2017

ALTERNATIVE PERFORMANCE MEASURES – THEMATIC SURVEY

SEPTEMBER 2017

IRISH AUDITING AND ACCOUNTING SUPERVISORY AUTHORITY

MISSION

To contribute to Ireland having a strong regulatory environment in which to do business by supervising and promoting high quality financial reporting, auditing and effective regulation of the accounting profession in the public interest

CONTENTS

1. INTRODUCTION

IAASA, Ireland's accounting enforcer, has responsibility for the examination and enforcement of certain listed entities' periodic financial reporting ('issuers').

IAASA has performed a desk top survey on the range of Alternative Performance Measures ('APMs') that issuers included in their 2016/17 financial reports with the objective of assessing the extent of compliance by issuers with the **European Securities and Markets Authority** ('ESMA') ***Guidelines on Alternative Performance Measures*** ('ESMA APM Guidelines').

Section 3 of this Paper presents the results of that desk top survey.

Section 4 sets out the IAASA examination activity relating to the ESMA APM Guidelines following our annual examination programme.

The ESMA APM Guidelines are in force since July 2016 and apply to issuers with securities traded on regulated markets and persons responsible for drawing up a prospectus.

An Alternative Performance Measure (APM') is a financial measure of historical or future financial performance, financial position, or cash flows. However, APMs disclosed within the financial statements themselves are outside the scope of the ESMA APM Guidelines because such measures are already governed by financial reporting standards.

Compliance with the ESMA APM Guidelines is supervised by competent authorities and other bodies in the EU with responsibilities under the Transparency Directive (in Ireland's case, IAASA), Prospectus Directive or Market Abuse Regulation (in Ireland's case, the Central Bank of Ireland).

As the accounting enforcer in Ireland, IAASA has engaged extensively with a number of issuers in Ireland on this topic in the past.

IAASA has published the results of its previous surveys on the use of APMs by Irish equity issuers in two Papers, namely:

- *Alternative Performance Measures – A Survey of their Use together with Key Recommendations* (November 2012); and

- *Alternative Performance Measures – A Survey of their Use together with Key Recommendations: An Update* (January 2015).

IAASA's survey is based on the 2016/17 annual financial reports published by all twenty eight equity issuers falling within IAASA's financial reporting review remit together with Allied Irish Banks plc, a debt issuer as at 31 December 2016 (see Appendix 4).

Readers should note that, in undertaking this survey, additional information was not sought from the selected issuers.

2. PURPOSES OF THE SURVEY

The primary purposes of this survey are:

(a) to determine the range of APMs that are used by issuers since the introduction of the ESMA APM Guidelines;

(b) to determine the type of APM information disclosed by issuers; and

(c) to provide preparers, auditors and users of financial statements with information to encourage discussion and stimulate debate on the nature of APMs used by issuers.

3. APM SURVEY RESULTS

3.1 Common APMs used

IAASA's desk top survey identified 126 different APMs used by issuers in their 2016/17 annual financial reports. Of the 126 APMs that were identified, 42 would appear to be adjusted profit measures. The more common APMs used by issuers were:

(a) EBITDA – used by fourteen issuers;

(b) Free cash flow – used by nine issuers;

(c) Adjusted earnings per share – used by eight issuers;

(d) Net debt – used by seven issuers; and

(e) Return on capital employed – used by six issuers.

It is also interesting to note that twenty six of the twenty nine issuers whose reports were included in this survey used adjusted profit measures and one issuer used only adjusted profit measures in the prior year to exclude an exceptional profit on the disposal of an investment. Two issuers did not use or present any APMs in their most recently published annual financial reports. Appendix 1 to this Paper lists the 126 APMs which were presented by issuers in their most recent annual financial reports.

3.2 Issuers who disclosed the most APMs

IAASA's survey identified that Kerry Group plc disclosed the largest number of APMs with twenty one measures. Both UDG Healthcare plc and DCC plc disclosed nineteen APMs and Hibernia REIT plc disclosed fifteen APMs.

