



**Alternative Performance Measures – A Survey of their Use together
with Key Recommendations: An Update**

January 2015

MISSION STATEMENT

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EXECUTIVE SUMMARY

In its 2012 Paper, IAASA encouraged issuers, in their selection preparation and presentation of Alternative Performance Measures ('APMs') to:

- **explain the reason for each APM**
- **clearly define each APM**
- **explain the calculation of each APM**
- **reconcile each APM to the relevant IFRS-based measure**
- **include comparative amounts for each APM**
- **disclose all APMs in a single location**
- **avoid presenting APMs that detract from or conflict with IFRS-based financial statement measures**
- **avoid giving undue prominence to non-IFRS-based APMs**

IAASA has now undertaken an updated review of selected equity issuers use of APMs in their 2013 annual financial statements

This updated review found that:

- **the use of APMs amongst the selected equity issuers is universal**
- **certain issuers distinguish between “key” APMs and other APMs**
- **improvements are evident in a number of cases compared to the results of the 2012 study but there is still scope for further improvements in order to aid users’ understanding of the financial results**
- **differing definitions of apparently similar APMs are used by different issuers**
- **there is a tendency for issuers to “flatter” their results by the exclusion of items from performance measures**

IAASA reiterates its 2012 recommendations and invites issuers to redouble their efforts to comply in full with those recommendations to better meet users’ needs

SECTION 1 – BACKGROUND TO AND PURPOSE OF THE UPDATED REVIEW

1.1 Use of APMs

Most equity issuers within IAASA's financial reporting review remit¹ choose to present alternative performance measures ('APMs')² in their annual reports. APMs are used to analyse the performance, financial position and cash flows of a business and to highlight the key components of an issuer's results for users of financial statements.

APMs can be derived from the financial statements prepared under IFRS³ (the statutory financial statements) or other sources and typically use alternative methodologies to those that are required to be used under IFRS. Furthermore, some issuers report non-financial key performance measures, such as production or activity levels. For the purpose of this document, APMs are limited to measures which are derived from items reported in the financial statements.

Typically, though not exclusively, APMs are to be found in sections of the annual report outside of the financial statements, such as in the Chairman's Statement, Operating and Financial Review, Directors' Report or other similar reports. APMs are often quoted in preliminary results and other market and press announcements and attract significant attention from users.

When appropriately used, APMs can supplement the information provided by the financial statements and add quality and depth to users' understanding of the performance, financial position and cash flows of issuers. However, where APMs are improperly used they may:

- (a) inhibit users' ability to interpret the issuer's results;
- (b) present an unbalanced assessment of the performance, financial position or cash flows (e.g. focussing on the positive with insufficient reference to the bad news);
- (c) confuse the message reported by the financial statements; and
- (d) mislead users as to the performance, financial position or cash flows arising.

“Earnings before the bad stuff”

– “The Information GAAP”, article by Prof Stephen Young, *By All Accounts*, ICAEW, January 2014, page 21

1.2 IAASA 2012 survey and key messages

In 2012, IAASA undertook a desk-top survey of 20 equity issuers with financial year ends occurring mainly during the calendar year ending December 2011 on their use of APMs in annual reports. The purpose of that survey was to identify and describe the most common financial APMs presented in equity issuers' annual reports and to identify key recommendations which, if applied, should enhance users' understanding of the performance, financial position and cash flows and enable better comparability across issuers. The results of that survey together with key findings and recommendations were published in IAASA's Paper *Alternative Performance Measures – A Survey of their Use together with Key Recommendations* (November 2012)⁴.

A summary of the findings and of the key recommendations arising from that 2012 thematic examination is set out in Appendix III to this Paper.

¹ For the purposes of this document, reference to equity issuers is a reference to issuers applying IFRS as endorsed by the EU and falling within the scope of the EU Transparency Directive (EU Directive 2004/109/EC)

² Also referred to as non-GAAP financial measures or key performance indicators ('KPIs')

³ International Financial Reporting Standards

⁴ Available at <http://www.iaasa.ie/publications/APM2012.pdf>

1.3 Developments since 2012

Since the publication of that Paper in November 2012 IAASA has engaged directly with issuers on their use of APMs which has led to improvements in individual issuers' reporting of APMs.

