



## Financial Reporting Committee

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5 December 2014

Dear Mr Bravo

### **Proposed Statement on Non-GAAP Financial Measures**

We welcome the opportunity to comment on the Proposed Statement in what we believe is an area where there is a need for consistency amongst international regulators.

#### **Who we are**

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 around 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.

#### **Our views**

##### **NGFMs enhance communication**

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 Non-GAAP Financial Measures (NGFMs) or similarly-titled adjusted performance measures supports this communication objective because they can provide useful information about the performance of businesses to stakeholders that sometimes is not readily accessible in financial statements prepared under IFRS. Indeed, in many cases, companies have developed the NGFMs that they report in response to requests from stakeholders.

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 it is important that regulation of the presentation of NGFMs does not hinder the ability of companies to do so and it is with this in mind that we are responding to IOSCO's consultation and would like to suggest certain changes to the proposals.

## **International consistency is needed**

Most of our member companies operate internationally and obtain funding on global equity and debt markets. Many of them have secondary listings on stock exchanges outside the UK. Earlier this year, we commented on ESMA's consultation on the use and presentation of what it terms 'Alternative Performance Measures'. ESMA's proposals differed in some important respects from IOSCO's. We find it rather concerning that two important international regulatory bodies have issued differing proposals on much the same subject within a few months of each other.

We understand that ESMA is now unlikely to finalise its guidelines until mid-2015. We therefore encourage IOSCO to work with ESMA with a view to aligning your respective guidelines.

Even if IOSCO and ESMA can reach an alignment we are unclear as to whether the respective bodies will be able to compel each of their national members to adopt their guidelines. If they cannot, there would remain the unwelcome possibility of continued international inconsistency in the presentation and disclosure of NGFMs.

## **We support many of the principles**

We support many of the principles contained in IOSCO's proposals, including that NGFMs should be clearly defined, used consistently from one period to another (unless change is justified) and reconciled to the nearest equivalent GAAP measure.

We do recommend, however, that IOSCO reflects on the following areas:

- (a) the definition of an NGFM;
- (b) the use of NGFMs in financial statements;
- (c) non-recurring items;
- (d) prominence of NGFMs; and
- (e) cross-referencing to definitions and reconciliations of NGFMs.

We consider each of these areas in more detail below

### **Definition of NGFM**

An NGFM is defined by IOSCO as "a numerical measure of an issuer's current historical or future earnings, financial performance, financial position or cash flow that is not determined by the GAAP used to prepare the issuer's financial statements and is reported outside the financial statements".

Most of our member companies prepare their consolidated financial statements in accordance with IFRS as do almost all companies that are listed within the European Union. IFRS is a principles-based accounting framework that contains relatively few defined measures and requires the presentation of relatively few totals and sub-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 may be considered to be NGFMs.

We therefore suggest an alternative definition of an NGFM for use in the context of IFRS and other frameworks that contain few specified measures:

"An NGFM 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 it is made clear that NGFMs do not include:

- Operating and other statistical measures (such as units 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 NGFMs.

We consider below the example of operating margin in order to illustrate how this definition may work in practice. Operating margin is not defined by IFRS. Under our proposed 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 a NGFM. If, however, either revenue or operating profit (or both) were not calculated in accordance with IFRS, the measure of operating margin would be a NGFM.

We suggest that IOSCO provides such application examples in order to assist users in interpreting its statement on NGFMs in what can be difficult situations.

We recognise that our suggested definition is similar to that of a 'non-GAAP measure' contained in the rules of the US Securities & Exchange Commission but we believe that it would be helpful to users of financial statements if there was greater consistency internationally on the definition of NGFMs.

### **NGFMs in financial statements**

We note that the proposals do not address the presentation of NGFMs in the financial statements. We recognise that the SEC is a member of IOSCO and that it prohibits the presentation of non-GAAP measures in financial statements. In other jurisdictions, however, non-GAAP measures are permitted to be included in financial statements. We believe that the guidelines should apply to NGFMs that are included in financial statements. We therefore suggest that the scope of the proposals is extended to financial statements in jurisdictions where the local regulator permits the presentation of NGFMs in financial statements.

We would strongly oppose any suggestion that NGFMs should be banned from financial statements by all IOSCO member bodies.

### **Presentation of recurring items**

We agree that items that have affected past periods and are reasonably likely to affect future ones should not be described as non-recurring, infrequent or unusual. We would, however, strongly oppose any move to prohibit recurring items from being treated as adjusting items in determining NGFMs.

Companies report NGFMs not only to enable comparison of their performance from one period to another, but also to enable comparison with other companies. It may, therefore, be perfectly reasonable for a company to exclude from a NGFM an item that recurs in its own financial statements but does not appear in those of its competitors. For example, many UK companies that have grown by acquisition exclude from their measure of adjusted operating profit the amortisation of acquired intangible assets to enable comparison with companies that have grown organically and no recognised intangible assets.

Many UK companies adjust their results to exclude 'exceptional items' (this is for historical reasons as UK GAAP contained a definition of an exceptional item). Exceptional items are typically defined by reference to size or incidence. So, for example, a company that regularly recognises asset impairments (recurring) may exclude them from adjusted operating profit as exceptional items only when they are material (size). We believe that this is legitimate to enable users easily to compare their performance with companies that have not recognised significant impairments.

### **Prominence relative to GAAP measures**

We strongly opposed ESMA's proposal that NGFMs should be presented with 'lesser prominence' than the equivalent GAAP measures because we believe that this would hinder effective communication with stakeholders. We believe that IOSCO's proposal that GAAP measures should be presented with 'equal or greater prominence' than NGFMs is more appropriate and would be more practicable to apply in commentaries. We do, however, suggest that the wording of the requirement should be aligned with the SEC's requirement that non-GAAP measures should be presented 'with no greater prominence' than the equivalent GAAP measures.

### **Financial measures required by regulators**

We note that it is intended that financial measures required by a securities regulator will be outside the scope of the statement. We agree with this proposal but suggest that its scope is extended to include financial measures specifically required by any regulator to which the issuer is required to report, e.g. banking, insurance or utilities regulators.

### **Use of cross references**

It is proposed that the guidelines will apply to any NGFM wherever the measure is disclosed outside the financial statements, i.e. including press releases, periodic reports, disclosure documents filed with securities regulators and stock exchanges and other communications with stakeholders and market participants.

We are concerned that if detailed explanation and reconciliation of NGFMs were to be required in all such documents, the disclosure may be repetitive and give rise to documents of excessive length. We recommend that IOSCO explores the possibility of permitting full disclosure to be given only in annual reports and to allow cross referencing to that disclosure from other reports unless different NGFMs are used in those reports.

### **Conclusion**

We believe that it is important that a consistent international approach is developed with regard to the definition and presentation of NGFMs. In order to assist IOSCO and ESMA in developing a consistent approach, we are pleased to attach for your reference our response to ESMA's recent consultation. Similarly, we have sent a copy of this letter to ESMA.

Please feel free to contact me should you wish to discuss our comments.

Yours sincerely



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

*Copy to: Stephen Maijoor, Chairman, European Securities and Markets Authority*