inappropriate. Fluctuations in market values of certain financial instruments which have to be recorded in shareholders' equity are just one example. Furthermore, even though certain disclosure items are usually hidden somewhere in the GAAP statements, they are often difficult to find. Thus, companies want to simplify the work of financial analysts.

The quantitative analysis has shown that APMs are often used internally for compensation bonuses. The interview partners also outlined that they are also used for budgets and forecasts.



> "Items that are excluded in arriving at APMs must first be judged to be consistent with our reporting and disclosure policies, and then must follow our approval and governance process, including receiving sign-off from our Disclosure Committee, which is chaired by our Group CFO."
>
> **Sandra Schreiner, Head External & Regulatory Reporting, UBS Group**

An increasing heterogeneity concerning internal governance mechanisms and guidelines at reporting companies seems to be present. These range from well-founded APMs and adjustments all the way to ad-hoc adjustments. Moreover, the Board of Directors or the Audit Committee is not always responsible for such adjustments. This is surprising given the fact that APMs may affect compensation. Additionally, they are seen as a significant component of the company's financial reporting. The audit of APMs seems to follow different approaches across firms as well. In some cases, reconciliations were audited in arrangement with investors or creditors in order to create confidence in the relevant APMs. In other cases, no assurance is deemed appropriate.

> "Our most important APM, adjusted EBITDA, is well defined, e.g. in contracts with Banks. Our auditors perform agreed audit procedures thereon to ensure appropriateness of individual adjustment components."
>
> **Daniel Geiger, Vice President Corporate Accounting & Controlling, SCHMOLZ + BICKENBACH AG**

Concluding remarks

Generally, financial analysts and companies agree on the high importance of APMs. SIX's attempt to regulate these is therefore consistently welcomed. This is also gratifying because the companies concerned are well aware that this is likely to lead to a need for action regarding their future reporting, guidelines and governance processes. The wish for a level playing field, i.e., comparability and confidence through transparency, is great. This shows that both companies and investors understand the sensitivity of APMs.

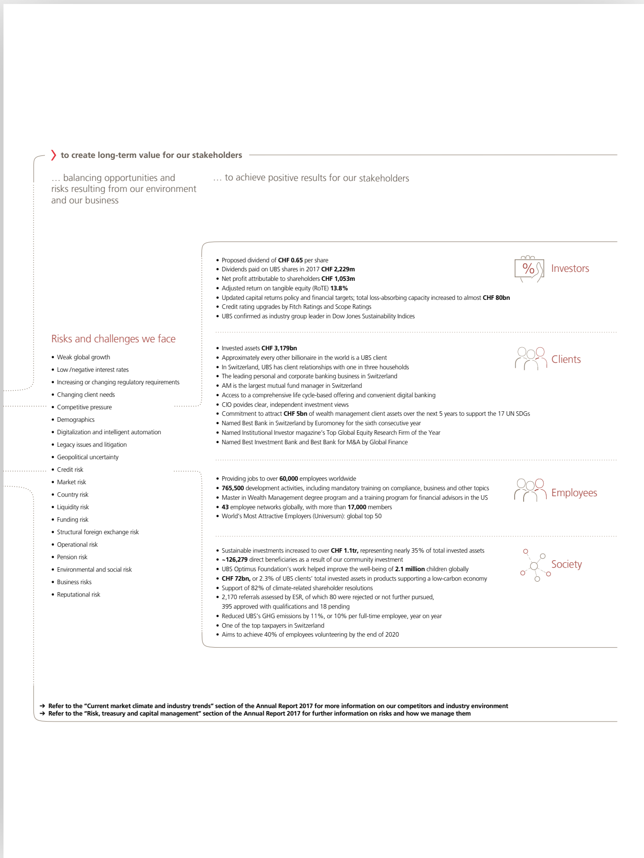
APMs: So what's next?

Why tackle these changes now?

The new SIX regulations will hit listed companies soon. As this study shows, many companies will have to improve their non-GAAP reporting to comply with the new regulations. This should be a wake-up call for Boards of Directors and Management, making them tackle the topic with more vigor in order to ensure compliance and avoid reputational risks.

