The 100 Group

Financial Reporting Committee

Steven Maijoor
Chairman
European Securities and Markets Authority
103 Rue de Grenelle
75007 Paris
FRANCE

12 May 2014

Dear Mr Maijoor

ESMA Consultation Paper: Guidelines on Alternative Performance Measures

We welcome the opportunity to comment on the Consultation Paper.

<u>Who we are</u>

The 100 Group of Finance Directors represents the views of the finance directors of FTSE 100 and several large UK private companies. Our member companies represent almost 90% of the market capitalisation of the UK FTSE 100 Index. Our aim is to contribute positively to the development of UK and international policy and practice on matters that affect our businesses, including taxation, financial reporting, corporate governance and capital market regulation. Whilst this letter expresses the views of The 100 Group of Finance Directors as a whole, those views are not necessarily those of our individual members or their respective employers.

<u>Our views</u>

We set out in the Appendix our responses to the specific questions that are included in the Consultation Paper. We summarise our views below.

<u>APMs enhance communication</u>

We consider that the primary purpose of financial statements is to communicate to investors, lenders and other stakeholders the results of management's stewardship of the resources entrusted to it. We believe that the use of Alternative Performance Measures ('APMs') supports this communication objective because they can provide useful information about the performance of businesses to stakeholders that sometimes is not easily accessible in financial statements prepared under IFRS.

Both the legal requirements of the Strategic Report in the UK and the Framework for Integrated Reporting published by the International Integrated Reporting Council encourage companies to communicate clearly their strategy and performance. We believe that ESMA's proposals as they stand would hinder the ability of companies to do so and it is with this in mind that we suggest in this comment letter a number of changes to the proposals.

We appreciate that ESMA seeks only to improve the guidelines on the definition and presentation of APMs and does not seek to prohibit the use of APMs in financial statements. We would strongly oppose any move to do so.

We support many of the principles

We support many of the principles contained in the [draft] guidelines, including that APMs should be clearly defined, used consistently from one period to another (unless change is justified) and reconciled to the nearest equivalent measure presented in the financial statements.

We have considerable concerns, however, with regard to three particular aspects of the [draft] guidelines. Specifically, we consider that: (a) the proposed scope of the guidelines is too wide; (b) the proposed definition of APMs is too wide; and (c) that the proposal to require APMs to be presented with lesser prominence, emphasis or authority than measures directly stemming from financial statements is unacceptable. We summarise our views in each of these areas in the following paragraphs.

Proposed scope of the guidelines is too wide

We believe that the proposed scope of the guidelines is too wide. We agree that guidelines should apply to APMs used in annual reports and in half-yearly reports and interim management statements issued under the Transparency Directive. We consider, however, that the reference to "all other documents containing regulated information" is unclear and seems likely to be very broad in scope as it would extend beyond documents issued under the Transparency Directive. We suggest a solution to this in our answer to Question 2.

Definition of APMs is too wide

ESMA considers APMs to be "any measure of historical, current or future performance, which relates to the financial position, comprehensive income or cash flows, other than a measure defined by the applicable financial reporting framework". IFRS is a principles-based accounting framework that contains relatively few defined measures and requires the presentation of relatively few sub-totals and totals in financial statements. IFRS permits additional line items, headings and sub-totals to be presented on the face of the financial statements where such presentation is considered to be relevant to an understanding of the issuer's financial performance or position. As such additional line items, headings and sub-totals are not strictly defined by IFRS, they could be considered to be APMs as defined under ESMA's [draft] guidelines. Moreover, measures such as operating margin that are not defined by IFRS would be considered to be APMs.

We consider the definition of an APM in detail in our answer to Question 5. We recommend that ESMA revisits its proposed definition with a view to specifically excluding non-financial performance measures and making the definition more precise and clearer for issuers. We suggest an alternative definition that is similar to the definition of a 'non-GAAP measure' contained in the rules of the US Securities & Exchange Commission. Whilst we would strongly oppose any move on the part of ESMA to enforce a ban on the presentation of APMs in financial statements such as has been imposed by the SEC, we believe that it would be helpful to users of financial statements if there was greater consistency internationally on the definition of APMs.

Lesser prominence of APMs is unacceptable

We strongly disagree with ESMA's proposal that APMs to be presented with lesser prominence, emphasis or authority than measures directly stemming from financial statements. We accept however, that APMs should not be presented with greater prominence than measures stemming from financial statements. We therefore suggest that ESMA's guidelines should be reworded to require that APMs should be presented with no greater prominence, emphasis or authority than the most directly comparable measure calculated and presented in accordance with the applicable financial reporting framework. We would add that this principle of 'no greater prominence' is already accepted best practice among companies listed in the UK.

Please feel free to contact me through the 100 Group's website, www.the100group.co.uk, should you wish to discuss our comments.

