Federation of European Accountants
Fédération des Experts comptables Européens

Mr Steven Maijoor
European Securities and Markets
Authority (ESMA)
103 rue de Grenelle
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13 May 2014

Ref.: CRPG/AKI/HBL/PPA/SRO

Dear Mr Maijoor,

Re: FEE comments on European Securities and Markets Authority (“ESMA”) consultation on Alternative Performance Measures (“APMs”)

FEE (the Federation of European Accountants, www.fee.be) is pleased to provide you below with its views on the ESMA consultation on Alternative Performance Measures (“APMs”).

FEE welcomes the initiative undertaken by ESMA to review the existing CESR Recommendations (“Recommendations”) with the aim to strengthen the principles contained in those Recommendations.

FEE actively supports the improvement of Corporate Reporting. APMs play an important role in Corporate Reporting as they can improve the communication between the entity and its stakeholders as long as they are reported in a transparent and unbiased manner. FEE supports the acknowledgement from ESMA that APMs fulfil an important role in Corporate Reporting.

FEE supports the effort of producing this framework on the European level as it would contribute to enhancing the reliability, relevance and understandability of APMs. We note that in accordance with the ESMA regulation, National Competent Authorities (“NCAs”) should make every effort to comply with the [draft] guidelines and are expected to incorporate these guidelines into their supervisory procedures and practices, and monitor compliance. However FEE underlines that the ultimate enforcement of the [draft] guidelines lies with NCAs.

However, FEE believes that the scope of the [draft] guidelines and the definition of APMs are too wide and need to be revised. In addition, FEE suggests that the [draft] guidance should clarify how it would interact with other principles, guidance and rules that exist and govern the preparation and presentation of financial and non-financial information, for example accounting standards (i.e. IFRS) or local legislation.

FEE identifies six main areas that the [draft] guidelines should address regarding the reporting of APMs. These are the definition and calculation of APMs, their reconciliation to financial information, their consistent application, benchmarking and industry comparisons and finally the “management’s interpretation” of APMs.

Similar to the CESR Recommendations, these [draft] guidelines address the main issues that arise from the use of APMs; they are not covering benchmarking and industry comparison and analysis and "management's interpretation" of APMs. In FEE's opinion a reference to industry best practice and to industry information, to the extent that such information is available and reliable, would enable issuers to identify proper benchmarks and facilitate management in the interpretation of APMs.

FEE believes that the International Accounting Standards Board ("IASB") should also be involved in the reporting of APMs in the context of financial reporting. *IAS 1 – Presentation of Financial Statements* allows entities to present their income statement by nature and include any subtotals that they believe are material and enhance the understanding of users. Therefore an entity can easily report measures like EBITDA or EBIT on the face of the income statement. Furthermore, the IASB has already in the past provided guidance on other APMs, for example *IAS 33 – Earnings per Share* and the requirements for presenting information that is used by management (which might include APMs) under *IFRS 8 – Operating Segments.*

Therefore, FEE suggests that ESMA should also work with international organisations, such as the IASB and the International Organisation of Securities Commissions ("IOSCO") in order to align efforts in developing [draft] guidelines towards the developments of global guidance in the field of APMs.

Finally FEE would like to take this opportunity to invite ESMA for a constructive and forward looking meeting during which we exchange views in relation to financial reporting and its enforcement and the accountancy profession's contribution to its improvement, including on APMs and the [draft] guidelines.

FEE's responses to the specific questions raised in the consultation are included in the enclosed appendix.

For further information on this letter, please contact Pantelis Pavlou, Project Manager, from the FEE Team on +32 2 285 40 74 or via e-mail at pantelis.pavlou@fee.be.

Yours sincerely,

André Kilesse
President

Olivier Boutellis-Taft
Chief Executive

Encl.
Appendix – FEE responses to specific questions.

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?

FEE supports efforts for defining a solid framework on how issuers should report APMs as this promotes transparency among market participants. Having a consistently applied framework enhances the public's confidence in financial and non-financial reporting, the comparability between entities and over time as well as users' understandability thereof.

FEE agrees that the ESMA guidance should apply to the issuers as defined in the [draft] guidelines. We note that National Competent Authorities (NCAs) should make their best efforts to comply with ESMA guidelines (in accordance with Article 16 (3) of the ESMA Regulation); however FEE underlines that the ultimate enforcement of the [draft] guidelines lies with the NCAs.

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?

FEE's response refers to IFRS as adopted by the EU, however relevant points can be drawn for the other financial reporting frameworks that are applied in different EU member states.

In principle FEE agrees that the [draft] guidelines should be applied to APMs included in the financial statements and to APMs included in other documents issued containing regulated information that are made publicly available. However FEE believes that the [draft] guidelines should better clarify which information is included in the scope (e.g. whether press releases or presentations to investors should be included in the scope) and whether ESMA intends to leave the decision to apply its [draft] guidelines to the NCAs.