3.3 Disclosure and presentation of APMs

Paragraphs 20, 21 and 22 of the ESMA APM Guidelines state that:

'20 *Issuers or persons responsible for the prospectus should define the APMs used and their components as well as the basis of calculation adopted, including details of any material hypotheses or assumptions used. Issuers or persons responsible for the prospectus should also indicate whether the APM or any of its components relate to the (expected) performance of the past or future reporting period.*

21 *Issuers or persons responsible for the prospectus should disclose the definitions of all APMs used, in a clear and readable way.*

22 *APMs disclosed should be given meaningful labels reflecting their content and basis of calculation in order to avoid conveying misleading messages to users …'*

Certain issuers did not provide the information required by paragraphs 20 to 22 of the ESMA APM guidelines. It is noted that:

(a) three issuers did not provide a separate section within their financial reports for their APM information; as a result, it is difficult to determine whether or not those issuers considered the ESMA APM Guidelines in full as not all of the definitions, reconciliations and comparatives for APMs had been provided;

(b) three issuers were not consistent in their use of the name and label of some APMs. For example, one issuer used the term *'like for like revenue growth'* in the Chairman's Report, while in the APM disclosures the term '*like for like sales growth*' was disclosed. Another issuer used the term EBITDA in the Chairman's Report while it would appear that the term 'Adjusted EBITDA' should have been used; and

(c) seven issuers presented measures in their annual financial reports which, in IAASA's view, would appear to be APMs; however, those issuers did not include those measures within their APM disclosures as the definitions, reconciliations or comparatives were not presented.

Examples of measures presented by issuers but not included within the APM disclosures were:

(a) Return on Capital Employed;

(b) Operating Margin;

(c) Total Shareholder Return;

(d) Gearing;

(e) Underlying Revenue Growth;

(f) EBITA Margin; and

(g) Net Debt.

3.4 Reconciliations of APMs

Paragraphs 26 and 27 of the ESMA APM Guidelines state that:

> '26 *A reconciliation of the APM to the most directly reconcilable line item, subtotal or total presented in the financial statements of the corresponding period should be disclosed, separately identifying and explaining the material reconciling items.*
>
> *27 Issuers or persons responsible for the prospectus should also present the most directly reconcilable line item, subtotal or total presented in the financial statements for that specific APM…*'

Certain issuers did not provide reconciliations as required by paragraphs 26 and 27 of the ESMA APM Guidelines. It is noted that:

(a) for each of the three issuers which did not have a separate section for APMs included in their annual report, it appears that no APM reconciliations were provided; and

(b) fourteen issuers did not provide reconciliations for all of the APMs presented in their annual reports. For example, some issuers did not provide reconciliations for the constant currency measures, return on average capital employed and operating profit measures.

3.5 Prominence and presentation of APMs

Paragraphs 35 and 36 of the ESMA APM Guidelines state that:

> '35 *APMs should not be displayed with more prominence, emphasis or authority than measures directly stemming from financial statements.*
>
> *36 Presentation of APMs should not distract from the presentation of the measures directly stemming from financial statements ….*'

IAASA's survey noted that nine issuers discussed the APM measures in narrative disclosures in, for example, the Chairman's Report or Chief Executive Review. However, it appears that there was no discussion or reference to relevant IFRS measures or to measures directly stemming from the financial statements.

In its document titled ***Questions and Answers – ESMA Guidelines on Alternative Performance Measures (APMs)*** (ESMA Q&A Document on APMs) ESMA includes further guidance on the concept of prominence. Question 9 from the aforementioned document is included in Appendix 2 to this Paper.

3.6 Comparatives

Paragraphs 37 and 38 of the ESMA APM Guidelines state that:

> '37 *APMs should be accompanied by comparatives for the corresponding previous periods. In situations where APMs relate to forecasts or estimations, the comparatives should be in relation to the last historical information available.*
>
> *38 Issuers or persons responsible for the prospectus should present reconciliations for all comparatives presented …*'

Issuers tend to include APM measures in either the Chairman's Statement, the Chief Executive's Review, the Operating and Financial Review and on the first page of the annual report, which is typically titled "Highlights of the Financial Year".

IAASA's survey identified twenty one issuers who did not provide a comparative for all APMs presented. IAASA noted that certain issuers were not consistent with the presentation of APM comparatives, for example, issuers may have presented comparatives for APMs in the "Highlights of the Financial Year" but no comparatives were presented for APMs in the Operating and Financial Review. In most cases, issuers had included a footnote referring readers to the location where further information on APMs could be obtained, for example, in the Glossary at the back of the annual report. Such APM disclosures included the relevant APM comparative information.

ESMA included a Question & Answer in its **ESMA Q&A Document on APMs** which provides further guidance on the compliance by reference principle. Question 10, together with the answer outlines the limits for compliance by reference and it clarifies that issuers cannot use the compliance by reference in order to avoid the presentation of comparatives. In this regard, IAASA considers that when an issuer presents an APM, a comparative for the corresponding prior period must be presented. Issuers cannot refer readers to an APM section to obtain information on APM comparatives. Question 10 from the **ESMA Q&A Document on APMs** is included in Appendix 3 to this Paper.

