

The Committee of European Securities Regulators  
11-13 Avenue de Friedland  
75008 Paris  
France

15 July 2005

Dear Sirs

### **Recommendation on Alternative Performance Measures**

We are writing to you on behalf of the PricewaterhouseCoopers firms in Europe in response to your request for comments on your proposed recommendation on alternative performance measures.

We are strongly of the view that transparency of the information provided to the markets should be encouraged. IFRS will not be viewed as consistent if many different types of performance measures and many types of presentations are used by companies, without being able to identify the differences. Hence we believe that guidance on presentation and disclosure of alternative performance measures is needed in order to promote consistency and transparency of corporate reporting across the European Union.

We believe that a recommendation of this type, rather than a more legislative approach, is an appropriate tool to deal with these issues and we welcome CESR's initiative.

### **Aligning approaches in major markets**

It will be beneficial to investors if similar approaches are adopted in major markets. For example, the US Securities and Exchange Commission (SEC) has already issued guidance on the use of non-GAAP financial measures in filings with the Commission. A harmonisation, as far as possible, of CESR recommendations and SEC requirements would be in line with the cooperation and collaboration agreement between the two supervisors. Also, it would allow investors in relevant markets to have access to consistent financial information. However, rules similar to the SEC's would be particularly difficult and inappropriate to implement for IFRS preparers at present, given the definition of alternative performance measures proposed and the nature of the IFRS framework which has very few defined/required measures compared with US GAAP.

The IASB and FASB joint project on Performance Reporting is currently examining the format and defined measures to be required on the face of the financial statements. When available, the outputs of the standard setters' joint project will be of particular relevance to

CESR's final recommendation to its members. We believe that evolution in the development of defined measures will make CESR's recommendations easier to apply and will facilitate transatlantic consistency.

SEC rules state that preparers should not present non-GAAP financial measures on the face of the financial statements or in the accompanying notes. However, IFRS, as a principles-based financial reporting framework, provides less guidance on presentation and classification of financial information than does US GAAP. We believe that CESR's recommendations should provide guidance on the appropriate location and prominence of alternative performance measures within the preparers' financial statements.

### **Application to different types of information and different media**

Companies routinely present financial and non-financial information in the format of presentations or announcements to investors and analysts. Whilst we understand CESR's concern about the transparency and consistency of information released to the markets through these channels, we believe the issues related to these other forms of communication should be addressed in a second stage. We encourage CESR to focus this recommendation on information to be filed with CESR members, as national securities regulators.

### **Auditor involvement**

We note that CESR has suggested that 'auditors could have a role in assuring issuers provide reliable, comparable and consistent information to investors in relation to alternative performance measures'. However, we are concerned that this may be misunderstood as a blurring of the distinction between the responsibilities of management and the auditors.

Certainly, auditors could be called upon to provide assurance on performance measures, contributing to the release of reliable, comparable and consistent information. However, it is not the auditor's role to help management decide what performance measures should be disclosed.

International Standards on Auditing define the auditor's responsibilities regarding other financial information included within the financial statements or outside the financial statements but in documents containing audited information. The auditor's responsibilities will depend on the specific circumstances affecting the engagement. For example, they will depend on: the nature of the indicator (e.g. financial/non-financial); its location in the report (e.g. within/outside the financial statements) and on the level of assurance provided on information to which the indicator relates (e.g. where there are cross-references between the alternative measures presented and other audited or reviewed information).

Our responses to the specific questions in the consultation paper are set out in the Appendix to this letter. We have also addressed other matters arising from the proposed recommendation under the respective section headings.

We would be happy to discuss with you any of the points made in this letter. In the first instance you should contact Ian Wright (+44 207804 3300) or Fernando Orihuela (+44 207804 2381) at the above address.

Yours faithfully

PricewaterhouseCoopers LLP

## APPENDIX

*1: Should additional elements be considered in terms of background? Do you agree that the current practice of presenting alternative financial performance measures justifies CESR's initiative? If not, please indicate why.*

We agree that it is becoming common practice for companies to provide analysts and other users with alternative financial performance measures - also described as “non-GAAP performance measures”- such as “EBITDA” and therefore guidance on disclosure, presentation and audit reporting on such indicators is needed.

*2: Do you think that a recommendation is an appropriate tool for dealing with this issue?*

Yes. We believe that a recommendation from CESR is an appropriate tool and we view the proposal as an important step towards greater transparency and consistency of corporate reporting in Europe. We do not consider that more prescriptive or legislative approaches are needed. However, in order to promote market confidence in the consistency of corporate reporting across Europe, we believe that CESR should mandate its members to in turn issue the principles set out in this paper at least as national recommendations.

*3: Do you agree with this definition of alternative performance measures? If not, please state your reason.*

It is not clear whether this recommendation applies to all kinds of alternative performance measures or only to financial performance measures.

Section B of the document defines “alternative performance measures”, however the definition in paragraph 7 states “CESR assumes all other financial performance measures are not defined”. We encourage CESR to make it clear whether “not defined” financial performance measures and alternative performance measures are treated as synonymous for the purpose of this recommendation.