FEE acknowledges that APMs might be included as part of the financial statements in an effort to enhance financial and non-financial reporting. Therefore FEE suggests that the [draft] guidelines should refer to the flexibility on the different locations that APMs can be reported in.

Regarding APMs that are included in the financial statements, FEE identifies that there might be some implications for the audit of financial statements. Users would appreciate information on whether those APMs have been audited or not, therefore they should be clearly labelled and we encourage that ESMA should consider providing guidance on how the issuers should report APMs in financial statements.

In addition to any APMs reported in the financial statements, as a common practice, entities usually issue other financial and non-financial information in the same document or publication which includes the financial statement (e.g. the management's report). The [draft] guidance should apply to APMs included in these reports in order to provide guidance to issuers on how to present and to users on how to interpret such information.

FEE suggests that the [draft] guidelines should also clarify the audit requirements on the APMs reported within the same document or publication as the financial statements. The current CESR Recommendation refers to the audit requirements under International Standards on Auditing (ISAs) and specifically to *ISA 720 The Auditor's Responsibilities Relating to Other Information in Documents Containing or Accompanying Audited Financial Statements and the Auditor's Report Thereon*. FEE draws attention to the fact that the International Auditing and Assurance Standards Board ("IAASB") has issued a second Exposure Draft on *ISA 720* and encourages ESMA to monitor such development and align the [draft] guidelines to the revised *ISA 720*.

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 or Prospectus Directive implementing regulation)? Please provide your reasons.

FEE believes that the [draft] guidance should be applicable to APMs included in prospectuses and other related documents that are not governed by the Prospectus Directive or Prospectus Directive implementing regulation. However FEEs encourages ESMA to explain how these [draft] guidelines would interact with the existing regulations and guidance.

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?

FEE identifies six main issues encountered with the use of APMs:

a) The definition of APMs;
b) The calculation of APMs;
c) The linkage of the APMs to the latest financial information;
d) The consistent application of APMs;
e) How the APMs facilitate benchmarking analysis and comparisons with industry information; and finally
f) Whether management takes an unbiased position when explaining or interpreting APMs ("management's interpretation").

The [draft] guidelines, as the already existing CESR Recommendations, address the majority of the issues that FEE identifies apart from the benchmarking analysis and management's interpretation of the APMs. Despite this fact, the [draft] guidelines constitute a useful tool for dealing with the main challenges that the issuers of APMs face.

FEE suggests that ESMA should consider promoting a reference to industry best practice and industry information to the extent the information is available and comes from a reliable source. This would assist in identifying proper benchmarks and in interpreting APMs.

FEE suggests that the reference to industry best practice could be introduced in the [draft] guidelines as an element that would enhance the quality and relevance of the reported APMs as well as users' understandability thereof. However, the [draft] guidelines should avoid providing detailed guidance on each industry and its relevant APMs.

Finally FEE points out that the need for an acceptable framework dealing with APMs is not limited to the European Union. Other international organisations have undertaken initiatives to prepare such frameworks, for example, the International Federation of accountants ("IFAC") has released a consultation on *International Good Practice Guidance on "Developing Reporting Supplementary Financial Measures – Definition, Principles and Disclosures*. Therefore we strongly suggest that ESMA should work together with international standard setters and regulators like IFAC, IASB and IOSCO, in order to align efforts in developing and applying a framework dealing with APMs.

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

In principle, FEE agrees with the definition of APMs; however some practical issues might arise since the definition might be considered too wide especially regarding the non-financial information.

The definition of APMs as included in the [draft] guidelines refers to any measures that are not defined by the applicable financial reporting framework. In the context of IFRS only very few performance measures are defined since IFRS serve as a principles-based reporting guidance, which provides flexibility on the presentation of financial statements.

Furthermore, *IFRS 8 – Operating Segments* requires that an entity presents information that is used by chief operating decision makers which is not necessarily prepared under IFRS; therefore it might include APMs not defined in IFRS.

Therefore FEE encourages ESMA to explain how the [draft] guidelines would interact with the existing reporting requirements, e.g. the IFRS or other country specific legislations.

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?

FEE agrees with the need for disclosing the definitions of APMs and how they have been calculated. However the way that APMs are presented should be at the discretion of the issuer, i.e. issuers may decide that the use of an appendix is the best way to present the definitions and calculations or that the information is best presented in the body of a report or in the financial statements.

In addition, FEE believes that issuers shall assume that users have a basic knowledge and understanding of the issuers' business and industry and that some APMs do not necessarily need to be defined, as long as they are properly labelled (e.g. EBIT or EBITDA).

Furthermore the [draft] guidelines should allow for some flexibility regarding the definition of those APMs that are used by the issuer on a systematic basis. Those APMs can be defined once and then subsequent information can refer to the existing definition of APMs as long as adequate transparency on the presentation of APMs is achieved.

FEE encourages ESMA to consider ways to avoid over-prescriptive rules and guidance as this might lead to the use of boilerplate reports which might impair the usefulness of the information for users or might force issuers to cease reporting specific APMs due to administrative costs.

