



Clarity in financial reporting

Non-IFRS measures – enhancements or embellishments?

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- Many preparers in the Australian and global markets make use of non-IFRS measures when communicating information to stakeholders, to explain the entity's unique business and provide additional meaning to the results.
- Non-IFRS measures, also known as non-GAAP or alternative performance measures, are under the spotlight from investors and regulators, who are concerned that entities are increasingly using them in ways that could mislead users.
- In our view, preparers that either give undue prominence to non-IFRS information or present it without an accompanying reconciliation to a statutory measure, are much more likely to risk misleading users.
- Locally in Australia, ASIC Regulatory Guide 230 *Disclosing non-IFRS financial information* provides the detailed requirements when presenting non-IFRS information. These requirements cover non-IFRS information in the following documents:
 - Financial reports – including the face of the financial statements and related notes and the operating and financial review
 - Transaction documents – for example pro forma information in prospectuses
 - Other documents – including market announcements and investor presentations.
- Internationally, the IASB has added this issue to its work plan and expects to make further progress on the project by the end of 2019.

For more information
please see the following
websites:

www.iasplus.com

www.deloitte.com

Background

Entities in our modern environment operate in new and innovative ways to set themselves apart from the competition. As a result, there is an increased desire to calculate and present financial information in ways that reflect the organisation's unique operations – ways that often align with how management view the business internally and how management performance is measured and incentivised. These ways may not align with the standard profit and performance measures required by International and Australian Accounting Standards¹.

We understand that entities have an important story to tell and communicating the message in a way that is meaningful to users is equally vital. However, the nature of each entity's specific performance measures and the lack of consistent bases for calculating these metrics can reduce comparability. If these measures are not used responsibly, they create a risk that users will be misled. When telling this story, it is critical that entities do so in a way that is within the bounds of the relevant regulation to ensure this risk is minimised.

This publication will help preparers understand how non-IFRS financial information can be communicated so that it best presents the entity's operations and, most importantly, includes the necessary additional disclosures to ensure that the information presented is not misleading.

What is non-IFRS financial information?

The term non-IFRS financial information – also referred to as 'non-GAAP' financial information or 'alternative performance measures' (APMs) – captures any measure of past or future financial position, performance or cash flows that is not prescribed by the relevant accounting standards, for example, International Financial Reporting Standards (IFRS) and those issued by the Australian Accounting Standards Board (AASB). In practice, these are usually presented as a derivation of an IFRS line item (e.g. profit before tax) and are typically adjusted by adding or subtracting specific amounts. Examples are adjusted earnings (or adjusted profit), normalised or underlying earnings, constant currency revenue growth (like-for-like earnings), net debt, and return on capital employed. Whether these metrics are disclosed in the financial report, the operating and financial review, management commentary or even in media announcements does not change the fact they are considered 'non-IFRS' in nature.

Helpful insights or smoke and mirrors?

When financial statements are prepared in accordance with IFRS they provide investors, analysts, and other users with a reliable and standardised foundation for assessing performance and facilitating comparison, both against different entities as well as over time within the same entity. Non-IFRS disclosures are not always subject to the same level of discipline that is associated with IFRS measures.

Preparers often believe that it is necessary to present additional financial information alongside or in addition to the IFRS information in order to provide further insight into the financial performance, financial position and/or cash flows of the organisation, in an attempt to explain these to users in a way they believe is more meaningful in understanding the entity's results. While the use of non-IFRS financial measures can provide preparers with flexibility in communicating entity-specific information, problems can arise when non-IFRS financial measures are used to conceal 'bad news.' For example, it would be considered inappropriate to add-back expenses to present a 'more favourable' adjusted measure of performance or by removing usual business expenses, such as share-based payments to employees, in a way that purports that this is an unusual or non-recurring expense. Further, a reduction in comparability arises where these alternative measures are presented inconsistently from year to year, defined inadequately, or used to obscure financial results determined in accordance with IFRS.

For these reasons, disclosure of non-IFRS information is a key focus area for regulators around the world and here in Australia the story is no different. In December 2018 the Australian Securities and Investments Commission (ASIC) added this as a focus area to its financial reporting surveillance program and recently announced it would continue as a focus area for the 30 June 2019 period. As a result of the increased regulatory focus during its 31 December 2018 surveillance cycle ASIC has reported that it did make enquiries of a number of entities in relation to inappropriate disclosure of non-IFRS information.