Yours sincerely

Russ Houlden

Russ Houlden
Chairman
Financial Reporting Committee
The 100 Group of Finance Directors

APPENDIX

RESPONSES TO SPECIFIC QUESTIONS

Question 1

Do you agree that the ESMA [draft] guidelines should apply to all issuers defined as a legal entity governed by private or public law, other than Member States or a Member State's regional or local authorities, whose securities are admitted to trading on a regulated market, the issuer being, in the case of depository receipts representing securities, the issuer of the securities represented regardless of the financial reporting framework they use to report? If not, why?

We agree that, once finalised, it would be appropriate for the guidelines to apply to issuers whose securities are admitted to trading on markets for which ESMA is the supra-national regulatory body.

Question 2

Do you agree that the ESMA [draft] guidelines should apply to APMs included in:

a) **financial statements prepared in accordance with the applicable financial reporting framework, that are made publicly available: and**

b) **all other issued documents containing regulated information that are made publicly available?**

If not, why?

We believe that the proposed scope of the guidelines is too wide. We agree that guidelines should apply to APMs used in annual reports and in half-yearly reports and interim management statements issued under the Transparency Directive. We consider, however, that the reference to "all other documents containing regulated information" is unclear and seems likely to be very broad in scope as it would extend beyond documents issued under the Transparency Directive.

We suggest that ESMA reviews the wording of the scope of the guidelines. We believe that situations in which APMs are used in documents that are not covered by the Transparency Directive could be covered by extending to all documents containing APMs the accommodation provided in paragraph 8 of the [draft] guidelines allowing cross reference from press releases to other documents containing the disclosures required by the [draft] guidelines. We also recommend that such cross reference should be permitted to be made in presentations, calls and other verbal communications of financial information.

Question 3

Do you believe that the ESMA [draft] guidelines should also be applicable to prospectuses and other related documents, which include APMs (except for pro forma information, profits forecasts or other measures which have specific requirements set out in the Prospectus Directive or Prospectus Directive implementation regulation)? Please provide your reasons.

We agree because we believe that financial information that is published by issuers should be subject to consistent guidelines on the presentation of APMs unless such information is governed by specific regulations such as the Prospectus Directive.

Question 4

Do you believe that issuing ESMA guidelines constitute a useful tool for dealing with the issues encountered with the use of APMs? If not, why?

Whilst we do not agree with all aspects of the ESMA [draft] guidelines, we do support such guidelines in principle because they will assist users of financial statements by encouraging consistency in the discussion, presentation and reconciliation of APMs among individual issuers and across particular industries.

We do not believe, however, that ESMA has identified clearly the changes that it proposes to make to the CESR recommendations and explained the reasons for them. Whilst there is discussion of the apparent deficiencies in the presentation of APMs by issuers in paragraph 4 of Section II of the proposals, no empirical evidence is provided in support of these assertions. ESMA does not make clear the extent to which this results from deficiencies in the existing CESR guidelines or from disregard of the guidelines. We believe that such evidence is important since it would inform ESMA whether the problem lies in deficiencies in the CESR guidelines or simply a need for stronger enforcement of those guidelines.

We recommend that ESMA includes a comparison with and an explanation of the changes to the CESR guidelines in its final guidance in order that its constituents can understand how they will improve the transparency, neutrality and comparability of financial performance measures.

Question 5

Do you agree with the suggested scope of the term APMs used in the [draft] guidelines? If not, why?

We believe that the scope of the term APMs used in the [draft] guidelines is too wide. ESMA considers APMs to be "any measure of historical, current or future performance, which relates to the financial position, comprehensive income or cash flows, other than a measure defined by the applicable financial reporting framework". Most issuers to whom the guidelines will apply will prepare their financial statements in accordance with IFRS adopted for use in the European Union. IFRS is a principles-based accounting framework that contains relatively few defined measures and requires the presentation of relatively few sub-totals and totals in financial statements. IFRS permits additional line items, headings and sub-totals to be presented on the face of the financial statements where such presentation is considered by the issuer to be relevant to an understanding of the issuer's financial performance or position. Such additional line items, headings and sub-totals are not strictly defined by IFRS, so they would be considered to be APMs as defined under ESMA's [draft] guidelines.

The CESR recommendations on APMs implicitly acknowledged the flexibility afforded by IFRS by considering as a defined measure (and therefore not an APM) all information included in audited IFRS financial statements in view of preparing a true and fair view, either on the face of the balance sheet, income statement, statement of changes in equity, cash flow statements or in the notes".

We would like to suggest an alternative approach. We suggest that APMs should be re-named Alterative Financial Performance Measures ('AFPMs) so as to distinguish them from non-financial performance measures that may be found outside the financial statements. We believe that this distinction will become important should 'integrated reporting' become the accepted reporting model in the European Union.

We suggest the following definition of an AFPM:

> "An AFPM is a numerical measure of an issuer's financial performance, financial position or cash flows that includes or excludes amounts that would not be so included or excluded from the most directly comparable measure calculated and presented in accordance with the applicable accounting framework in the statement of income, the statement of financial position or the statement of cash flows (or equivalent statements) of the issuer".

