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FAC005 An analysis of non-IFRS earnings measures presented by South African JSE listed companies

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ABSTRACT

This paper investigates the extent to which non-IFRS earnings measures (defined as a voluntarily presented earnings measure, whose calculation is not obvious from its title) are presented within the integrated reports of the top 40 companies listed on the Johannesburg Stock Exchange (JSE) in the 2015 financial year. In addition to this, the differing descriptions of non-IFRS earnings measures, and the adjustments made in calculating these measures, are identified and analysed for consistency. Finally, this study compares the value of non-IFRS earnings to both the value of IFRS earnings and headline earnings, in order to identify whether non-IFRS earnings are predominantly higher or lower than the other measures. This study finds that 21 of the JSE Top 40 companies (53%) present non-IFRS earnings measures, of which the most common titles are 'adjusted earnings'; 'normalised headline earnings' and 'underlying earnings'. The most common adjustments made in calculating these measures were 'fair value adjustments', 'restructuring costs' and 'amortisation'. Furthermore, 11 companies reported non-IFRS earnings that are greater than IFRS earnings, and 10 companies reported non-IFRS earnings that are greater than headline earnings. The nature of the adjustments made in calculating headline earnings was not consistent with the nature of adjustments made in calculating non-IFRS earnings. The results suggest that the majority of South African companies are presenting non-IFRS earnings measures, with large variability in title, of which the majority contain income-increasing adjustments that are dissimilar to the adjustments made for headline earnings purposes.

Key words: non-IFRS earnings measures; headline earnings; performance reporting; IFRS.

INTRODUCTION

The Integrated Reporting Committee of South Africa (IRCSA) has stated that the collapse of a number of high-profile companies over the past decade has led to stakeholders doubting the reliability and relevance of financial information presented in financial reports as a primary basis for decision making by investors and stakeholders (IRCSA, 2011). Stakeholders have urged companies to provide more forward-looking and reliable information to enable effective evaluation of the economic operations of a company and its ability to create value (IRCSA, 2011).

Generally Accepted Accounting Principles (GAAP) such as International Financial Reporting Standards (IFRS), issued by the International Accounting Standards Board (IASB) are used in the preparation of financial statements contained within annual reports, and now within integrated reports of South African listed companies. The International Integrated Reporting Framework, published by the International Integrated Reporting Council (IIRC) in 2013 provides guidance on the purpose and content of an integrated report. These reports are the primary mechanism used by companies to communicate information to their providers of financial capital (De Villiers, Rinaldi & Unerman, 2014; IIRC, 2013). However, the International Integrated Reporting Framework and IFRS[33] allow some flexibility to companies in determining what financial information is reported (IIRC, 2013; IASB, 2016). This flexibility has facilitated the reporting of additional discretionary performance measures in corporate reporting (Libby & Emett, 2014).

Management have used this discretion to present non-IFRS earnings measures[34] which are derived by adjusting the IFRS information to a figure that they believe is more useful to users in understanding the underlying performance of a company (Libby & Emett, 2014; CFA Society of the United Kingdom, 2015). For the purpose of this study, non-IFRS earnings measures are defined as voluntarily presented earnings measures, whose calculation is not obvious from its title, for example ‘normalised earnings’.

The use of non-IFRS earnings measures has attracted increased attention (De Villiers, et al. 2014; CFA Society of the United Kingdom, 2015; PriceWaterhouseCoopers, 2014; Hoogervorst, 2015). The studies already conducted have focused mainly on developed economies. Hoogervorst (2016) highlighted the lack of academic research on the topic of performance reporting and the need for such research, given that academic literature enables the separation of evidence from opinion.

The aim of this study is therefore to contribute towards meeting this need, by exploring the extent to which non-IFRS earnings measures are presented by the Top 40 JSE listed South African companies. Furthermore, this study identifies the extent to which there is consistency in the descriptions (or titles) for these measures and the adjustments made in calculating these measures. Finally, a comparison per company of the monetary value of the non-IFRS earnings measures with the IFRS and headline earnings monetary values is presented.

[33] For example IAS 1 Presentation of financial statements, and IFRS 8 Operating segments, which permit or require disclosure of different earnings measures.
[34] Also referred to as non-GAAP measures.