Some serious changes are coming up in regard to communication for 2018 and 2019. With the revision of the standards on revenue recognition, financial instruments and leasing, both IFRS and US GAAP users will have to make numerous adjustments to their financial statements. For many, it will be a significant challenge to be able to demonstrate the impact in a transparent and understandable manner. In any case, the sheer amount of information is increasing even more due to additional disclosure requirements. There is a risk that significant information is watered down accordingly.

These are good reasons to give the future content of financial reports some serious thought. Various other initiatives have also identified the need for action and offer solutions for re-conceptualizing financial reports. A good example for this is the Disclosure Initiative of the IASB, which may result in the re-orientation and trimming of reports. Looking at it from a holistic view, the topic 'integrated reporting' is becoming more important and may offer an important impetus to start linking and organizing all of the annual report's content. A more transparent and understandable presentation of the business model and the strategic orientation may also be conducive for the comprehensibility of APMs. Holistic and consistent views therefore make sense.


to create long-term value for our stakeholders

… balancing opportunities and risks resulting from our environment and our business

… to achieve positive results for our stakeholders

Investors

- Proposed dividend of **CHF 0.65** per share
- Dividends paid on UBS shares in 2017 **CHF 2,229m**
- Net profit attributable to shareholders **CHF 1,053m**
- Adjusted return on tangible equity (RoTE) **13.8%**
- Updated capital returns policy and financial targets; total loss-absorbing capacity increased to almost **CHF 80bn**
- Credit rating upgrades by Fitch Ratings and Scope Ratings
- UBS confirmed as industry group leader in Dow Jones Sustainability Indices

Risks and challenges we face

- Weak global growth
- Low /negative interest rates
- Increasing or changing regulatory requirements
- Changing client needs
- Competitive pressure
- Demographics
- Digitalization and intelligent automation
- Legacy issues and litigation
- Geopolitical uncertainty
- Credit risk
- Market risk
- Country risk
- Liquidity risk
- Funding risk
- Structural foreign exchange risk
- Operational risk
- Pension risk
- Environmental and social risk
- Business risks
- Reputational risk

Clients

- Invested assets **CHF 3,179bn**
- Approximately every other billionaire in the world is a UBS client
- In Switzerland, UBS has client relationships with one in three households
- The leading personal and corporate banking business in Switzerland
- AM is the largest mutual fund manager in Switzerland
- Access to a comprehensive life cycle-based offering and convenient digital banking
- CIO povides clear, independent investment views
- Commitment to attract **CHF 5bn** of wealth management client assets over the next 5 years to support the 17 UN SDGs
- Named Best Bank in Switzerland by Euromoney for the sixth consecutive year
- Named Institutional Investor magazine's Top Global Equity Research Firm of the Year
- Named Best Investment Bank and Best Bank for M&A by Global Finance

Employees

- Providing jobs to over **60,000** employees worldwide
- **765,500** development activities, including mandatory training on compliance, business and other topics
- Master in Wealth Management degree program and a training program for financial advisors in the US
- **43** employee networks globally, with more than **17,000** members
- World's Most Attractive Employers (Universum): global top 50

Society

- Sustainable investments increased to over **CHF 1.1tr,** representing nearly 35% of total invested assets
- **~126,279** direct beneficiaries as a result of our community investment
- UBS Optimus Foundation's work helped improve the well-being of **2.1 million** children globally
- **CHF 72bn,** or 2.3% of UBS clients' total invested assets in products supporting a low-carbon economy
- Support of 82% of climate-related shareholder resolutions
- 2,170 referrals assessed by ESR, of which 80 were rejected or not further pursued, 395 approved with qualifications and 18 pending
- Reduced UBS's GHG emissions by 11%, or 10% per full-time employee, year on year
- One of the top taxpayers in Switzerland
- Aims to achieve 40% of employees volunteering by the end of 2020

→ Refer to the "Current market climate and industry trends" section of the Annual Report 2017 for more information on our competitors and industry environment
→ Refer to the "Risk, treasury and capital management" section of the Annual Report 2017 for further information on risks and how we manage them

UBS Group: Integrated Reporting 2017

Important considerations

Members of Boards of Directors and Management should be able to answer the following questions:

