MIDLANDS STATE UNIVERSITY

FACULTY OF COMMERCE

DEPARTMENT OF ACCOUNTING

# "Examining the use of Alternative Performance Measures (Non-IFRS Measures) in comparing financial performance of listed companies"

**by**

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Submitted in partial fulfilment of the requirements for the degree of

**BACHELOR OF COMMERCE ACCOUNTING (HONOURS) DEGREE**

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## **DECLARATION**

I, Munyaradzi Mtangi, do hereby declare that the dissertation entitled *"Examining the use of Alternative Performance Measures (Non-IFRS Measures) in comparing financial performance of listed companies'* is not more than 12,342 words in length, with the exception of the abstract, appendices and references. I further declare that the dissertation titled above is my original piece of work and, to the best of my knowledge and belief, contains no material that has been previously published or written by another individual, whether to be accepted for the award of a degree or otherwise, except where due reference has been given.

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## DEDICATION

In loving memory of my late parents, Kennedy and Irene, who went to be with the Lord in 2004. I dedicate, not only this dissertation, but the entire degree itself to them… *May their dear souls continue to rest in eternal peace.*

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*"Education, whatever else it should or should not be, must be an inoculation against the poisons of life and an adequate equipment in knowledge and skill for meeting the chances of life."*(Havelock Ellis)

# ABSTRACT

The research was conducted to identify whether Alternative Performance Measures (Non-IFRS Measures) could be used by external stakeholders to compare financial performance of corporate entities listed on the Zimbabwe Stock Exchange. The research was triggered by the prevalence of these additional measures of performance, which were deemed to be marring and driving away focus from the traditional financial information: the IFRS-complaint financial statements. It was perceived that the common use of these performance measures might deter the smooth comparability of financial information. Data was gathered from 10 audit clerks employed in a mid-tier auditing firm. The data collection dictated that companies calculated Alternative Performance Measures differently from one another, thereby impairing financial performance comparability. Evidence from data collection also noted that management bias was inherent in the reporting of Alternative Performance Measures. The research, however, concluded that this information was reliable and that listed counters primarily used them to re-emphasise matters already discussed in the financial statements and disclose those events and transactions that are peculiar to the firm. The researcher encouraged the engagement of external assurance providers in the verification process, to ensure that Alternative Performance Measures are reconciled to financial statements and that their quality and credibility is enhanced. He also recommended a consultative dialogue between relevant stakeholders on the responsible reporting of these measures, as he identified that the duties of individual groups of stakeholders were not clearly defined. He however discouraged the regulation of reporting the performance measures, as he discovered that many corporate Boards were experiencing regulatory fatigue from an excessive imposition of rules and standards in their corporate reporting processes.

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## ACRONYMS

| | |
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| APM | Alternative Performance Measure |
| CFA | Chartered Financial Analyst |
| ESMA | European Securities and Markets Authority |
| FASB | Financial Accounting Standards Board |
| FRC | Financial Reporting Council |
| FTSE | Financial Times and Stock Exchange |
| GAAP | Generally Accepted Accounting Principles |
| IASB | International Accounting Standards Board |
| IAASB | International Audit and Assurance Standards Board |
| IFRS | International Financial Reporting Standards |
| IIRC | International Integrated Reporting Council |
| IOSCO | International Organisation for Securities Commission |
| IPEC | Insurance and Pensions Commission |
| ISA | International Standards on Auditing |
| KPI | Key Performance Indicator |
| RBZ | Reserve Bank of Zimbabwe |
| SEC | (American) Securities and Exchange Commission |
| SECZ | Securities and Exchange Commission of Zimbabwe |
| UK | United Kingdom |
| ZSE | Zimbabwe Stock Exchange |

## DEFINITION OF KEY TERMS

**Alternative Performance Measure** – a financial measure of historical or future financial performance, position or cash flows of an entity which is not a financial measure defined or specified in the financial reporting framework

**Annual report -** A document, or combination of documents, prepared typically on an annual basis by management or those charged with governance in accordance with law, regulation or custom, the purpose of which is to provide owners (or similar stakeholders) with information on the entity's operations and the entity's financial results and financial position as set out in the financial statements

**Bourse** – the Dutch term for "Stock Exchange"

**Corporate reporting** – presentation and disclosure, as distinct from accounting measurement, about an organisation's financial performance, executive remuneration and narrative reporting, among other aspects, in a given period

**Key performance indicator** – a measurable value that determines how effectively a company is achieving key business objectives

**Integrated reporting** – communication made by an organisation to its stakeholders, through a period report, providing an interconnected representation of the key factors that influence value creation over time

**Regulatory fatigue** – weariness and exhaustion of compliance, resulting from an overlap and continuous redrafting of rules, laws, standards and regulations of companies

**Shareholder** – an individual, entity, trust, investment fund etc with shares in another company and, as such, is entitled to a dividend and has a right to vote on contentious matters

**Stakeholder** – any such individual or group of individuals, whether in the form of an organisation or otherwise, with an interest in the affairs of another individual's or organisation's activities

**Standard** - a document that provides requirements, specifications, guidelines or characteristics that can be used consistently to ensure that materials, products, processes and services are fit for their purpose.

**Stock exchange** – a market organised for the trading of shares, bonds and other related instruments

# CHAPTER ONE

# INTRODUCTION

## 1.1 Introduction

This chapter introduces the area of study and overall research problem. A synopsis of performance measurement, financial reporting and the use of non-IFRS measures is touched on. *Inter alia,* the chapter goes on to highlight the key questions as well as the overall objectives. A summary is provided at the end to conclude the whole chapter.

## 1.2 Background of the study

In recent years, the use of Alternative Performance Measures (APMs) has increased both in magnitude and prominence the world over (Brouwer, 2013). The importance of such performance measures cannot be over-emphasised (Maseko and Manyani, 2011). They have been widely regarded as a step towards attaining self-evaluation, and subsequently improving accountability and transparency (Tehran et.al, 2012).

ESMA (2015) defined an APM as "a financial measure of historical or future financial performance, position or cash flows of an entity which is not a financial measure defined or specified in the financial reporting framework". According to Deloitte (2016), of the 100 FTSE companies whose annual reports they reviewed, 81% used APMs in the opening summary section of their annual report, 83% presented at least one APM as a key performance indicator, while 74% presented APMs somewhere in their financial statements. CFA Society (2015) also conducted a survey in which two-thirds of the 292 respondents felt it was necessary to have both APMs and IFRS, while in two other surveys conducted by the same organisation and PriceWaterhouseCoopers respectively, 61% of CFA Society members and 65% of investors polled stated that they actively used APMs for their investment analysis. This can be attributed to the fact that APMs compliment financial information that is inherently missing in the financial statements (CFA Society, 2015) as a way of clarifying, rather than obscuring, the true performance of organisations (Deloitte, 2016a) but without any intention of substituting the financial statements (Allianz, 2016; Siemens, 2016). APMs also provide better insight and transparency into company performance (Deloitte, 2016b; PriceWaterhouseCoopers, 2016). They provide stakeholders with information that is understandable and investor-friendly (PriceWaterhouseCoopers, 2016) by communicating the key value drivers of the organisation (Ernst and Young, 2015).

Brouwer (2013) however raised worries that there was the prevalence of management bias in the reporting of APMs. According to him, management might be motivated by strategic motives to disclose certain APMs. Thus, it is highly likely that only APMs which show a favourable result will be disclosed, thereby putting the credibility of APMs into question. ESMA (2015) also feared that there was inconsistency in the disclosure of APMs and PriceWaterhouseCoopers (2016) attributed this ad hoc reporting behaviour to a lack of regulation and established reporting rules. There is also limited guidance in the reporting of APMs resulting in difficulties in comparing performance from one organisation to the next (ESMA, 2015). Allianz (2016) and Siemens (2016) both warned users of their respective annual reports that even if two companies report the same APM using the same name and definition, the APM might have been calculated differently possibly impairing inter-company comparability. As a result of these reporting inconsistencies, Hoogervost (2015) felt that there was need for an established standard that guides the reporting of APMs globally.

It is against this background that the researcher was motivated to conduct this research, as a means of identifying the possibility of financial performance comparability by use of APMs. Very little research has been conducted on APMs, as these have only come to the attention of academics in recent years. This therefore creates a platform for futile research.

## 1.3 Statement of the problem

The role played by APMs in influencing the interpretation of financial performance has gained momentum over the years. APMs have taken centre stage by providing information that some have considered insightful, understandable, transparent and investor-friendly. However, critics still feel that management bias, questionable credibility, limited regulatory oversight, the absence of a defined measurement criteria and inconsistency in the reporting process inhibit the comparability of performance. This research therefore seeks to establish whether the disclosure of APMs enhances performance of organisations to be compared from one period to the other, and from one organisation to the other.

## 1.4 Main research question

Does the reporting of Alternative Performance Measures enhance, or impede, comparability of financial performance in listed companies?

## 1.5 Sub-research question

a) Which APMs are commonly reported by listed companies?

b) What are the determinants of APM disclosure?

c) What are the limitations of APM information in enhancing comparability?

d) What are the benefits of APM reporting?

e) What role do relevant stakeholders play in enhancing the quality and credibility of APM information?

## 1.6 Objectives

a) To ascertain the commonly reported APMs

b) To establish the determinants of APM disclosure

c) To identify the limitations of APM information in enhancing comparability

d) To ascertain the benefits of APM reporting

e) To establish the roles played by the relevant stakeholders in enhancing the quality and credibility of APM information

## 1.7 Significance of the study

**To the researcher**

The research will assist the researcher to develop logical and conceptual thinking, over and above, critical thinking. He should be able to make decisions in life by being able to process and analyse information, without merely looking at a problem at face value.

The researcher should also enhance his skills in the areas of performance measurement, integrated reporting and financial reporting. He will get an in-depth understanding of IFRS and APMs, and be better able to provide value-driven business and financial advice to corporate entities.

**To the university**

The research will create a breeding ground for a more extensive research in the area of APMs. The university will go on further to incorporate accounting literature in its existing body of knowledge, which will be taught to students in future.

**To listed companies**

The research will inform listed companies on the external reporting of performance measures. The institutions will be able to better inform their investors about actual key value drivers that determine performance in their respective organisations in a manner that fosters comparability and improves the quality of their integrated reports

**To the investing community**

The investing public will be able to make informed decisions. They will learn to better analyse financial measures of institutions, with a more cautious approach. They will understand both the advantages and disadvantages of using alternative financial information. This will primarily result in improved share price forecasting and better allocation of capital on the local bourse

### 1.8 Limitations

**a) Confidentiality of information**

Entities may refuse to release sensitive information. As a result, the research will focus on publicly available information so as to preserve confidential information of organisations.

**b) Financial constraints**

The researcher is limited by financial constraints. To counter this, the researcher will set a reasonable budget to avoid wasteful expenditure.

**c) Time constraints**

There is limited time to conduct the research. A time-table shall be set in consultation with the supervisor to ensure that the research does not override regular learning.

### 1.9 Delimitations

a) The research is confined to companies in the financial services, industrial and consumer goods sector listed on the ZSE. As per the www.african-markets.com classification, these sectors have the highest representation of companies on the ZSE (47, in total).

b) All information was obtained from annual reports, press releases, corporate announcements and other publicly available data, as well as referenced from journals, articles, publications etc from previous researchers and writers.

c) The research only covered a manageable period of 5 years, from 2011 to 2015. It only considered companies listed as at 31 December, 2015.

d) Responses of interviews and questionnaires were issued to professional accountants and corporate finance experts from an auditing firm.

### 1.10 Assumptions

In the researcher's on point of view, the problem of comparing financial performance by use of Alternative Performance Measures will continue to exist during the research period and there is no immediate solution in sight from all relevant stakeholders.

# CHAPTER TWO

# LITERATURE REVIEW

## 2.1 Introduction

This chapter discusses the available literature on Alternative Performance Measures, by putting across the views of past authors and researchers. It highlights the major APMs reported by entities, the determinants behind their disclosure as well as their advantages and disadvantages in the enhancement of comparability. The chapter will go on to confront the quality of this information by examining the roles that those responsible for such information play in enhancing its credibility. The chapter will close off with a summary of the literature findings, and thereupon, justify a literature gap that sought to be filled by this research.

## 2.2 Commonly reported APMs

Many approaches have been developed to counter the shortcomings of the traditional approach of measuring performance, but the various players in the development of this literature are still divided on the characteristics and components of performance measurement (Striteska, 2012). There, therefore, remains a gap between what companies report and what they actually do (Ndlovu, 2014). For this reason, a standard definition of performance measurement will never be established (Brouwer, 2013).

Many companies have, over the years, developed performance measures to try and cover up for the information deemed to be missing in the financial statements (CFA Society, 2015). These measures are now technically referred to as “alternative performance measures”, a term which was initially introduced by CESR in 2005, and endorsed by ESMA (2015). They are sometimes referred to by different names such as non-GAAP measures in the United States (IOSCO, 2015). The more commonly reported APMs are discussed below.

