



Alternative Performance Measures:

ARE THEY MEETING USER NEEDS?

JULY 2017



EXTERNAL REPORTING BOARD
Te Kāwai Ārahi Pūrongo Mōwaho

Introduction

THE EXTERNAL REPORTING BOARD

The External Reporting Board (XRB) is responsible for financial reporting strategy and for accounting and auditing & assurance standard setting in New Zealand.

Our aim is to assist in giving New Zealanders trust and confidence in the financial reporting of our organisations, across the for-profit, public and not-for profit sectors. Alternative Performance Measures (APMs) are company performance measures other than those reported under Generally Accepted Accounting Practice (GAAP). They are used by companies all around the world to help them explain their performance. Examples include 'underlying profits', 'normalised profits', and EBIT (earnings before interest and tax).

We undertook this survey to better understand how APMs are viewed and whether they are effective in meeting the needs of users of financial reports in New Zealand.

METHODOLOGY

The survey was conducted via an online questionnaire between November 2016 and January 2017. A total of 87 users, mainly individual equity investors, responded to the survey.

There was an even split between those who classified themselves as non-expert and expert in terms of their use of financial information.

The responses from the majority of both non-expert users and expert users were generally consistent. There were variations in the percentage response rates to individual questions but there were no statistical significant differences between the two groups for the use of APMs, their information needs and/or the understanding of APMs and related information.



45.3%

A prudent but non-expert user of financial information

42.7%

A professional and/or expert user of financial information

12%

Other
(Consider themselves having a better than average expertise in using financial information)

The results in summary

APMs ARE USED AND FOUND TO BE USEFUL FOR ASSESSING A COMPANY'S PERFORMANCE

88.5%

found APMs useful or sometimes useful



"MOST HELPFUL"
"ABSOLUTELY NECESSARY"



11.5%

found APMs not useful

"MESSAGE THE FIGURES"
"ROSY GLOSS ON PERFORMANCE"



Respondents use APMs to clarify, understand and assess a company's business, underlying performance and future prospects. APMs are widely used, but are also subject to a few caveats, with respondents wanting to understand why they are being used and how they have been calculated.



67.8%

found **multiple** APMs really useful or usually useful



"IMPROVED USER CONFIDENCE. MANAGEMENT IS VOLUNTARILY PROVIDING ADDITIONAL INSIGHTS"

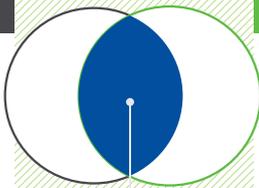


APMs ARE MOST USEFUL WHEN VIEWED ALONGSIDE GAAP MEASURES

GAAP

20.7%

use GAAP as the primary measure of performance



APM

18.4%

use APMs as the primary measure of performance

56.3%

use both **GAAP** measures and **APMs** together

One of the main reasons for using APMs was the growing complexity of GAAP, and the difficulty users have determining a company's core operating business performance from GAAP financial statements.

The usefulness of APMs depended on the adjustments made, the frequency of 'unusual' or 'one-off' items, and the reasons for the company's APMs.

APMs SHOULD BE RECONCILED OR EXPLAINED AGAINST GAAP MEASURES



80.2%

found the **reconciliation** or **explanation** between an APM and a GAAP measure useful, with many commenting that this information is **essential, vital** or **should be mandatory**



61.4%

recalled company **disclosing reconciliations** and **explanations**

91.4%

Of those, **the vast majority** understood the **reconciliation** and **explanation**

The results in summary

APMs ARE RELATIVELY WELL UNDERSTOOD

71.9% were clear whether a company was referring to a GAAP measure or an APM

71.4% understood the reason the company was using the APM, and 76.2% agreed that the APM met the intended purpose

77.8% understood how the APM was calculated or derived

83.1% were comfortable that APMs with accepted calculation methods (eg EBIT) were calculated in the usual way

Overall, respondents were not confused by APMs but many question why specific APMs have been used or how they have been derived.

WHAT ARE THE MOST USEFUL APMs?

1

UNDERLYING PROFIT

2

EBITDA

Most respondents found APMs useful as they provide an insight into what management considers to be important measures. However, at the same time respondents were cautious as they believe companies tend to choose measures that show a better picture than GAAP measures.

APMs NEED TO BE CLEAR – WHY THEY ARE BEING USED AND HOW THEY HAVE BEEN DERIVED

How can companies improve the quality and usefulness of APMs?

- ✓ Explain how the APM is derived/calculated
- ✓ Provide comparatives for previous years and explain any changes
- ✓ Explain why selected components are included or excluded
- ✓ Explain why the APM is being used and is suitable
- ✓ Indicate whether the measure is a APM or GAAP measure
- ✓ Reconcile to the closest GAAP measure

GAAP IS TRUSTED BUT HAS LIMITATIONS

Should performance measures be limited to GAAP measures?



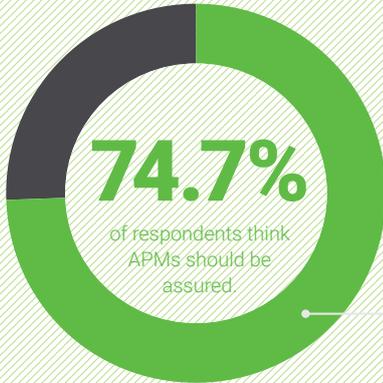
Respondents are looking for measures that provide an indication of the company's 'core' operating activities. APMs, used in conjunction with, or to supplement, GAAP measures often provide this additional detail.

“Do not belittle and make insignificant legitimate expenses”

“Let managers tell their story”

The results in summary

ASSURANCE NEEDS TO BE CLARIFIED



Respondents indicate a lack of clarity and understanding over when APMs have been assured. The respondents presumed APMs were assured because they were derived from audited financial statements and/or because the auditor is required to review the whole annual report for consistency.

While the majority of respondents felt that having APMs assured by an independent auditor would provide greater confidence in the measure, many felt this would be difficult to achieve in practice, as there is often no standardised definition for the APM, the audit may be of little value.

HOW CAN WE IMPROVE GAAP MEASURES OF A COMPANY'S PERFORMANCE?

66.3% support

Accounting standards should provide more information about a company's 'core operations' or 'underlying performance'



There was also some support for:

- ✓ Principle-based definition of operating profit
- ✓ More subtotals in the income statement
- ✓ Standardised calculation of selected APMs
- ✓ More disaggregated information in the income statement
- ✓ Definitions for non-recurring, one-off, and infrequent items
- ✓ Standardised definitions for selected APMs, such as EBIT and EBITDA

What does this mean for XRB?

OUR GOAL IS TO ENSURE THE REPORTING OF CORPORATE PERFORMANCE MEASURES REMAIN APPROPRIATE, CREDIBLE AND MEET USER NEEDS



INTERNATIONAL INFLUENCE AND PARTICIPATION

- We will maintain our strategy of influencing the work of the international standard setting boards to ensure accounting and assurance standards are appropriate for, and continue to be trusted in, New Zealand; and
- We will continue to actively participate and contribute to the International Accounting Standards Board (IASB®) Disclosure Initiative project to ensure improved communication in financial reporting and improved disclosure of performance measures in financial statements.



OPEN CONSTITUENT ENGAGEMENT

- We will actively engage with companies, directors and regulators on the communication of APMs and related information (including any related assurance information) in annual reports and/or other media; and
- We will facilitate and encourage continued discussion to improve corporate reporting.



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