- Do APMs draw an appropriate and honest picture of company performance?
- Does the company have a reliable and transparent policy (including definitions and reconciliation tables) for the APMs to be reported?
- Is it possible to report these key figures consistently over a longer period?
- Are processes and control mechanisms sufficiently robust to produce reliable APMs?
- Are APMs related to the compensation system? If yes, are appropriate governance processes and safeguards in place?
- Are the disclosures in the financial communication consistent with regulatory requirements?
- Are the APMs relevant if benchmarked against industry averages?
- Do they meet the expectations of stakeholder groups (especially financial analysts and investors)?
- Is an appropriate assurance concept in place?

The new regulatory requirements will not necessarily require a complete re-orientation by companies. However, the following considerations should also flow into a review of the company's own compliance readiness.

1. Analysis

To start with, the currently used reporting should be reviewed to see whether it fulfills the regulatory requirements, thus allowing the identification of gaps in the status quo.

An ambitious approach will also try to identify and take into account the expectations of the relevant stakeholder groups. Some crucial considerations around this topic are:

- Who are the readers and users of our reporting?
- What are their vital needs regarding information and financial key figures?
- What kinds of modifications will they generally accept as appropriate?
- Should relevant information be assured?

A structured analysis could involve a stakeholder matrix, showing which stakeholders are most likely to influence the company. An important indication of average information needs are industry practices, which may be established with benchmarks and analyst interviews.

However, also the internal view should be considered. Companies like to have a narrative showing the value drivers and KPIs of their business models. For instance, reporting companies should ask themselves the following questions:

- Which are the most important features of our strategy and business model?
- How can success be measured objectively and which financial key figures help assess these?
- Do the identified APMs contain controversial adjustments (e.g., costs that are disclosed as one-off but which may well be recurring)?
- What is the objective and purpose of using specific APMs?

The APMs selected for these criteria can then be put on a short list. The current draft of the SIX directive clearly states:

"Companies must ensure there is a balance between performance measures defined or specified under applicable accounting standards and alternative performance measures used." (Art. 7)

Therefore, the company should take care that APMs are not treated with more prominence than GAAP key figures. In addition, companies should strive for few, but consistent APMs.

2. Design

Clear definitions of APMs are the basis of a robust reporting. These should be worded clearly and consistently and show an appropriate degree of granularity. In addition, detailed reconciliation tables ensure that the adjustment types and magnitudes are presented transparently.

High levels of awareness by all stakeholders involved are likely to heighten companies' aspiration to provide reliable and correct APMs. It is therefore crucial to have an adequate governance structure and to carefully allocate responsibilities. The Board of Directors or the Audit Committee is responsible for the reporting of APMs. This includes the selection of the APMs, the evaluation of the adequacy of the adjustments performed by Management as well as the implementation of adequate reporting processes and controls in order to ensure the correctness of the disclosed APMs.

The conceptualization of reports, their formalization and the linking (i.e., by cross-referencing) can already be tackled early on. This way, the Board of Directors and Management have the possibility to intervene in time and assume their full responsibility.

3. Reporting

The ultimate result in the form of the final APMs and additional explanations should be subject to an internal or even external audit. Due to the above-mentioned changes in financial reporting as a result of the first-time application of standards, significant changes in the financial key figures are to be expected. An overall assessment of the APM reporting should therefore also keep these developments in mind. The different components of the report should be coordinated and consistent. It is also advisable to discuss the relevant key figures with the auditor early on in order to avoid surprises later.

In order to enable future improvements in the reporting it is important to engage with the stakeholders and to pro-actively seek their feedback, especially from analysts. This in turn could be integrated into the reporting process as part of an annual cycle.

Lead authors and contributions

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Karla Linden is a research associate and doctoral student at the Institute of Accounting, Control and Auditing at the University of St.Gallen. She completed her Bachelor in Business Administration at the University of Mannheim in 2013. During and after her bachelor, she gained practical experience in the accounting and finance departments of various international corporations. In 2016, she finished the Master in Accounting & Finance as well as the CEMS Master in International Management at the University of St.Gallen. Her research focuses on the capital market effects of financial reporting.

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