Thinking it through

Investors in Australia may be wary of information presented outside the structure of IFRS where the lack of transparency and comparability can increase the risk of misinformation. Application of the requirements of RG 230, and specifically, appropriate reconciliation to IFRS information will help the financial statements remain credible in the eyes of users.

¹ Throughout this document the terms 'IFRS' and 'non-IFRS' are used for consistency with RG 230, however these are intended to be interchangeable with the Australian equivalents to IFRS, Australian Accounting Standards issued by the Australian Accounting Standards Board.

What guidance is out there for preparers disclosing non-IFRS information?

Australian and International Accounting Standards

AASB 101 *Presentation of Financial Statements*² specifies minimum line items for the face of the financial statements, but also stipulates that additional line items, headings and subtotals should be presented in the statement of financial position when such presentation is relevant to an understanding of the entity's financial position [AASB 101.85].

Local jurisdictional guidance

Globally, regulators have differing views about the nature of the additional line items, headings and subtotals presented in accordance with AASB 101 (IAS 1). For example, measures such as earnings before interest and tax (EBIT) can be legitimate sub-totals in an income statement, provided that they simply adjust profit before tax by interest, as measured by applying IFRS. The requirements differ from jurisdiction to jurisdiction, and entities should be aware of the regulations and policies of any securities regulators with jurisdiction over its financial statements or reports. The requirements can also change quickly, as regulators determine what they consider to be acceptable disclosure.

In Australia, ASIC issued Regulatory Guide 230 *Disclosing non-IFRS financial information* ('RG 230') in 2011 to promote full and clear disclosure of non-statutory financial information. RG 230 is applicable for all financial statements prepared under Chapter 2M of the *Corporations Act 2001* and any other documents that state compliance with Australian Accounting Standards.

The guide specifically considers non-IFRS information in the context of three types of documents, and gives explicit requirements and considerations for each of these:

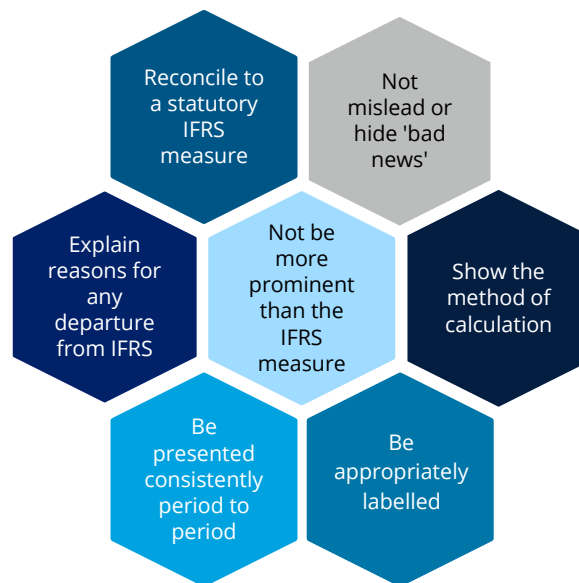
- Statutory financial reports
- Transaction documents such as pro-forma information in prospectuses
- Other documents including those accompanying the financial report, as well as market announcements, presentations to investors and briefings to analysts.



Later in this document

A summary of the key requirements for each of these types of documents are summarised in the Appendix.

Below are some guidelines for disclosing non-IFRS information, as set out in RG 230. When disclosing non-IFRS information, it should:



It is important to highlight that ASIC does not aim to eliminate the use of non-IFRS information. Instead, application within the accounting and regulatory guidelines ensures that non-IFRS information is used appropriately to enhance rather than embellish IFRS financial measures and clarify, rather than obscure, the true financial performance of entities. There will invariably be situations in which entities are affected by significant one-off events and the impact of these should be highlighted to investors to ensure the results are correctly understood. In our view non-IFRS information can be useful as a means for companies to present the results of their operations in the way they believe to be most meaningful, provided that it is presented in a clear and transparent manner.

² AASB 101 is the Australian equivalent to IAS 1 *Presentation of Financial Statements*.

Illustrative examples

Below we explain two of the most common issues that we see, prominence and reconciliation, both of which should be considered in all documents when presenting non-IFRS information:

Prominence

When non-IFRS financial information is included in a financial report, it should not be presented with greater prominence than the corresponding IFRS financial information [RG 230.60–64].