We recommend that ESMA makes it clear that AFPMs do not include:

- operating and other statistical measures (such as unit sales, numbers of employees, numbers of subscribers, safety levels etc); and
- ratios or statistical measures that are calculated using exclusively one or both of:
  - financial measures calculated in accordance with the applicable accounting framework; and
  - operating measures or other measures that are not AFPMs.

We consider below the example of operating margin in order to illustrate how this definition may work in practice. Under ESMAs [draft] guidelines, the operating margin would be an APM because operating margin is not a defined by IFRS. Under our proposed alternative definition, an operating margin that is calculated by dividing operating profit by revenue where both revenue and operating profit are calculated in accordance with IFRS would not be an AFPM. If, however, either revenue or operating profit (or both) were not calculated in accordance with IFRS, the measure of operating margin would be an AFPM.

We suggest that ESMA provides such application examples in order to assist issuers in interpreting its final guidelines in what can be difficult situations.

We recognise that our suggested definition is similar to that contained in the definition of a 'non-GAAP measure' contained in the rules of the US Securities & Exchange Commission. Whilst we would strongly oppose any move on the part of ESMA to enforce a ban on the presentation of APMs in financial statements such as has been imposed by the SEC, we believe that it would be helpful to users of financial statements if there was greater consistency internationally on the definition of APMs.

Question 6

Do you believe that issuers should disclose in an appendix to the publication a list giving definitions of all APMs used? If not, why?

We believe that a requirement to provide definitions of all APMs used in every document within the scope of the guidelines may lead to such documents becoming of excessive length. We believe that it would be appropriate to require such definitions to accompany the issuer's annual financial statements but we believe that issuers should be given the flexibility to decide where in the annual report the definitions should be presented, e.g. in a narrative section on key performance indicators, as an accounting policy or in the notes to the financial statements.

Consistent with our support for the UK Financial Reporting Council's initiative to 'cut clutter' in financial reports, we recommend that ESMA should permit reference to be made in results announcements and other publications to the definitions of APMs accompanying the most recently published annual financial statements or presented on the issuer's website.

Question 7

Do you agree that users should disclose a reconciliation of an APM to the most relevant amount presented in financial statements? If not, why?

We agree in principle that such reconciliations should be provided for components of APMs that cannot be readily derived from the financial statements. We would, however, ask that ESMA addresses in its final guidelines whether such reconciliations should be provided in practically difficult situations, e.g. for average capital employed and other performance measures that are based on monthly or rolling averages and alternative cash flow measures. If ESMA decides that such reconciliations should always provided, we recommend that it provides some guidance on how they should be presented. We would suggest that if the components of such measures cannot be reconciled to amounts appearing in the relevant financial statements it should be sufficient to provide a definition of the measure and provide a reconciliation of the components of the measure to the amounts presented in the annual statements.

Question 8

Do you agree that issuers should explain the use of APM's? If not, why?

Whilst some APMs will be aligned with the financial measures found in the issuer's banking covenants or may be used for the purposes of employee incentive arrangements, many APMs will be presented solely to assist users in assessing the financial performance of the issuer's businesses either from one period to another or compared with other businesses. We agree that issuers should explain the use of APMs provided it remains acceptable for an APM to be presented to assist users in assessing financial performance and for no other reason.

Question 9

Do you agree that APMs presented outside financial statements should be displayed with less prominence, emphasis or authority than measures directly stemming from financial statements prepared in accordance with the applicable financial reporting framework? If not, why?

We strongly disagree with this proposal. As we contend in our answer to Question 8, most APMs will be presented solely as a means of assisting users in assessing the financial performance or position of the issuer's businesses. We accept that APMs should not be presented with greater prominence than measures stemming from financial statements prepared in accordance with the applicable financial reporting framework. We therefore believe that the ESMA [draft] guidelines should be reworded to require that APMs should be presented with no greater prominence, emphasis or authority than the most directly comparable measure calculated and presented in accordance with the applicable financial reporting framework. We would add that this principle of 'no greater prominence' is already accepted best practice among companies listed in the UK.

Question 10

Do you agree that issuers should explain the reasons for changing the definition and/or calculation of an APM? If not, why?

We agree.

Question 11

Do you believe that issuers should provide comparatives and/or restatements when an APM changes? If not, why?

We agree.

Question 12

Do you believe that issuers should provide explanations when they no longer use an APM? If not, why?

We agree.

Question 13

Do you agree that the [draft] guidelines will improve transparency, neutrality and comparability on financial performance measures to users? If not, please provide suggestions.

For the reasons explained in our answers to the preceding questions, we are not convinced that the guidelines as drafted will give rise to an appreciable improvement in transparency, neutrality and comparability of financial performance measures compared with the existing CESR recommendations on APMs. We believe, however, that this could be achieved if the final guidelines:

(a) contain a more precise and clear definition of an APM (perhaps along the lines that we have suggested in our response to Question 5);

(b) were less broad in scope and provided the flexibility to cross reference from financial information published during the year to the most recent annual report or to the issuer's website where the relevant information is presented; and

(c) require that APMs are presented with 'no greater' prominence, emphasis or authority than measures calculated and presented in accordance with the applicable financial reporting framework.