Improvements in the use of APMs include issuers:

- agreeing to provide definitions of and/or enhanced definitions of APMs;
- agreeing to provide the rationale for and/or expanded rationale for their use of particular APMs; and
- Including APMs in a single place in their reports.

We continue to engage with issuers on their use of APMs.

In February 2014, ESMA issued its Consultation Paper *ESMA Guidelines on Alternative Performance Measures*⁵ ESMA intends to issue final Guidelines in 2015 with the objective of ensuring that issuers and EU accounting enforcers will make every effort to comply with them. ESMA's Consultation Paper proposed that the Guidelines:

- a) would apply to the presentation of APMs by issuers in publications such as financial statements, management reports and public disclosures issued under the requirements of the Market Abuse Directive;
- b) be aimed at promoting transparency on APMs used by issuers by ensuring their adherence to the general qualitative characteristics that enhance usefulness of financial information to their users;
- c) would contain principles to be followed by issuers who provide APMs in order to ensure their usefulness for the decision making process of users;
- d) should not impede the prompt disclosure of information to the market; and
- e) Are not to be applied to APMs that are disclosed in accordance with other applicable law that sets out specific requirements governing the determination of such measures.

The Guidelines would specify requirements regarding the definition, reconciliation, explanation, presentation comparability and consistency in the selection, calculation and presentation of APMs by issuers. It is expected that the Guidelines will have mandatory effect and as such it is hoped that they will remove any ambivalence of enforceability in this area.

1.4 Purpose of updated survey

Given the publication of IAASA's APM Paper in November 2012, the ESMA Consultation Paper in February 2014 and the continued interest of stakeholders in the use of APMs by issuer, IAASA has undertaken this follow-up thematic examination to assess the extent, if any, to which the use of APMs by issuers in Ireland has been modified in the past two years.

This Paper is primarily directed at the preparers of periodic financial statements of issuers falling within IAASA's financial statement review remit. However, users, preparers, auditors, and other stakeholders of the financial statements of entities not within IAASA's financial statement review remit may also find the Paper of interest.

1.5 Survey sample

This follow-up thematic survey covered a sample of ten annual financial reports of equity issuers from the 20 issuers reviewed as part of the 2012 survey. The sample objective was to cover a cross section of industry sectors and to review issuers ranging from the larger issuers in terms of market

⁵ Available at http://www.esma.europa.eu/system/files/esma-2014-175_cp_on_the_draft_guidelines_on_apms.pdf

capitalisation to smaller sized entities. In an effort to achieve comparability with IAASA's 2012 APM Paper, all ten annual financial reports of equity issuers selected for this follow-up thematic examination were also included in the original 2012 sample.

The ten annual financial statements selected for inclusion in this review are set out in Appendix II.

The review comprised a desk top review of the published annual financial statements to evaluate the extent, if any, to which the selected issuers appear to be implementing the recommendations included in IAASA's 2012 APM Paper. Additional information and explanations was not sought from the selected issuers.

1.6 Enforceability of rules

Issuers' financial statements are subject to particular rules and have to be prepared in accordance with a prescribed financial reporting framework (IFRS for Irish equity issuers). While the use of APMs is not the subject of a financial reporting pronouncement, the [Transparency \(Directive 2004/109/EC\) Regulations \('the Regulations'\)](#) require an issuer's management report to include a fair review of the development and performance of the business and the position of the issuer and the undertakings included in the consolidation taken as a whole⁶. The [Transparency Rules \(November 2012\)](#) issued by the Central Bank of Ireland give further guidance on the management reports in this regard and the relevant extracts are contained in Appendix I to this Paper. IAASA is the designated Authority responsible for examining whether the annual and half-yearly financial reports of issuers coming within scope of the [Transparency Directive](#)⁷, as transposed into Irish law, have been drawn up in accordance with the relevant reporting framework. This includes certain limited aspects in relation to the management report as outlined above and it is in this context that IAASA has engaged with certain issuers as outlined further in section 1.3. In addition and as further elaborated upon in section 1.3 below, ESMA⁸ will be issuing guidelines regarding the presentation of APMs which are expected to be mandatory.

