Financial Reporting Council

May 2016

ESMA Guidelines on Alternative Performance Measures

Frequently Asked Questions

The FRC is responsible for promoting high quality corporate governance and reporting to foster investment. We set the UK Corporate Governance and Stewardship Codes as well as UK standards for accounting, auditing and actuarial work. We represent UK interests in international standard-setting. We also monitor and take action to promote the quality of corporate reporting and auditing. We operate independent disciplinary arrangements for accountants and actuaries, and oversee the regulatory activities of the accountancy and actuarial professional bodies.

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Registered in England number 2486368. Registered Office:
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Introduction

Background

In June 2015, the European Securities and Markets Authority (ESMA) published *Guidelines on Alternative Performance Measures* (“the Guidelines”) which replace the *Recommendation on Alternative Performance Measures* issued by the Committee of European Securities Regulators in October 2005. The Guidelines apply to relevant communications released on or after 3 July 2016 by issuers of securities on a regulated market and to preparers of prospectuses. ESMA has the legal power to issue guidelines that market participants must make every effort to comply with.

Through these Guidelines, ESMA aims to promote the usefulness and transparency of Alternative Performance Measures (APMs) presented to investors.

The Financial Conduct Authority (FCA) and the Financial Reporting Council (FRC) are the UK Competent Authorities responsible for monitoring the compliance with the Guidelines. The FRC will consider the Guidelines when reviewing company reports and accounts in assessing whether they are fair, balanced and comprehensive.

The FRC has developed these responses to frequently asked questions to assist directors in their consideration of the Guidelines. In doing so the FRC has drawn on its *Guidance on the Strategic Report* and other existing guidance on preparing annual reports which have included principles consistent with the Guidelines. For example, in 2013 the Financial Reporting Review Panel (FRRP) issued a press notice on the presentation of exceptional items that made similar recommendations on the clarity and consistency of disclosures. The answers below should not be considered a substitute for the Guidelines which preparers of relevant financial information should still review.

Frequently Asked Questions

What is an APM?

In the context of the Guidelines, an APM is “*a financial measure of historical or future financial performance, position or cash flows of an entity which is not a financial measure defined or specified in the financial reporting framework* (e.g. EU-adopted IFRS) *applied by the entity*”.

In other words, the Guidelines are focussed on the provision of financial information on a company’s performance, its financial state of affairs and future expectations when that information has not been drawn directly from the financial statements. Such measures include Earnings before interest, taxation, depreciation and amortisation (EBITDA) and other adjusted operating measures, Free Cash Flows (FCF) and various measures of operating or financial gearing.

Some Key Performance Indicators (KPIs), as disclosed in the Strategic Report, will meet this definition and thereby be subject to the Guidelines.

The guidelines are not directed at the provision of non-financial measures, such as customer numbers or retail floor space, although the principles of clarity of explanation and definition will also be useful to ensure such measures are properly understood.

Are APMs prohibited or required?

APMs are neither prohibited nor required. The disclosure of APMs which are clearly presented and chosen to provide a balanced view of the company can be useful for investors when they provide relevant information on the entity's future or past performance, position or cash flows and equivalent information cannot be presented by using financial measures defined in the financial reporting framework.

APMs are sometimes used across an industry or sector, assisting investors in the comparison of performance between peers.

Do the Guidelines apply to all APMs?

The Guidelines apply to APMs presented on or after 3 July 2016 in prospectuses and regulated information, being information provided in accordance with the Transparency Directive and any information subject to the requirements of the Market Abuse Regulation Directive.

The Guidelines apply to APMs represented in periodic reports, such as the narrative sections of the Annual Report, including the Strategic Report and Interim Management Reports in half-yearly financial reports. They also apply to APMs included in prospectuses (subject to the exceptions below), RNS announcements and other documents such as press releases where they are considered to contain inside information subject to disclosure under article 17 of the Market Abuse Directive.

As exceptions to this scope, the Guidelines do not apply to APMs presented in the financial statements or to disclosures made in accordance with legislation that explicitly governs the determination and presentation of specific measures. Such measures include pro-forma financial information and certain other disclosures in prospectuses which are specified in the Prospectus Directive and prudential measures set out in relevant legislation.

What APMs should be provided?

The Guidelines do not prescribe the provision of specific APMs. The choice of APMs, if any, is a matter of judgement of those responsible for providing the information, such as the directors in respect of the Annual Report. This judgement should be applied to ensure the APMs provided are relevant and understandable for users within the context of wider reporting responsibilities such as the provision of an Annual Report that is fair, balanced and understandable.

The use of labels that are overly optimistic or misleading (e.g. items labelled as non-recurring which in fact recur) or the use of APMs that are deliberately skewed towards presenting an overly favourable message (e.g. by including income but excluding directly related expenditure) may undermine these wider reporting responsibilities.

How should APMs be presented?

Clear labelling of APMs makes them more easily identifiable and distinguishable from financial statements line-items. In presenting APMs, they should not be given more prominence, emphasis and authority than the most directly reconcilable line items in the financial statements.

A reconciliation of an APM to the most directly reconcilable line item, subtotal or total presented in the financial statements of the corresponding period should be given. Material reconciling items should be separately identified and explained. If the APM relates to future periods or profit forecasts so cannot be reconciled to a line item in published financial statements, an explanation of its consistency with the accounting policies applied in the financial statements should be given.

APMs should be measured and presented consistently over time.

The placement of the APMs and related disclosures should ensure effective communication with the use of clear signposting to limit duplication whilst ensuring the linkages between related information are highlighted and understood. Within the Annual Report linkages might exist between APMs, KPIs, the company's business model, strategy and objectives and remuneration policies. Further guidance on clear communication, placement and signposting can be drawn from the FRC's *Guidance on the Strategic Report.*

The Guidelines permit the inclusion of the disclosures below by signposting to a previously published document where the information is contained, except where limited by legislation such as the Prospectus Directive. Preparers of financial information should consider their wider reporting responsibilities when using signposting to external information, such as the UK Corporate Governance Code's requirement to ensure, when taken as a whole, the Annual Report is fair, balanced and understandable.

What disclosures should be given about APMs?

Under the Guidelines certain disclosures are required for each APM including:

a. Definition of the APM, including its method of calculation and details of any material assumptions;
b. Indication of whether the APM or any of its components relate to the performance of the past or expected performance of a future reporting period;
c. Explanation for the use of an APM to allow users to understand its relevance and reliability;
d. Reconciliation identifying and explaining the material adjustments between the APM and a financial statement line-item; and
e. APMs of comparative previous periods or explanations why an APM was revised or is no longer presented.

These disclosures should be prepared to give a clear and complete understanding of the APM presented, how it is calculated and why it is useful and relevant, and to place it in the context of the financial statements.

How will the FRC monitor compliance with the Guidelines?

The scope of the FRC's monitoring activities extends only to Annual Reports and Half-yearly financial reports. As explained above, the scope of the Guidelines is wider than this and includes publications for which the FCA is the competent authority under the Transparency and Prospectus Directives.

The FRC's Corporate Reporting Review team (CRR) will extend its reviews of reports and accounts to consider whether strategic reports are consistent with the Guidelines. Where there are material inconsistencies, CRR will bring this to the attention of the company.

CRR currently reviews strategic reports for compliance with the Companies Act 2006 and, in particular, the requirement that strategic reports should contain a fair review of the company's business that is balanced and comprehensive. CRR will take material inconsistencies with the Guidelines into account when deciding whether the strategic report is fair, balanced and comprehensive and, as a consequence, whether enforcement action is required.