

Secretary General
The Committee of European Securities Regulators

11 July 2005

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Dear Sirs,

CESR RECOMMENDATION ON ALTERNATIVE PERFORMANCE MEASURES

The global organisation of Ernst & Young is pleased to respond to the above consultation paper.

Whilst we are supportive of the initiative to encourage listed companies to provide the financial markets with appropriate and useful performance measures, the draft Recommendation is a poorly drafted document. In particular, since alternative performance measures are not adequately defined in the document, the actual recommendation is rendered somewhat meaningless.

We set out below our comments on each of the questions posed in the consultation paper. We then suggest an alternative presentation for the Recommendation.

In our view, if there is to be any chance of achieving pan-EU consistency and comparability on this important subject, the status of this document should be elevated to that of a mandatory requirement for national regulators to incorporate into their Listing Rules (ie similar to CESR Standard No.1).

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.

The background is sufficient.

The diversity in practice of presentation of alternative presentation measures and how they are used and calculated justifies the initiative. We support CESR's view that properly used and presented alternative performance measures complement GAAP measures. In our view the Recommendation should state explicitly that its objective is to eliminate misleading information from the market place.

Question 2: Do you think that a recommendation is a [sic] appropriate tool for dealing with this issue?

As noted above, in our view, in view of the importance of this issue and the need for consistency and comparability throughout the EU, the status of this document should be elevated to that of a mandatory requirement for national regulators to incorporate into their Listing Rules (ie similar to CESR Standard No.1).

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

No. Alternative performance measures are not in fact defined in the paper as it is not clear from paragraph 7 what the phrase 'all other financial performance measures' actually means.

The 'defined measures' identified in paragraph 7 of the consultation paper are all income-related. However, it appears from paragraph 3 of the consultation paper that CESR intends cash flow and balance sheet-based measures to be regarded as alternative performance measures. If so, a term such as 'cash flows from operating activities', for example, is sufficiently well defined in IAS 7 to be regarded as a 'defined measure'.

We agree with the concept but, as currently written, it seems to encompass common financial statement measures such as dividends per share and we believe that to be inappropriate. The proposal should not apply to common nomenclature found in financial statements prepared in accordance with an applicable set of generally accepted accounting principles. Measures or ratios that use financial measures extracted without amendment from the financial statements (eg cost per employee, cost per tonne) should be scoped out of the definition of alternative performance measures.

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 reasons.

Generally yes. However, paragraph 12 should identify the more important reporting mechanisms such as results announcements.

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.

Generally yes, however, we have certain questions and observations.

Paragraph 14 limits the scope of the draft Recommendation to consolidated performance figures even though the market often considers alternative performance measures on a segment basis. We believe the scope generally should include those measures so long as the draft recommendation would not conflict with other existing literature (eg, use of EBITDA in segment information).

In paragraph 16, the characteristics mentioned are not 'principles for financial reporting' but are the qualitative characteristics that make information in financial statements useful to users. The four characteristics mentioned are not, as stated, 'examples' but are comprehensive.

We are not sure what is meant in paragraph 17 by the phrase 'define the terminology used'. We assume that this is calling for issuers to explain the terminology in the document in which the alternative performance measure is published. The wording of paragraph 17 should be clarified.

Paragraph 18 is expressed in such general terms that it is impossible to know what is intended. In particular, it is not clear whether the phrase 'in combination with' means 'in the same document', or 'immediately adjacent to', or whether some sort of reconciliation of the alternative performance measure with the relevant defined measure is being recommended. The requirement in the second sentence of paragraph 18 to explain the differences between an alternative performance measure and a defined measure suggests some sort of reconciliation. However, since paragraph 7 of the draft recommendation states that there are only three defined measures and that all other financial

performance measures are not defined, such a reconciliation requirement is highly impractical. Furthermore, operating measures or statistics (for example cost per employee or cost per tonne) cannot be compared with defined measures and, as noted above in answer to question 3, should be scoped out of the definition of alternative performance measures.

Paragraph 19 should specify that the periods of comparable guidance should match the related financial statements.

The recommendation in paragraph 21 that issuers present defined performance measures 'with greater prominence than alternative performance measures' is in our view inappropriate in the light of CESR's statement in paragraph 5 that 'properly used and presented, [alternative performance] measures can assist investors in gaining a better understanding of a company's financial performance'. We suggest that the requirement be changed to 'at least equal prominence'.

Taken in isolation, paragraph 22 appears appropriate and sensible. However, as CESR has identified only three defined measures and regards all other financial performance measures as alternative performance measures, the effect of paragraph 22 could be to require issuers to explain numerous measures. This reinforces the need to restrict the definition of alternative performance measures as we have suggested.

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

Paragraph 23 is grossly deficient in not explaining the nature or extent of the auditor involvement that CESR has in mind.

In relation to other information that is published by an issuer in a document containing audited financial statements, International Standards on Auditing (as well as national auditing standards in various countries) require the auditor to read the other information to identify material inconsistencies with the financial statements. The auditor has no specific responsibility to determine that the other information is properly stated.

An extension of the auditor's responsibilities in relation to other information such that the auditor had 'a role in assuring (sic) issuers provide reliable, comparable and consistent information to investors in relation to alternative performance measures' would involve significant modifications to auditing standards and a significant increase in the scope of the auditor's work.

Furthermore, according to paragraph 12 CESR intends the draft recommendation to apply 'to any kind of reporting to markets by issuers', including results announcements, ie not merely to other information in documents containing audited financial statements. It would therefore seem that CESR is recommending that auditors become involved in other reports by issuers.

It is essential to address the practical implications of auditor involvement before recommending such involvement. We therefore urge CESR to delete paragraph 23 until such time as the implications have been addressed and a practicable way forward has been found.

Alternative Presentation of the Recommendation

While we are supportive of the initiative to encourage listed companies to provide the financial markets with appropriate and useful performance measures, we would like to offer an alternative presentation for the draft recommendation in an effort to make the document more understandable and operational.

We believe that the draft recommendation should be based on a set of guiding principles, presented after the background and definitions, which we summarise as follows:

- Companies should be encouraged to present alternative performance measures that complement required financial statement presentation in accordance with generally accepted accounting principles which, for companies domiciled in the European Union generally will be International Financial Reporting Standards. Companies that use alternative performance measures appropriately can provide investors and other users of the financial statements with valuable analytical insights into how their business is managed and what lies ahead in the future. Companies should be encouraged to disclose why the alternative performance measures are presented.
- If applicable, companies that report alternative performance measures should present those measures alongside the related information reported in accordance with generally accepted accounting principles. The alternative performance measures should not be given more prominence than the related information reported in accordance with generally accepted accounting principles. Companies should be encouraged to reconcile the alternative performance measure to the related information reported in accordance with generally accepted accounting principles.
- Companies that present alternative performance measures should disclose the basis of presentation and generally should use that basis consistently. If the basis of presentation is changed, the reason for the change should be disclosed. Comparative figures should be provided for the same periods required for the related financial statements, however more periods should be allowed.
- If a company makes use of alternative performance measures they should not be misleading nor should the measures re-cast generally accepted accounting principles in any circumstances.

Should you wish to discuss the contents of this letter, please contact David Lindsell at ++44 20 7980 0106.

Yours faithfully

