

# Presenting performance: The journey to greater clarity

## Alternative performance measures

Audit Committee Institute

From adjusted EBIT, to like-for-like sales, non-GAAP alternative performance measures (APMs) can provide valuable information on a company’s performance. This year, new requirements put the focus on transparency of APM reporting. A KPMG survey of half-yearly reports suggests companies are responding – there is a direction of travel – but the Financial Reporting Council (FRC) has highlighted concerns that, for some companies, there may still be a way to go on this journey.

### The journey to greater clarity

APMs have long been a hot topic. The gap between IFRS and ‘adjusted’ earnings measures mean that this is a recurring topic in the financial press, particularly when linked to executive remuneration.

In the past year or so, the European Securities and Markets Authority (ESMA), International Organization of Securities Commissions (IOSCO), the International Accounting Standards Board (IASB) and the FRC have all released statements of one sort or another, shining a spotlight on how APMs are presented by companies. The goal is transparency: enhancing comparability and understanding of the various measures companies use.

Boards and audit committees should be considering these developments in light of their responsibilities to present fair, balanced annual reports.

A KPMG survey of half-yearly reports of 50 FTSE350 companies, shows that there have been changes in the way some companies are presenting APMs (see page 4 for details of survey source and methodology). Companies are re-considering APM presentation, and changes are being made.

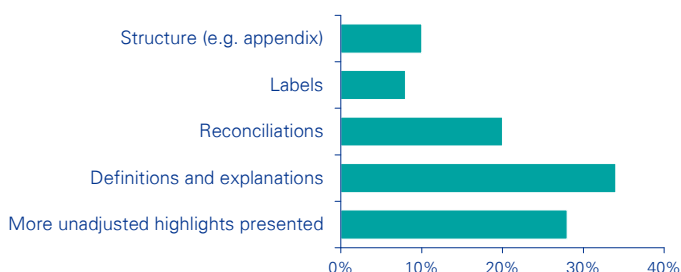
The focus on annual reports will be even more intense. The FRC’s [Thematic Review of APMs](#) also noted improvements in APM reporting in half-year reports, but crucially says that further improvements are required.

Overall, we see this as a journey: the destination is consistent transparency, balance and comparability. Some companies may be nearing journey’s end, but some may yet have a way to go.

### Changes in APM presentation

#### Survey of 50 FTSE350 half-yearly reports versus previous year

% of the 50 companies surveyed that made changes to:



ESMA Guidelines on Alternative Performance Measures, effective this year, are considered by the UK FRC to...

‘largely represent a codification of what is needed for APMs to support a fair, balanced and understandable strategic report and of best practice in this area’.

The FRC expects many companies to make changes in response to the Guidelines.

[FRC Thematic Review of APMs]

### Where next?

Despite the finalisation of the ESMA Guidelines, we are unlikely to be at the end of the debate on how APMs should be presented. Investors will continue to consider whether they get the information that they want.

The composition of APMs – in particular what adjustments to profit are appropriate – is likely to be the next port of call on the ongoing journey.

The make-up of APMs is not addressed by ESMA Guidelines and, as best practice presentation of APMs becomes business as usual, we expect that the focus will shift even more to that question. The FRC’s Thematic Review also voices concerns as to why certain items are being excluded from adjusted profits.

The IASB is also looking at how APMs should be presented in financial statements. That project is in addition to IFRS amendments effective this year that apply some presentation principles, similar to those for the front end, to income statement subtotals.

Over **55%**  
of companies surveyed made changes to their presentation of APMs

# Applying the ESMA Guidelines

ESMA Guidelines on Alternative Performance Measures apply to various documents including the front end of half-yearly and annual reports of FTSE listed companies.

Our survey of half-yearly reports issued after the Guidelines became effective in mid 2016, saw over 55% of companies making changes to their presentation of APM information. A consistent picture in the FTSE100 and 250. However, some companies may have further to go to reflect the new rules. The immediate question for boards and audit committees is how this will translate into annual reports.

The [Guidelines themselves](#), and the FRC's related [FAQs](#) and [Thematic Review](#) give more detail of the requirements. The discussion below summarises some key rules, highlights areas in which the FRC have raised concerns on APM presentation, and looks at the extent of changes in APM presentation based on our survey of half-yearly reporting of 50 FTSE350 companies.

## 1. Prominence

Don't present APMs with more prominence than IFRS measures.

Prominence is about the picture of performance presented, its balance and completeness. It not only relates to the positioning of figures, but also to the balance of messages in narrative information. Be up-front and clear on IFRS performance, and use APMs as necessary in explaining that performance.

