



Reporting of performance metrics June 2018

The reporting of performance metrics continues to be of significant interest to investors. Regardless of their position in the investment chain, investors have strong views about how companies should report their performance. It is clear that this issue is central to questions about how companies demonstrate the value they create and how investors value companies. As a result of wide-ranging discussions, the Financial Reporting Lab ('the Lab') has developed a framework and set of questions for companies and their boards to consider when reviewing their reporting of performance metrics.

Investors often refer to the impact the reporting of performance metrics has on their assessment of management credibility. The metrics chosen, how they are reported, and whether or not the information is reported in a way that investors consider to be fair, balanced and understandable are central to this assessment.

Investors want to see the metrics that management uses internally to monitor and manage performance, as these give insight into a company's strategy and measure how it is performing against that strategy. In this context, investors find it important to be given insight into how management links its metrics to its business model and strategy, including why metrics 'make sense' for the company and what it is trying to achieve.

A view of performance is important for a number of reasons. However, investors most often seek to understand how a company has performed in order to assess its future prospects. Metrics act as a signal, and performance is understood in the context of the targets set, the wider environment, and where the company intends to go next. Because of this, investors are also concerned about the quality and sustainability of the reported performance, which helps explain why wider metrics, beyond the traditional financial metrics, are of increasing importance.

Investors' use of performance metrics

During the project we heard that investors use metrics for a range of reasons:

- analysis and valuation (benchmarking, comparing across a sector and screening);
- assessing management's credibility;
- assessing long-term value;
- stewardship;
- forecasting or assessing trends; and
- assessing whether management is appropriately incentivised.

These various uses and approaches mean investors may be seeking different metrics, or using them in different ways, depending on their position in the investment chain and the reason for assessment. For example, a sell-side analyst may be more interested in standardised measures for forecasting purposes, a governance specialist may be more interested in wider metrics as leading indicators of long-term value, and a buy-side analyst may be more interested in first assessing the performance metrics of an individual company at an in-depth level before comparing these metrics to other companies. However, these are only generalisations and all investors we spoke to, regardless of their position in the investment chain, mentioned using GAAP, non-GAAP and wider metrics in different ways. The framework and questions for companies consolidate an overall investor view, but there will always be some difference depending on investment style, position in the investment chain, place in the market and personal approach.

Investors use all information that might help them build a picture about management and the company's

performance, position and prospects. They rely on company reporting as a base, but they also use a range of external sources to triangulate that information, or where reporting is not provided by the company.

Regulatory and market initiatives

The last few years has seen a number of regulatory and market initiatives regarding the reporting of performance metrics. The European Union's Non-Financial Reporting Directive, the Commission's Action Plan on Sustainable Finance, and initiatives such as the Task Force on Climate-Related Financial Disclosures, are changing the way that companies are thinking about reporting on wider metrics.

In relation to financial metrics, in October 2015, the European Securities and Markets Association (ESMA) published its Guidelines on Alternative Performance Measures (APMs). Following its release, the Financial Reporting Council's Corporate Reporting Review team conducted two reviews into the use of APMs, which considered the extent to which companies were applying the guidelines. The principles set out in this report are consistent with ESMA's guidelines but provide an investor perspective on the reporting of all types of metrics (including wider metrics that are not covered by ESMA's guidelines).

What do we mean by ‘performance metrics’?

This project has taken the term ‘performance metrics’ to mean all forms of metric a company might disclose in order to provide information about its performance, position and prospects.

There are no universally agreed labels or definitions for the terms we have used in this project. However, we use the terminology set out in Figure One throughout this report.

The metrics investors assess include GAAP, non-GAAP and wider metrics. These may be reported in investor presentations, preliminary announcements, sustainability reports and other communications as well as the annual report.

Investors consider that these metrics add value, and the focus on information beyond the standard financial metrics is increasing. The principles set out on the next page can be applied to all types of metrics.