The scope of this study is restricted to an investigation of non-IFRS *earnings* measures as opposed to *all* non-IFRS alternative performance measures[35]. This study therefore aims to provide insight into one specific group of alternative performance measures: namely, non-IFRS *earnings*.

A literature review follows that includes a brief history of GAAP and the development of IFRS, both internationally and within South Africa. Thereafter a discussion follows on the arguments in favour of and against the use of non-IFRS earnings measures, including the extent to which non-IFRS earnings is presented internationally. Finally, the purpose and contents of an integrated report and the concept of headline earnings is expounded upon.

LITERATURE REVIEW

History of GAAP and the IASB

GAAP provides the broad and detailed guidelines, rules and procedures related to the general accounting process. Formalised GAAP principles were first introduced in 1930 in an attempt to create a uniform set of financial reporting requirements to prescribe the treatment of various accounting events (Zeff, 2005). The accounting academic literature and knowledge has since grown in response to the change in business needs (Fischer & Tayler, 2015).

The International Accounting Standards Committee (IASC) was formed in 1973 with the goal of publishing accounting standards that would result in international accounting harmonisation (Fischer & Tayler, 2015). Since its inception, the IASC began the process of producing a core set of accounting standards, which became the financial reporting basis used by various multinational companies with cross-border listings (IFRS Foundation, 2016). In 2001, the IASC was superseded by the IASB who maintained the objective of developing and communicating a single set of high quality, understandable and globally accepted financial reporting standards (Fischer & Tayler, 2015). These standards are known as IFRS.

In order for the IASB to achieve its harmonisation objective, it continues to conduct extensive public consultations and seeks to gain co-operation from other international accounting regulatory bodies (IFRS Foundation, 2015). Significant progress has been made in promoting the use of IFRS, as over 140 counties have since adopted and now use the standards (IASB, 2014). However, the accounting regulatory board in the United States, the Financial Accounting Standards Board (FASB), has not yet adopted IFRS, which has been, and continues to be, a significant challenge to the IASB's objective of developing a unified set of international accounting standards (IFRS Foundation, 2016).

Accounting Standards development: South Africa

From a South African perspective, the South African Institute of Charted Accountants (SAICA) formed the Accounting Practises Board (APB) in 1973, which was tasked with developing generally accepted accounting practise for South Africa (SA GAAP), which was largely aligned with IFRS. In 2005, South Africa became one of the 140 countries to adopt IFRS, resulting in IFRS replacing SA GAAP. The Companies Act 2008 subsequently

[35] Non-IFRS alternative performance measures include for example, margin ratios or 'per share' measures, which are beyond the scope of this study.

required all listed companies (amongst others) to comply and use IFRS as their basis for accounting statement preparation (Republic of South Africa, 2008).

Arguments in favour of and against the use of IFRS

The IASB explains that accounting standards play a vital public interest role in the form of transparency, efficiency and accountability to the global economy (Hoogervorst, 2016). IFRS standards however have been criticized as being complex and difficult to understand by users (Bhatia, 2013), a criticism which the IASB has acknowledged. The IASB continue to engage with investors to ensure IFRS standards provide sufficient information by which users are able to judge company performance (Hoogervorst, 2016).

Proponents of IFRS explain that some of the positive characteristics of IFRS standards include the elimination of choices in accounting treatments; the fact that IFRS is principle-based (rather than overly prescriptive); and that the disclosure requirements are helpful in making an assessment of the entity's future cash flows (Graham & Winfield, 2010; CFA Society of the United Kingdom, 2015).

Negative characteristics of IFRS include the complexity of the standards and that the guidance provided is often lengthy and complex itself (Graham & Winfield, 2010; Bhatia, 2013). In addition, some users' potential inability to understand and process the information presented may lead to distorted or incorrect decision making. Further criticism is based on the argument that financial statements do not provide an accurate interpretation of companies' core operations (Young, 2014).

The IASB is aware of these negative perceptions and have acknowledged the difficulties involved in setting standards, which requires a multifaceted approach on the influences these standards may have on various companies and economies. However, their objective remains that of providing a global set of understandable and principle-based accounting standards (Hoogervorst, 2016).