### 2.2.1 Earnings before Interest, Tax, Depreciation and Amortisation (EBITDA)

EBITDA is obtained by adding back depreciation, amortisation and net finance costs to the profit before tax and other unusual items. The calculation of EBITDA is necessary for uses such as determining an entity's cash generating capacity and liquidity position. This is achieved by removing the key elements that 'distort' the net cash flows from operations. The same source however criticised EBITDA for not removing all the effects of non-cash items. It is pointed out that elements such as credit loss provisions and fair value adjustments are not adjusted when determining EBITDA. It also has a natural effect of inflating the companies' performance by ignoring the depletion of assets in the achievement of operational results.

### 2.2.2 Return on Assets (ROA)

ROA is calculated to identify how effectively management used those resources that were at their disposal during the period. It is normally calculated by dividing the profit figure by the assets. The assets are usually the total number of assets available, that is, both current and non-current. Some banks also calculate the 'Return on Risk-Weighted Assets' (Agarwal and Valecha, 2014). The concept of risk-weighting assets is brought forward by the Basel Committee on Bank Supervision. The ROA calculation does not however consider the financing of these assets (Price, 2012). It incorporates both borrowed assets and those assets that actually belong to the firm, according to the same source. This distorts the actual return to shareholders.

### 2.2.3 Return on Equity (ROE)

ROE is the net profit after tax divided by total shareholders' equity (Kabajeh et.al, 2012). It is a way of determining management's ability to efficiently and effectively use available resources, according to the same author (Price, 2012). It is simply a good way of ascertaining whether it is even worth the risk, to invest in a certain company (Berman et.al, 2013). It can be viewed as a modification to the ROA calculation. In comparison to ROA, ROE considers only those resources contributed to the organisation by the providers of capital and ignores borrowed resources (Price, 2012). By so doing, it gives a picture of how capital funds are being exploited by management to achieve the desired results. However, it cannot determine how much management will issue out as dividends (Berzkhalne and Zelgalve, 2014).

### 2.2.4 Earnings before Interest and Tax (EBIT)

EBIT is similar to EBITDA, but however excludes depreciation from the adjustments. EBIT is normally calculated to remove interest and tax effects from the earnings figure. EBIT is so commonly used that users (and even preparers) are actually unaware of the fact that it is not in essence an IFRS requirement to calculate this figure. IAS 1 does not explicitly require the disclosure of this figure, thus it is at management's discretion to include it within the Statement of Comprehensive Income. EBIT is calculated to remove the effects of gearing on the profit figure. Gearing particularly refers to the contribution of fixed cost debt to the overall long term financing of a business. Given two companies with comparable operational performance, but one with more borrowed capital than the other; the company with more debt will likely pay a higher interest expense than its counterpart but remain with a lower tax burden. The effect of such inconsistencies is therefore removed by the calculation of EBIT.

### 2.2.5 Operating Margin

Operating margin is calculated by dividing cost of sales by the sales figure. Another school of thought states that this measure is calculated by dividing operating profit by the sales. The operating profit is deduced from deducting operating expenses (excluding interest and tax) from the sales figure. This measure focuses on key operations of organisation, and thus removes the effect of non-core business activities. It enables companies to highlight earnings of the key products and services provided by the firm (Heikal et.al, 2014). There is however little consensus on what should constitute the denominator and what should constitute the numerator (Pink et.al 2008). According to their study, many hospitals in the United States calculated this measure differently. These hospitals had difficult deducing their operating income due to the many factors that drive hospital performance, something which is tantamount to any business outside of the retail space.

### 2.2.6 Funds from Operations (FFO)

FFO is obtained by deducting back capital expenditure to cash flows from operations (Drake, n.d.). The same source suggests that this measure is used for investment analysis, particularly forecasted free cash flows. He also pointed out that there is flexibility in the use of FFO. Drake (n.d.) pointed out several problems associated with this measure. Firstly, the absence of a standard definition has resulted in misinterpretation of results. Secondly, the use of current cash flows patterns to forecast cash flows is based on an unrealistic assumption that the current organisational performance shows its cash flow generating capacity. He feels that variations in capital expenditures by companies from one year to the other, as well as changes in net income, may distort the results.

### 2.2.7 Adjusted earnings

Adjusted earnings are referred to by several names such as ‘pro-forma-’; ‘headline-’; ‘normalised-’; ‘core-’ or ‘non-statutory’ earnings (Harrison and Morton, 2010). Common practice in calculating this measure is removing unusual and non-recurring items from the ordinary earnings figure (Liu, 2013). This measure is used as an input in the calculation of Adjusted Earnings per Share (EPS), which is an alternative to the required traditional EPS under IAS 33 (Harrison and Morton, 2010). Adjusted earnings are also used by credit rating agencies to ascertain the creditworthiness of a client, since the removal of once-off, unusual, non-recurring items from the earnings figure establishes a clearer picture of the revenue growth pattern of an organisation (Brouwer, 2013; CFA Society, 2015). SEC however opposed the use of adjusted earnings measures (Verschoor, 2014). Verschoor highlighted that in 1976, the SEC issued conditions on how to use APMs, and the release statement explicitly stated that *“If accounting net income computed in conformity with (the applicable financial reporting framework) is not an accurate reflection of economic performance for a company or an industry, it is not an appropriate solution to have each company independently decide what the best measure of its performance should be and present that figure to its shareholders as Truth”.* This shows that the SEC was not in favour of earnings adjustments. In addition, they felt that leaving the adjustment process to management’s discretion was inappropriate and could lead to catastrophic consequences.

### 2.2.8 Adjusted Earnings per Share (Adjusted EPS)

Adjusted EPS is derived from the adjusted earnings figure. The adjustments in question are the removal of unusual, non-recurring items particularly those which management feel were beyond their control, and thus should not be used against them in judging their performance. It is a good measure of determining how good management handled those areas that they believe where within their control. However, criticism is to decide which measures should be adjusted and which should not. Verschoor (2014) gave an example of Exelon Corporation which inflated its EPS by more than 100% through adjustments. Its audited EPS was $1.42. The corporation went on to adjust for plant retirements and divestitures($0.29), merger and integration costs ($0.31), State of Maryland commitments related to merger ($0.28), amortization of commodity contract intangibles($0.93), and Federal Energy Regulatory Commission (FERC) settlement($0.21). These adjustments increased EPS by $2.02.

The adjustments that decreased EPS were mark-to-market impact of economic hedging activities ($0.38), unrealised gains related to nuclear decommissioning trust funds ($0.07), and reassessment of state deferred income taxes ($0.14), resulting in a total decrease of $0.59. The resulting Adjusted EPS was $2.91, having been further inflated by a $0.06 arbitrary increase resulting from rounding off of figures. This gave a clear reflection of earnings manipulation in the reporting of EPS within the annual report.

### 2.3 Determinants of APM disclosure

A complete discussion of APMs would not be complete without examining what determines management to disclose APMs. It necessary to investigate what motivates management to disclose any additional information over and above the required IFRS information.

#### 2.3.1 Adequacy of IFRS information

As IFRS information does not provide all the information so-desired, APMs come in to compliment the missing information (CFA Society, 2015). Management therefore naturally uses APMs in cases where the financial statements have not reviewed all the entity specific information of a firm in a given period (Young, 2013). However, APMs may create confusion (Convington, 2016). They sometimes provide information that is inconsistent with IFRS (Hoorgevost, 2015). The gap (or deviation) between IFRS and APMs increased from 12% to 30% in 2015 (Deloitte, 2016b). Inconsistency between IFRS and APMs has impaired the reliability and credibility of APM information.

### 2.3.2 Strategic motives

Brouwer (2013) pointed to the possibility that APM disclosure could be primarily motivated by strategic motives. He referred to this behaviour as strategic financial reporting. Young (2013) supported the views of Brouwer (2013), and stated that APM disclosure was motivated by "opportunistic" motives. Companies would deliberately disclose information to move the share price in a certain direction, and cause mispricing. According to him, erratic reporting had a strong relationship with share mispricing, while, standardised regulated reporting was strongly associated with less mispricing. Therefore, management would disclose information to soothe their share price.

### 2.3.3 Emphasis of performance area

Management may disclose all necessary performance measures but may re-emphasised certain issues to draw the attention of investors as investors pay particular attention to matters that are emphasised by management (Brouwer, 2013). According to the same author, investors are deemed to have "limited attention and processing power", therefore they would not spend a lot of time and attention trying to process information whose costs would not exceed the benefits. To put into context, management are likely to re-arrange certain information in the annual report, by including measures which show a favourable result in a clearer way, while those that show poor results are expressed in an unclear and complex manner, to deliberately shift users' attention away from these poor results.

### 2.3.4 Legal and regulatory pressure

Brouwer (2013) pointed out that companies from common law countries disclose more financial information, that those from code law countries. Legal enforcement in Zimbabwe is deemed to be weak, and resulting in lowered transparency (Betah, 2013). According to his study, companies disclosed little financial information particularly in the hyper-inflationary of 2008. Regulators such as RBZ and IPEC, do give pressure to the organisations under their belt to provide additional financial disclosures such as capital adequacy ratios and risk-weighted assets for regulatory purposes. This information is not readily provided by financial statements, and therefore motivates management to include within their annual reports.

## 2.4 The limitations of APM information in enhancing credibility

Ernst and Young (2016) has pointed out the limitations of APM reporting. The key limitations have been inter-company comparability, management bias and conflict with IFRS statements, among others.

### 2.4.1 Differences in input variables

Comparability is the very basis of this research. Much of the literature has been included in an attempt to resolve the problem of comparability by use of APMs. While companies may report the same APMs using the same title and possibly definition, these APMs might have been calculated differently (Allianz, 2016; Siemens, 2016). This confirms that companies differ in their reporting of APMs, heavily resulting in material inconsistencies in APM disclosure. This however can be challenged by certain academics (Young, 2013; Aubert, 2010) who feel that the generic principles of calculating performance measures were well defined, and thus, any APM could be adjusted to ensure comparability.

### 2.4.2 Disguise of poor performance areas

There has been speculation of management bias in the reporting of APMs (Young, 2013; Brouwer, 2013; PriceWaterhouseCoopers, 2015; Deloitte, 2016). According to the authors, management may disclose only that information which shows a positive result. Studies conducted in this regard (Brouwer, 2013; Young, 2013) have suggested that management bias is inherent in the reporting of APMs. Aubert (2010) weighed in by stating that the voluntary disclosure of APMs, or "street earnings" as he colloquially called them, was subject to management bias as management would use them to seek comfort, while misleading investors. However, IFRS Foundation (2014) believed that management bias has its own positives. It can help investors determine management's character and the overall nature of their decision-making. Investors will be able to know the honesty of their chosen stewards.

### 2.4.3 Conflict between APMs and IFRS

In his speech, Hoogervost (2015) echoed the following sentiments,

> *".... IFRS numbers should serve as the primary performance measures by which companies describe their financial position and performance. Alternative performance measures must not be misleading and should not be given so much prominence in financial statements that they over-shadow the IFRS numbers."*

In his speech, Hoogervost clearly pointed out that his biggest worry was that of APMs overpowering IFRS information, which in turn leads to interpretation of financial information which is misleading. Stakeholders are now spoon-fed with two sets of financial information from the same organisation, which however may not necessarily be consistent. The primary source of financial information, according to him, should be IFRS information. However, undue attention has now been shifted towards APMs, and worries are that this source of information could be the primary communicator of financial performance in decades to come. CFA Society (2015) has also emphasised the fact APMs are meant to play a complimentary role to IFRS. Balakrishnan et.al (2012) believed that IFRS and APMs could work together. They cited that mandatory financial disclosure (i.e. IFRS) could play a confirmatory role to voluntarily disclosed financial information (i.e. APMs), thereby necessitating the two forms of disclosures.

### 2.4.4 Risk of share mispricing

Young (2013) pointed out that management may be influenced by "opportunistic motives" to disclose certain APMs. This, he said, APMs had a strong, positive relationship with share mispricing. He believed that regulated reporting, such as IFRS reporting, was strongly associated with less share mispricing. Thus, he encouraged the regulation of APM reporting.

Aubert (2010) however felt that IFRS figures included non-recurring, unusual items which were removed in the calculation of APMs, and thus resulting in much more stable forecasting of future earnings and share price stability. The author also felt that APMs resulted in higher abnormal equity returns than the return of IFRS measures, suggesting that investors overreact more to APMs than IFRS numbers. IFRS Foundation (2014) argued that it is difficult to test how investors react to APM information in isolation, because, more often than not, all APM information is disclosed concurrently and within the same report as IFRS information.

### 2.4.5 Auditor disclaimer

The external verification process of APMs has been under scrutiny for some time. APMs are not subject to the ordinary audit process (Ernst and Young, 2016). There have been questions over the reliability of APMs. Much of the debate revolves around whether APMs are audited or not. A survey conducted by CFA Society (2015) reviewed than 74% of APMs are found somewhere within the financial statements. This would therefore imply that 74% of APMs within an annual report are audited. APMs such as EBITDA, EBIT or operating profit are normally implicit within the financial statements and therefore are subject to the normal audit process. Vershoor (2014) viewed that APMs are an adjustment to IFRS information. This would mean that APMs can and should be reconcilable to IFRS.

