

Survey questions and answers

Presentation of income under IFRS: flexibility and consistency explored

1. What is this research about?

It looks at additional, non-GAAP income measure that companies include in their financial statements beyond the minimum required by IFRS. It also examined the way companies present these in their income statements.

2. Who conducted this research?

This research was conceived and conducted by Arjan Brouwer, PwC senior manager, and sponsored by PricewaterhouseCoopers.

3. Why did PwC research the use of non-GAAP income measures in European financial statements?

Debate around this topic has intensified with the move to IFRS so we wanted to help companies understand emerging trends, compare practices with their peers and start to re-evaluate the effectiveness of their communications in an IFRS environment.

4. What do investors want? Page 1

In separate PwC research, investors said that they find additional, non-GAAP income measures useful and take them into account when making investment decisions. They look for non-GAAP measures that management use to run the business as well as consistency of information over time and comparability among companies, particularly in the same industry.

5. What do regulators say about the use of non-GAAP income measures? Page 1

Generally regulators have acknowledged that they may be useful, but some raised questions in the first year of IFRS reporting about appropriate use of these measures. Regulators have different views on exactly what is appropriate in practice.

6. How many companies' financial statements were studied? Page 4-5

The PwC research examined 2,800 financial statements (around half from 2004 and half from 2005) from the largest capital markets – France, Germany and the UK – and focused in detail on 250 income statements from eight European countries.

7. What proportion of companies report 'earnings before interest, tax, depreciation and amortisation' (EBITDA) or similar measures? Page 6-8

Our research found that 44% of companies in Europe's largest capital markets reported additional income measures excluding depreciation and /or amortisation (EBITDA and similar measures p6) somewhere in their financial statements. There were clear national and industry trends: 59% of companies in Germany reported these measures, while only 32% in the UK did so; 70% of information/ communications companies reported these measures, but only 12% of FS companies and 25% of real estate companies did so. Across eight European countries, 10% of companies included these measures on the face of the income statement.

8. What proportion of companies report results that exclude certain non-recurring items? Page 9-10

34% of companies in the largest capital markets reported one or more results that excluded certain non-recurring items in their financial statements. The popularity of different terms in this category varies by territory, as does the proportion of companies reporting one or more of these measures – thus only 12% of German companies reported these measures, while almost four times as many companies in the UK and France did so. Across Europe, 26% of companies overall reported one or more of these measures on the face of the income statement.

9. **How comparable is the content of income statements under IFRS?** Page 11-12

There is considerable variation between companies in what they include on the face of the income statement. The number of line items varies between 8 and 48, while the range of subtotals showing revenues plus or minus certain items varies from 2 to 8. However the average numbers are similar across all territories. There is also agreement on whether to report operating profit or 'earnings before interest and tax' (EBIT) on the face of the income statement – 96% of companies do this, but they do not necessarily define it in exactly the same way.

10. **How comparable is the visual presentation of income statements under IFRS?** Page 13-14

Again practices differ in each country. A significant minority of companies present non-GAAP measures in additional columns or boxes – this is most common in the UK where 24% use separate columns and 20% use boxes and sub-analysis on the face of the income statement. It is interesting to note that the use of boxes and sub-analysis in Belgium (11%), France (3%) and the Netherlands (8%) is in line with best practice outlined by Report Leadership (see appendix 4)

11. **What are the key trends from these findings?** See Executive summary and comments in blue boxes.

A bridge from old reporting to IFRS. Companies have aligned their choice and presentation of non-GAAP measures under IFRS as much as possible with what they reported under national GAAP, offering the reader consistency of presentation over time so that they did not add to the burden of change. This approach has allowed readers to compare and contrast non-GAAP measures calculated using IFRS recognition and measurement principles with the measures calculated on the previous basis.

National trends are still strong. Countries that have traditionally reported certain non-GAAP measures still do so under IFRS and those that did not report specific non-GAAP measures did not start to do so.

Industry variations. For EBITDA and similar measures industry variations are strong and consistent between 2004 reporting under national GAAP and 2005 IFRS reporting. This indicates that companies are already responding to investor demands for international comparability within industry sectors.

12. **What can we expect going forwards?**

Continued reporting of non-GAAP measures. Companies will continue to report non-GAAP measures in their financial statements that investors find useful.

Convergence along industry lines. As companies re-evaluate the effectiveness of their non-GAAP reporting to the market in an IFRS environment, they are likely to compare themselves with peers in the same industry sector. This is likely to bring further convergence around the choice and presentation of non-GAAP measures along industry lines as long as companies are allowed a level of freedom to respond to market demands.

More consistent definitions for certain measures. This may also emerge from the process described just above.

Further cooperation between regulators. This will be needed to avoid enforcing different national preferences or prohibitions and to allow market forces to influence convergence.

13. **Who can you contact for further information?**

Your usual PwC contact or one of the IFRS specialists mentioned on the inside front cover of this report. Sarah Grey (email: sarah.grey@uk.pwc.com Tel: +44 20 7804 1617) can answer general queries about this research and put you in touch with appropriate national contacts for business issues, media queries and research questions.