

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?

Investors are demanding more than GAAP is delivering.

GAAP rarely tells the whole story of a company's performance. To bridge the gap, companies and investors communicate through key performance indicators (KPIs)¹, alongside the GAAP numbers.

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? Previously, varied regulatory approaches resulted in inconsistent requirements. But now a consensus seems to be building globally.

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 also 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, they seek to enhance transparency and comparability when APMs are presented to enhance communication with the users (see Key facts on ESMA's guidelines below).

"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."

Another step towards global consistency

ESMA's guidelines also bring its approach to APMs further in line with those issued by [IOSCO](#).

Furthermore, IOSCO's and ESMA's guidelines are broadly similar to the requirements on the presentation of subtotals introduced by the recent [IASB Disclosure Initiative – Amendments to IAS 1](#). As such, consistent disclosure principles will apply to APMs whether they are presented within or outside financial statements.

1. Such KPIs are referred to, interchangeably, as 'non-GAAP information' and 'alternative performance measures' (APMs).

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.

So what more is needed?

Now that ESMA's guidelines and the IASB's amendments to IAS 1 *Presentation of Financial Statements* on IFRS subtotals are effective, companies have an opportunity to enhance and improve their presentation and disclosure of APMs. This is a trend that we are seeing in practice.

Investor organisations are also actively contributing to the discussion – notably, in late 2016, the CFA Institute conducted a member survey, with responses from over 550 members, and published a two-part CFA Institute publication covering:

- [Investor Uses, Expectations and Concerns on Non-GAAP Financial Measures](#); and
- [Bridging the Gap: Ensuring Effective Non-GAAP and Performance Reporting](#).

ESMA is keen to ensure that its guidelines are implemented and overseen consistently. In January 2017, it issued a question-and-answer ([Q&A](#)) document to help users, preparers and supervisors with the practical application of its APM guidelines. The Q&A focuses on scope and applicability issues, and clarifies certain concepts. ESMA has also invited stakeholders to submit questions whenever they need more clarity, with a view to further enhancing the Q&A.

All stakeholders have their own role to play in ensuring that APMs are presented in a way that contributes rather than detracts from corporate communication.

- **Investors** should continue to contribute to the evolution of best practice: helping preparers, standard setters and regulators to understand and better address their needs; commenting on evolving practice and what more is needed.
- **Preparers** should focus on more effective communication with users by providing APMs that are clearly defined and presented in an unbiased and transparent way.
- **Executives and audit committees** might ask whether APMs are subject to sufficiently robust systems and processes.
- **Industry bodies** could step up and deliver sector-specific definitions of key metrics to enhance consistency and comparability.
- **Standard setters** could consider how GAAP itself could change to deliver information that addresses investor demands, and provide information that is reliable and relevant. To this end, the IASB is working on a research project on [Primary Financial Statements](#), focusing on the structure and content of the statement of profit or loss and OCI, including the possible requirement for a defined subtotal for operating profit and the use of APMs.

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.