

technical release



TECH 29/05

ALTERNATIVE PERFORMANCE MEASURES

Memorandum of comment submitted in July 2005 to the Committee of European Securities Regulators regarding the consultation paper 'CESR Recommendation on Alternative Performance Measures'

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INTRODUCTION

1. The Institute of Chartered Accountants in England and Wales welcomes the opportunity to respond to the Consultation Paper 'CESR Recommendation on Alternative Performance Measures', published by the Committee of European Securities Regulators for comment on 11 May 2005.
2. We have reviewed the consultation paper and set out below our overall response and then our answers to the specific questions raised.

OVERALL RESPONSE

3. We welcome CESR's initiative in seeking to encourage and harmonise best practice in the use of alternative performance measures throughout Europe. We support the underlying principle of the draft guidance, that '*alternative performance measures can provide investors with appropriate additional information. Properly used and presented, these measures can assist investors in gaining a better understanding of a company's financial performance*'. This view contrasts with the approach adopted in the United States of prohibiting the use of non-GAAP measures, which in our view detracts from the quality of financial information available to the markets.

SPECIFIC QUESTIONS

Question 1

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

4. We are content with the background elements taken into account by CESR.
5. We agree that CESR's initiative is justified.

Question 2

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

6. Yes. However, CESR should make it clear that it is addressing its own members, rather than companies direct. CESR might indicate the extent to which, if at all, it considers that its members should require companies to implement the recommendations, rather than merely recommend that companies implement them.

Question 3

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

7. We agree in principle. However, it is possible that the definition could be construed too broadly in practice, to bring in a range of non-financial performance measures. We suggest that CESR confirms that its guidance deals only with financial performance measures.
8. Diluted Earnings Per Share (EPS) is also a defined measure, and should be referred to as such in the CESR guidance.
9. While we agree with the defined measures identified by CESR in IAS 1 and IAS 33 (subject to the addition of diluted EPS), we note that further measures may come to be defined in IFRS. We suggest that CESR should consider including a statement of principle in the recommendation to the effect that defined measures are those defined in accounting standards at the time the financial statements are prepared. The text could then go on to identify those defined in standards current at the time of issue of the recommendation.

Question 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 reason.

10. We agree.

Question 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.

11. We support the proposed requirement in paragraphs 17 and 18 for definitions and explanations of differences, which are in line with UK practice on preliminary announcements set out in APB Bulletin 2004/1. However, paragraph 18 should be strengthened to make it clear that companies should present a comprehensive reconciliation of the differences between the defined and the alternative performance measures so that, for example, the individual items excluded from adjusted earnings and the assumed tax effect of each item are given. Where there is no defined performance measure for comparison, the company should provide an explanation of the basis of the measure it presents.
12. We do not agree that companies should 'present defined measures with greater prominence than alternative performance measures' (paragraph 21). A requirement to present alternative measures with no greater prominence than the defined measures would be preferable in principle and easier to achieve in practice.

Question 6

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

13. Question 6 does not replicate the thrust of paragraph 23, which states that the 'company should *consider* involving the auditor in relation to alternative performance measures' (*emphasis added*). We are content with paragraph 23, but it is important that CESR does not - by design, or inadvertently - add to the existing responsibilities of auditors through piecemeal extensions. The auditor is already required to report on performance indicators to the extent that they form part of the notes to the accounts, part of the annual report or other supplementary information. Such a requirement is covered by other legislation, notably the accounting and transparency directives, and by ISAs. The Fourth Directive requires statutory auditors to express an opinion on the consistency of the annual report with the annual accounts, and ISA 700 introduces a requirement from 2007 for a consistency check on unaudited supplementary information.
14. Clearly, CESR has no remit to set requirements for auditors, although it has a role in offering advice to its members. Given the existing requirements set out in paragraph 13 above, and the lack of certainty attached to any CESR pronouncement on auditor involvement, we suggest that the recommendation should remain in the nature of encouragement without purporting to establish any additional requirements.