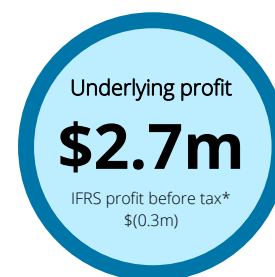
This refers to the aesthetic presentation of the non-IFRS financial information. It should be clear to users that they are looking at a non-IFRS measure. For example, the non-IFRS information should not be presented in a larger or bolder font, or be referred to as a 'key metric' without giving equal standing to the related IFRS measure. Non-IFRS information should also not be disclosed or discussed without the corresponding statutory IFRS measures in the front half the financial report in such a way so as to give undue prominence to the non-IFRS measure. Furthermore, the non-IFRS information should not in any way confuse or obscure the presentation of the IFRS measures.

Examples of inappropriate prominence

Key Financial Metrics		FY18	FY19
Underlying Revenue	(\$million)	289.7	309.4
Underlying EBIT	(\$million)	65.7	71.6
Underlying Net Profit After Tax (NPAT)	(\$million)	45.7	39.1
Underlying Earnings Per Share (EPS)	(cents)	4.5	3.8

When looking at the above disclosure³ it becomes clear that these metrics presented as the 'Key Financial Metrics' are all non-IFRS in nature and equal prominence has not been given to the related IFRS measures in each case. Further, no reconciliations or explanations are provided that would explain why these metrics are more relevant to the user's understanding than the related IFRS measures.

The diagram to the right³ is also based on disclosures often made in the OFR. Even though the non-IFRS measure is accompanied by the related IFRS measure, the non-IFRS measure is clearly intended to be more prominent than the IFRS measure. Further, the explanation provided refers to 'extraordinary' items (specifically prohibited by RG 230) and is not specific enough to allow reconciliation to other amounts in the financial statements.



**IFRS profit before tax has been adjusted by various one-off and extraordinary items to arrive at underlying profit.*

Reconciliation and calculation with reference to IFRS measures

When non-IFRS financial information is included in a financial report, a reconciliation between the non-IFRS and IFRS financial information should be provided, separately itemising and explaining each significant adjustment [RG 230.56].

When the reconciling items are themselves IFRS measures, they should agree to amounts included within the financial report. When a reconciling item cannot be obtained directly from the financial report, the reconciliation should show how the reconciling amount is calculated.

There is some consistency between the reason many entities decide to disclose non-IFRS measures and the requirements of AASB 8 *Operating Segments* – which requires disclosure of profit or loss for segments based on the measure reported internally to management. For this reason ASIC expects that non-IFRS profit measures used throughout the financial report will be consistent with the segment reporting disclosures. If non-IFRS profit information is disclosed and it differs from the segment reporting disclosures, an explanation should be included justifying this difference [RG 230.57].

Example of relevant reconciliation and calculation

Over the page is an example disclosure³ that shows the reconciliation, as well as an explanation of the basis of calculation and its relevance in relation to a non-IFRS alternative profit measure.

³ Example disclosure only, based on information commonly presented in the Operating and Financial Review (OFR).

Reconciliation of underlying profit before tax (PBT, a non-IFRS measure) to statutory profit before tax

Statutory Profit Before Tax (millions)	1,391	1,181
<i>Items not included in Underlying PBT</i>		
Restructure costs	162	142
Transaction-related employee bonuses	53	85
Net (gains) / losses on investments	(12)	(20)
Other	10	13
Total items not included in Underlying PBT	213	220
Underlying PBT	1,604	1,401

Items which are identified by management as not representing the underlying performance of the business are not included in Underlying PBT. The determination of these items is made after consideration of their nature and materiality and is applied consistently from period to period.

Items not included in Underlying PBT primarily result from costs relating to major restructuring initiatives, gains/(losses) on transactions involving investments, impairments of assets and other transactions outside the ordinary course of business.

- Transformation costs of \$162 million were incurred during the year. Transformation costs included redundancy and related costs of \$43 million, fleet restructuring costs of \$81 million (primarily relates to costs for the introduction of the ABC model and the retirement of the DEF fleet) and other costs of \$38 million directly incurred to enable the delivery of restructuring benefits.
- Employee bonus of \$53 million payable to non-executive employees in recognition of the completion of the Bluesky Project.
- Net gains / (losses) on investments of \$12 million relates to the sale of a business within the XYZ segment and the recycling of the foreign exchange translation reserve on disposal of an investment.