3.7 Location of APMs definitions and reconciliations

With regard to the location of the APM information within each issuer's respective annual report, IAASA's desk top survey noted that:

(a) twelve issuers included their APM definitions and reconciliations in either a glossary or as supplementary information at the back of their respective annual reports;

(b) seven issuers included their APMs information within the Strategic Report or the Operating and Financial Review;

(c) three issuers had split their presentation of their APM information between both the supplementary information at the back of the report and within the Strategic Report at the front end of the report;

(d) two issuers included their APM information within a note to the financial statements;

(e) three issuers did not provide a separate section within their reports for APM information; and

(f) two issuers did not present or use any APMs.

4. IAASA ACTIVITY RELATING TO THE ESMA APM GUIDELINES

As part of its programme of examining the annual financial statements of issuers, IAASA has engaged with a number issuers regarding the ESMA APM Guidelines.

This section summarises the outcome of such engagement. As part of our annual examination programme, to date the ESMA APM Guidelines have been raised with seven equity issuers. However, at the time of writing, the examinations of two issuers have not been completed and, consequently, details of those two cases have not been included in the Table below.

TABLE – IAASA ACTIVITY RELATING TO ESMA APM GUIDELINES

	Matter raised	Outcome
1.	Directors' rationale for not including reconciliations for the following APMs in their annual report: (a) Return on Average Equity (ROAE); (b) Return on Average Capital Employed (ROACE); (c) Cash Flow Return on Investment (CFROI); and (d) the effects of exchange rates on the growth in adjusted earnings per share for which the increase in constant currency is quoted in the management commentary.	The directors provided the reconciliations to IAASA. In addition, the directors provided undertakings to include reconciliations for the APMs in future periodic financial reports.
2.	Definition of adjusted earnings – directors' rationale for excluding all amortisation charges on intangible assets not acquired by acquisition (e.g. software costs) in the calculation of the adjusted earnings per share.	The directors provided an undertaking to amend the calculation of the adjusted earnings per share in future periodic financial reports.
3.	Directors' view as to whether or not the requirements of paragraph 37 of the ESMA APM Guidelines relating to comparatives were complied with in full.	The directors indicated that they believed that the cross-referencing to the Glossary, which included the comparatives, provided the appropriate level of detail. However, the directors accepted that further improvements were possible and IAASA's concerns would be addressed in future periodic financial reports. IAASA indicated that it was its expectation that the directors would continue to consider the principles set out in the ESMA APM Guidelines and to further improve the disclosures in future periodic financial reports.
4.	Directors of two issuers were requested to outline their rationale for not including constant currency reconciliations in their annual report.	The directors of the two issuers provided the constant currency reconciliations to IAASA. In addition, the directors of the two issuers also provided undertakings to include the

		constant currency reconciliations in their respective future periodic financial reports.
5.	Directors' rationale for not including definitions for certain APMs.	The directors provided an undertaking to include definitions for APMs in future periodic financial reports.

5. CONCLUSIONS

IAASA will continue to focus on and engage with issuers in relation to:

(a) the directors' rationale for not including definitions, reconciliations and comparatives for APMs presented in periodic financial reports;

(b) the reasons why certain items have been excluded from adjusted earnings measures;

(c) the directors' rationale for not considering certain measures to be APMs within the scope of the ESMA APM Guidelines;

(d) the directors' rationale for not including a discussion or reference to IFRS measures when discussing APMs; and

(e) the reasons and explanations for APMs, which are redefined or not used by the directors in subsequent periodic financial reports [paragraphs 41 and 42 of the ESMA APM Guidelines refer].