Appropriate relative prominence of APMs and IFRS measures involves judgement. This doesn't mean giving an IFRS number every single time an APM is mentioned, but the APM picture cannot detract from the message of IFRS performance. Do 'highlights' summaries include both APMs and IFRS measures? Is there a clear picture of the IFRS result early in the annual report? Is there a clear explanation of the whole result – the APM and the adjustments?

# 28%

of the companies surveyed included at least one additional unadjusted/ IFRS measure in their financial highlights summary, compared to that company's 2015 half-yearly report.

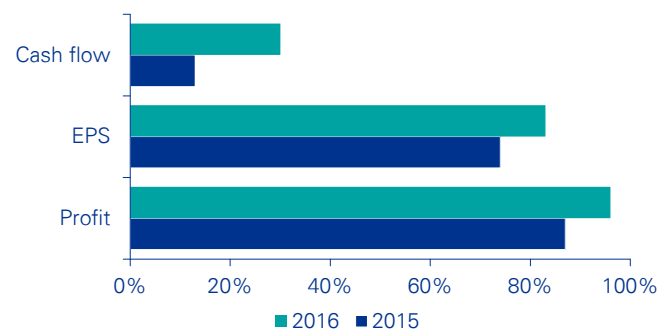
## Survey findings

Some companies added additional unadjusted/IFRS measures, such as operating profit, PBT or EPS, to their financial highlights tables.

There was also an increase in the number of companies presenting at least one related unadjusted measure together with their adjusted measures in that table.

While the vast majority of companies highlighting adjusted EPS or adjusted profit measures also highlighted unadjusted measures, a much smaller proportion gave IFRS cash flow measures along with their cash flow APM highlights. Remember, APMs don't only relate to profit.

% of survey companies that give an adjusted measure in the financial highlights summary that also give an unadjusted measure



In some cases, relative prominence in the half-year narrative had changed, with some companies changing the order in which they discuss elements of their results, or referring to IFRS numbers in places they previously had not.

The overall finding that 55% of companies surveyed made at least one change to their APM presentation does not pick up these less quantifiable changes in the balance of narrative. This area of improvement is therefore in addition to the other changes we found in APM presentation.



### From the FRC Thematic Review of APMs

'We would stress that equal prominence applies to how APMs are dealt with in the narrative as well as to how they are presented'.

'... We will question companies where ... the IFRS results are not highlighted at an early point in the narrative.'

## 2. Definitions, explanations and descriptions

Clearly define and explain APMs, including basis of calculation and material assumptions. Explain the purposes for which APMs are used, and why the APM provides useful information.

APMs, clearly explained and described, can enhance the annual report, helping to link the financial statements to a disaggregated explanation of business performance.

Defining and explaining those measures involves explaining why they are useful, how they are calculated and any relevant assumptions. Such transparency allows greater understanding of how measures used by different companies actually compare. However, the FRC's Thematic review found some companies missing useful explanations of why APMs are used.

Explaining and defining measures applies to all APMs – For example measures such as constant currency organic growth, or like-for-like sales can be calculated in different ways. If the approach is clearly defined then the measure can be better understood and compared.

### Survey findings

34%

of the companies surveyed had added or amended definitions, descriptions and/or explanations of APMs, compared to their 2015 half-yearly report.

We saw a third of companies adding or amending this narrative. Explaining what measures are, how they are approached, and why they are relevant, is likely to be a continued area of development and focus. This is echoed by the FRC's Thematic Review that also saw improvements in explanations of APMs, but 'boilerplate' statements by others.

In our survey, some types of APM were better explained than others; for example, only 38% of companies reporting constant currency growth rates explained how that calculation was approached.



#### From the FRC Thematic Review of APMs

Definitions are usually given. There were some good explanations of why APMs are used, but in other cases explanations were either not given or were 'cursory/boilerplate'.

'In our view a good explanation cites why an APM is useful, helpful or more meaningful rather than asserting that this is the case and clarifies whether the APM is used internally, why it is so used, by whom and for what purpose.'

## 3. Reconciliations

Give a reconciliation of APMs to IFRS measures where possible, identifying and explaining material reconciling items.

The ESMA requirement to give a reconciliation of APMs to IFRS measures is perhaps the greatest change from the predecessor Committee of European Securities Regulators (CESR) recommendations that referred only to being 'reconcilable'. For some companies, therefore, this may be one of the greatest structural changes as a result of the ESMA Guidelines.

