CFA INSTITUTE
Centre for Financial Market Integrity

11 July 2005

Mr. Fabrice Demarigny
The Committee of European
Securities Regulators
17 Place de la Bourse
75082 Paris Cedex 02
France

Via email

Re: CESR's Recommendation on Alternative Performance Measures (Ref. CESR/05-178)

Dear Mr. Demarigny:

The Capital Markets Policy Council (the "Council") of the CFA Institute's CFA Centre for Financial Market Integrity (the "Centre")[1] is pleased to comment on CESR's *Recommendation on Alternative Performance Measures* (the "Consultation"). The Centre, through the experience in international markets and different investment disciplines of the 12 CFA Institute members on the Council, represents the interests of investors and investment professionals to standard setters, regulatory authorities, and legislative bodies worldwide on issues that affect the practice of financial analysis, investment management, and the efficiency of global financial markets.

General Comments

Support for the Proposed Amendment

In general the Council supports CESR's recommendations relating to alternative performance measures ("APMs"). If permitted to present and distribute performance measures without regard for how investors may use such information—either positively or negatively—APMs could mislead investors in their investment decisions. Consequently the Council not only supports the spirit of the proposed principles (the "Principles") but also the content of those Principles.

[1] With headquarters in Charlottesville, VA and regional offices in New York, Hong Kong and London, CFA Institute (formerly, the Association for Investment Management and Research®) is a non-profit professional association of 78,000 financial analysts, portfolio managers, and other investment professionals in 119 countries of which 63,000 are holders of the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 132 Member Societies and Chapters in 52 countries and territories.
The CFA Centre develops, promulgates, and maintains the highest ethical standards for the investment community including the CFA Institute *Code of Ethics and Standards of Professional Conduct*.

Charlottesville New York Hong Kong London
560 Ray C. Hunt Drive
PO Box 3668
Charlottesville, VA
22903-0668 USA
434 951 5499 tel
434 951 5262 fax
info@cfainstitute.org
www.cfainstitute.org

Nonetheless, the Council has two concerns relating to the Principles. First, a mechanism for enforcement must accompany these Principles if they are to achieve their goal. If these are presented to issuers of such information (the "Issuers" or the "Companies") as recommendations by the Competent Authority in each Member State, it is unlikely that the Companies will eliminate all such practices, particularly when their performance is suffering as a result of mismanagement. As a consequence, the Council suggests that CESR propose these not as recommendations but fully enforceable required disclosures in the same manner that Member States require companies to follow International Financial Reporting Standards or to follow the rules of the Prospectus Directive.

This is not to suggest that the Council does not approve of the use of APMs. On the contrary, such measures can provide relevance, value, and context about how an Issuer is performing. However, such information can achieve these purposes only if it is accompanied by an appropriate and sufficient degree of transparency and comparability to enable investors to understand their full meaning.

However, Issuers are at least as likely to use APMs to create a positive perspective on company performance as to provide insights into how management view's company operations. Often, such efforts can create confusion even for sophisticated investors if Issuers are permitted to present such information in any manner they wish and without sufficient supporting documentation.

As representatives of a global organization, members of the Council and CFA Institute have had to deal with issues similar to those presented in the Consultation previously. Based on its experience in other jurisdictions, CFA Institute has developed a set of positions (the "CFA Institute Positions") relating to the use of APMs which, in many cases, mirror CESR's Principles. The CFA Institute Positions state that Companies providing APMs should:

- Always present performance measures based on generally accepted accounting principles ("GAAP") prior to and more prominently than APMs.
- Never include APMs in the headline or leading paragraph of the release or presentation.
- Include the most-comparable GAAP measures in the same disclosure or release of APMs
- Include a reconciliation between the disclosed APM and the most-comparable GAAP measure. Reconciliations should include all the line items that are, or will be, reported in the Company's GAAP-based financial reports.
- Disclose all data included in the APMs that are not included in GAAP-based financial reports.
- Disclose whether their independent auditors have audited or reviewed the information.
- Include all of the GAAP-based financial statements in any release that includes APMs.