## 2.5 The benefits of APM reporting

The benefits of APMs in the financial reporting process have been heavily under-researched. Much focus of the studies has been in the United States, with little literature over their use in the developing world, particularly in Zimbabwe. However, the limited available literature does not imply that APMs are not used in this part of the world. Ernst and Young (2016) pointed to a few benefits which have been discussed below.

### 2.5.1 Enhanced insight and transparency

APMs provide useful information to stakeholders (Hoogervost, 2015). The information provided gives stakeholders better insight about the performance of the organisation (Deloitte, 2016a). It generally shows more transparency in the performance of the organisation. However, increased scrutiny has started arising in several parts of the world, with stakeholders asking the question of whether APM reporting actually "enhances, or deceives, corporate transparency" (PriceWaterhouseCoopers, 2016). The increased transparency is not necessarily considered by many to be reliable transparency. Many believed that APMs are reported so as to mislead investors (Young, 2013; Brouwer, 2013).

### 2.5.2 Provision of entity-specific performance information

APMs allow external stakeholders to "see through the lens of management" (CFA Society, 2015). This is to say that investors and analysts, in particular, are able to actually evaluate the performance of organisations by using the same performance measures that management actually use in the internal decision-making process. This helps external stakeholders relate better with management, and ask the right questions. However, APMs have been used by some managers to re-emphasise issues already reported in the financial statements (Brouwer, 2013). By so doing, he says, only that financial information which shows a positive result is reported as an APM and thus negative information is not shown.

### 2.5.3 Exposure of prospects and strategic intentions of management

Ernst and Young (2016) believed that APMs can enable analysts and investors to compare the prospects of different companies. The same author believed that APMs expose the intentions of management, and thus the future plans of organisations can be known. This reiterates the views of Brouwer (2013) that, strategic motives strongly influenced the reporting of APMs. The ability of APMs in exposing the future plans of management helps investors compare which firm is working in line with their demands.

### 2.5.4 Links financial statements to non-financial information

APMs create a useful link between financial statements and non-financial information, thereby, enhancing the quality of integrated reporting in corporate entities (Ernst and Young, 2016). Financial statements cannot be examined in isolation, and thus APMs help explain the numbers, in a more meaningful way. However, APMs are often used by management to justify poor performance (Brouwer, 2013). Companies that have incurred losses, spend a lot of time giving explanations, and thus, use APMs as a cushion to protect their jobs and reputation.

## 2.6 The role played by the relevant stakeholders to enhance credibility of APMs

The question of credibility has been raised by many market watchers (Hoorgevost, 2015; Deloitte, 2016b; CFA Society, 2015). It is therefore necessary to identify all the stakeholders directly involved in the reporting of APMs. Furthermore, the role that each of these participants plays in attempting to enhance credibility of this information is examined. It should be noted, however, that none of these participants can “ensure” that APM information is credible. The participants can only "enhance" its credibility, thus justifying the researcher's use of the term "enhance" as opposed to "ensure".

### 2.6.1 The role of the independent auditor (ISA 720, *Revised*)

ISA 720 is the only standard that deals with Other Information in the annual report. The standard defines 'Other Information' as "financial or non-financial information (other than financial statements and the auditor's report thereon) included in an entity's annual report". By definition, APMs would qualify to be Other Information. The standard requires the auditor to review Other Information, and ensure that there are no material inconsistencies between Other Information and the audited financial statements. If any such inconsistencies are identified by the auditor, during the audit, the auditor should demand management to make corrections to such information. Where management refuses to make such corrections, the auditor should make aware to the users of the annual report of the inconsistencies, or consider other legal or regulatory alternatives that are appropriate in the circumstances. The responsibility of the financial disclosures according to the ISA rests with management. As a result, ISA 720 requires an auditor to expressly disclaim an opinion on Other Information. The auditor's opinion, therefore, does not cover all the Other Information. Ironically, however, 74% of APMs are included somewhere in the financial statements according to a survey (CFA Society, 2015). This means that statistically, 74% of APM information, is part of the audited financial statements, and thus, the information would have been audited and is therefore covered by the overall audit opinion. Entwistle et.al (2010) also felt that high audit quality increased the confidence that investors had in APMs, and that despite the fact that they may not have been audited, investors will still consider them to be credible.

### 2.6.2 The role of the audit committee (King 3)

The King 3 code of corporate governance ("King 3") requires the Audit committee, as part of its mandate, to satisfy itself as to the integrity of the annual report. King 3 requires the audit committee to review the entire annual report, and ensure that the information in the report (financial disclosures included) are all authentic information of the organisation, and related to events and circumstances that have actually occurred and relate to the respective organisation. Ernst and Young (2016) identified the three key responsibilities that the audit committee should play in assuring credibility of APMs. Firstly, the committee should demand reconciliation schedules of APM information to IFRS, to ensure the two sets of information are aligned. Secondly, the audit committee should ensure clarity and consistency in the reporting of APMs. Management should explain to the committee if it so decides to stop reporting a certain APM, to avoid unexpected market reactions. The audit committee should also ensure that if the financial statements are reported for a different time frame, other than a year, then the committee should ensure that the APM covers the same period covered by the financial statements. Lastly, the committee should challenge management's interaction with external parties. It should ensure that APMs are not given greater prominence than IFRS in all press statements, releases and all other forms of external communication. Entwistle et.al (2010) weighed in by stating that the perception that investors had on the quality of corporate governance in a firm directly impacted their perception of the credibility of APMs.

### 2.6.3 The role of the regulators

Organisations such as IOSCO and ESMA have stepped up to the plate, to propose a globally accepted standard of APM reporting (CFA Society, 2015). These organisations have issued guidelines on the reporting of APMs, with the former issuing its first set of guidelines as CESR in 2005 and proposed revisions in 2015, and the latter organisations proposing an internationally accepted set of guidelines for APM reporting in 2015. These guidelines however, have been criticised for only addressing the widely used APMs. Sadly, these guidelines have no authority in Zimbabwe. In addition, regulatory reforms with regards to APM reporting have differed from country to country, with the United Kingdom and Australia having adopted a more conservative approach while the United States and South Africa have been radical in their reforms (Sinnewe, 2013).

### 2.6.4 The role of the preparer

Preparers might provide measures that are clearly defined and presented in a transparent and unbiased way to ensure that information is of quality and effectiveness (KPMG, 2016). Preparers should be consistent in their reporting of Non-IFRS measures. As recommended practice (IOSCO, 2015; ESMA, 2015), preparers should report an APM with its prior year comparative. This will help analysts and investors analyse performance better, and improve on resource allocation. Prepares however cannot endorse the credibility of their own work as this would result in a self-review threat. This therefore means that a third-party has to be sought to express an independent opinion.

## 2.7 Summary

The chapter managed to highlight the measures used as APMs by listed companies. The chapter went on further to argue on the benefits and limitations of APMs, as well as whether they can enhance or impede comparability.

# CHAPTER THREE

# RESEARCH METHODOLOGY

## 3.1 Introduction

This chapter introduces the methodology employed by the research in completing his research. This incorporates the research design, the population surveyed and the instruments utilised in gathering data from the participants. The chapter will close off with a summary. Analysis of the data obtained will be presented in subsequent chapters.

## 3.2 Research design

Kumar (2011) asserts that a research design is the plan, structure, pattern of procedures and methods used to gather information for research. It is required to enable the researcher to plan and implement the research in such a way that accurate results can be achieved (Grove et.al, 2012). It therefore typically entails how data will be collected, the instruments used, and the ways in which the data will be analysed (Dhliwayo, 2013). According to the same source, there are basically three classifications of research designs that is causal, descriptive and exploratory design. The researcher adopted a descriptive design.

## 3.3 Descriptive Research Design

According to Pandey and Pandey (2015), a descriptive design basically entails a study which shows the participants in an accurate manner that is describing who took part in the response. This researcher adopted this design because it placed emphasis on determination of the rate at which certain variables relate or how frequently an event occurs. It also related the population study to key variables. It aimed at interpreting conditions at present, differences as well as relationships that might have been existent, opinions held, processes going on and evident trains.

### 3.4 Target Population

It is essentially a collection of the necessary elements which are of interest to the researcher (Amviko, 2010 as cited in Dliwayo, 2013; Hacket and Caunt, 1994 as cited in Ndlovu, 2014). This therefore includes all the participants that were primarily targeted by the researcher and analysis of their response rate. The researcher targeted a total of 15 respondents with varying skills and responsibilities within their respective trade. A total of 10 professional accountants (auditors) were targeted from an auditing firm. An additional 3 corporate finance experts were targeted from the said firm. The remaining 2 respondents were representatives of SECZ, which is responsible for *inter alia* regulating capital markets and ensuring market integrity. An analysis of the response rate is provided below

**Table 3.1**

| Target | Population | Sample Size | Sample Size % | Research Design |
|---|---|---|---|---|
| Professional accountants | 10 | 10 | 100 | Questionnaire |
| Corporate Finance Experts | 3 | 0 | 0 | Interview |
| Regulators | 2 | 0 | 0 | Interview |
| **TOTAL** | **15** | **10** | **67** | |

In the researcher's own judgement, a 67% response rate is a good representation of the target population.

### 3.4.1 Justification of population

The researcher decided to select an equitable sample of investment analysts and professional accountants. Professional accountants were included due to their knowledge of financial reporting, while corporate finance experts were selected as a result of their understanding of integrated reporting, corporate disclosure as well as stoke market dynamics. The SECZ regulators were included in their capacity as the watchdog of how companies report performance on the ZSE.

## 3.5 Judgmental sampling

The researcher employed judgmental sampling to select the professionals to take up in the survey. Ten professional accountants and three corporate finance professionals were selected because their understanding of financial reporting and corporate disclosure, two skills, which in the researcher's judgment were fundamental qualities required for an individual to give an opinion on the matter at hand. The researcher went to solicit information from the regulators. The researcher selected a reasonable sample, which in his personal judgment, was a good representation of the relevant stakeholders (Headlam and MacDonald, n.d.). This was perceived to give more accurate responses.

## 3.6 Sources of data

### 3.6.1 Primary sources of data

Primary data is information that is collected for the purpose of a research project and is specifically tailored to research needs (Headlam and MacDonald, n.d.). Primary data was obtained directly from the participants through interviews and questionnaires. This information was obtained at the time of the research giving detailed, up-to-date responses. The researcher considered primary data to be tailored for the issue at hand, because it was raw and unprocessed.

### 3.6.2 Secondary data

According to Headlam and MacDonald (n.d.), secondary sources usually use primary data to solve research problems. The same authors define secondary data as data collected by someone else besides the user. During the course of this research, secondary data was obtained from analysis and publications by investment firms, newspapers and other previous research articles on the same topic. Secondary data was used to reduce costs as the information was readily available and simplified. The researcher however placed less reliance on secondary data because, as a result of the fact that very little has been researched on the area, there was little available secondary data. Moreover, the secondary data obtained was not deemed to be fit-for-purpose.

## 3.7 Instruments: Questionnaires

Questionnaires were mostly used where the researcher wanted to profile the sample in terms of numbers or be able to count the frequency of occurrence (Rowley, 2010). These were completed without any direct interaction with the respondents. The researcher used closed ended questions. By so doing, respondents were only required to select from a given set of answers. The close-ended questions were issued to the professional accountants and corporate finance professionals. This was the preferred set of questions, as the researcher felt that giving respondents the discretion to give open answers would result in completely varying answers which would be difficult to analyse (Rowley, 2010). In addition, there were 13 respondents, thus the use of questionnaires would be less time consuming. The questionnaire was divided into two sections; a section for yes/no questions and a section for agree/disagree questions. The yes/no questions were intended to enlighten the respondents on the topic and were more introductory in nature (Rowley, 2010). The agree/disagree questions needed a more qualitative view but without giving respondents the freedom to answer anyhow (Rowley, 2010; Pandey and Pandey, 2015). The agree/disagree questions did not explicitly give respondents the option to avoid answering any question, as it expected a view from all respondents. The last part on the questionnaire allowed respondents to give additional comments in areas where they felt their opinion had not been fully exhausted.

## 3.8 Validity and reliability of data

### 3.8.1 Validity

Validity exists when another person were to look at the data and make the same conclusions (Blaxter et.al, 2010). It is a question of the depth to which the instrument selected answers the research objectives (Easterby-Smith et.al, 2008). The researcher used a set of interview questions and questionnaires. He issued questionnaires to a given set of respondents and interview questions to another set. Those that were given questionnaires were deemed to be experts in the area of study and thus could answers without a need for interaction with the researcher. The interview questions were mainly directed to the regulators whose verbal explanations and interactions were deemed to be more valid. A different set of questions were developed for the regulator, to ensure that the questions asked were appropriate and valid. Supervision and third-party commentary was also sought to ensure that the questions at hand were valid for the intended purpose.