Transparency in what is being adjusted contributes to clear communications and investor confidence. In a [2015 CFA UK Survey](#) around 60% of their member survey respondents said that they trusted IFRS numbers more than non-IFRS numbers. In the same survey some 61% of respondents said that they use adjusted numbers in their analysis. With adjusting items varying between companies and periods, clarity on what is being adjusted would appear to be welcome.

As attention focuses increasingly on what adjustments to profit are being made, these reconciliations, and the explanations of the reconciling items, will continue to be important.

As with the explanations of the usefulness of the APM itself, the explanation of the reasons for adjusting items is also important. For example, the ESMA Guidelines say that charges such as impairment or restructuring that occurred in the past and will occur in the future, can rarely be described as unusual or non-recurring.

### Survey findings

A fifth of companies surveyed included additional reconciliations of APMs, or modified existing reconciliations in some way (14% and 10% respectively).

10% of companies had made significant layout changes to where they give definitions and reconciliations – for example adding an appendix.

The reconciliation requirement applies to all APMs. Measures such as constant currency organic revenue growth, are not always reconciled.



#### From the FRC Thematic Review of APMs

'In our view when a company adjusts for an item not adjusted for by other companies, further explanation of the reason for the adjustment should be given.'

'... We will question companies where ... a description such as non-recurring is used and that description does not appear to apply in the circumstances.'

## 4. APM labels

Give APMs meaningful labels, that are not confusingly similar to IFRS labels.

In targeting clarity and transparency, the labels used are important. Statements viewed in isolation can take on a different meaning if the term suggests an IFRS number when the figure is actually adjusted. The ESMA guidelines are clear on this: IFRS terms, or terms that are confusingly similar, should not be used to refer to APMs.

Consistent use of labels is also important. Each APM will have a definition. If more than one term is used to refer to the same number, or the same term is used to refer to more than one number, there is potential for confusion! A defined, descriptive, term, used consistently and indicating the nature of the item is what the ESMA Guidelines are looking for, and will add to clarity.

## Survey findings

80%

of the companies surveyed had changed the labels they used to refer to APMs

Our survey did show a number of companies making statements such as 'all future references to operating profit are on an adjusted basis'. That approach risks misdescribing performance if the measures being discussed are not crystal clear. We also saw companies referring to 'EBITDA' when that measure excluded certain specific adjusting items. It seems unlikely that a reader would always know such a measure was adjusted.

Therefore, while labelling may seem to be a straightforward requirement, some companies may need to give this further consideration.



### FRC 'area of concern' identified in reviews of corporate reporting.

'Lack of clarity of when a measure is an APM, for example, referring to "profit before tax" when the amount shown is actually calculated on a non-GAAP basis ...'

[FRC Annual Review of Corporate Reporting 2015/16](#)

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## 5. Consistency and comparatives

Define APMs consistently over time, give comparative information, give reconciliations to IFRS for all comparatives.

Consistently makes trends in performance clearer. In the ordinary course of things this is one of the simplest areas to apply as it takes the same approach year on year.

There will naturally be more focus when there are changes to APM definitions, or a measure is no longer used. Explaining the reason for the change, and restating comparatives, will be important in communicating performance clearly and consistently.



### From the FRC Thematic Review of APMs

'We are ... concerned, based on the limited evidence available, that companies may not appreciate the importance of explaining changes either in the APMs they use or in their definition.'

### The role of the board/ audit committee

The governance imperatives for APMs are to consider:

- The quality of the measures reported.
- Whether use of APMs in the annual report contributes to a fair, balanced and comprehensive review of the business.

Considering the ESMA Guidelines will support the latter assessment.

## Survey methodology

We looked at the presentation of APMs in the June 2016 half-yearly reports of 50 FTSE350 companies, issued on or before 5 August 2016, all issued after ESMA Guidelines came into effect on 3 July.

The selection of companies was weighted to take 20 from the FTSE100, and 30 from the FTSE250, reflecting the proportions of the total population from each index. The companies were selected to give a broad coverage of industries, reflective of the total population, with the companies within each sector selected randomly.

We compared presentation of APMs in those reports to the presentation in June 2015 reports, focussing mainly on the initial financial highlights and looking at changes in presentation between those reports.

## Better business reporting

The focus on APMs reflects expectations that IFRS is the start of a company's performance story, not the end. The onus is on companies to find the right mix of IFRS, the financial APMs discussed in this paper, and non financial measures to communicate performance in a fair and balanced way. For more information see

[www.kpmg.com/uk/betterbusinessreporting](http://www.kpmg.com/uk/betterbusinessreporting)

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