⁶ Regulation 5(4)(c)(ii)

⁷ Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC; available at http://www.iaasa.eu/legislation/Transparency_Directive.pdf

⁸ European Securities and Markets Authority

SECTION 2 – KEY MESSAGES AND FINDINGS

2.1 Key messages

Issuers included in the sample presented a range of APMs in their reports. While the APMs presented covered revenue, earnings, EPS, cash flows, shareholder return and other measures, within these broad categories, there was a widely diverse range of individual APMs presented. Appendix V to this Paper lists the range of APMs presented by issuers included in the sample. In some instances, similarly titled measures were defined differently as between different issuers.

Certain issuers made a distinction between what they termed “key” APMs and other APMs and provided more expansive explanation as to their use of “key” APMs. However, the majority of issuers did not make such a distinction in presenting APMs.

The diversity of APMs and the varying definitions used by issuers mitigates against comparability of APMs between issuers. Consequently, users of issuers’ reports should exercise caution in comparing reported APMs across issuers.

“Financial reports present opportunities to distort a company’s true financial position through managerial discretion, such as the use of non-GAAP measures This skews the comparability of company financial reports, complicating investor decisions”

- *Credit Week, Standard & Poor’s Ratings Services, Vol. 34, No. 8, 26 February 2014, page 13*

2.2 Summary of findings

IAASA’s 2012 APM Paper encouraged directors to give further consideration to their judgements concerning the preparation and presentation of APMs given the attention these command from users.

Specifically, where APMs are presented, the directors were strongly encouraged to ensure their appropriate selection, preparation and presentation and to apply the following recommendations:

- a) explain the reason for the presentation of each APM;
- b) provide a clear definition of each APM used;
- c) Provide an explanation of the basis for the calculation of each APM including details as to why selected APMs exclude certain items. The reasons for the adjustments should be clearly explained (i.e. how the underlying residual figure is key to understanding the performance or financial position or cash flows);
- d) provide a reconciliation of each APM to the relevant IFRS data, where applicable;
- e) include a comparative measure for all reported APMs;
- f) disclose all APMs used within a single location in the annual report where possible, making it easier for users to assess the performance measures as a whole;
- g) avoid the preparation and presentation of APMs in a manner that has the potential to detract from, or conflict with, the information provided in the financial statements; and
- h) Avoid the presentation of APMs in a manner that gives them inappropriate prominence over the IFRS measures.

“Although EBITDA is a key part of the financial information many companies present, it is a non-GAAP measure, and different companies approach calculating it differently, which skews comparability”

- *Credit Week*, Standard & Poor’s Ratings Services, Vol. 34, No. 8, 26 February 2014, page 17

2012 recommendation	2014 evaluation
Explain the reason for the presentation of each APM	<p>Issuers varied in the extent to which they explained the reason for the presentation of each APM:</p> <ul style="list-style-type: none"> • in four instances, the issuer disclosed the reason for the use of each “key” APM; • in two instances, the issuer disclosed the reason for the use of certain, but not all, of its “key” APMs; and • in four instances, no disclosure of the reason was provided
Provide a clear definition of each APM used	<p>Again, the selected issuers demonstrated variability in the extent to which they complied with this recommendation:</p> <ul style="list-style-type: none"> • in five instances, a clear definition of each “key” APM was provided; • in three instances, definitions were provided for some, but not all, “key” APMs; and • in two instances, definitions were not provided
Provide an explanation of the basis for the calculation of each APM including details as to why selected APMs exclude certain items. The reasons for the adjustments should be clearly explained (i.e. how the underlying residual figure is key to understanding the performance or financial position or cash flows)	<p>Six of the ten selected issuers complied with this recommendation through either the definition provided or through a combination of the definition and a numerical reconciliation.</p> <p>Three issuers complied with this recommendation in some but not all instances; however, of these three, one did not provide details as to why selected APMs exclude certain items.</p> <p>One issuer did not provide an explanation of the basis for the calculation of each APM</p>
Provide a reconciliation of each APM to the relevant IFRS data, where applicable	<p>Eight issuers complied or substantially complied with this recommendation.</p> <p>One issuer did not comply with this recommendation.</p> <p>The tenth issuer did not present any non-IFRS based APMs</p>
Include a comparative measure for all reported	All ten selected equity issuers presented

