KPMG Reporting Insights

KPMG's review of 30 ASX200 companies for non-IFRS performance measures in 2015 Annual Reports

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The headlines

KPMG reviewed 30 ASX200 annual reports for the June to September 2015 reporting season. Our overall observations are detailed below and in the following pages.

86 percent of companies reviewed reported at least one non-IFRS result or performance measure in their annual report.

69%

69 percent of these companies reported a 2015 non-IFRS measures that implied "better" performance than the relevant statutory measure. However, for the same companies the 2014 non-IFRS measure was not always higher than the statutory measure, suggesting the nature of adjustment used by companies are not biased to consistently provide a "better" non-IFRS result.

The most common non-IFRS performance measures used were adjusted net profit after tax (NPAT) and adjusted earnings before interest, taxes, depreciation and amortisation (EBITDA).

67%

67 percent of companies had segment results measures that were consistent with non-IFRS measures discussed elsewhere in the annual report.

In 65 percent of cases, non-IFRS measures appeared to be discussed prior to or instead of their equivalent statutory measures.

Impairments, transaction and restructure costs, gains/losses on derivatives and hedging, along with gains/losses on the purchase or sale of investments were the most common adjustments to statutory results.

57%

57 percent of companies included non-IFRS remuneration tables in their remuneration reports.

68 percent of companies used and disclosed non-IFRS performance measures as their primary financial target for assessing eligibility for short-term incentive remuneration of key management personnel.

7%

7 percent of companies obtained some form of assurance over their non-IFRS measures.

Introduction

Non-IFRS financial information or underlying profits that adjust financial results determined by accounting standards (statutory measures) continue to play a key role in how companies communicate and analyse their financial performance.

These measures are traditionally used by directors and management internally and analysts externally to assess and benchmark a company's performance. In December 2011, ASIC released Regulatory Guide 230 *Disclosing Non-IFRS Information* (RG 230) that acknowledged the value of these non-IFRS financial performance measures and established some boundaries or expectations around their use.

What we have seen previously

Since 2009 KPMG have undertaken a number of reviews of listed company annual reports to assess the prevalence of non-IFRS performance measures.

Review of the ASX100 over the 2008 to 2011 reporting season[1] consistently identified over 80 percent of companies reporting a non-IFRS measure of performance in their annual reports. From 2012 to 2014 KPMG have been tracking the ASX50 and have seen more than 70 percent of companies reporting some form of non-IFRS measures in their annual and interim reports.[2]

Over this period the two most significant reconciling items between non-IFRS and statutory equivalent measures have related to impairments and fair value adjustments on financial instruments. For over 60 percent of companies reviewed, the non-IFRS performance measures exceeded the relevant statutory measure, though this trend has been decreasing from 76 percent in 2009 to 64 percent in 2014.

What we have seen in the 2015 reporting period

What follows are KPMG's observations after a detailed review of 30 ASX200 company annual reports for the June to September 2015 annual reporting season. Our review has identified over 86 percent of these companies reporting at least one non-IFRS performance measure in their annual report (compared to 72 percent of ASX50 for June 2015 reporting season).

Of the 30 companies reviewed in the 2015 year, 69 percent reported a non-IFRS measure that exceeded the corresponding statutory measure.

Our observations in 2015 for the 30 ASX200 companies continues to support the trends and observations we have made over the last seven years across the various samples of ASX company annual reports we have reviewed.

In particular:

- Non-IFRS measures are used by the majority of listed companies;
- On average, non-IFRS measures appear to exceed their equivalent statutory measures; and
- Impairments and fair value adjustments on financial instruments continue to be two of the more common adjustments between non-IFRS and statutory measures.

Purpose of this publication

To assist listed entities asses how their non-IFRS reporting practices compare to other entities in the ASX200, this publication provides insights into:

- The common types of non-IFRS performance measures disclosed in annual reports;
- The more and less common adjustments made to statutory results in arriving at non-IFRS measures;
- How non-IFRS measures impact remuneration structures and remuneration reports that form part of the directors' report; and
- How other listed entities have applied some of the general principles of RG 230.

1. Visit kpmg.com.au to access the *Underlying Profits Reports* issued in 2009, 2010 and 2011.
2. Visit kpmg.com.au to access the ASX50 Financial Reporting Insights for 2014 and 2015.