### 3.8.2 Reliability

Reliability of data exists when readers can depend on the responses given (Pindey and Pindey, 2015). Questionnaires were pre-distributed to see if the respondents understood the data to ensure if the questions were precise and clear. Data triangulation was used for more persuasive evidence for data collected through questionnaires and interviews. Interview questions were issued to a few individuals whose responses needed direct interaction between the researcher and the respondent. This enabled the respondents to give verbal explanations to the responses given, thereby enhancing the reliability of data (Harwell, n.d.). Questionnaires were also issued in the form of closed-ended questions and the respondents answered without the researcher's interference. This enabled data to be more reliable as the respondents were not influenced by the researcher to answer in a certain way (Pindey and Pindey, 2015). The questions issued were also independently evaluated by a supervisor to ensure that the questions were not biased, and thus, would give an independent and objective analysis of the topic at hand.

## 3.9 Data presentation

Data was presented by use of graphs, pie charts, tables, bars etc. Data compiled was grouped according to similarities, mode and percentages (Blaxter et.al, 2010). Pie charts, bars and column graphs were used when the researcher felt they would enhance the reader's understanding of the responses given. The researcher used tables and graphs to provide clarity. Texts were best suited for presenting numerical data, on the other hand, graphs were deemed to better depict relationships, comparisons and showing trends. Charts, tables and graphs were used to analyze the qualitative data accumulated from the closed-ended questionnaires. The researcher chose these presentation tools since they made data analysis and interpretation relatively easy (Headlam and MacDonald, n.d.).

### 3.10 Data analysis

Having been presented in graphs, bars, charts etc., the data collected was further analysed. The researcher used summaries and narrative explanations below the presented data. This enabled the reader to relate the explanations with the data presentation (Blaxter et.al, 2010). The researcher also went on further to agree the data responses to theoretical findings. This was done to obtain patterns of resemblance or divergence to provide persuasive conclusions

### 3.11 Summary

This chapter mainly looked at the research methodology used during the research process, including the sources of data, sampling techniques, population sample and the presentation and analysis of data. The next chapter will be based on data presentation and analysis.

CHAPTER FOUR

# DATA PRESENTATION AND ANALYSIS

## 4.1 Introduction

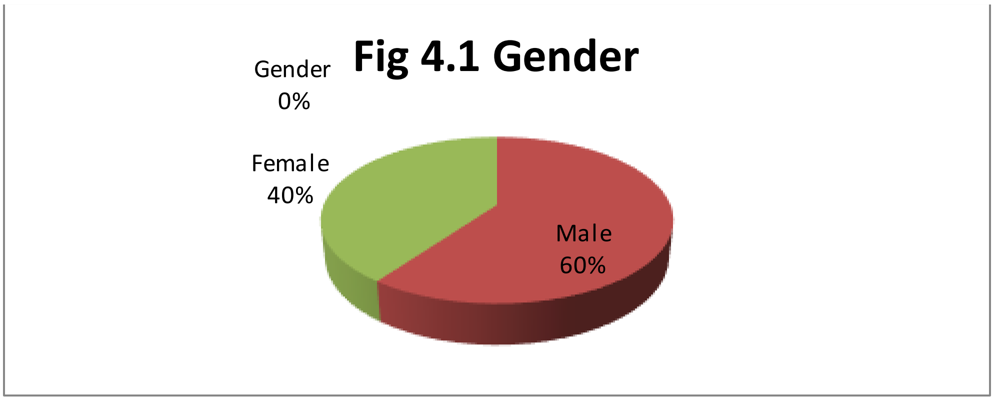
This chapter analyses the data collected in the previous chapter. The results presented are based on the findings obtained during the distribution of questionnaires in the field study. The chapter will assess the demographics of the respondents. It will go on further to analyse each question asked and the response thereof. The chapter will conclude by summarising the findings of the data analysis.

## 4.2 Questionnaires

Ten questionnaires were distributed to an auditing firm. The questionnaires targeted those with a reasonable knowledge in IFRS and audit. All the questionnaires issued were responded, thus giving a 100% response rate.

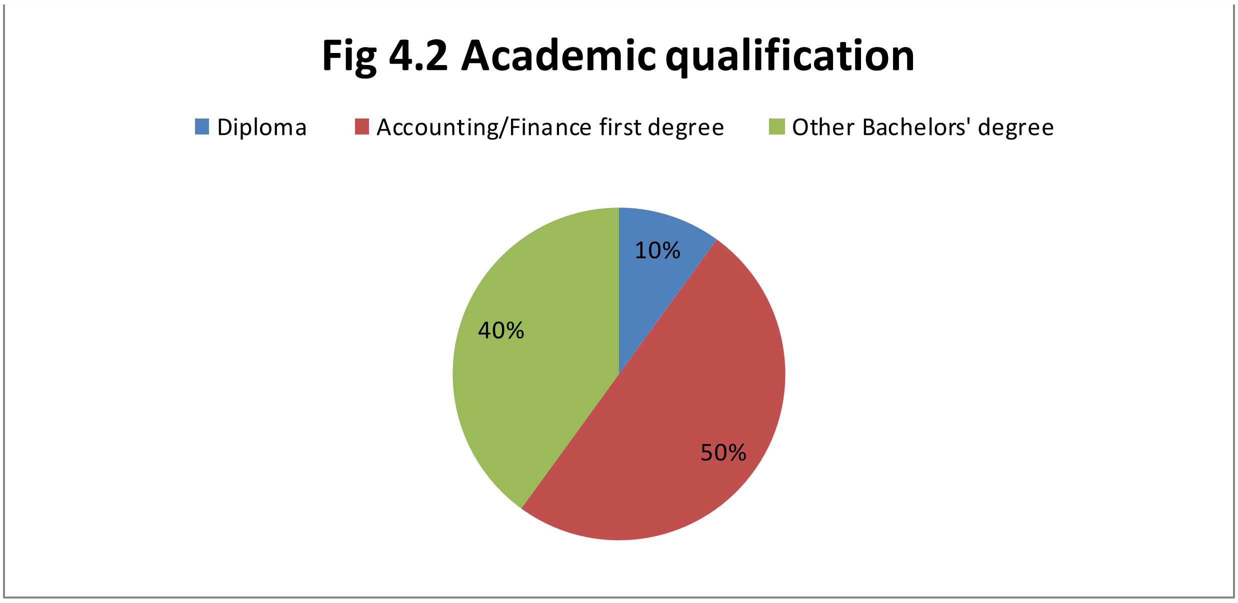
## 4.3 Demographic Assessment

### 4.3.1 Gender



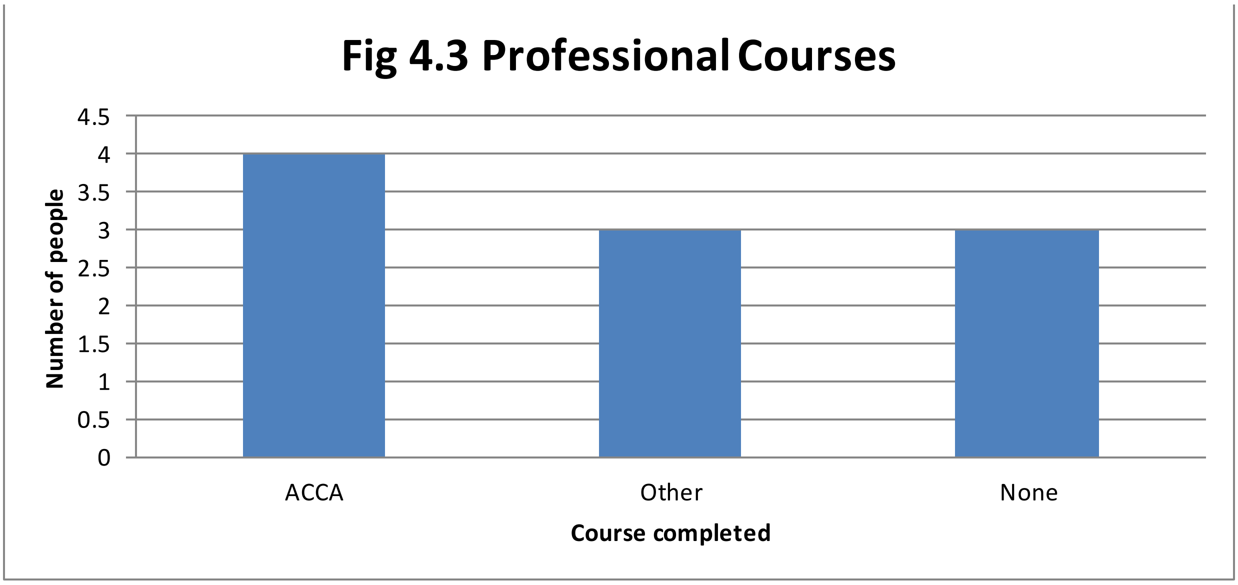
Of the respondents, 60% were male and 40% were female. As result, gender bias did not have an impact on the assessment

### 4.3.2 Academic Qualification




50% of the respondents had a first degree in either Accounting or Finance, or both. This was a good representation of the academic qualifications necessary for analysing the topic at hand. 40% represented other bachelor's degrees. The questionnaires did not enquire further, whether these other degrees were business-related. The remaining 10% had a diploma

### 4.3.3 Professional courses

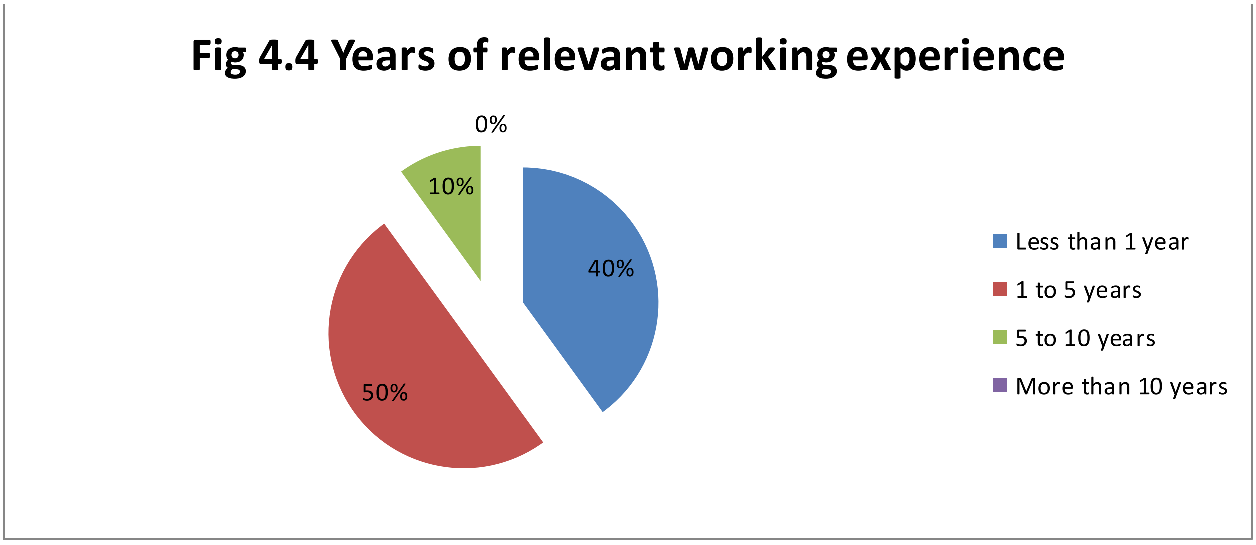



Of the respondents, 7 of the 10 (70%) had a professional course successfully completed. Of the 7 qualifications, 4 of them were ACCA designations. None of the respondents unfortunately were fully qualified CA (Z). None of the respondents had any of the following: CIMA; CIS; CIA: CPA; CFA nor CAIB.

### 4.3.4 Position and Department

All the respondents who participated in the survey were from the Audit/Assurance Department. They were all articled clerks training towards becoming Chartered Accountants.

