

Mr Jonathan Bravo  
IOSCO General Secretariat  
International Organization of Securities Commissions (IOSCO)  
Calle Oquendo 12  
28006 Madrid  
Spain

20 November 2014

Dear Mr Bravo,

**Response to the IOSCO ‘Proposed Statement on Non-GAAP Financial Measures’**

This letter sets out the comments of the UK Financial Reporting Council (FRC) on the IOSCO ‘Proposed Statement on Non-GAAP Financial Measures’ (the proposed statement).

In our view, non-GAAP financial measures (NGFMs) are useful for investors and we share IOSCO’s view that NGFMs should be clear and not misleading. We are supportive of the fact that the proposed statement is not overly prescriptive, and encourages a focus on clear communication. We also welcome the fact that disclosures in the financial statements and GAAP measures provided in other documents are excluded from the scope of the guidelines. However, we note that the European Securities and Markets Authority (ESMA) also intends to issue guidelines in this area and this may cause confusion for companies to which both sets of guidelines apply. With that in mind, we believe it would be more helpful for IOSCO and ESMA to work collaboratively to produce a single set of guidelines on the disclosure of NGFMs than to produce two separate sets of guidelines. As a minimum, if ESMA and IOSCO proceed to issue separate guidelines, it would be helpful for the two organisations to ensure that their guidelines are consistent so that it is possible for companies that are within the scope of both sets of guidelines to comply with both simultaneously. Our comments on the proposed statement as currently drafted are below.

**a) Purpose and scope of the proposed statement**

The proposed statement states that it is ‘intended to assist issuers in providing clear and useful disclosure for investors and other users of non-GAAP financial measures, and to help reduce the risk that such measures are presented in a way that could be misleading.’ We encourage IOSCO to consider whether this objective of promoting clear and useful disclosure will be more effectively achieved by collaborating with other standard setters and regulators that are already performing work in this area. We are concerned that several organisations issuing potentially conflicting guidelines on NGFMs - with differing requirements, scopes, statuses (mandatory or best practice), and different definitions of NGFMs - will create unnecessary complexity in the reporting framework and may result in lower quality disclosures that are less comparable, clear and useful.

Following its recent consultation, ESMA is intending to issue mandatory requirements on the disclosure of alternative performance measures (APMs) in early 2015. The draft

ESMA guidelines are applicable to all non-GAAP financial information published by issuers whose securities are admitted to trading on a regulated market in the EU/EEA. There will therefore be some overlap between the scope of the ESMA guidelines and the scope of IOSCO's proposed statement; as currently drafted, both will apply to NGFMs presented by EU/EEA issuers outside the financial statements. We believe it would be more helpful for IOSCO and ESMA to collaborate to produce a single set of guidelines on the disclosure of NGFMs.

While we recognise that NGFMs provided in the financial statements are outside the scope of IOSCO's proposed statement, it is worth noting that the International Accounting Standards Board (IASB) is considering principles for the fair presentation of non-GAAP sub-totals as part of its recent Exposure Draft 'Disclosure Initiative: Proposed Amendments to IAS 1' and intends to consider APMs as part of its Principles of Disclosure project. The Financial Accounting Standards Board (FASB) is also undertaking a research project on financial performance reporting which will examine the use of NGFMs by private and public companies, with a view to developing a framework for defining 'operating activities' and distinguishing between recurring and infrequent items. As a result, when an identical NGFM is disclosed both inside and outside the financial statements, preparers may need to apply different guidelines or disclosure requirements set by different organisations to each disclosure of that same NGFM, depending only on where the disclosure is displayed.

We also note that footnote 3 to the proposed statement states that an NGFM required by a securities regulator is not within the scope of the guidelines however, it is not clear why requirements set by securities regulators are excluded while requirements set by other regulators (such as bank or insurance regulators) or requirements specified by law are not; while the foreword and the final two paragraphs to the proposed statement emphasise that the regulatory requirements of the relevant jurisdiction must be complied with, such requirements are not actually excluded from the scope of the proposed statement. We recommend that all requirements set by regulators or specified by law are explicitly excluded from the scope of the proposed statement to avoid confusion.

More generally, we are also concerned that the scope of the proposed statement is very broad, encompassing all NGFMs disclosed outside the financial statements, except for information specified by a securities regulator. In our view, it may not be appropriate for the guidelines to apply to all types of communication from issuers that contain NGFMs (excluding the financial statements). In particular we are concerned that prospectuses, which contain a significant amount of non-GAAP financial information, will be expected to comply with the guidelines and that this will result in unnecessary additional disclosures that may not provide relevant information.