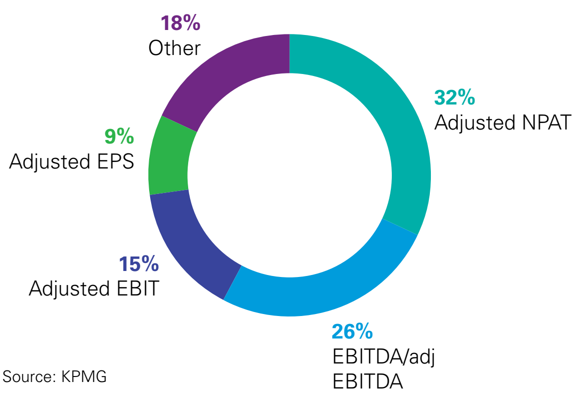
Common types of non-IFRS measures

Of the 26 companies reporting non-IFRS measures in their annual report, 88 percent reported more than one measure. The most common measures used included adjusted, normalised or underlying net profit after tax; adjusted earnings before interest, tax, depreciation and amortisation (EBITDA); and adjusted earnings before interest and tax (EBIT). Some of the less common measures included free cash flows, adjusted operating cash flows, funds from operations and revenue adjusted for specific items.

In 69 percent of cases the non-IFRS measure exceeded the relevant statutory measure. This continues to highlight the trend we have seen over the years that adjustments to statutory results relate primarily to expense type items.

Even though in 69 percent of cases the 2015 non-IFRS measure may have exceeded the equivalent statutory measure, this was not consistently the case year on year. In fact, we observed that in 58 percent of cases, where the non-IFRS measure was higher than the statutory measure in 2015, it was actually lower than the statutory measure in the 2014 comparative period (or vice versa i.e. 2015 non-IFRS was lower than 2015 statutory measure, but 2014 non-IFRS was higher than the 2014 statutory measure). This suggests that the nature of adjustments used by companies are not biased to consistently provide for a higher or better non-IFRS result.

Common types of non IFRS measures

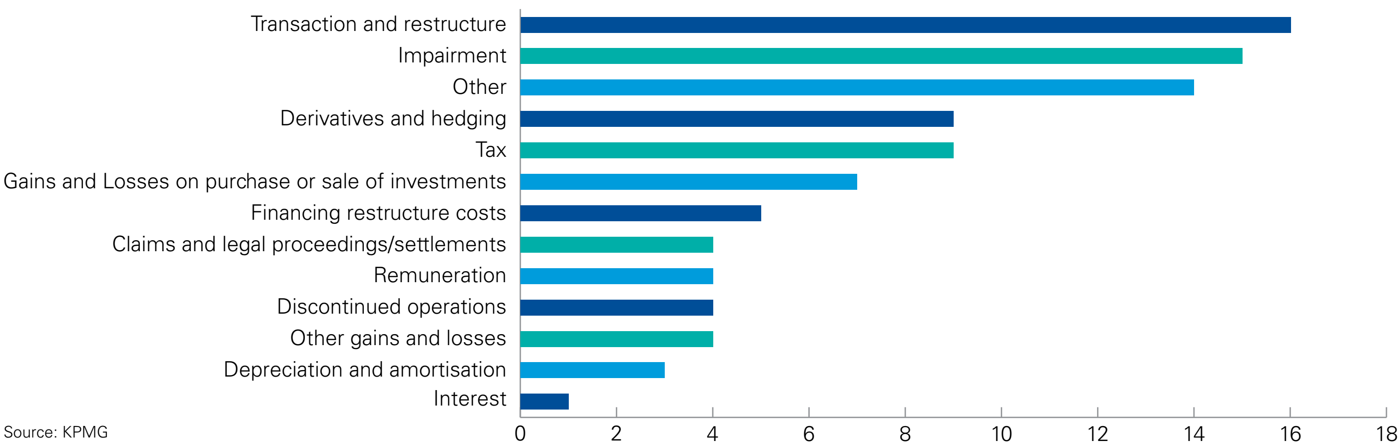


Source: KPMG

Common adjustments

The most common adjustments between statutory and non-IFRS measures[3] in the 2015 and comparative period related to:

Common adjustments by company in 2015 and 2014



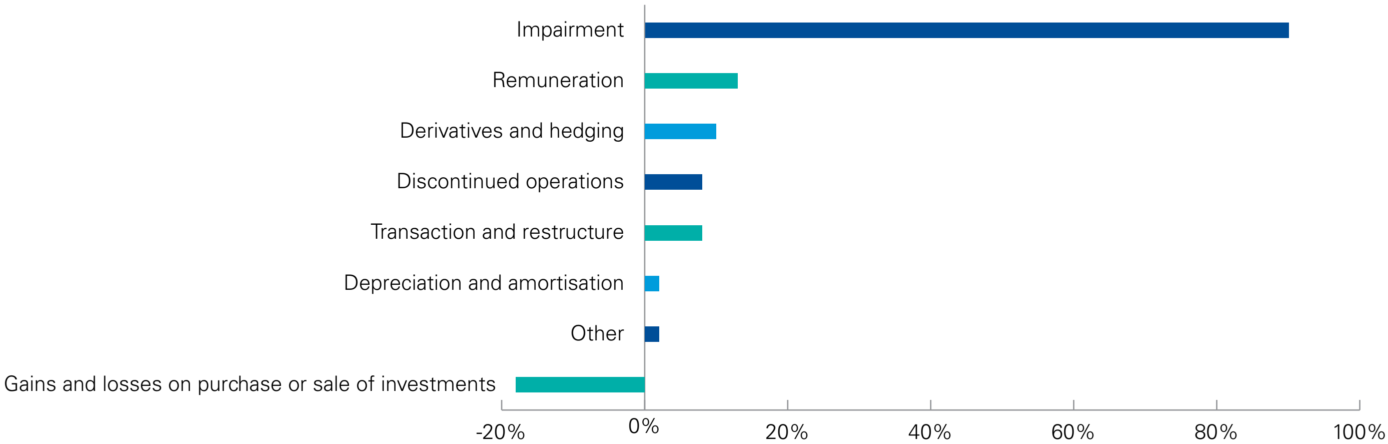
Source: KPMG

3. In reviewing the nature of reconciling items, KPMG reviewed reconciliations to the closest IFRS measure, for example if the non-IFRS measure was underlying EBITDA, we reviewed reconciling items to EBITDA determined under accounting standards (i.e. PAT, less tax, less net interest costs, less depreciation and amortisation).

More information relating to the types of adjustments is provided in the table below.

Adjustment name	Description
Transaction and restructure costs	Costs relating to acquisitions of businesses, disposals, business restructures, initial public offerings and takeover defence.
Impairments	Impairments relating to property, plant and equipment; goodwill and other intangibles; equity accounted investments; and write downs of inventories. Of the companies that reported non-IFRS performance measures 19 had recorded an impairment expense in their 2015 financial statements, but only 15 of these companies included impairments as an adjustment in arriving at their non-IFRS measure.
Derivatives and hedging	Gains and losses relating to fair value adjustments on derivative financial instruments and the impacts of economic hedges (accounting for derivatives that do not qualify for hedge accounting as if they did qualify).
Tax	Tax on significant/adjusting items; recognition of deferred tax assets; and costs/benefits associated with resolution of uncertain tax positions with the tax office.
Gains and losses on purchase or sale of investments	Gains and losses on sale of assets, businesses, subsidiaries and associates; gains on business combinations (bargain purchases); and gains on the acquisition of equity accounted investments.
Financing restructure costs	Costs associated with early settlement or termination of debt and derivative arrangement; and modification of debt arrangements.
Remuneration	Adjustments relating to voluntary redundancies; share based payment expenses – excluding all share based payments expenses or reflecting cash cost in non-IFRS result; and remuneration adjustments associated with IPO's.
Other gains and losses	Gains on sale of other investments and foreign exchange gains and losses.
Depreciation and amortisation	Adjustments relate to excluding specific items of depreciation or amortisation such as amortisation on acquired intangibles.

Common adjustments by relative size (%) of total adjustments – 2015



Source: KPMG

The most significant adjustments (as a percentage of total adjustments) were for impairments and gains and losses on the sale or purchase of investments. Remuneration, along with derivative and hedging adjustments rounded off the top four.

Interestingly some companies referred to a number of these adjusting items as one-off or non-recurring in their financial statements, even though they have occurred in both years and may reoccur in the future. The most common items referred to in this way were impairments and restructuring costs. Other items described as "one-off" included transaction, restructure and litigation costs and fair value adjustments on the re-measurement of held for sale assets.

Companies should take care in describing these items, particularly impairments, restructure and transaction costs, as depending on the nature of the operations of a company, they may well be recurring in nature. Referring to these items as one-off or non-recurring can be considered misleading and inconsistent with the principles described in RG 230.56 table 2. Possible alternate descriptions companies could consider using include, "significant" or "material" items, or "items outside of the companies underlying performance".