A current problem facing the IASB is that of defining performance. Debate has arisen as to whether or not financial statements prepared in accordance with IFRS provide the necessary tools for an investor to evaluate and compare company performance (Hoogervorst, 2016). Currently, IFRS allows flexibility in the presentation of the components that make up a company's profit or loss. Although the IASB believe that the most important indicator of performance is a company's profit (IASB, 2015), the flexibility of performance presentation has allowed managers to incorporate non-IFRS earnings measures (Hoogervorst, 2016). The IASB has expressed that these measures have their benefits, however there is concern as to whether non-IFRS earnings are "getting increasingly detached from reality" (Hoogervorst, 2016:5).

Non-IFRS earnings: Measure of Performance

Non-IFRS earnings are measures that are calculated by adjusting the reported IFRS profit for various items, in order to obtain a measure that management often perceive to be a more reliable representation of company performance (Entwist, Feltham & Mbagwu, 2010; CFA Society of the United Kingdom, 2015).

Part of the rational for making these adjustments, is that IFRS earnings are not always seen to accurately reflect the results of business operations (Young, 2014). Studies have shown that more than 88% of S&P 500 companies (Hoogervorst, 2016) and 95% of Financial Times Stock Exchange 100 Index (FTSE 100) companies (PriceWaterhouseCoopers, 2016) are now disclosing non-IFRS earnings, an indication of the increasing popularity of the use of non-IFRS earnings in various jurisdictions (Young, 2014).

In addition, the CFA Society of the United Kingdom (2015) conducted a survey whereby 292 UK managers provided their response on the usefulness of non-IFRS earnings in financial reports. The survey found that 61% of respondents use non-IFRS earnings as a measure of performance on a regular basis. This was consistent with findings of a similar study conducted by PriceWaterhouseCoopers (PWC) in 2014 whereby 65% of respondents found adjusted profit figures to be useful in their analysis. These studies provide evidence that investment professionals are incorporating the adjusted metrics into their investment decisions.

Dichev, Graham, Harvey, & Rajgopal (2015) recently conducted a large-scale survey interviewing 375 Chief Financial Officers, of which the hallmarks of 'earnings quality' were described as "sustainable" and "without the presence of one-time items". Moreover, earnings quality was shown to be shaped by factors that are both controllable by management and uncontrollable, making it difficult for investors and other stakeholders to make sense of financial information (Dichev et al. 2015). Graham, Harvey & Rajgopal (2005: 4) found that financial executives regarded earnings measures as being the "most important performance metrics disclosed to investors", together with a description of the adjustments made by management in calculating these measures. Various studies conducted over the past few decades have shown evidence that non-IFRS earnings may be more predictive of future operating performance (Brown & Sivakumar, 2001; Curtis, McVay & Whipple, 2014).

Barton, Hansen & Pownall (2010) used eight different performance measures to test the value-relevance of 20 000 firms in 46 different countries. The study used various measures including that of 'sales', 'EBITDA', 'operating income', 'income before income taxes', 'income before extraordinary items and discontinued operations', 'net income, total comprehensive income' and 'operating cash flows'. The study identified factors that would provide evidence of a measurement metric being value-relevant. The factors examined included 'Persistence', 'Predictability', ' Smoothness', 'Predictability of Future Cash Flows', 'Substitute for Cash Flow'', Conservatism' and 'Timeliness'. The conclusion reached was that of differences amongst different countries with no one measure clearly outweighing other in terms of relevance to investors. The study did find that 'EBITDA' and 'operating income' measures exhibited more value-relevance than the other measures.

Coulton, Ribeiro, Shan & Taylor (2016) performed a similar study that showed that non-GAAP measures have substantially smaller variation from year to year, and have less extreme annual variations than for GAAP earnings results. A finding that potentially supports the above study relating to greater 'smoothness' of non-GAAP earnings. The value relevance[36] of the non-GAAP measures is outside of the scope of this research paper however it should be noted that Bhattacharya, Black, Christensen and Larsen (2003) and

[36] Value relevance is the ability of a metric to explain or fundamentally describe a measure's usefulness with respect to an investors decision making (Barton et al., 2010).