Paragraph 7 seems to imply that “defined measures” are those defined in paragraph 81 and 83 of IAS 1 and in IAS 33. We would not refer in the definition to paragraph 83 of IAS 1 and we would refer to these measures as “measures required by IAS 1.81 and IAS 33” rather than “defined measures”. We would define “alternative measures” as “those measures not required by IAS 1.81 and IAS 33”.

We encourage CESR to consider expanding the qualitative guidance regarding the definition of alternative performance measures, considering for example its nature. It would be helpful to distinguish for example financial and non-financial performance measures, and those based on historical information as distinct from forward-looking measures.

*4: Do you agree that the principles described in this draft recommendation are valid for any kind of reporting to markets by issuers (with the exception of prospectuses)? If not, please state your reasons.*

We believe that it may be difficult for preparers to apply this recommendation to all types of communications to the markets containing information of a financial nature.

It is common practice for EU listed companies to present financial information to analysts and investors. These reports vary in form and length, from complex and detailed announcements to short presentations on key figures, indicators or new developments. Irrespective of their degree of elaboration, these reports may have wide distribution (e.g. included in the company's website), media coverage and impact on stakeholders.

Whilst we understand CESR's concern about the transparency, consistency and reliability of all information released to the markets, we encourage CESR to address these other types of communications in a second stage and to keep this recommendation focused on financial information to be filed with CESR members, as national securities regulators.

*5: Do you agree with the scope of this recommendation (paragraph 14) and the content of this recommendation (paragraph 16 to 22)? If not, please state your reason.*

We agree with CESR regarding the scope of the recommendation. Information under the scope of the European Commission's Regulation on Prospectuses should not be covered by this recommendation.

Although the approaches are similar, we note that the following principles in this recommendation are not specifically addressed in CESR's previous advice on the consistent implementation of the EC Regulation on Prospectuses:

- Provide comparatives
- Present alternative performance measures consistently over time
- Explain why alternative performance measures are presented and how they are used internally

We believe that the principles defined by CESR in this recommendation should be consistently applied irrespective of whether the alternative performance measures are included in a prospectus document or other filings (e.g. the company's annual report).

We strongly agree with the principle that alternative performance measures should be presented with less prominence than GAAP measures. We would encourage CESR to provide examples of situations where GAAP measures are presented with greater prominence than alternative performance measures – for example where alternative performance measures are presented in light type and GAAP measures in bold type.

CESR should provide guidance on the appropriate location of alternative performance measures in the financial statements. In this regard, we note the SEC rules state that preparers should not present non-GAAP financial measures on the face of the financial statements. However, as there are so few line items and subtotals required under IFRS and considering that IAS1.83 allows additional items, subheadings and subtotals to be presented on the face of the income statement in certain circumstances, the SEC approach may well be inappropriate for IFRS reporters. CESR may need to adopt a different approach. It is our view that such indicators as those covered by IAS1.83 should only be included on the face of the financial statements where the principles set out in the recommendation are observed. There would need to be a review of each circumstance to ensure that any alternative performance measures presented did not detract from the fair presentation of the GAAP amounts (for example because of the prominence, lack of comparability, cluttering of the financial statements, etc.)

Finally, we note that the recommendation requires issuers to “explain the differences” between the alternative performance measures presented and the defined measures. In the interest of clarity, we suggest CESR require issuers to provide a reconciliation between the alternative performance measures presented and the most directly comparable GAAP-based measures.

*6: Do you agree with CESR’s recommendation to involve the auditor in relation to alternative performance measures? If not, please state your reason.*

CESR has suggested that ‘management should consider involving the auditor in relation to alternative performance measures’. However, we are concerned that this may be perceived as a blurring of the distinction between the responsibilities of management and the auditors. The auditor should be, and should be seen to be, independent from management – it is not the auditor’s role to help management decide what performance measures should be disclosed. The auditor may however be called upon by management to give assurance on alternative performance measures.

The auditors’ responsibilities in connection with alternative performance measures will depend on the specific circumstances. For example, it will depend on the nature of the indicator and its location in the company’s financial report.

Alternative performance measures included within the financial statements are likely to be considered closely related to the financial statements and therefore, covered by the auditor’s report. In these circumstances the auditor should carry out additional procedures in order to obtain sufficient appropriate audit evidence regarding the measures presented.

In accordance with International Standard on Auditing 720, if alternative performance measures are presented outside the financial statements but within a document containing audited financial information, the auditor has certain responsibilities, even if there is no requirement to report on them. In these circumstances, the auditor should read the information containing the alternative performance measures to identify any material inconsistency with the financial statements and discuss with management misleading items or misstatements of fact. In some territories auditors are required by local regulation to report on the whole annual report or prospectus document filed with the national regulator.

The auditor's involvement would also depend on the nature of the indicator. It might be difficult for the auditor to assess alternative performance measures that are not of a financial nature or where the indicator is not defined and there are no criteria to evaluate the measure against.