APMs;	comparative amounts for APMs
Disclose all APMs used within a single location in the annual report where possible, making it easier for users to assess the performance measures as a whole	<p>Eight issuers complied or substantially complied with this recommendation.</p> <p>The remaining two issuers presented APMs in various locations in their reports</p>
Avoid the preparation and presentation of APMs in a manner that has the potential to detract from, or conflict with, the information provided in the financial statements	<p>The preparation and presentation of APMs in a manner that has the potential to detract from, or conflict with, the information provided in the financial statements requires the exercise of judgement.</p> <p>In certain instances it was difficult to understand issuers' rationale regarding the preparation and presentation of APMs (e.g. one issuer appears to focus on Operating Profit and EBITDA measures in consequence of which "below the line" items such as exceptional charges were de-emphasised; another issuer presented seven "key" APMs of which six were non-IFRS based measures)</p>
Avoid the presentation of APMs in a manner that gives them inappropriate prominence over the IFRS measures	While implementation of this recommendation requires the exercise of management judgement, instances were identified where issuers appear to emphasise "underlying" and "adjusted" APMs to the detriment of IFRS-based APMs. Certain issuers presented significantly more non-IFRS based measures as compared to IFRS based measures

Extracts from the Central Bank of Ireland's Transparency Rules (November 2012)

6.0.1 Guidance regarding Content of Annual Management Report

The financial key performance indicators referred to in paragraph 2(i) of Rule 6.1 are factors by reference to which the development, performance or position of the issuer's business can be measured effectively.

Rule 6.1 – Content of Annual Management Report

The annual management report referred to in Regulation 4(3)(b) must contain:

- (a) a fair review of the issuer's business; and
- (b) A description of the principal risks and uncertainties facing the issuer.

The review required by (a) above must:

- (1) be a balanced and comprehensive analysis of:
 - (i) the development and performance of the issuer's business during the financial year; and
 - (ii) the position of the issuer's business at the end of that year, consistent with the size and complexity of the business;
- (2) include, to the extent necessary for an understanding of the development, performance or position of the issuer's business:
 - (i) analysis using financial key performance indicators (see Guidance 6.0.1 above); and
 - (ii) where appropriate, analysis using other key performance indicators including information relating to environmental matters and employee matters; and
- (3) Include references to, and additional explanations of, amounts included in the issuer's annual financial statements, where appropriate.
- (4)

Equity issuers under IAASA's financial reporting examination remit selected for inclusion in this follow-up thematic examination

	Issuer	Reporting date
1.	Aer Lingus Group plc	31 December 2013
2.	C&C Group plc	28 February 2014
3.	CRH plc	31 December 2013
4.	FBD Holdings plc	31 December 2013
5.	Glanbia plc	4 January 2014
6.	Grafton Group plc	31 December 2013
7.	IFG Group plc	31 December 2013
8.	Kerry Group plc	31 December 2013
9.	Kingspan Group plc	31 December 2013
10.	Smurfit Kappa Group plc	31 December 2013

Summary of findings and key recommendations arising from IAASA's 2012 APM thematic examination

Summary of findings

The most common APMs presented by the equity issuers included in the survey were:

- (a) EBITDA and other variations of earnings;
- (b) operating profit/results of operating activities;
- (c) free cash flow;
- (d) net debt/gross debt;
- (e) adjusted earnings per share ('adjusted EPS');
- (f) return on capital employed; and
- (g) Revenue growth.