- Include a) a discussion of how the Company uses the disclosed APMs in specific operating and investing decisions, and b) why presentation of the APMs is useful to investors.
- Whether and which APMs are used to determine management compensation.
- Never report APMs on a per-share basis. Such per-share presentations should be reserved solely GAAP net income or gain or loss from discontinued operations.
- Present APMs in a separate section of a release or presentation, along with labels indicating clearly that the measures are not prepared in accordance with GAAP.

There are four intended goals of these CFA Institute Positions. First, they seek to enhance the comparability of the information conveyed in the APM with traditional and more readily understood GAAP measures. Second, they seek to prevent publication of manipulative or misleading information. Third, they attempt to give investors the supporting information they need to evaluate the quality of the information conveyed by the APM. And finally, they seek to warn users of the financial reports that the APMs should not be regarded as economically reliable substitutes for GAAP measures.

Below the Council responds to the specific questions raised in the Consultation. In many of its answers it refers back to the CFA Institute Positions noted above.

Specific Comments

A. Background and Objectives of This Recommendation

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.

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

In describing the background and objectives of this Consultation, CESR stated that European listed companies "widely use diverging financial data in press releases and other documents." It also stated that in some cases, it is difficult to derive these financial data "from the issuer's audited financial statements." Finally, it conveys its concern that the adoption of International Financial Reporting Standards ("IFRS") "and the elimination of binding formats will increase the use" of APMs.

CESR points out that its objective is "to provide guidance on the best way to appropriately use and present alternative performance measures." The recommendations, it notes, are addressed to CESR members who, in turn, are encouraged to recommend their use to the listed companies within their jurisdictions.

As noted above under "General Comments," the Council believes the use of APMs by listed companies justifies CESR's initiative. Also as noted above, the Council encourages CESR to recommend these Principles as fully enforceable required disclosures in the same manner that IFRS and Prospectus Directive disclosures are required by the Member States.

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

The Council has interpreted the definition for APMs referred to in the question as relating to any financial performance measures other than revenue, profit or loss, and earnings per share, all of which are defined either in IAS1 or IAS33. If this is the case, the Council finds no reason to disagree with the definition, in large part because it would prove impossible to define all possible APMs due to the virtually limitless ways for companies to report performance.

C. Different Types of Financial Information
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.

The Consultation specifically addresses press releases as an example of a specific kind of reporting.

The Council strongly concurs with CESR that these Principles should apply to all kinds of reporting. The Council also suggests that the Principles apply to forecasts and earnings projections, and oral communication of APMs. Earnings projections and revenue forecasts, in particular, are considered a major determinant of market prices and, as a consequence are very relevant to investors. Requiring that Issuers reconcile their forecasts, earnings projections and oral communications with GAAP-based financial measures will help ensure the consistency and comparability of the information given to investors.

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.

This question refers to the cited paragraphs in the Consultation which present CESR's recommendations relating to APMs. These Principles, which apply only to listed companies presenting alternative performance measures and do not apply to prospectuses, which are already covered by the Prospectus Directive, include the following:

(i) These recommendations apply only to the consolidated financial performance figures of listed companies presenting APMs and do not apply to APMs presented in prospectuses, which are covered by similar requirements within the Prospectus Directive.

(ii) APMs are to respect IFRS principles for financial reporting, including relevance, comparability, consistency, and understandability.

(iii) Issuers are to define the terminology they use and the basis for preparation they have adopted.

(iv) Issuers are to supplement APMs with "defined measures" and explain any differences with enough information to enable investors to "understand the results and financial position of the company."

(v) Issuers using APMs are to provide comparable information for other periods in the past.

(vi) Issuers are to define APMs consistently over time to avoid investor confusion, and "in the exceptional circumstances that the issuer chooses to redefine its" APM, it should thoroughly explain the change and present comparable historic figures.

(vii) Issuers are to present defined measures with greater prominence than APMs.

(viii) Issuers are to explain why APMs are presented and how they use the information internally.