#### **b) The extent that information is necessary for an understanding of an NGFM**

There is no reference to materiality in the proposed statement. It would be helpful for the proposed statement to refer to the internationally recognised definition of materiality set out in international accounting standards, to emphasise that the suggested disclosures should be included only when they provide relevant information that could impact the decisions taken by investors.

Some aspects of the current drafting give the impression that the proposals are more prescriptive than may have been intended. In the absence of a statement that information should be disclosed only to the extent that it provides useful information and is necessary for an understanding of an NGFM, the guidelines may be interpreted as a

list of mandatory requirements for every NGFM disclosed and may therefore lead to boilerplate disclosures.

For example, when an issuer discloses earnings before interest and taxes (EBIT), or gross profit as a percentage of revenue, the method of calculating each of the measures is self-evident from its label. An 'explanation of the basis of calculation' (as requested in point 1 of the proposed statement) or a 'reconciliation from the non-GAAP financial measure to the most directly comparable GAAP measure presented in the financial statements' (as requested in point 7 of the proposed statement) would not provide useful information for investors in such cases. We encourage IOSCO to include a clear objective for the guidelines that focuses on providing relevant information for investors.

### **c) Placement**

We agree with IOSCO that the disclosure of NGFMs should not in any way confuse or obscure the presentation of GAAP measures. It is important for NGFMs to be clearly identifiable and in our view they should not be given undue prominence however, we do not agree that a comparable GAAP measure should always be given 'equal or greater prominence'. For some purposes, widely used industry specific NGFMs may be more useful than GAAP measures and provide information which is highly valued by investors, and there may not be a comparable GAAP measure to disclose. For example, it is common for oil extraction companies to disclose 'finding and development costs per barrel of oil equivalent' because this measure provides an indication of a company's ability to add reserves at a reasonable cost over the long term and thereby assists investors with predicting future profitability in comparison to the company's competitors. There is no GAAP measure that provides information that is comparable to this NGFM; the reason for providing such NGFMs is often that there is not a suitable GAAP measure that can be used to communicate similar information.

In our view it would also be an unjustified burden for issuers to be expected to include standing information, such as definitions and explanations of NGFMs, in every document in which NGFMs are disclosed. This could obscure other information in the publication. We suggest that issuers are given the flexibility to disclose this information in the location they consider most appropriate. This information could be located outside the publication (for example, on the company website), with a signpost in the publication making it clear where the information can be accessed.

### **d) Reconciliations**

The proposed statement requests that each NGFM is reconciled to the most directly comparable GAAP measure in the financial statements. This will not always be practicable. Some NGFMs are not derived from and will not reconcile to the historical GAAP information in financial statements, for example embedded value disclosures provided by companies in the insurance sector, which are based on projections of future cash-flows. In other cases reconciliation may not be necessary (as noted in our comments in section b)), for example when the NGFM was calculated directly from line items presented in the financial statements, without adjustments.

When providing a reconciliation is practicable and will provide useful information, we believe the reconciliation should provide a disaggregation of reconciling adjustments only to the extent that the line items in the reconciliation are material.

**e) Consistency from period to period**

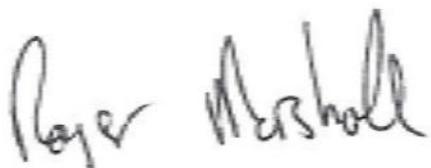
While we agree with IOSCO that it is generally helpful for NGFMs to be disclosed with comparatives, remain consistent from period to period, and for changes to be clearly explained if this is relevant for investors, we believe that it is important not to discourage issuers from making changes to their NGFMs when this is necessary to ensure that the NGFMs provide useful information to investors; sometimes there may be good reasons to make changes to the NGFMs disclosed. For example, historic NGFMs may become less relevant and need replacing with updated measures if the issuer has significantly modified its business strategy and changed the way the business is managed and monitored.

**f) Recurring items**

It is not clear from the proposed statement why issuers are advised not to label items as 'non-recurring, infrequent or unusual'. In some cases, GAAP information may include items that have such characteristics and it may be helpful to separately identify such items in the calculation of an NGFM, to ensure that the NGFM disclosure provides information that is comparable to competitors and from period to period. Investors often wish to separately identify such 'non-recurring, infrequent or unusual' items so that they can make more accurate predictions about recurring cash-flows. It is not clear why the disclosure of such information should be discouraged, providing that sufficient explanation is disclosed to enable investors to understand the nature of the item and why it has been separately identified.

If you would like to discuss these comments, please contact me or Rosalind Szentpéteri on 020 7492 2474.

Yours sincerely



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