In respect of the EBITDA earnings measure, there was variation across issuers in respect of the items included or excluded from the earnings component, although there was, in most cases, no explanation as to why adjustment was considered necessary. A majority of issuers did not reconcile the IFRS earnings line item to the earnings used in the EBITDA measure. A majority of the items for which earnings were adjusted were expenditure, rather than income items.

All of the issuers surveyed reported some form of 'operating profit' as an APM. Net debt was a popular APM, with 80% of the issuers surveyed reporting the measure. Free cash flow was a less used, although still popular, APM. With regard to the latter two APMs, it was found that the measure was often not explained and that the basis of calculation included different combinations of a range of items. Similarly, in the case of adjusted EPS, most issuers did not disclose the reasons for the adjustments.

In respect of return on capital employed, there were a variety of interpretations regarding both the components of the profit measure and the measure of capital employed used to calculate the percentage.

Only a minority of issuers surveyed identified the various different components of revenue growth, including volume increases, price growth, acquisition related revenue growth and the effects of currency movements.

Key recommendations

In preparing future annual reports, directors are encouraged to give further consideration to their judgements concerning the preparation and presentation of APMs given the attention these command from users. Specifically, where APMs are presented, the directors are strongly encouraged to ensure their appropriate selection, preparation and presentation and to apply the following recommendations:

- (a) explain the reason for the presentation of each APM;
- (b) provide a clear definition of each APM used;
- (c) Provide an explanation of the basis for the calculation of each APM including details as to why selected APMs exclude certain items. The reasons for the adjustments should be clearly explained (i.e. how the underlying residual figure is key to understanding the performance or financial position or cash flows);

Key recommendations

- (d) provide a reconciliation of each APM to the relevant IFRS data, where applicable;
- (e) include a comparative measure for all reported APMs;
- (f) disclose all APMs used within a single location in the annual report where possible, making it easier for users to assess the performance measures as a whole;
- (g) avoid the preparation and presentation of APMs in a manner that has the potential to detract from, or conflict with, the information provided in the financial statements; and
- (h) Avoid the presentation of APMs in a manner that gives them inappropriate prominence over the IFRS measures.

Definitions

Abbreviation	Explanation
APM	Alternative performance measure; also referred to as key performance indicator (KPI)
CESR	Committee of European Securities Regulators
ESMA	European Securities and Markets Authority
EU	European Union
GAAP	Generally Accepted accounting practice
IFRS	International Financial Reporting Standard
KPI	Key performance indicator
SEC	Securities and Exchange Commission (US)

Range of APMs used by issuers

Category of APM	Examples
Revenue measures	
	Total revenue
	Sales growth
	Gross premium written
	Constant currency revenue
Earnings measures	
	Operating profit
	Operating earnings
	Underlying operating profit
	Adjusted operating profit
	Operating margin
	Operating profit margin
	Trading profit
	Trading margin
	Trading profit margin
	Earnings before Interest, Tax, Depreciation and Amortisation (EBITDA)
	EBITDA margin
	Earnings before Interest, Tax and Amortisation (EBITA)
	EBITA margin
	Earnings before Interest, Tax, Depreciation, Amortisation, Fleet Rentals and Net Exceptional Items (EBITDAR)
	Underlying Profit before Tax (PBT)
Earnings per share (EPS) measures	
	Adjusted EPS
	Pre-exceptional EPS
	Adjusted diluted EPS
	Underlying EPS
	Basic EPS growth
	Adjusted EPS growth
Cash flow based measures	
	Free cash flow
	Operating cash flow
	Free cash flow conversion ration
	Gross cash
	Gross debt
	Net cash/(debt)
	Cash flow return on investment
Shareholder return measures	
	Shareholder returns
	Total shareholder return
	Return on equity
	Return on average equity
	Progressive dividend/return to shareholders
Other measures	

Category of APM	Examples
	Sales and marketing as % of Net Sales Value
	Net debt/EBITDA
	Net debt/Adjusted EBITDA
	Dividend cover
	Return on capital employed
	Return on average capital employed
	EBITDA/Net interest cover
	Underlying EBITDA interest cover
	Capital turn
	Net asset value per share
	Return on net assets
	Cash flow return on investment