APPENDIX 1

LIST OF APMS DISCLOSED IN ISSUERS' FINANCIAL STATEMENTS

	APM		APM
1	Adjusted Basic EPRA Earnings Per Share	64	Gross Profit
2	Adjusted Cost Income Ratio	65	Gross Yield
3	Adjusted Diluted Earnings Per Share	66	Interest Cover
4	Adjusted Earnings	67	Investment Return
5	Adjusted Earnings Per Share	68	Like For Like Revenue
6	Adjusted Earnings Per Share Growth	69	Liquidity Coverage Ratio
7	Adjusted EBITDA	70	Loan To Deposit Ratio
8	Adjusted EPRA Cost Ratio Excluding Vacancy Costs	71	Loss Ratio
9	Adjusted EPRA Cost Ratio Including Vacancy Costs	72	Market Capitalisation
10	Adjusted Net Interest	73	Mining HMC Produced
11	Adjusted Operating Margin	74	Net Asset Value Per Share
12	Adjusted Operating Profit (Continuing)	75	Net Capital Expenditure
13	Adjusted Operating Profit (Discontinued)	76	Net Cash/(Debt) To EBITDA
14	Adjusted Operating Profit/EBITA Before Property Profit	77	Net Cash/(Net Debt)
15	Adjusted Operating Profit/EBITA Margin Before Property Profit	78	Net Debt
16	Adjusted Profit After Tax (Continuing)	79	Net Debt To EBITDA
17	Adjusted Profit Before Tax (Continuing)	80	Net Debt To Total Equity
18	Adjusted Profit Before Tax (Discontinued)	81	Net Interest
19	Annualised EBITDA	82	Net Interest Margin
20	Average Monthly Rent	83	Net Interest Margin (Excluding Liabilities Guarantee Scheme)
21	Capital Costs	84	Net Operating Margin (Continuing)
22	Capital Turn	85	Net Revenue Continuing
23	Cash Conversion Ratio	86	Net Stable Funding Ratio
24	Cash Flow	87	Net Working Capital
25	Cash Flow Return On Investment (CFROI)	88	Non-Trading Items
26	Cash Operating Cost Per Tonne	89	Occupancy
27	Combined Operating Ratio	90	Operating Cash Flow
28	Committed Acquisition Expenditure	91	Operating Margin
29	Common Equity Tier 1 Ratio	92	Operating Profit
30	Constant Currency	93	Operating Profit Before Exceptional Items
31	Cost Income Ratio	94	Operating Profit Before Impairment Charges
32	Dividend Cover	95	Operating Profit Before Net Exceptionals And Amortisation Of Intangible Asset (EBITA)
33	EBIT	96	Operating Profit Before Net Exceptionals, Depreciation And Amortisation Of Intangible Asset (EBITDA)
34	EBITA	97	Organic EBITDA
35	EBITA Interest Cover	98	Organic Operating Profit
36	EBITA Margin	99	Organic Revenue
37	EBITDA (Continuing)	100	Other External Charges
38	EBITDA (Discontinued)	101	Other Operating Charges
39	EBITDA Margin %	102	Pre-Exceptional Earnings Per Share
40	EBITDA Net Interest Cover	103	Profit Before Tax
41	EBITDAR	104	Return On Assets

	APM		APM
42	EBITDAR Margin	**105**	Return On Average Capital Employed (ROACE)
43	Effective Tax Rate (Continuing)	**106**	Return On Average Equity (ROAE)
44	Enterprise Resource Planning Intangible Asset	**107**	Return On Capital Employed (ROCE)
45	Enterprise Value	**108**	Return On Invested Capital (ROIC)
46	EPRA Cost Ratio	**109**	Return On Net Assets
47	EPRA Cost Ratio Excluding Vacancy Costs	**110**	Revenue (Wholly Owned Revenue)
48	EPRA Cost Ratio Including Vacancy Costs	**111**	Sales Growth
49	EPRA Diluted Earnings Per Share	**112**	Total Group
50	EPRA Earnings Per Share	**113**	Total Return
51	EPRA NAV Per Share	**114**	Total Shareholder Return
52	EPRA Net Initial Yield	**115**	Trading Margin
53	EPRA NNAV	**116**	Trading Margin Expansion
54	EPRA Topped Up Net Initial Yield	**117**	Trading Profit
55	EPRA Vacancy Rate	**118**	Underlying EBITDA
56	Estimated Rental Value	**119**	Underlying Free Cash Flow
57	Expense Ratio	**120**	Underlying Net Profit
58	Financial Ratios	**121**	Underlying Operating Profit
59	Finished Products Produced	**122**	Underlying Profit Before Tax
60	Free Cash Flow	**123**	Underlying Profit For The Year
61	Free Cash Flow (After Interest And Tax Payments)	**124**	Volume Growth
62	Gearing	**125**	Working Capital (Continuing)
63	Gross New Lending	**126**	Working Capital Days

APPENDIX 2

QUESTIONS AND ANSWERS ESMA GUIDELINES ON ALTERNATIVE PERFORMANCE MEASURES (APMS) – QUESTION 9

Question 9: Concept of Prominence; Paragraph 35 and 36 of the APM Guidelines.