Barton et al. (2016) both identified, using differing sample sizes, evidence that the non-GAAP measures are more informative and permanent that that of GAAP earnings.

Young (2014) illustrated that the most frequent adjustments during the period 1998-2000 were that of excluding depreciation and amortisation from reported earnings. Management justified these adjustments as non-recurring items that related to the historic cost-based estimates that were not representative of the current and future expenditure of companies (Young, 2014). A more recent study conducted by the CFA Society of the United Kingdom (2015) on FTSE listed companies found that non-IFRS earnings were being used to better approximate cash earnings by removing the effects of amortisation and impairments of assets such as intangibles.

Non-IFRS earnings measures are therefore widely used, and believed to be beneficial, although concerns and criticisms of these measures exist.

Non-IFRS earnings: concerns and criticisms

An opposing view on the usefulness of non-IFRS information, is that presenting such information reduces comparability amongst entities (Australian Securities and Investments Commission, 2011). The adjustments made and descriptions used have at times been seen as confusing and potentially misleading to investors and financial statement users (Standard and Poor, 2014; PWC 2016). PWC (2016) found that within the FTSE 100 companies, 28% (£6 billion) of adjustments remained undisclosed, as the adjustments could not be assigned to a relevant category or balance within the financial statements.

A study was conducted by Standard and Poor (2014) in which the four annual reports prior to June 2012 of 10 financial companies on the FTSE 100 were examined. The study investigated whether these companies reported non-IFRS earnings that were higher or lower than IFRS earnings over this period. The study found that five out the ten companies reported non-IFRS earnings that were higher than that of IFRS earnings for *three years*, with the remaining five having the *same result* but for *fou*r *years*. Following these findings, Standard and Poor (2014) expressed concern that financial statement users must remain vigilant to the risk that management may prioritise adjusting for exceptional charges (i.e. expenses) more frequently than exceptional credits (i.e. incomes). The issue relating to the degree of flexibility open to management to define and adjust for exceptional items is an area of concern to the IASB and other regulators, as it makes comparability difficult between different companies and financial periods (Hoogervorst, 2016).

A more detailed examination of the potential consequences of non-IFRS earnings reporting was presented by Libby & Emett (2014), who stated that users may find it difficult to process the relevance of non-IFRS earnings measures and adjustments, resulting in differing conclusions on essentially the same underlying information.

Further to this, Libby & Emett (2014) discuss the phenomenon that users react differently depending on the placement of accounting information within the reports. Behavioural psychology theory suggests that cognitive biases, in addition to management exploiting their presentation discretion, can result in the misleading of users, especially when the adjusting item is material and the adjustment can transform a loss into a profit (Young, 2014).

The IASB and other stakeholders have consulted on the degree to which harmonisation of non-IFRS earnings reporting can be achieved, in order to enhance comparability (PWC, 2014; CFA Society of the United Kingdom, 2015). Hoogervorst (2016) confirmed that the IASB is investigating the possibility of defining more subtotals in the income statement, incorporating a principle-based operating income definition as well as providing a definition for the commonly used non-IFRS earnings measures, such as Earnings before Interest and Tax (EBIT).

Amidst the concerns and criticisms of using non-IFRS earnings, the IASB and other regulatory bodies have however acknowledged that additional measures presented by management may be useful to users, as long as reconciliations that identify the adjustments made are disclosed (PWC, 2007).

A solution to the concerns of the international community regarding the use of non-IFRS earnings measures may be the formation of clear definitions for such measures, disclosure of reconciliations of non-IFRS earnings measures to IFRS measures, and appropriate assurance of these measures.

