



Stephen Maijoor  
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14 May 2014

Dear Mr Maijoor,

**Response to Consultation Paper ‘ESMA Guidelines on Alternative Performance Measures’**

This letter sets out the comments of the UK Financial Reporting Council (FRC) on the Consultation Paper (CP) ‘*ESMA Guidelines on Alternative Performance Measures*’ (APMs).

In our view, APMs are useful for investors and with that in mind we share ESMA’s view that APMs should be relevant, understandable and not misleading. We welcome ESMA’s contribution to the debate in this area. However, the FRC does not support the ESMA Guidelines. Our main concerns are outlined below with the detailed responses to the questions in the CP included in the Appendix to this letter.

- a) *Interpretation of accounting standards* – The ESMA guidelines will apply to APMs that are presented in the financial statements. Consequently, we do not consider that it is appropriate for ESMA, as an enforcement authority, to be providing guidance in this area. In our view, it would be more appropriate for the International Accounting Standards Board (IASB) to provide application guidance in this area. We would also like to highlight that the IASB is already considering principles for 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 disclosure framework project.
- b) *Status of guidelines* – We note that the proposals represent a shift from best practice recommendations as issued by CESR to the issue of guidelines that are intended to be mandatory. In addition, we consider that it is important for ESMA to articulate why it considers the existing CESR Recommendation is inadequate and the reasons why these proposals are a better solution.
- c) *Enforceability of the guidelines* – The guidelines are intended to be binding on enforcers. The FRC’s Conduct Committee will be unable to enforce given the extent of its powers set out in UK legislation. Before issuing guidelines, we would suggest that ESMA seeks legal advice on the powers of enforcers across European jurisdictions.

- d) *Scope* – We disagree with the scope of the proposals as we consider it to be too broad in respect of the documents that would be covered. As currently drafted, we believe that the proposals would bring any document containing financial information within the scope.
- e) *Principles-based guidelines* – Whilst we agree that investors find definitions, reconciliations and comparatives to be helpful, our experience in the UK is that principles based guidelines are more effective than those containing detailed rules. The approach set out in the CP could result in the proliferation of boilerplate disclosure or issuers avoiding the use of APMs. This is likely to lead to less relevant reporting for investors. We believe that any guidelines should contain reference to the application of the concept of materiality.
- f) *Placement* – We disagree with the principle that APMs should always be presented with less prominence than GAAP measures. We believe that non-GAAP measures can be as useful for investors as GAAP measures and therefore should not necessarily be given less prominence. On a related point, we are also unclear on the extent to which ESMA has considered the interaction of the proposed guidelines with the EU Accounting Directive (2013/34/EU) requirement for a company to include Key Performance Indicators (KPIs) as part of its Management Report.

If you would like to discuss these comments, please contact me or Deepa Raval on 020 7492 2424.

Yours sincerely



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## Appendix: responses to questions set out in the CP

**Q1. 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 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?**

No. We believe that it is inappropriate for ESMA, as an enforcement authority to be publishing guidance for issuers. We believe that it is the role of standard setters to be providing guidance in this area. ESMA publishing guidelines in this area creates complexity in the regulatory framework. It also creates a problem for NCAs who may be unable to enforce guidelines upon issuers where the guidelines are not part of national law.

**Q2. 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?**

- a) No. We believe that it is more appropriate for an accounting standard setter, such as the IASB, to provide guidance in areas which relate to the application of accounting standards.
- b) No. There is already a regulatory framework around the provision of APMs in Management Reports in UK Company Law and in the EU Accounting Directive.

We would also like to note that although the CP is written with a broad scope in mind, some of the language used in the drafting seems to be more focused towards APMs in financial statements. We would encourage ESMA to be clear about the scope.

**Q3. 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 implementing regulation)? Please provide your reasons.**

No. We consider that extending the scope of the CESR Recommendations is inappropriate. Applying the guidelines to all financial information produced by an issuer would be an unjustified burden on issuers.

**Q4. 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?**

No. Paragraph 12 of the [draft] guidelines states that “NCAs are expected to incorporate the [draft] guidelines into their supervisory procedures and practices and monitor whether issuers comply with them”. As noted in our cover letter, we are unable to enforce these guidelines.

**Q5. Do you agree with the suggested scope of the term APM as used in the [draft] guidelines? If not, why?**

Yes. However, we believe that ESMA needs to consider whether the guidelines should apply to all APMs within the scope. For example, it may not be necessary to define an APM which is a total or subtotal.