#### 4.3.5 Relevant working experience

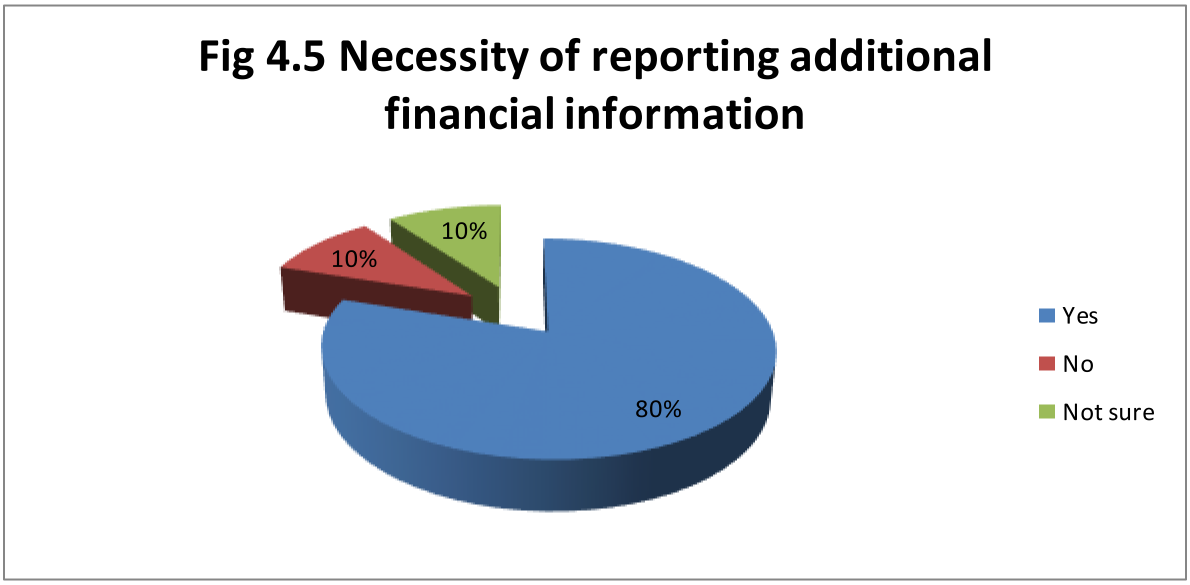



The researcher did not manage to access a reasonable number of experienced personnel as half of the respondents were in their first year of relevant working experience. 4 of the respondents (40%) were within 1 to 5 years of experience. The group also included one outlier, who had more than 5 years' experience, but no one had more than 10 years' experience.

### 4.4 Questionnaire responses and analysis

#### 4.4.1 Is it necessary for companies to disclose additional financial information in the annual report, over and above IFRS-compliant financial statement?

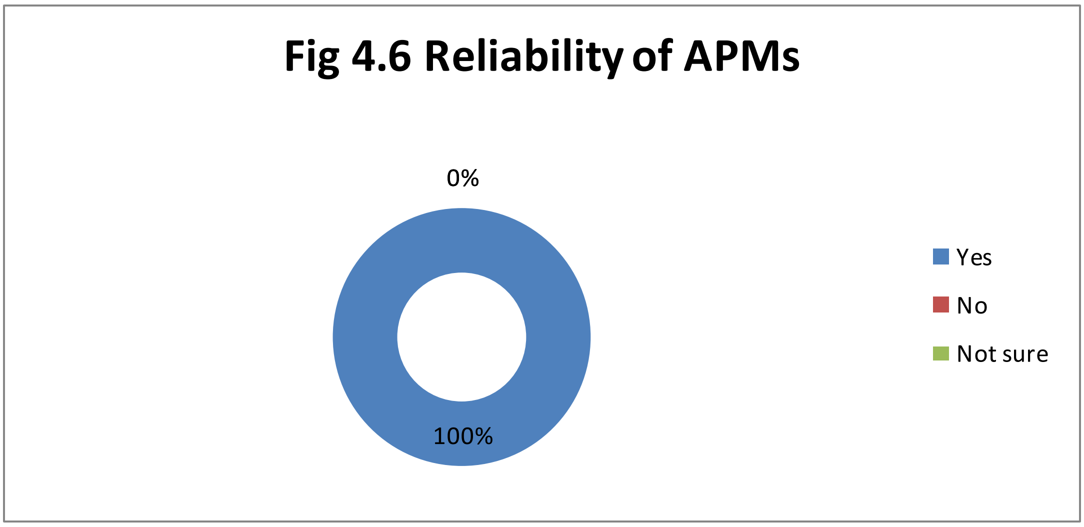
The question was intended to introduce the issue at hand, by soliciting whether respondents felt it was necessary for companies to include more financial information than that already included in the financial statements.




Of the respondents, 8 (80%) felt it was necessary for companies to include additional information in the annual report above the required IFRS requirements. This supports the assertion that IFRS information does not provide all the financial information required for investment analysis, as mentioned by the CFA Society (2016). 1 respondent (10%) felt otherwise. The respondent believed that IFRS information was enough to provide all the information necessary and required by the shareholders. The other respondent (10%) was not sure. This therefore means that IFRS financial information does not provide all the financial information necessary for investment analysis. As a result, it is necessary for corporates to disclose more financial information.

### 4.4.2 Do additional performance measures provide financial information that is reliable?

The question was intended to ascertain whether this additional financial information provides reliable financial information.

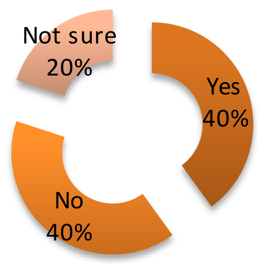



All the respondents (100%) felt that alternative performance measures provided financial information that was reliable. This implies that investors can use this information for their analysis and other purposes. This puts to bed the notion that additional financial measures are not reliable.

### 4.4.3 Do investors focus more of their attention to financial information that is summarised and/or presented in a graphical form than raw financial statements?

This question was intended to enquire which financial information investors focused more on, between the financial statements and summarised financial information. Those who said Yes to the question believed that investors focused more of their attention to summarised financial information, and those who answered No believed that investors still focused more of their attention to the full set of financial statements.

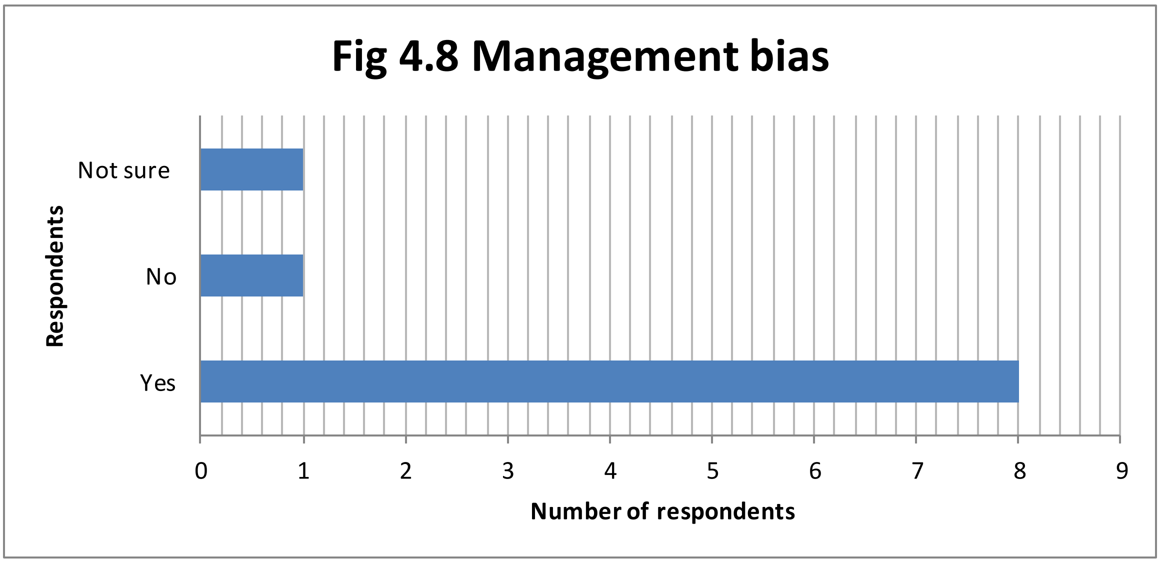
Fig 4.7 Investor focus




Respondents were equally divided on their opinion of the matter. 4 of the respondents (40%) felt that investors focused more their attention to summarised and graphically presented financial information. Another 40% (4 respondents) however, still felt that all investor attention was still centred towards the financial statements. The 20% (2 respondents) remained neutral in their response. As a result, the results of the findings were inconclusive on this matter. The limited attention model proposed by Hischfelier (2003), as quoted by Brouwer (2013), did not receive overwhelming support. This means that the limited attention model does not apply to this part of the world. Furthermore, despite the complexity and difficulty of analysing the full set of financial statements, the respondents still felt that investors had sufficient time and attention to dissect the financial statements.

#### 4.4.4 Is there management bias in the reporting of additional performance measures?

This question was brought about by the researcher's curiosity on whether the additional performance measures had management bias.

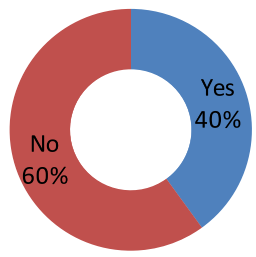



Of the respondents, 8 of them (80%) believed that there was management bias in the reporting of alternative performance measures. The responses were not conclusive on the type of management bias that was perpetrated by companies in the reporting of the performance measures. 1 respondent (10%) felt otherwise. The respondent felt that there was no management bias in the reporting of these measures. The remaining 10% (1 respondent) remained neutral. The 20% who did not believe that there was management bias, probably supported their assertion that these performance measures were reliable, as ascertained in 4.4.2. 80% of the respondents therefore felt that, despite the fact that there was the prevalence of management bias in the reporting of alternative performance measures, these measures still provided financial information that was reliable.

### 4.4.5 Is it necessary to regulate the reporting of voluntarily disclosed financial information in the annual report?

This question was meant to solicit from respondents whether they felt that financial information that is voluntarily disclosed in the annual report over and above the required IFRS statements should be regulated, or not.

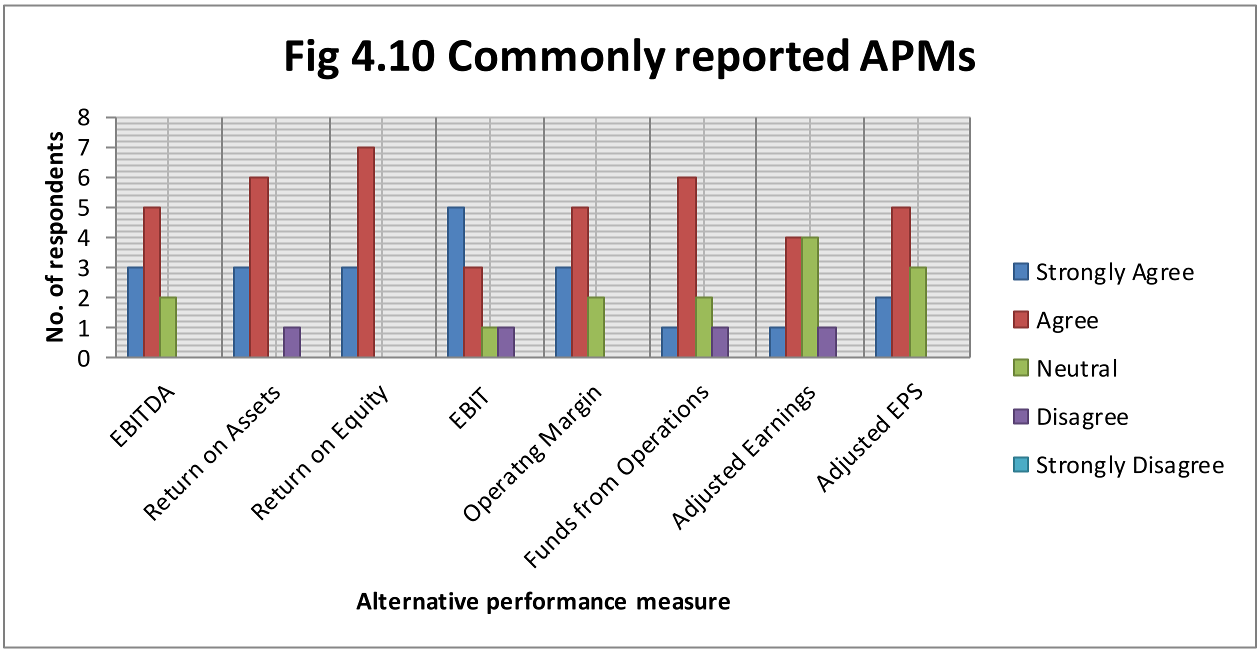
Fig 4.9 Necessity of regulation




6 of the respondents (60%) felt that it was not necessary to regulate additional financial information. They felt that, as a result of its voluntary disclosure nature, management are supposed to be given freewill by regulators to disclose financial information in any way that they deem necessary. The remaining 40% (4 respondents) however felt that lack of regulation might result in catastrophic consequences which the relevant stakeholders might fail to resolve. As a result, they supported the views expressed in the speech of Hoorgevost (2015) that it was necessary to oversee the reporting process.

#### 4.4.6 Which APMs are commonly reported by ZSE-listed companies?

The question was intended to identify the APMs commonly exploited by listed companies in Zimbabwe. The main objective was to formally introduce APMs to readers.




**Earnings before Interest, Tax, Depreciation and Amortisation (EBITDA)**

Of the 10 respondents, 3 (30%) respondents strongly supported the wide use of EBITDA as an APM. Another 50% (5 respondents) simply agreed to the use of this measure. As a total, 80% of respondents were overally in agreement to the fact that EBITDA is commonly reported by listed corporate on the ZSE. 2 respondents (20%) remained neutral. None of the respondents however disagreed to its use.

**Return on Assets (ROA)**

ROA is commonly used by listed companies, according to 90% of the respondents. 3 respondents (30%) strongly agreed to its use. 6 respondents (60%) agreed to the use of ROA. 1 respondent (10%) however disagreed to its reporting of ROA. The 10% felt that ROA was not generally used.