Non-IFRS information in remuneration reports

Remuneration tables required by the Corporations Act 2001

The contents of the remuneration report are governed by the Corporations Act 2001 which requires that remuneration disclosures are determined in accordance with accounting standards. Remuneration determined in accordance with the accounting standards in essence represents the "cost to the company" where equity compensation in particular is measured at the grant date and allocated to each reporting period over the performance period. Subsequent changes in share prices are ignored even though these changes in share prices impact on the employees "realised" or "take home" pay.

As observed in KPMG's 2013 publication on remuneration reports[4], companies are increasingly including adjusted remuneration information in their remuneration reports for this "realised" pay.

Of the 30 companies sampled, 57 percent included non-IFRS remuneration information in their remuneration report. The most common non-IFRS remuneration information that was provided related to actual/cash/take home pay which most frequently adjusted the share based payment component of the remuneration to the value vested (i.e. fair value of vested shares determined on vesting date) or granted (i.e. fair value of all shares granted, regardless of vesting) in the year.

Non-IFRS measures used as financial performance targets in short term incentive schemes

We identified that 29 of the 30 companies provided short term incentive (STI) awards to key management personnel. Not all of these companies clearly disclosed the financial targets used to assess eligibility, however of the 25 that did, 68 percent included non-IFRS financial performance targets as a primary measure. In all cases, these targets were consistent with one or more of the non-IFRS measures discussed elsewhere in the annual report.

The one company that did not have a traditional STI plan granted an annual performance right to all executives that converted to a fixed value of shares after 18 months. The value of shares was determined by a predetermined or fixed percentage of each executive's total remuneration.

The most common STI target used was adjusted, underlying or normalised NPAT. Other common targets included adjusted revenue, EBITDA, EBIT and EPS and measures linked back to free or operating cash flows.

It is encouraging to see companies using non-IFRS targets in their STI plans that are consistent with those used elsewhere in the annual report as this implies alignment of the interests of the key management personnel and the organisation. However, given the discretion that can be exercised by directors or senior executives in determining the nature of adjusting items in arriving at these non-IFRS measures, tension can arise between shareholders and company interests, particularly where the statutory results are below market expectations, yet significant STI awards are granted. Directors and management need to take care in how the relationship between these measures and STI awards are communicated to ensure shareholders understand the Board's rationale for allowing the STIs to vest in these circumstances.

4. Visit kpmg.com.au to access the *Enhanced Remuneration Reporting – KPMG's survey of company remuneration reports* issued in June 2013.

Segments and EPS disclosures in the financial report

ASIC's RG 230 requires that non-IFRS financial information should not be included in the financial statements and associated notes. However AASB 8 *Operating Segments* and AASB 133 *Earnings per Share* permit the disclosure of "segment results" and "alternate EPS". These can often be based on non-IFRS performance measures.

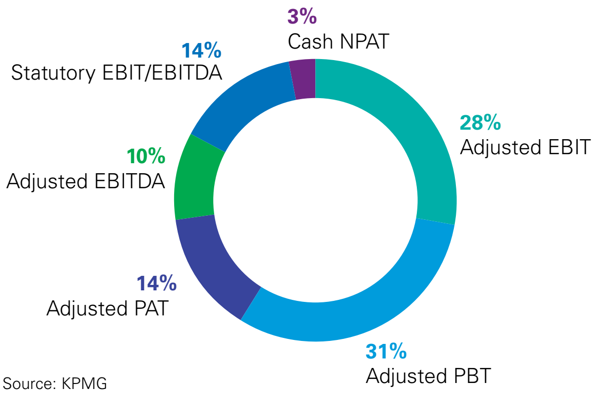
The most common measures of segment results identified from our review were adjusted profit before tax and adjusted EBIT. Other common measures included adjusted profit after tax and statutory EBIT or EBITDA.

Of the companies that reported non-IFRS measures outside the financial statements and reported more than one operating segment, 67 percent had a segment measure of performance that was consistent with a non-IFRS performance measure.

None of the 33 percent of companies that had a different segment results measure articulated why this was appropriate. Given the segment measure should represent the measure used by the chief operating decision maker to make decisions about the allocation of resources and in assessing performance, we would have expected to see consistency between the segment and non-IFRS measures for all companies.