As a general point, we consider that the [draft] guidelines should be structured so that the exemptions available are clearly listed. For instance, totals or subtotals are exempt from the requirement to provide reconciliations (paragraph 25, Annex III).

**Q6. Do you believe that issuers should disclose in an appendix to the publication a list giving definitions of all APMs used? If not, why?**

No. We consider that there are two questions here – a) whether issuers should be required to include a list of definitions of all APMs in publications; and b) whether the definitions should be included in an appendix.

a) We believe that defining an APM is helpful where the label attached to the APM is unclear. This may not be necessary for all APMs, for example, the label ‘sales per square meter’ is clear.

b) Requiring a list of definitions of all APMs in an appendix would lead to clutter in each publication. In our view, issuers should also be given the flexibility to disclose definitions in the location they consider most appropriate, rather than being restricted to including this information in an appendix. This information could also be signposted to a location outside the publication.

**Q7. Do you agree that issuers should disclose a reconciliation of an APM to the most relevant amount presented in the financial statements? If not, why?**

Yes. We agree with the principle of providing reconciliations where an APM is derived from, or based on, the financial statements but they may not be necessary in all circumstances. For example, where a user of the annual report can easily re-calculate or tie-back the APM to the financial statements e.g. gross profit as a percentage of revenue. The FRC’s Financial Reporting Lab<sup>1</sup> has published a report on net debt reconciliations that may be of interest.

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<sup>1</sup> A copy of the report can be assessed at <https://frc.org.uk/Our-Work/Publications/Financial-Reporting-Lab/FRC-Lab-project-report-Net-Debt-Reconciliations.aspx>

Furthermore, we consider that reconciliations to GAAP numbers should only be provided when the resulting information would be meaningful to investors. For example, the use of embedded value reporting is common in the insurance industry but reconciliation to GAAP numbers for this type of information is unlikely to provide meaningful information.

We also disagree with the level of detail required for the reconciliation as set out in paragraphs 22 and 23 of Annex III. In our view, these are onerous requirements for preparers and may provide a level of granularity that is not required by investors.

**Q8. Do you agree that issuers should explain the use of APMs? If not, why?**

Yes. We agree that it is helpful to explain the purpose of an APM. However, we believe that disclosure should only be required when the information would be relevant to investors.

**Q9. 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?**

No. We believe that non-GAAP measures can be as useful for investors as GAAP measures and therefore should not always be given less prominence.

Paragraph 9 of Annex III notes that the guidelines “are not to be applied to APMs that are disclosed in accordance with other applicable law that sets out specific requirements governing the determination of such measures”. As noted in our cover letter, the EU Accounting Directives require KPIs to be included in the Management Report. In this case, in the UK, any presentational requirements in the ESMA guidelines would be redundant as UK Company law would take precedence.

**Q10. Do you agree that issuers should explain the reasons for changing the definition and/or calculation of an APM? If not, why?**

Yes. We agree with the principle of explaining changes in the APM, however, we consider that this information should only be provided when the information is relevant for investors.

**Q11. Do you believe that issuers should provide comparatives and/or restatements when an APM changes? If not, why?**

Yes. In our view, including a comparative figure for an APM is helpful.

We disagree with the proposal to re-state figures in the level of detail as set out in the CP. In particular, paragraphs 32 and 36 of the [draft] guidelines would be a burden on preparers. We

also consider that those paragraphs are written with APMs derived from financial statements in mind whereas the current scope of the draft guidelines is broader.

We are also concerned about the reference to hindsight in paragraph 38 of the background to the guidance. It is common practice for companies to present APMs and comparatives to reflect changes in the group. Investors find this information useful in making an assessment of future performance. Paragraph 38 seems to suggest that this practice would no longer be permitted under the guidelines.

**Q12. Do you believe that issuers should provide explanations when they no longer use an APM? If not, why?**

Yes, but these should only be given when it would result in relevant information for investors.

**Q13. Do you agree that the [draft] guidelines will improve transparency, neutrality and comparability on financial measures to users? If not, please provide suggestions.**

No. Overall, we believe that the prescriptive nature of the draft guidelines is likely to lead to preparers adopting a compliance approach to APMs rather than focusing on communication. As noted in our cover paper, we would suggest that any guidelines are principle based. We believe that the existing CESR Recommendations are sufficient.

**Q14. Do you agree with the analysis of the cost and benefit impact of the [draft] guidelines? Please provide any evidence or data that would further inform the analysis of the likely cost and benefits impacts.**

No, we disagree. In our view, the costs do not outweigh the benefits to investors.