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?

FEE agrees that issuers should present reconciliations to the most recently published financial information. Reconciliations should identify the source of information (i.e. annual or interim financial statements) and should also state whether that financial information has been audited.

If issuers need to adjust some figures that have been extracted from the financial statements they should explain the rationale for these adjustments (e.g. the APMs at 30 September might use the profit reported in the interim financial statements of the 6-month period to 30 June and add the 3 month profit up to 30 September. This might be necessary in instances that the quarterly results are not published or are not audited).

However, certain industries use APMs that are based on information that is not included in financial statements nor derived from financial reporting systems. Therefore, the reconciliation to the financial statements might be very burdensome and the related costs may outweigh the benefits for users. In particular paragraph 22 requires explanations of each reconciling item and this could lead to an unduly large volume of disclosures.. FEE suggests that ESMA should clarify that reconciliations for APMs, that do not use information derived from financial reporting systems, are not applicable and, therefore, an exception should be introduced in the [draft] guidelines for such circumstances.

FEE agrees with paragraph 25 of the [draft] guidelines which provides a relief to issuers from providing reconciliations if the totals or subtotals are directly readable from the financial statements as long as there is proper reference to those financial statements.

Finally, with reference to assurance on reconciliations, unless the entity has requested additional assurance on APMs it should be explicitly stated that despite that the information used has been extracted from audited financial statements, the APMs and the reconciliations have not been audited. Such an explicit statement would enable users to assess the extent to which they can rely on the reported APMs.

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

FEE agrees that issuers should explain the rationale for selecting the reported APMs and why they believe that these APMs complement the presentation of the underlying performance, position and cash flows of their entity as reported in accordance with the applicable financial reporting framework. This would enhance transparency in the reporting of APMs.

However, FEE believes that users should have a general understanding of the issuers' industry. Therefore the [draft] guidelines should not require any additional explanations regarding the use of APMs; instead it should be at the discretion of issuers whether additional guidance should be provided to enhance users' understandability.

Finally a reference to industry performance, e.g. industry averages, might enhance the usefulness of the information presented as well as users' understandability thereof. The [draft] guidelines could promote such references for certain APMs that can be compared within the industry, provided that such information is available and that it comes from a reliable source (e.g. industry regulator).

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?

Prominence comes in different forms, e.g. order of presentation, the emphasis given or the font that is used. However ESMA does not sufficiently explain the overall objective of the [draft] guidelines therefore the issuers are not provided with clear guidance on how the APMs should be reported. In FEE's opinion, the [draft] guidelines should aim to provide reliable, relevant and faithfully represented information to users which complements the financial statements. Clarifying the overall objective would enable the issuers to identify the best way to present the APMs.

Furthermore, FEE believes that the information presented should be balanced. This means that management should provide transparent information on how the APMs have been selected, on the definition as well as on the calculation of APMs to ensure an unbiased presentation which provides a comprehensive financial view of the reported entity. The "management's interpretation" of APMs should facilitate, not influence, the users' assessment of the entity's performance and position when making their economic decisions.

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

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

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

These questions can be grouped together as in FEE's view they relate to the consistent application of APMs. As already stated, consistency is one of the main issues that relates to reporting of APMs.

Critics of APMs argue that issuers can choose to report those APMs that present the most favourable position, performance or cash flows. Therefore, FEE strongly agrees that issuers should explain the reasons for changing the definition or calculation of APMs in order to enhance the credibility of the reported information.

Requesting to report the reasons for any changes in the selection of APMs enables users to assess the management's views and it also eliminates any concerns relating to management bias and to "cherry picking" only the favourable APMs.

FEE suggests that to the extent that the costs to issuers do not outweigh the benefits for users, issuers should present comparative information on those APMs that have been changed or redefined. In addition, issuers should assess whether they shall present comparable information for more than one period. This might be expected, as often issuers present APMs for more than one comparable period. Therefore, depending on the reasons for the change in the APMs' measurement or definition, the industry practice, the availability of information and the cost-benefit analysis, issuers should assess to which extent comparable information should be presented.

Finally, FEE agrees that similar explanations should be presented when issuers decide to cease reporting some APMs.

Such requirements for transparency ion the reporting of APMs enhance the understandability, comparability and reliability of the reported information.

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

Transparency can be achieved by establishing a framework on how the APMS are reported and how they are interpreted in the management's analysis and interpretation. Applying a best practice framework can help issuers to present an analysis which is also accurate and relevant to users.

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Neutrality and comparability are also subject to proper implementation of the guidance by issuers with reference to the industry benchmarks and best practice. As explained above, a reliable benchmarking analysis and an unbiased “management’s interpretation” are the two key areas that enhance the neutrality and comparability of the financial performance measures for users.

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 of the proposals.

FEE is not in a position to comment on the cost benefit impact of the [draft] guidelines.