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Current Issue

Additional Performance Measures

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Many jurisdictions have enforced a standard format for performance reporting, with no additional analysis permitted on the face of the Statement of Profit or Loss. Others have allowed entities to adopt various methods of conveying the nature of ‘underlying’ or ‘sustainable’ earnings.

Although financial statements are prepared in accordance with applicable financial reporting standards, users are demanding more information and issuers seem willing to give users their understanding of the financial information. This information varies from the disclosure of additional key performance indicators of the business to providing more information on individual items within the financial statements. These additional performance measures (APMs) can assist users in making investment decisions, but they do have limitations.

It is common practice for entities to present APMs, such as normalised profit, earnings before interest and tax (EBIT) and earnings before interest, tax, depreciation and amortisation (EBITDA). These alternative profit figures can appear in various communications, including company media releases and analyst briefings. Alternative profit calculations normally exclude particular income and expense items from the profit figure reported in the financial statements.

Also, there could be the exclusion of income or expenses that are considered irrelevant from the viewpoint of the impact on this year's performance or when considering the expected impact on future performance.

An example of the latter has been gains or losses from changes in the fair value of financial instruments. The exclusion of interest and tax helps to distinguish between the results of the entity's operations and the impact of financing and taxation.

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These APMs can help enhance users' understanding of the company's results and can be important in assisting users in making investment decisions, as they allow them to gain a better understanding of an entity's financial statements and evaluate the entity through the eyes of the management. They can also be an important instrument for easier comparison of entities in the same sector, market or economic area.

However, they can be misleading due to bias in calculation, inconsistency in the basis of calculation from year to year, inaccurate classification of items and, as a result, a lack of transparency. Often there is little information provided on how the alternative profit figure has been calculated or how it reconciles with the profit reported in the financial statements.

APMs include:

- all measures of financial performance not specifically defined by the applicable financial reporting framework
- all measures designed to illustrate the physical performance of the activity of an issuer's business
- all measures disclosed to fulfil other disclosure requirements included in public documents containing regulated information.

An example demonstrating the use of APMs is the financial statements of Telecom Italia Group for the year ended 31 December 2011. These contained a variety of APMs as well as the conventional financial performance measures laid down by IFRS® Standards. The non-IFRS APMs used in the Telecom Italia statements were:

EBITDA. Used by Telecom Italia as the financial target in its internal presentations (business plans) and in its external presentations (to analysts and investors). The entity regarded EBITDA as a useful unit of measurement for evaluating the operating performance of the group and the parent.

Organic change in revenues, EBITDA and EBIT. These measures express changes in revenues, EBITDA and EBIT, excluding the effects of the change in the scope of consolidation, exchange differences and non-organic components constituted by non-recurring items and other non-organic income and expenses. The organic change in revenues, EBITDA and EBIT is also used in presentations to analysts and investors.

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Net financial debt. Telecom Italia saw net financial debt as an accurate indicator of its ability to meet its financial obligations. It is represented by gross financial debt less cash and cash equivalents and other financial assets. The report on operations includes two tables showing the amounts taken from the statement of financial position and used to calculate the net financial debt of the group and parent.

Adjusted net financial debt. A new measure introduced by Telecom Italia to exclude effects that are purely accounting in nature resulting from the fair value measurement of derivatives and related financial assets and liabilities.

Evaluating the aims

The International Accounting Standards Board (IASB) is undertaking an initiative to explore how disclosures in IFRS financial reporting can be improved. The project has started to look at possible ways to address the issues arising from the use of APMs. This initiative is made up of a number of projects. It will consider such things as adding an explanation in IAS® 1 that too much detail can obscure useful information and adding more explanations, with examples, of how IAS 1 requirements are designed to shape financial statements instead of specifying precise terms that must be used. This includes whether subtotals of IFRS numbers such as EBIT and EBITDA should be acknowledged in IAS 1.

APMs appear to be used by some issuers to present a confusing or optimistic picture of their performance by removing negative aspects. There seems to be a strong demand for guidance in this area, but there needs to be a balance between providing enough flexibility, while ensuring users have the necessary information to judge the usefulness of the APMs.

to this end, the European Securities and Markets Authority (ESMA) has launched a consultation on APMs. The aim is to improve the transparency and comparability of financial information while reducing information asymmetry among the users of financial statements. ESMA also wishes to improve coherency in APM use and presentation and restore confidence in the accuracy and usefulness of financial information.

ESMA has therefore developed draft guidelines that address the concept and description of APMs, guidance for the presentation of APMs and consistency in using APMs. The main requirements are:

- Issuers should define the APM used, the basis of calculation and give it a meaningful label and context.
- APMs should be reconciled to the financial statements.
- APMs that are presented outside financial statements should be displayed with less prominence.
- An issuer should provide comparatives for APMs and the definition and calculation of the APM should be consistent over time.
- If an APM ceases to be used, the issuer should explain its removal and the reasons for the newly defined APM.

However, these guidelines may not be practicable when the cost of providing this information outweighs the benefit obtained or the information provided may not be useful to users. Issuers will most likely incur both implementation costs and ongoing costs. Most of the information required by the guidelines is already collected for internal management purposes, but may not be in the format needed to satisfy the disclosure principles.

ESMA believes that the costs will not be significant because APMs should generally not change over periods. Therefore, ongoing costs will relate almost exclusively to updating information for every reporting period. ESMA believes that the application of these guidelines will improve the understandability, relevance and comparability of APMs.

Application of the guidelines will enable users to understand the adjustments made by management to figures presented in the financial statements. ESMA believes that this information will help users to make better-grounded projections and estimates of future cashflows and assist in equity analysis and valuations. The information provided by issuers in complying with these guidelines will increase the level of disclosures, but should lead issuers to provide more qualitative information. The national competent authorities will have to implement these guidelines as part of their supervisory activities and provide a framework against which they can require issuers to provide information about APMs.

This Article/Blog is based on Article by SBR Examination Team

Zeeshan Hasan

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