**Return on Equity (ROE)**

All the respondents surveyed agreed to the wide use of ROE in the annual report. 30% of the respondents strongly agreed to its use. The remainder were simply in agreement. This shows consensus with available literature that ROE, was a necessary measure for providing information about the effective use of resources, which preparers felt was necessary information to investors.

**Earnings before Interest and Tax (EBIT)**

EBIT was commonly reported according to 8 of the respondents (80%). 5 of them (50% of the total) strongly agreed to its use, and 3 simply agreed. Another respondent (10%) remained undecided, and the other respondent (10%) was not agreement with the available literature and stated that EBIT was not as widely used. The results therefore support the fact EBIT is commonly used.

**Operating Margin**

None of the respondents surveyed disagreed to the use of Operating Margin. 20 % (2 respondents) however were undecided. Half of the respondents agreed to its use, and the remainder (30%) strongly agreed. There was therefore little debate over its wide use.

**Funds from Operations**

Of the 10 respondents surveyed, only 1 (10%) strongly agreed that Funds from Operations were heavily disclosed by corporates listed on the local bourse. Another 60% (6 respondents) were in agreement to its use. 20% (2 respondents) remained neutral. However, 1 respondent, representing 10%, disagreed to its use. The respondent felt that the Statement of Cash Flows provided all the liquidity information so required by shareholders.

### Adjusted Earnings

Adjusted earnings are heavily addressed in literature, but did not have the expected supported. Only half of the respondents agreed to the fact that earnings adjustments were common on the ZSE. Of those that agreed, 1 respondent (10% of the total) strongly agreed with the remaining 4 agreeing. 40% (4 respondents) were not sure as to its use. They could not decide. 10% (1 respondent) disagreed and thus felt that there was no prevalence of earnings adjustments by listed corporates.

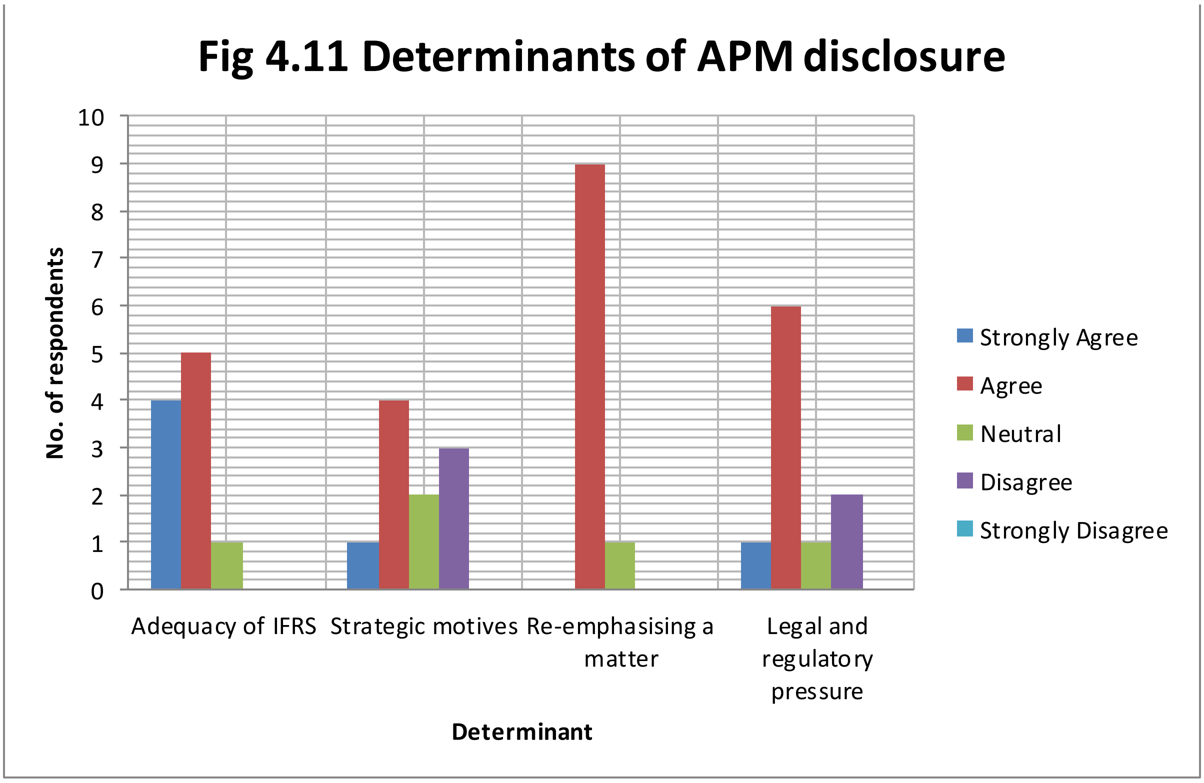
### Adjusted Earnings per Share (Adjusted EPS)

The derivative of adjusted earnings, which is Adjusted EPS, was commonly reported according to 70% of the respondents. 2 of the respondents (20%) strongly and another 5 (50%) were simply in agreement to its use. The remaining 30% (3 respondents) remained neutral. None of the respondents were in disagreement. This implies that the two measures Adjusted Earnings and Adjusted EPS were reported at varying magnitudes, further suggesting that companies do not always report the two measures at the same time.

The wide use of APMs such as EBITDA and Return on Equity were not disputed, suggesting that they had become common in the annual reports of listed corporates. Measures such as Return on Assets, EBIT and Funds from Operations were heavily supported, with negligible disagreements. Adjusted EPS had strong support, with however few respondents (30%) being unsure of its wide use. Scepticism was however high, with regards to Adjusted Earnings, with 4 out of the 10 respondents expressing neutrality to its use.

### 4.4.7 What are the determinants of APM disclosure?

The question sought to investigate what actually determines management to disclose APMs, when in essence, they are not under any obligation to disclose additional financial information above the required IFRS information.



**Adequacy of IFRS information**

4 of the respondents (40%) strongly supported the views of the CFA Society (2016) which stated that IFRS financial statements did not provide all the information necessary for investment analysis. This is also in line with 80 % of the respondents who deemed it necessary for companies to disclose additional financial information, above the required IFRS. Half of the respondents (5) were also in agreement with this fact. This brought the total of those who agreed to 9 (90%). The remaining 10% were neutral in their opinion. None of the respondents disagreed to the inadequacies of IFRS.

**Strategic motives**

The assertion of Brouwer (2013) did not receive overwhelming support, as only half of the respondents (50%) felt that management were motivated by strategic motives to disclose APMs. An overwhelming 30 % (3 respondents) disagreed to this notion, suggesting that they felt there was no relationship between strategic motives and APM disclosure. 20% remained undecided, as they were not sure whether there was indeed a relationship between two the variables.

**Re-emphasising a performance area**

An overwhelming 90% of the respondents (9 in total) agreed to the fact that management disclose APMs to re-emphasise an issue that has already been disclosed in the financial statements. They felt that certain events that might have been disclosed in the financial statements might not have been given the prominence it deserves and management would feel they should highlight the matter in a clearer manner to shareholders. Only the 10% (1 respondent) remainder were unsure. None of the respondents disagreed.

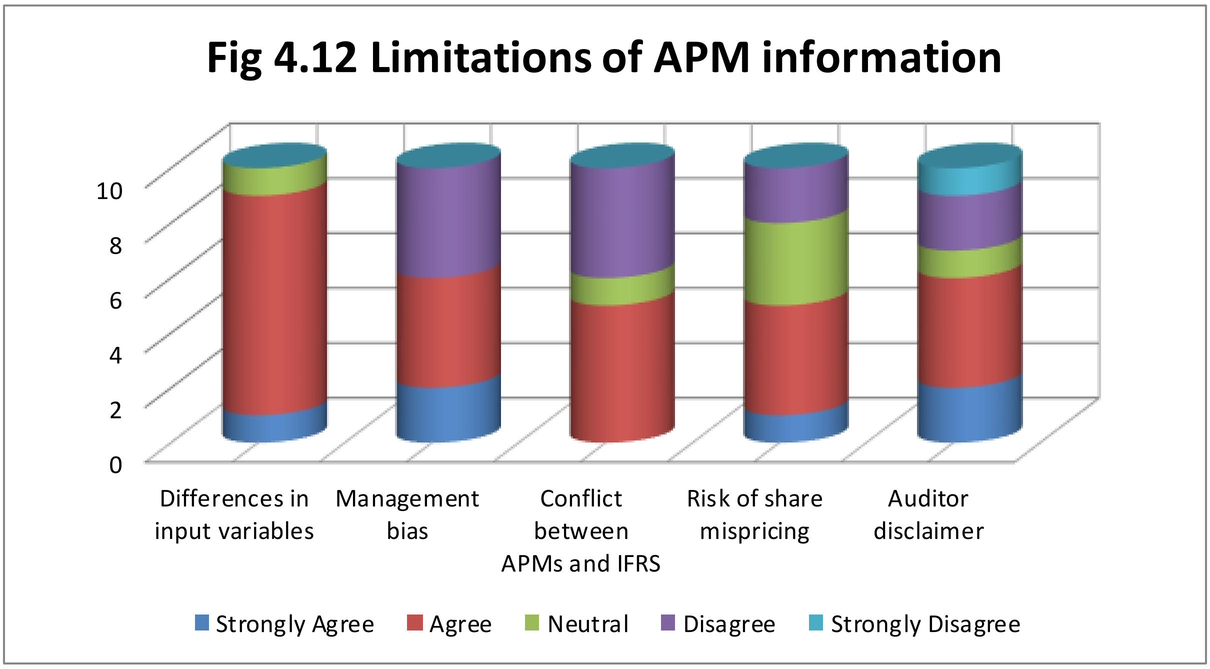
**Legal and regulatory pressure**

Opinions were divided on this matter. 10% strongly agreed that legal and regulatory pressure heavily determined the disclosure of APMs by management. An additional 60% (6 respondents) were also in agreement to this fact. Another 10% of the respondents were neutral. Ironically, however, 20% disagreed to this fact. They believed that the IFRS financial statements are the ones required by law and regulation, and therefore, it would be oxymoronic for the same legal and regulatory authorities to give companies any extra pressure to disclose additional performance measures.

The factors that pushed management to disclose APMs were not heavily debated. The inadequacies of IFRS were acknowledged by 90% of the respondents, and only one neutral respondent. Re-emphasis of matter was agreed to by the majority of the respondents. They did feel that financial statements sometimes report a certain performance matter by simply including it as a single line item in the financial statements, which impairs its significance to the entity. This therefore motivates management to re-emphasise the matter elsewhere in the annual report, with the required level of clarity. With legal and regulatory pressure, some felt that regulators such as RBZ demand greater information than that required by IFRS, and this would force companies to disclose additional financial information. Others disagreed, and felt that such regulators do not give companies additional pressure, and therefore enhanced transparency was entirely up to the entity. The notion that strategic motives were a force behind APM disclosure was heavily disputed. 20% of the respondents remain sceptical of the relationship between strategic motives and APM disclosure brought forward by Brouwer (2013)

### 4.4.8 What are the limitations of APM information in enhancing comparability?

The question sought to ascertain the drawbacks of APMs in comparing performance of listed companies. The question was derived from the alternative hypothesis, which impliedly stated that 'APMs impede comparability of financial performance in listed companies'.




**Differences in input variables**

With the exception of 1 respondent (10%), all the other 9 respondents (90%) agreed that companies used different input variables to calculate the same APMs. While two companies may calculate, say Return on Assets, one company may calculate using it pre-tax return while another may use after-tax return thereby impairing comparability. This is in support of the key warning issued by many American companies (Allianz 2016; Siemens 2016) that companies may give the same name and definition to an APM that might have been calculated differently.

**Management bias**

Of the 10 respondents surveyed, 2 strongly agreed that management deliberately disclosed only those APMs that show a positive result, and disguises poor results. An additional 4 (40%) agreed. The remaining 40% (4 respondents) believed otherwise. They felt that management disclosed all APMs whether, positive or negative performance measures. As 60% were in agreement, it shows that unethical practices were inherent in the APM reporting process.

**Conflict between IFRS and APMs**

While Hoorgevost (2015) raised worries about the possibility that APMs might override IFRS, only half of the respondents were in agreement with this fact. 40% of the respondents disagreed, and felt that there was no material inconsistency between the two sets of financial information. They felt that both APMs and IFRS were derived from the same accounting system, and they ought to report the same results however presented differently. 10% of the respondents neutralised the argument by remaining undecided. This meant that the existence of a conflict between the two did in essence exist, and it was a limitation of APM disclosure.

**Risk of share mispricing**

The assertion of Young (2013) that ad hoc reporting of financial information was strongly associated with share mispricing was only supported by half of the respondents (5 in total). Of the 5, 1 of them (10%) strongly agreed to this fact. 2 respondents (20%) however crashed the argument, by implying that there was no relationship between the two variables and therefore share mispricing was not a limitation. 30% of the respondents remained inconclusive on the matter, suggesting that they were not sure whether there was indeed a relationship. IFRS Foundation (2014) had suggested that it was difficult to examine investor reaction to APM information in isolation, as it is common that one annual report would include both APMs and IFRS. Investor reaction would only come from information overload.