There were six companies that reported an alternate EPS measure in the notes to the financial statements. Of these, all used a numerator (financial performance measure) that was consistent with a non-IFRS financial measure discussed outside the financial statements.

Segment results measures



Source: KPMG

Other observations related to the general guidelines of RG 230

RG 230.56 table 2 provides general guidelines on the presentation of non-IFRS financial information outside the financial statements and notes, such as the operating and financial review, directors' report and other information provided in the annual report. Below is a summary of on how these guidelines were applied by the 30 companies reviewed.

Guideline	Observation
Prominence **IFRS financial information should be presented with equal or greater prominence than corresponding non-IFRS information.**	• Whilst most companies presenting non-IFRS measures in their annual report discussed both non-IFRS and statutory measures, only 35 percent of these companies consistently presented or discussed the statutory measure before the non-IFRS measure. In some instances, particularly in the Chairman's Report, the statutory measure was not mentioned. • 76 percent of companies presenting non-IFRS remuneration tables, presented this information before the remuneration table prepared in accordance with the Corporations Act. In some instances the Corporations Act remuneration table was a few pages behind the non-IFRS table, or in an appendix to the Remuneration Report.
Reconciliation **A reconciliation should be provided between the IFRS and non-IFRS information clearly identifying and explaining each item.**	• All companies presenting non-IFRS information provided some form of reconciliation for some of their measures. In instances where multiple measures were disclosed, not all measures were reconciled. • 15 percent of these companies only reconciled these measures in their segment note or other notes to the financial statements (i.e. significant items note), even though the measure was discussed in the operating and financial review forming part of the directors report. In some of these instances, the operating and financial review did not include a reference to the reconciliation contained in the financial statements. • 15 percent of companies provided a narrative reconciliation of the measure, rather than a numerical reconciliation table. • Less than 50 percent of companies provided a narrative or description of each reconciling item in their annual report. • One company did not provide a reconciliation of their comparative non-IFRS information rather referring the reader to the prior year annual report.
Positive assurance statement **A clear statement should be made as to whether the non-IFRS financial information has been audited or reviewed.**	• Only 38 percent of companies that presented non-IFRS information included a positive statement around assurance. • Of these, 80 percent stated that the information was not subject to audit or review; 10 percent stated it was subject to audit and 10 percent subject to review. • All but one of the companies that presented non-IFRS remuneration tables had this information audited.
Rationale for non-IFRS information **An explanation should be provided as to why the directors believe the non-IFRS financial information is useful for an understanding of the company's performance.**	• Only 42 percent of companies appeared to provide some form of rationale or explanation as to why the non-IFRS information was considered to be of importance to understanding the financial results of the company. • The most common rationale provided for the usefulness of this information was that it provides a better understanding of the "underlying" performance of the business and allows for comparability year-on-year. • A couple of companies highlighted that these were the measures used by either key management personnel, management, investors or analysts in assessing performance.
Clear identification **Non-IFRS information should be clearly labelled to distinguish it from IFRS information.**	• 69 percent of companies presenting non-IFRS information clearly identified this information as non-IFRS. • These non-IFRS measures were either labelled as "non-IFRS" or distinguished from IFRS measures by referring to the IFRS measures as 'statutory'. • Some companies had specific sections in their annual report dedicated to explaining what "non-IFRS" measures were and why they were considered important.

Methodology

To provide observations relevant across a broader cross section of companies, we focused this review on 30 companies across the ASX200 where previously our review was focused on the larger listed entities. These 30 companies were randomly selected for a review from a list of ASX200 companies that was determined based on their market capitalisation as at 21 October 2015.

ASX ranking	Year end	GIC Industry Group
ASX 50: 5 companies	• June (4) • September (1)	• Banks (1) • Insurance (1) • Transportation (1) • Energy (1) • Materials (1)
ASX 51-100: 10 companies	• June (5) • July (1) • September (4)	• Materials (1) • Software and services (1) • Consumer services (1) • Utilities (1) • Health care equipment and services (2) • Commercial and professional services (1) • Energy (1) • Diversified financials (1) • Household and personal products (1)
ASX 101-150: 8 companies	• June (6) • July (1) • September (1)	• Commercial and professional services (1) • Materials (3) • Food, beverage and tobacco (1) • Retailing (1) • Energy (1) • Insurance (1)
ASX 151-200: 7 companies	• June (7)	• Telecommunication services (1) • Capital goods (1) • Media (1) • Real estate (1) • Retailing (2) • Materials (1)

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