The Council strongly supports the Principles listed above. As noted in the General Comments section, the Principles are similar to the CFA Institute Positions on APMs in most cases. For example, Principle (iv) requires Issuers to provide defined measures, which is similar to the CFA Institute's position of requiring Issuers to include the most-comparable GAAP measure in any release or presentation using APMs.

Indeed, the comments in the following paragraphs on specific Principles relate primarily to their implementation or supplementation rather than a contradiction of them.

<u>Principle (iii).</u> In principle (iii), it appears that Issuers are given significant latitude in defining their terminology. The Council is concerned that some may interpret this to permit them to present APMs in per-share amounts. Such a definition would not adhere to IFRS' definition of per-share measures, and would represent an artificial presentation of the actual amount of accounting profit or loss that is applicable to each share. Consequently, the Council suggests that this principle should include the negative definition described in Question 2 above, namely that which is not already defined by IAS1 or IAS33.

<u>Principle (iv).</u> In principle (iv) Issuers are to explain any differences between the APMs and the defined measures with enough information to enable investors to understand the results and financial condition of the Company. The Council believes this is a necessary element of giving investors information they need to understand the relevance of the APM. However, this

disclosure also should require that Issuers include a line-by-line reconciliation between the APM and the most-comparable GAAP measure. It also should require Issuers to publish their financial statements to ensure that investors have the full context in which the APMs are presented.

Principle (vii). In this principle defined measures — deemed to refer to those measures defined under IFRSs — are to receive greater prominence. The Council is concerned that an Issuer could interpret "prominence" to mean how much space is devoted to the measure rather than position of the disclosure. For example, an Issuer might determine that two paragraphs for the defined measure beginning on page two of the release is more prominent that the single paragraph and headline devoted to the APM on page one of the release.

The Council would prefer this principle to read that Issuers always should present defined measures first and with more prominence than APMs. Furthermore, APMs should never appear in the headline to a release or presentation, and should only appear in a specially marked section of the release or presentation and include a reconciliation with the most-comparable GAAP measure.

Principle (viii). The Council suggests that CESR amend principle (viii) to require Issuers to discuss how the APM is used in specific operating and investing decisions, and why it is useful to investors.

The Council has suggestions for two supplements to the Principles. First, CESR should recommend requiring Issuers to disclose whether the APM is used to determine management compensation. If it is, it will help investors determine whether the measure is relevant for that purpose while also giving an indication of the importance management attaches to the APM.

The second suggestion is that CESR recommend that Issuers apply these Principles to translations of original documents to additional languages other than their home Member State language. For example, a French Issuer should apply these principles not only to its French-language press releases but also to its English-, German-, and Spanish-language releases. This will ensure that cross-border investors in listed companies are not disadvantaged by lack of disclosure relating to APMs in translated documents.

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

As noted in the Consultation, this part of the recommendation states:

> *The auditor could have a role in assuring issuers provide reliable, comparable and consistent information to investors in relation to alternative performance measures. Therefore, CESR believes that management of the company should consider involving the auditor in relation to alternative performance measures.*

The Council supports this recommendation. Furthermore, the Council suggests that regardless of whether or not Issuers involve their independent auditors in the presentation of APMs, CESR should call on Issuers to disclose in any report including an APM whether their independent auditors have audited or reviewed the information contained in the APM. This will alert investors to the quality of the APM and the risks that may come from relying on the information.

Closing Remarks

The CFA Centre for Financial Market Integrity and its Capital Markets Policy Council appreciate the opportunity to provide comment to CESR's *Recommendation on Alternative Performance Measures*. If you or your staff have questions or seek amplification of our views, please feel free to contact James C. Allen, CFA, by phone at +1.434.951.5558 or by e-mail at james.allen@cfainstitute.org.

Sincerely,

/s/ Frederic P. Lebel	*/s/ James C. Allen*
Frederic P. Lebel, CFA	James C. Allen, CFA
Chair Capital Markets Policy Council	Senior Policy Analyst CFA Centre for Financial Market Integrity