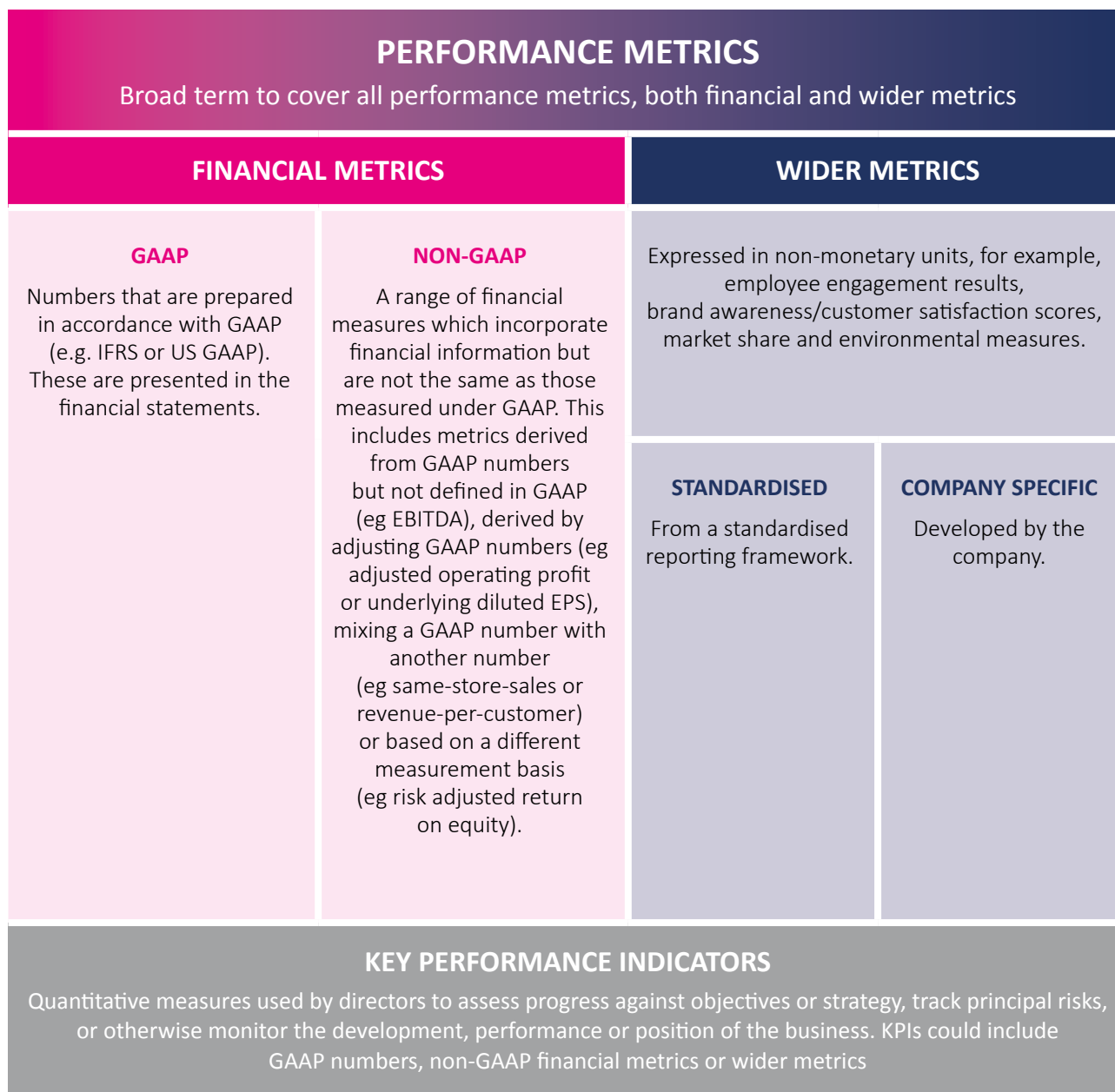
Project History

The Lab has carried out a series of projects addressing narrative reporting elements. The first, on business model reporting, established that good business models provide the foundation for the strategic report as a whole. The second project, on risk and viability reporting, explored how a company’s principal risks and assessment of viability could be reported in a way which best meets investor needs.

We have approached this project in a slightly different way, given that there have been so many recent developments in this area of reporting. This report, the outcome of the first stage of the project, focuses predominantly on an investor view. Views were obtained from 38 members of the investment community. A number of companies have also taken part (see participants and process for more details).

The next phase of the project, including examples of how companies have put these principles into practice, will be published in Autumn 2018. If you are an investor or company representative interested in taking part please contact financialreportinglab@frc.org.uk.