Conclusion

Non-IFRS disclosures, particularly those that provide an alternative performance measure, have been receiving their fair share of attention from regulators, standard-setters, analysts and the press. In Australia, ASIC's RG 230 is a guideline document on the reporting and use of non-IFRS measures. The International Accounting Standards Board has also acted to improve the integrity of additional sub-totals and adjustments reported in financial statements. The debate and discussion seen over the last year in respect of non-IFRS measures indicates these will continue to receive attention during the next reporting season. Rather than embellishing the entities' performance measures, ensuring that non-IFRS measures are presented in a manner to enhance users understanding of the entities' performance is key.



Quick reference checklist for the use of non-IFRS measures:

- Have the non-IFRS measures been given no more prominence than other statutory measures?
- Have the non-IFRS measures been clearly reconciled to statutory measures?
- Have these been clearly labelled as non-IFRS information?
- Are the non-IFRS measures presented so as to not mislead the reader by, for example, not hiding bad news?
- Are consistent definitions used across periods with clear explanation of the nature and purpose of the measure?
- When presenting non-IFRS measures, have you considered the detailed ASIC requirements contained in RG 230?

If the answer to any of these questions is 'no' it is likely that the accounting and regulatory requirements surrounding non-IFRS measures have not been met. Ensuring that equal prominence is given, as well as appropriate reconciliations are made, to the statutory performance metrics will go a long way in giving credibility to non-IFRS financial measures.



Upcoming developments

Acknowledging this as an issue, in December 2016 the IASB added a major research project titled 'Primary Financial Statements' to its work plan. While the project aims to address a number of diverse issues, presentation of the statement of profit or loss (P&L) and non-IFRS earnings measures are a key focus area, including to what extent, if any, should entities be required or permitted to include APMs on its face. At the date of this publication, the IASB expects to release an exposure draft in late 2019.



Accessing information

REGULATORY GUIDE 230 *Disclosing non-IFRS financial information* (ASIC, 2011) Available from asic.gov.au.

Alternative performance measures: Need to know – A practical guide (Deloitte UK, 2016). Available from iasplus.com.

A Roadmap to Non-GAAP Financial Measures (Deloitte US, 2019). Available from iasplus.com.

Appendix

Key aspects of RG 230

Non-IFRS information should:

- ✗ Not mislead or hide 'bad news'

- ✗ Not be more prominent than IFRS

- ✓ Be appropriately labelled

- ✓ Show the method of calculation

- ✓ Reconcile to an IFRS measure

- ✓ Be presented consistently period to period

- ✓ Explain reasons for any departure from IFRS

In addition to the above,
considerations for specific
types of reports:

Financial reports

Financial statements

- ✗ Non-IFRS information is not permitted on the face of the financial statements⁴
- ✗ Items should not be presented as 'extraordinary' or 'one-off'
- ✓ Disaggregation or additional IFRS line items should be presented where relevant to an understanding
- ✗ Additional columns are not permitted
- ✗ Information should not be presented in a separate section below a financial statement
- ✓ Where relevant, internal profit measures should be consistent with those disclosed under AASB 8

Operating and financial review (OFR) and other documents in the financial report⁵

- ✓ The OFR is an appropriate place for non-IFRS information and an effective OFR can eliminate the need for non-IFRS information elsewhere

Transaction documents⁵

- ✓ Apply IFRS, subject to assumptions relevant to the notional acquisition and combination of entities
- ✓ Consider and disclose the full effect of the transaction
- ✓ Include disclosure of assumptions applied
- ✗ Pro-forma information should not consider hypothetical scenarios
- ✗ When disclosing a range, more favourable points should not be shown more prominently
- ✓ Include clear statement as to whether information was audited or reviewed

Other documents⁵

- ✗ Items should not be presented as 'one-off' or 'non-recurring'.
- ✓ Include clear statement as to whether information was audited or reviewed

⁴Except in rare circumstances when entity has applied to ASIC for relief.

⁵Refer to detailed requirements contained in RG 230; Table 2 for non-IFRS disclosures within both the OFR and documents other than financial reports and transaction documents, and Table 3 for disclosures within transaction documents.

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