**Auditor disclaimer**

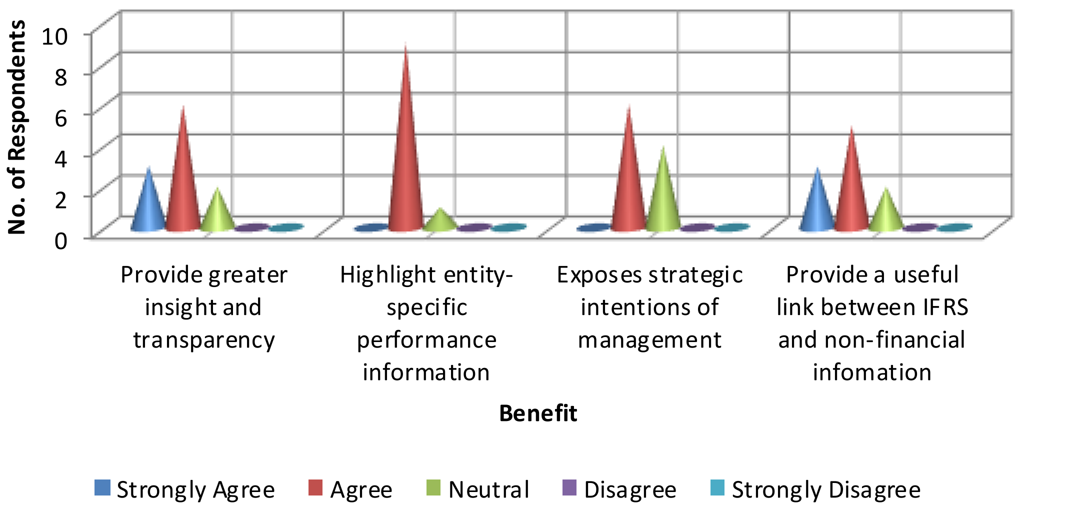
The respondents, all of whom were in the audit department, were completely divided in their opinion. 2 respondents (20%) strongly agreed that the failure by auditors to express an opinion on APMs was limitation. A further 40% (4 respondents) further agreed to this notion. 1 respondent remained neutral. However, 20% (2 respondents) were not in agreement to this fact. A further 10% (1 respondent) strongly disagreed to this. While it is clearly established in ISA 720 (Revised) that auditors do not express an opinion on 'Other Information', 30% felt that this was not a limitation to APM disclosure.

Opinions remained strongly divided on the limitations of APMs in ensuring comparability. The fact that companies calculated APMs differently from one another, was however, established fact, as 90% were in agreement. The fact that corporate only disclosed positive performance measures was heavily disputed, as 40% of the respondents questioned this assertion. The existence of a conflict between APMs and IFRS also kept respondents divided, with only half agreeing that a conflict actually existed. 40% did not agree to this, and the remainder were unsure, further enhancing the debate. The relationship between APMs and share prices is a foreign concept to many accountants, and although the findings showed greater support to the fact that APMs facilitated share mispricing, 30% were unsure of what to comment and remained neutral. Auditor disclaimer also created strong division, but however, the majority of the respondents were in favour of the fact that the failure by auditors to express their opinion on APMs was indeed a limitation.

#### 4.4.9 What are the benefits of APM reporting?

The question sought to discover whether stakeholders actually benefitted from APMs since 80% felt it was necessary to have them in the annual report, as investigated in Section 4.4.1 above.

Fig 4.13 Benefits of APM reporting



**Provide greater insight and transparency into company performance**

None of the respondents disagreed to this fact, with 90% of the respondents agreeing and one respondent (10%) remaining neutral. Of the 9 respondents that agreed, 3 of them (30% of total) strongly agreed. The remaining 6 respondents were merely in agreement. This clearly establishes the fact brought about by the big 4 firms (Deloitte, 2016; Price Waterhouse Coopers, 2015 Ernst and Young, 2016) that APMs enhanced transparency.

**Highlight entity-specific performance information**

An overwhelming 90% of the respondents agreed to the fact that APMs highlighted entity-specific financial information which could not be exposed by the general purpose financial statements required under the auspices of IFRS. In spite of the fact that IAS 1 allowed the use of additional line items, they all felt that IFRS did not put into consideration the unique circumstances of individual companies. 1 respondent (10%) however was not sure of the assertion. None of the respondents disagreed.

**Exposes the strategic intentions of management**

6 respondents (60%) agreed that APMs exposed the prospects and strategic intentions of Boards, thereby enabling investors and analysts to compare corporate strategies of companies. 40% were however not sure of this fact, and thus could not express their opinion.

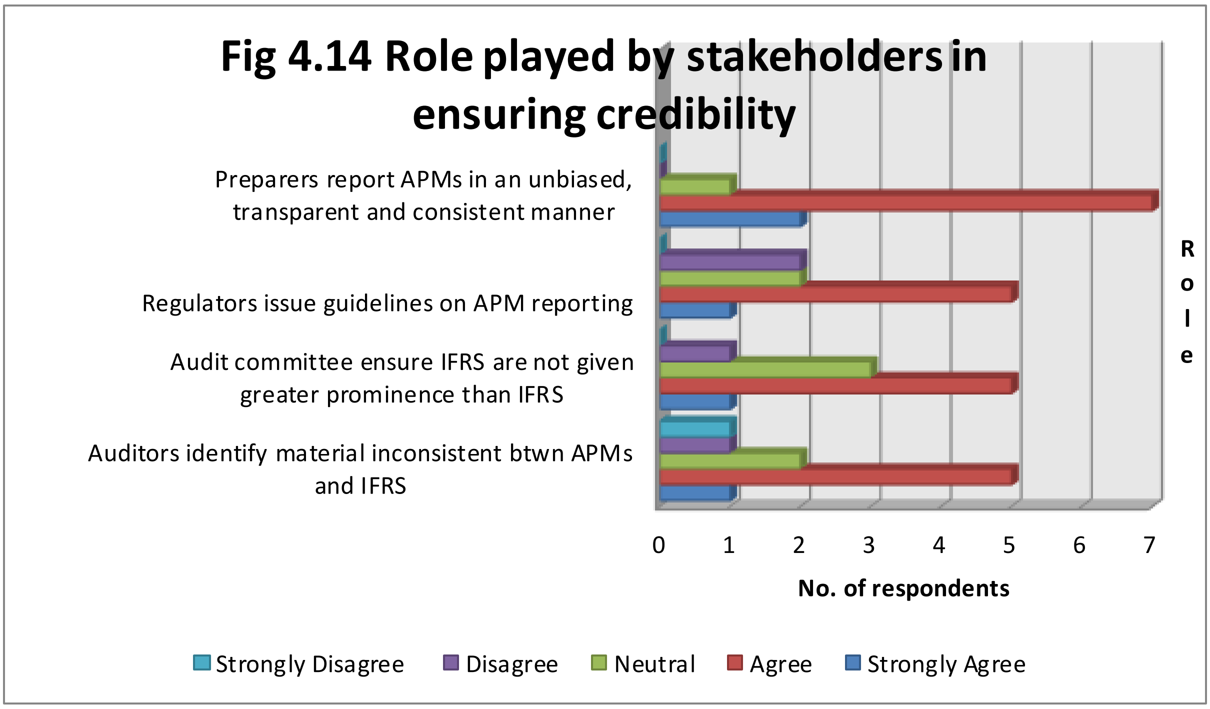
**Links IFRS to non-financial information**

80% of the respondents were overally in agreement, with 3 respondents strongly agreeing. Half of the respondents were merely in agreement. They believed that APMs were the umbilical code that connected the financial statements to non-financial information in the annual report. They believed that investors and analysts needed an additional explanation to the IFRS information which was thereby brought about by APMs. 2 of the respondents, 20%, could not decide which side to take and thus remained neutral. None of the respondents disagreed.

There was very little debate over the benefits of APMs. The majority agreed to enhanced insight and transparency. The majority also acknowledged the fact IFRS did not consider individual circumstances of companies, and therefore, APM reporting created this unique platform for management to express their individual situations. 80% of the respondents also believed that the quality of integrated reporting by companies was enhanced, as APMs created a useful link between financial statements and non-financial information.

### 4.4.10 What role do the relevant stakeholders play to enhance quality and credibility of APM information?

An investigation of the role played by each stakeholder in the credibility process, and whether such stakeholders acknowledged the said responsibilities, was conducted to obtain corroborative evidence as to the reliability of APMs.




**The role of the auditors**

As the respondents all had exceptional audit expertise, it brought division in their opinion. 1 respondent (10%) strongly agreed that their role was to ensure that there were no material inconsistency between IFRS and APMs. A further 5 respondents (50%) also supported this assertion and accepted this as their role. Not surprising however, 2 respondents, were not sure whether they had such a responsibility with regards to APMs. Another respondent disagreed to this responsibility and the remaining respondent also strongly disagreed. Two arguments best explain why there was such immense division. Firstly, it is the use of the technical term 'alternative performance measure' formally adopted by ESMA (2015) and IOSCO (2015) that brought confusion. ISAs use the term 'Other Information' to refer to additional financial and non-financial information in the annual report. It is therefore a question of judgement whether APMs meet the definition of Other Information adopted by ISA 720. The second argument was that, APMs were alternatively referred to as "Non-GAAP measures" or "Non-

IFRS measures”. The use of the term ’Non-IFRS measures’ would imply that APMs are not reported in line with IFRS and therefore fall out of the scope of the audit process. Intuitively therefore, auditors would not have any responsibility on the reporting of APMs

**The role of the audit committee**

1 respondent (10%) strongly agreed that the audit committee was responsible for ensuring that APMs are not given greater prominence in the annual report than the IFRS information itself. A further 5 respondents (50%) agreed to this responsibility. 1 respondent (10%) disagreed to this fact. Understandably however, 3 respondents (30%) were not sure. The confusion was brought about by the fact that the corporate governance code that has been in full force, the King 3, never explicitly mentioned APM reporting and what the audit committee’s role was. The code generalised by stated that the committee was responsible for ‘the integrity of the whole integrated report’. The respondents answered this question based on their interpretation of whether ‘ensuring that the APMs are not given greater prominence than IFRS’ would result in ‘the integrity of the whole integrated report’. 60% of the respondents therefore believed this was the case.

**The role of the regulators**

1 respondent strongly agreed to issuing guidelines on how APMs ought to be reported. A further 5 respondents (50%) agreed to the same. 2 of the respondents (20%) were not sure whether the regulators had such a responsibility. The remaining 20% disagreed to this notion, by suggesting that regulators were not responsible for issuing any such guidelines.

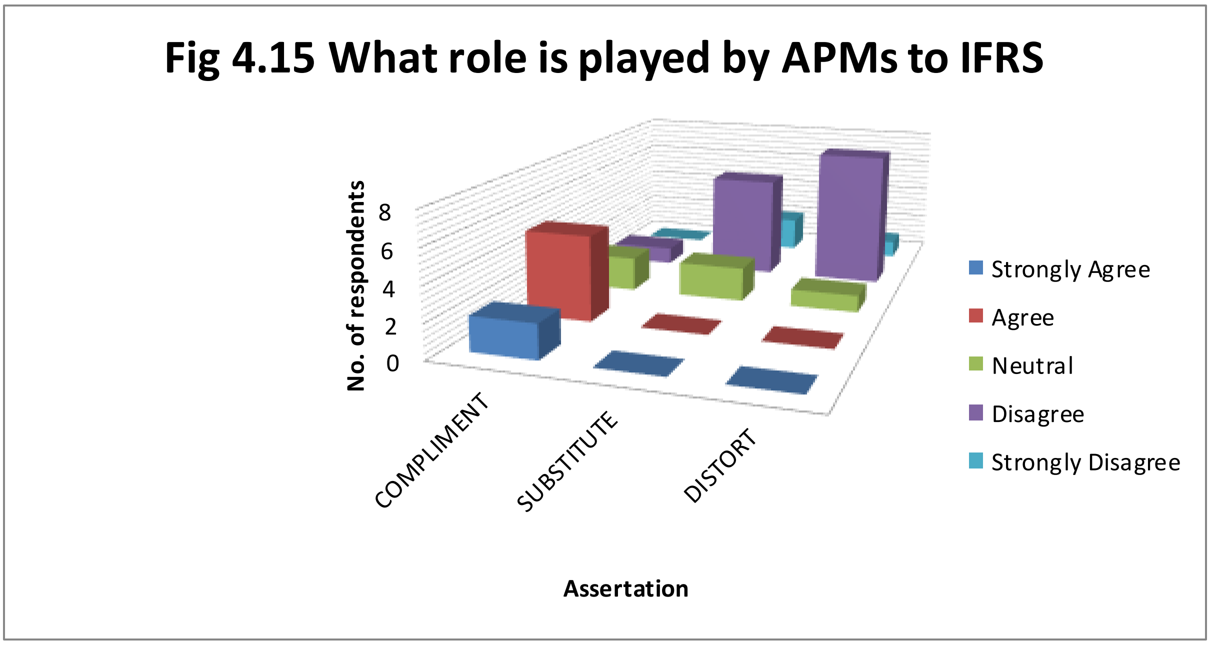
**The role of the preparers**

70% of the respondents agreed that preparers were responsible for presenting APMs in a transparent, unbiased and consistent manner. A further, 20% were strongly in agreement to this fact. None of the respondents disagreed, with only neutral respondent (10%).