Figure One: Performance metrics terminology



Performance metrics – an investor perspective



GAAP



Non-GAAP



Wider metrics

Principles	Investors seek disclosure...	Company management and their boards should ask...
Aligned to strategy	<ul style="list-style-type: none"> Of metrics that provide insight into the company's business model, strategy and competitive advantage and measure its success Of metrics that demonstrate how the company creates long-term value Of the metrics used internally to make business decisions and to manage, monitor and incentivise the achievement of the business strategy 	<ul style="list-style-type: none"> Do our metrics clearly link to our company's strategy and value drivers? Have we addressed all relevant financial and wider metrics? Are we reporting the metrics that are being monitored and managed internally? Is there a clear link between the metrics that drive our business model and strategy, and our remuneration policy?
Transparent	<ul style="list-style-type: none"> That provides transparency on how metrics are calculated and defined to help investors make their own assessments, with clear reconciliations from GAAP to non-GAAP metrics That gives a clear explanation of why metrics have been used and, in the case of non-GAAP metrics, why management think these are a more faithful representation of the value that has been generated by the company's business model than the GAAP metrics 	<ul style="list-style-type: none"> Is it clear to investors why we use these metrics and what performance they are trying to represent? Are we transparent about the way in which our metrics are calculated and defined? Where we report non-GAAP metrics, do we explain why and how they more appropriately represent our business model and strategy? Where we make adjustments to exclude cost items do we also exclude the related gains? Do we explain why we have made specific adjustments, at least at a material level?
In Context	<ul style="list-style-type: none"> That shows how a company has performed, with explanations where this is different from what it was trying to achieve, either good or bad That explains the company's position, for example, its balance sheet strength, liquidity and market position That gives an indication of the company's prospects within the context of the market and market changes. Longer-term objectives are often preferable 	<ul style="list-style-type: none"> Do we explain what performance we were expecting to achieve, what we actually achieved, and why? Do we explain what performance our metrics are trying to achieve in the future, and provide an understanding of our overall long-term objectives?
Reliable	<ul style="list-style-type: none"> That provides information to help investors gain confidence on the process of developing, monitoring and reporting reliable metrics, and whether there are appropriate controls in place That provides clarity over the level of scrutiny that metrics are subject to (including Board, Audit Committee, internal and external assurance processes) and the boundary of the information 	<ul style="list-style-type: none"> Do we provide an overview of how our metrics have been developed and monitored to allow investors to assess their reliability? Do we explain the level of scrutiny to which metrics are subject to allow an assessment of whether they are fair, balanced and understandable? Do we outline the Audit Committee's (or other Executive or non-Executive Committee) oversight and whether they consider the appropriateness of specific metrics or adjustments in addition to the way in which the metrics are reported? Do we explain what additional scrutiny may be given to adjusted metrics used in remuneration? Is the boundary of each metric clear (for example, the timeframe, parts of business covered etc)?
Consistent	<ul style="list-style-type: none"> Of metrics that are calculated consistently year-on-year and also presented consistently across reporting formats (annual report, investor presentation, sustainability reports, press releases etc) That provides a track record, preferably over five years That provides enough detail to allow effective comparisons of similar companies, either at a business model or sector level 	<ul style="list-style-type: none"> Are our metrics consistent year-on-year? If our metrics have changed, do we provide a clear explanation as to why the change has been made and why the new metric is better? Do we provide comparatives for a number of years? Are our metrics calculated consistently every year? If they are not, do we provide an explanation for any change, and an outline of the impact of the change? Are the same metrics reported consistently across the investor presentation, preliminary announcement, annual report, press releases and other documents? Is a track record of our performance provided, preferably over five years? Are our metrics consistent with an industry standard or our close competitors? If not, do we explain why our metrics are more appropriate?

Participants and Process

Participants join projects by responding to a public call or being approached by the Lab. An iterative approach is taken, with additional participants sought during the project, though it is not intended that the participants represent a statistical sample.

References made to views of ‘companies’ and ‘investors’ refer to the individuals from companies and investment organisations that participated in this project. Views do not necessarily represent those of the participants’ companies or organisations.

Views were received from a range of UK and international institutional investors, analysts and retail investors. Whilst the project has predominantly focused on an investor view at this stage, a number of companies have also taken part individually and will be named in the next phase of the project. We have also held a roundtable for Audit Committee Chairs and four company roundtables with Conran Design Group, Luminous, Radley Yeldar and Superunion.

Thank you to all of the participants for contributing their time to this project.

The investor participants were from the following organisations:

- Aberdeen Standard Investments
- Allianz Global Investors GmbH
- Barclays
- The Church Commissioners for England
- Colorado PERA
- Fidelity International
- Fuller Analysis
- HSBC Global Asset Management
- Independent Franchise Partners LLP
- Institutional Shareholder Services
- Invesco Asset Management Limited
- Kames Capital
- Legal and General Investment Management
- Martin Currie Investment Management
- Moody’s Investors Service Limited
- Old Mutual Global Investors
- RBC Global Asset Management
- Schroder Investment Management Limited
- Shore Capital
- State Street Global Advisors
- S&P Global Ratings
- The Investment Association’s Company Reporting and Auditing Group
- Toscafund Asset Management Limited
- Three representatives from the UK Shareholders’ Association
- WHEB

What is the Lab?

Over the last six years the Financial Reporting Lab has sought to improve the effectiveness of corporate reporting in the UK. We do this by working with companies, investors and others on topics that matter. Our reports explore innovative reporting solutions that better meet their needs. Lab reports do not form new reporting requirements, but do seek to highlight best practice and thought leadership.

For more information about the difference the Lab makes to reporting, watch our video:



<https://youtu.be/6L9UGyalNoY>

All of our published reports can be found on the FRC’s website: www.frc.org.uk/Lab

Do you have suggestions or want to get involved?

The Lab encourages readers of this report to provide comments on its contents and get involved in upcoming Lab projects. To provide comments or get involved, please contact us at:

FinancialReportingLab@frc.org.uk

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