Question: *How should an issuer apply the principle of "prominence" as included in the APMs Guidelines?*

Answer: *As the APMs Guidelines do not define the concept of prominence, issuers should use their judgement when complying with this principle. This judgment should be made on a case-by-case basis depending on the documents where the APMs are included.*

The notion of prominence is, in essence, qualitative and not merely quantitative. Therefore, counting the number of APMs and measures directly stemming from financial statements may not suffice. When applying its judgement, the issuer should ensure that the measures stemming from financial statements are not displayed with less prominence, emphasis or authority than APMs.

The following factors, among others, could help issuers when exercising their judgement:

- *Attention paid to APMs in comparison with measures directly stemming from financial statements;*
- *Location of APMs within the document;*
- *Frequency of use;*
- *Use of bold letters, font size, italic;*
- *Length of analysis of APMs.*

The following illustrative examples may help understand disclosure of APMs being more prominent than disclosure of measures stemming directly from financial statements:

- *Presenting an analysis of the income statement only with APMs;*
- *Omitting comparable measures stemming directly from financial statements in an earnings result release headline or in their key messages;*
- *Presenting an APM using a style of presentation (e.g. bold, font size) that overly emphasizes the APM used over the comparable measure stemming directly from financial statements;*
- *Presenting an APM significantly before the most directly comparable measure directly stemming from financial statements (e.g. including the APM in the 1st page of a document and the comparable measure/figure directly stemming from financial statements in the last page);*
- *Describing an APM as, for example "record performance" or "exceptional" without at least an equally prominent descriptive characterization of the comparable measure directly stemming from financial statements;*
- *Providing tabular disclosure of APMs without (i) preceding/accompanying it with an equally prominent tabular disclosure of the comparable measures stemming from financial statements or (ii) including the comparable measures stemming from financial statements in the same table;*
- *Providing a discussion and/or analysis of an APM without any reference to the comparable measure/figure stemming directly from financial statements.*

APPENDIX 3

QUESTIONS AND ANSWERS ESMA GUIDELINES ON ALTERNATIVE PERFORMANCE MEASURES (APMS) – QUESTION 10

Question 10: Compliance by reference; Paragraph 45 and 46 of the APM Guidelines (not applicable to prospectuses which are covered by a separate regime)

Question: *What are the limits for the compliance by reference principle included in paragraph 45 of the APMs Guidelines?*

Answer: *Paragraphs 45 and 46 provide a practical relief to issuers who may comply with the principles included in the APMs Guidelines if they include a direct reference to other documents previously published which contain the disclosures required by the APMs Guidelines.*

Issuers may use the compliance by reference in order to avoid repetition of information in regulated information documents (e.g. ad-hoc disclosures presented in accordance with article 17 of MAR). However, the reference principle cannot be used when complying with the following requirements:

- *Comparatives (paragraph 46 of the APMs Guidelines)*
- *Meaningful labels to the APMs used (paragraph 22 of the APMs Guidelines)*
- *Prominence and presentation of APMs (paragraph 35 and 36 of the APMs Guidelines)*
- *Consistency (Paragraph 41 of the APMs Guidelines – however, the explanations required therein may be complied with by reference).*

APPENDIX 4

ISSUERS INCLUDED IN THIS SURVEY

	Issuer	Report
1	Allied Irish Banks plc	31 December 2016
2	Aminex plc	31 December 2016
3	Aryzta AG	31 July 2016
4	Bank of Ireland	31 December 2016
5	C&C Group plc	28 February 2017
6	Cairn Homes plc	31 December 2016
7	CRH plc	31 December 2016
8	Dalata Hotel Group plc	31 December 2016
9	Datalex plc	31 December 2016
10	DCC plc	31 March 2017
11	FBD Holdings plc	31 December 2016
12	Glanbia plc	31 December 2016
13	Grafton Group plc	31 December 2016
14	Green REIT plc	30 June 2016
15	Greencore Group plc	30 September 2016
16	Hibernia REIT plc	31 March 2017
17	IFG Group plc	31 December 2016
18	Independent News & Media plc	31 December 2016
19	Irish Continental Group plc	31 December 2016
20	Irish Residential Properties REIT plc	31 December 2016
21	Kenmare Resources plc	31 December 2016
22	Kerry Group plc	31 December 2016
23	Kingspan Group plc	31 December 2016
24	Mainstay Medical International plc	31 December 2016
25	Paddy Power Betfair plc	31 December 2016
26	Permanent TSB Group Holdings plc	31 December 2016
27	Ryanair Holdings plc	31 March 2017
28	Smurfit Kappa Group plc	31 December 2016
29	UDG Healthcare plc	30 September 2016