It has been noted from the findings above that the role that each stakeholder should play to ensure that APMs are credible and of high quality was not yet clearly established among participants, as characterised by the strong division in opinion. This points to a loophole in the regulatory system raising the need to update corporate governance codes, ISAs and IFRS.

**What role does APM information play to IFRS financial statements?**

This question was introduced to further investigate the conflict between IFRS and APMs by soliciting from respondents, what role was played APMs to financial statements.



**APMs COMPLIMENT IFRS**

An overall 70% of the respondents overally agreed that APMs played a complimentary role to IFRS. Of the 7 that agreed, 2 were strongly in agreement. 20% however remained neutral. 1 respondent disagreed to this fact.

**APMs are a SUBSTITUTE of IFRS**

As expected, none of the respondents agreed that APMs could be used as a substitute of IFRS. 60% (6 respondents) disagreed and a further 20% strongly disagreed. Ironically, a pair comprising 20% of the respondents were not sure whether APMs could be used interchangeably with IFRS. This implies that stakeholders did not have as much confidence in APMs that they would use them in place of IFRS.

**APMs DISTORT IFRS**

None of the respondents agreed that APMs distort the information provided by IFRS. They felt that despite the prevalence of these APMs, they did not have the power to override what had already been included in the financial statements. One respondent, representing 10% of the total, was not sure whether to agree to this or not. An overwhelming 80% understandably disagreed, with a further 10% strongly disagreeing. This reiterates the fact that financial statements still retained unquestionable authority in communicating financial performance.

It can be concluded that APMs still play a complimentary role to IFRS. They do not, therefore, either substitute or distort IFRS information. This further suggests that APMs have not overridden IFRS.

### 4.5 Chapter Summary

Many of the APMs have become known by the society, as characterised by strong agreements in the first objective. The limitations of APMs raised the most scepticism from participants, with strong division of opinion. Aspects to do with the audit process also created dispute among the participants, given the fact that they were all members of the audit team of their organisation. Overally the benefits of APMs were strongly supported, which further provides a reasonable basis for concluding the main research question in the ensuing chapter.

# CHAPTER FIVE

# SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

## 5.1 Introduction

This chapter summarises the entire research document. It identifies whether all the research objectives have been met. It also provides recommendations from the research on the research problem at hand. It also makes a conscientious attempt to answer the main research question.

## 5.2 Chapter Summary

The first chapter was intended to officially introduce the research problem, by clearly highlighting the root causes of the problem. It also identified a research gap to which this dissertation sought to fill, by unmasking the characteristics and components of what are now termed “alternative performance measures”. This chapter also intended to further promote the wide use and acceptance of this term in accounting literature. The research objectives were also clearly highlighted, and they guided the entire research. The chapter also put across the limitations of the research as well as the delimitations to which the dissertation was restricted.

The second chapter brought to light the available literature on APMs. It addressed all the research objectives and sought from previous authors and publications on this topic, information that would guide the overall research to a reasonable conclusion. The researcher heavily relied on limited literature, as this area remains heavily under-researched in the developing world. The researcher introduced the commonly reported APMs on the ZSE. It also identified the motives behind their disclosure. It went on further to argue both the benefits and shortcomings of relying on APMs to compare financial performance. The chapter then went further to address the heavily disputed credibility aspect of APMs.

The third chapter introduced the research design adopted by the researcher in gathering data for analysis. The chapter highlighted the descriptive research design. The selected population was also provided, and the justification. The chapter then examined the researcher's use of questionnaires. For a reliable and valid analysis, the researcher focused on primary data which was deemed fit-for-purpose.

The fourth chapter lab-tested the data gathered in the third chapter through the issuance of questionnaires. The chapter provided graphical and summarised representations of analysed information. The researcher also provided commentaries for each question that was asked to respondents, and drew up reasonable conclusions based on his findings.

### 5.3 Main research findings

The research discovered that APMs are known and widely reported by listed companies. It also concluded that it was necessary for companies to disclose these performance measures. It attributed this to the fact that financial statements sometimes do not provide all the financial information necessary for investment analysis and decision making. The research also noted that alternative performance measures provided entity specific performance information which highlighted the uniqueness and peculiarity of events that might have transpired in an individual firm, which are not provided by general purpose financial statements.

However, the research noted irregularities in APM reporting. Firstly, companies calculated APMs differently from one another. There were differences in recognition and measurement criterion, as well as input variables among firms. This was the case despite the fact these measures might be named and defined similarly. It also noted that APM reporting was marred by management bias. This did not necessarily imply that the information is not reliable. It did however note tendencies by some corporates of emphasising positive performance areas, disguising areas of poor performance.

### 5.4 Conclusion to the Main Research Question

The research was successful as it managed to highlight the key issues that address the main research problem.

### 5.5 Recommendations

Regulators should not regulate APM reporting. This will likely result in regulatory fatigue, as companies will struggle to meet up with excessive legal and regulatory demands. This will remove the flexibility that companies enjoy in reporting APMs. Furthermore, it will increase compliance costs, as companies will have to continuously update their reporting processes and internal controls. There is however need for an alternative to the mandatory reporting process enunciated by IFRS. Companies should limit their use thereof, and due attention should remain on the IFRS information. Companies should therefore deviate from over-emphasising APMs in an attempt to shift users' attention away from IFRS.

As there is lack of clarity on the external verification process of APMs, it is necessary for companies to engage auditors to provide special engagements with regards to APMs. Companies should hire auditors to perform audit tests on this information, by inspecting reconciliation schedules of APM information to IFRS and investigating unusual variances.

A consultative workshop should also be held to discuss this issue. All relevant stakeholders such as the SECZ, ZSE, finance directors and local accountancy bodies should engage in a dialogue that brings consensus as to the reporting of these performance measures. These stakeholders should design a framework for monitoring the reporting of additional financial information in the annual reports of listed companies. The framework should allocate the duties and responsibilities of each stakeholder, to ensure that APMs are credible and of high quality.

### 5.6 Areas of further research

The researcher identified that the relationship between share price movement and additional performance measures in the annual report was heavily under-researched. He also noted the prevalence of non-financial information in the annual report, and might recommend further research on the determinants of non-financial information disclosure by companies and the extent of audit effort in providing assurance to this information. The researcher also recommends future research projects in this area to investigate the effects of regulation on corporate reporting.

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**APPENDIX I**

Midlands State University

Established 2000

Dear Sir/Madam

**RE: ACADEMIC RESEARCH**

I am a student at Midlands State University currently conducting a research on ***"Examining the use of Alternative Performance Measures in comparing financial performance of listed companies".*** I am kindly asking your firm to participate in the research by responding to the questionnaires provided. The answers provided by the respondents will be used solely for the purposes of the research. The names of the respondents shall not be required.

Please may you kindly assist me in this regard?

Yours Faithfully,

Munyaradzi Mtangi

## APPENDIX II

## QUESTIONNAIRE

***For: professional accountants, investment analysts and corporate finance practitioners***

**INSTRUCTION(S)**

1. Please **DO NOT** disclose the following:
   a) your name
   b) the name of the organization that you work for; and
   c) private information of clients
2. There is no right or wrong answer. The answer that you provide is based on your opinion on the matter

**SECTION A Demographic Assessment**

1. **Please indicate whether you are male or female by ticking in the relevant box**

   Male ☐

   Female ☐

2. **Please indicate your highest academic qualification**

   Ordinary Levels ☐

   Advanced Levels ☐

   National Certificate ☐

   Diploma ☐

   Accounting/Finance first degree ☐

   Other Bachelor's Degree ☐

   Masters' Degree ☐

   PhD ☐

3. **Please indicate the professional course(s) that you successfully completed**

| | | |
|---|---|---|
| CA (Z) ☐ | CIS ☐ | CFA ☐ |
| ACCA ☐ | CIA ☐ | CAIB ☐ |
| CIMA ☐ | CPA ☐ | Other ☐ |

**4. Please state your position in the organization that you work**

**…………………………………………………………………………………………..**

**5. Please state the department that you are employed in**

**……………………………………………………………………………………………**

**6. Please indicate your years of relevant working experience**

Less than 1 year ☐

1 to 5 years ☐

5 to 10 years ☐

More than 10 years ☐

**SECTION B** ***Please tick your answer in the box provided***

**1.** Is it necessary for companies to disclose additional financial information in the annual report, over and above IFRS-compliant financial statements?

Yes ☐ No ☐ Not sure ☐

**2.** Do additional performance measures provide financial information that is reliable?

Yes ☐ No ☐ Not sure ☐

**3.** Do investors focus more of their attention to financial information that is summarized and/or presented in a graphical form than raw financial statements?

Yes ☐ No ☐ Not sure ☐

**4.** Is there management bias in the reporting of additional performance measures?

Yes ☐ No ☐ Not sure ☐

5. Is it necessary to regulate the reporting of voluntarily disclosed financial information in the annual report?

Yes ☐ No ☐ Not sure ☐

**SECTION C:** ***For each scenario given, please state the extent to which you agree or disagree***

**6. Commonly used alternative performance measures**

The following alternative performance measures are commonly reported by companies listed on the Zimbabwe Stock Exchange.

| Performance Measure | Strongly Agree | Agree | Undecided | Disagree | Strongly Disagree |
|---|---|---|---|---|---|
| Earnings before Interest, Tax, Depreciation and Amortisation (EBITDA) | | | | | |
| Return on Assets | | | | | |
| Return on Equity | | | | | |
| Earnings before Interest and Tax (EBIT) | | | | | |
| Operating Margin | | | | | |
| Funds from Operations | | | | | |
| Adjusted Earnings | | | | | |
| Adjusted Earnings per Share (Adjusted EPS) | | | | | |

**7. Determinants of disclosing alternative performance measures**

The following factors strongly determine why management disclose alternative performance measures

| Reason | Strongly Agree | Agree | Undecided | Disagree | Strongly Disagree |
|---|---|---|---|---|---|
| When management feel that a certain matter has not been fully | | | | | |

| | | | | | |
|---|---|---|---|---|---|
| disclosed in the financial statements | | | | | |
| When management want to meet their own strategic motives | | | | | |
| As a way of re-emphasizing matters that have already been disclosed in the financial statements | | | | | |
| Pressure from legal and regulatory authorities | | | | | |

**8. Limitations of alternative performance measures**

The following are the limitations of alternative performance measures.

| Limitation | Strongly Agree | Agree | Undecided | Disagree | Strongly Disagree |
|---|---|---|---|---|---|
| Alternative performance measures of two different companies might have the same name and definition, but could have been calculated differently | | | | | |
| Management only discloses those alternative performance measures which show favourable results, and disguise poor results | | | | | |
| There is normally inconsistency between alternative performance measures and information provided by financial statements | | | | | |
| There is a risk that a company's shares may be incorrectly valued | | | | | |
| External auditors do not express an opinion on the alternative performance measures | | | | | |

### 9. Benefits of alternative performance measures

The following are the benefits of alternative performance measures.

| Benefit | Strongly Agree | Agree | Undecided | Disagree | Strongly Disagree |
|---|---|---|---|---|---|
| They provide greater insight and transparency into the company's performance | | | | | |
| They enable investors to know entity-specific performance information | | | | | |
| They enable investors to know and compare the future prospects and strategic intentions of management | | | | | |
| They create a useful link between financial statements and non-financial information | | | | | |

### 10. Quality and credibility of Alternative Performance Measures

The following are the roles played by the various stakeholders in ensuring that the alternative performance measures are credible and of high quality.

| Role | Strongly Agree | Agree | Undecided | Disagree | Strongly Disagree |
|---|---|---|---|---|---|
| The duty of the independent (external) auditors is to ensure that there are no material inconsistencies between alternative performance measures and information in the financial statements | | | | | |
| The audit committee should ensure that alternative performance measures are not given greater prominence than financial statements in annual report | | | | | |
| The regulators should issue guidelines to all listed companies on how alternative performance measures should be reported | | | | | |
| Preparers should report alternative performance measures in an unbiased, transparent and consistent manner | | | | | |

**11. Please state the extent to which you either agree or disagree to each of the following statements**

| Statement | Strongly Agree | Agree | Undecided | Disagree | Strongly Disagree |
|---|---|---|---|---|---|
| Alternative performance measures **COMPLIMENT** financial statements | | | | | |
| Alternative performance measures are a **SUBSTITUTE** of financial statements | | | | | |
| Alternative performance measures **DISTORT** information in the financial statements | | | | | |

**Additional comments**

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