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Communicating effectively through non-GAAP information

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ESMA guidelines on alternative performance measures promote transparency and comparability

Highlights

- Transparency and comparability are key
- Another step towards global consistency
- So what more is needed?

Guidelines on alternative performance measures issued by the European regulator, ESMA, seek to promote the presentation of transparent and comparable financial information.

GAAP rarely tells the whole story of a company's performance. To bridge the gap, companies and investors communicate through key performance indicators (KPIs), alongside the GAAP numbers. Such KPIs are referred to, interchangeably, as 'non-GAAP information' and 'alternative performance measures' (APMs).

This topic has prompted much debate. When do KPIs enhance GAAP by aiding communication with users, and when do they present a confusing or overly optimistic picture? To date, regulators around the world have taken different approaches to non-GAAP information. This recent development could help to drive consistency in this area.

Transparency and comparability are key

ESMA's guidelines, applicable to member states of the EU, apply to APMs presented in regulated information and prospectuses, except those in financial statements. Similar regulations already exist in other major financial markets around the world, such as Australia, Canada and the US.

The guidelines acknowledge the importance of APMs and user demand for them. They don't try to ban APMs; they don't define specific APMs; and they don't limit the measures that a company presents. Instead, the guidelines seek to enhance transparency and comparability when APMs are presented to enhance communication with the users (see Key facts on ESMA's guidelines below).

Another step towards global consistency

ESMA's guidelines also bring its approach to APMs further in line with those proposed by IOSCO.

While it remains to be seen whether IOSCO's proposals will be finalised in their current form, we support the general alignment of approach by these two bodies as it is likely to foster greater global consistency in the presentation of APMs.

"We are encouraged at the alignment between ESMA's guidelines and those of other regulators, helping to build a globally consistent approach to the presentation of APMs."

So what more is needed?

Given that ESMA's guidelines on APMs appear similar to the requirements on the presentation of subtotals introduced by the recent IASB Disclosure Initiative – Amendments to IAS 1, consistent disclosure principles will apply to such financial APMs whether they are presented within or outside of financial statements.

However, further action is needed to develop similar principles to be applied in the presentation of quasi-financial measures (order pipeline) and operational metrics (cost per …, proven and probable reserves).

- **Regulators and standard setters** may need to further consider the transparency of presentation for these measures and metrics. For example, the IASB could update its practice statement on management commentary, and regulators could develop their own guidance on the way such measures and metrics should be presented and disclosed.
- **Preparers**, in the absence of sector-specific definitions, could define and explain the APMs used to enhance communication with users.

Furthermore, as APMs become more widely used and accepted:

- **executives and audit committees** should ask whether APMs are subject to sufficiently robust systems and processes;
- **investors** should consider whether the level of consistency, transparency and reliability is sufficient and, if not, what more is needed; and
- **industry bodies** could develop sector-specific definitions of key metrics to enhance consistency and comparability.

Key facts on ESMA's guidelines

Complying with the guidelines

Under ESMA's guidelines companies:

- do not display APMs with more prominence, emphasis or authority than measures directly stemming from the financial statements;
- define APMs and give them meaningful labels to avoid conveying misleading messages to users, and explain their context;
- reconcile APMs to the most directly reconcilable line item, subtotal or total presented in the financial statements, explaining any material reconciling items;
- present comparatives, disclosing APMs consistently over time;
- change the disclosed APMs only if they provide reliable and more relevant information, then explain such changes; and
- if permitted, may replace the required APM disclosures with a direct reference to other published documents that contain those disclosures and are readily and easily accessible to users.

ESMA's definition of an APM

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. Examples include: operating earnings, cash earnings, earnings before one-time changes, EBITDA and net debt.

Enforcement

National regulators will retain responsibility for enforcing the application of the guidelines in their jurisdiction.

Effective date

The guidelines are effective from 3 July 2016.

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