South African context

i. Integrated reporting

Since March 2010, many South African companies have been preparing 'integrated reports', in accordance with a JSE listing requirement. This requirement forms part of the broader requirement to comply (or explain areas of non-compliance) with the King Code on Corporate Governance 2016 ('King IV'[37]), which encourages preparation of an 'integrated report' (JSE, 2014:425). The International Integrated Reporting Framework states that "the primary purpose of an integrated report is to explain to providers of financial capital how an organisation creates value over time" (IIRC, 2013). This framework allows management the presentation and content discretion discussed earlier, as it is not prescriptive, but rather principle-based, in order to accommodate the reporting of different organisations and different circumstances. Key performance indicators (KPIs) are not prescribed by the International Integrated reporting Framework, but an integrated report must contain material information on company performance (IIRC 2013: 28), which includes the effect on financial capital. Users of integrated reports can benefit from an informed assessment of the value-creating ability of the company (De Villiers et al., 2014). The Association of Chartered Certified Accountants (ACCA) conducted interviews amongst the South African institutional investment community and found that these investors view integrated reports as an improvement in disclosures for the purpose of investment decision making (ACCA, 2014).

Integrated reporting is therefore relevant to this study, given the requirement for JSE companies to prepare integrated reports; the reports' purpose of providing relevant information on value creation (which includes financial performance); the discretion available for the report's contents; and the usefulness of integrated reports to investors.

ii. Headline Earnings

[37] King IV replaces King III, which was effective during the financial year analysed in this study. King III contained the same requirement as King IV to 'apply or explain' areas of non-compliance.

In South Africa, some consistency in the type of adjustments made in calculating a non-IFRS earnings measure has been achieved, due to the JSE-required disclosure of ‘Headline Earnings’ (SAICA, 2007; CFA Society of the United Kingdom, 2015).

SAICA (2007: 6) describes headline earnings as “not a departure from IFRS, [but] a way of dividing the IFRS-reported profit between re-measurements that are more closely aligned to the operating/trading activities of the entity and the platform used to create those results". The advantage of Headline earnings is that a detailed set of rules exists for the calculation of headline earnings and the disclosure requirements. Clearly defined, required, adjustments enable companies to report results that are not influenced by managers' discretionary choices (Venter, Emanuel & Cahan, 2014).

Although the requirement that consistent adjustments be made has been criticised by some investors who question the appropriateness of some of the adjustments (CFA Society of the United Kingdom, 2015), headline earnings was found to be a better representation of firm performance than that of IFRS earnings (Venter et al, 2014). The higher value relevance of headline earnings is considered to be due to the use of consistent adjustments and terminology.

Finally, unlike other non-IFRS earnings measures, headline earnings is subject to audit. This provides investors with greater surety over information reported by management, which aids in its usefulness.

Conclusion

A review of past literature has provided insight into the historical use of non-IFRS earnings measures presented in companies financial reports. It is clear that there is both support and criticism of the presentation of non-IFRS metrics. Recent studies provide evidence that non-IFRS performance measures are useful to investors and can provide valuable insight into the current and future operations of a company. The main consequences however include a lack of comparability of non-IFRS earnings measures across companies and a lack of clarity in the type of adjustments made to arrive at non-IFRS earnings, which may result in investors making inappropriate decisions. The JSE requirement that companies present an integrated report, provides companies with flexibility in selecting and presenting meaningful measures of performance. In South Africa, the requirement to calculate and disclose headline earnings, is a unique case of a clearly defined, comparable, non-IFRS earnings measure.

METHODOLOGY

Due to the lack of research on the use of non-IFRS earnings within South Africa, the methodology for this study will take a similar approach to studies conducted by the CFA Society of the United Kingdom (2015) and PWC (2016). The focus of this study will be to:

1. Identify the number of companies reporting non-IFRS earnings measures, and the types of non-IFRS earnings measures presented.
2. Where reconciliations of these measures to IFRS earnings are provided, identify the more common adjustments used to calculate the non-IFRS earnings measure. Also note any reason given for choosing to present the non-IFRS earnings measure.

3. Compare the value of non-IFRS earnings to that of IFRS earnings.
4. Compare the value of non-IFRS earnings to that of headline earnings, and briefly investigate whether consistent adjustments are made in these calculations.

Sample:

The sample comprises of the top 40 JSE listed companies, ranked according to market capitalisation (Refer to Appendix 1). The scope of the sample was limited to the top 40 companies due to these companies making up approximately 51% of the JSE market capitalisation.

The 2015 integrated reports of the top 40 companies were used to collect the necessary information required for analysis. The rational for choosing to use integrated reports was twofold. The first being that the contents of integrated reports are not regulated by binding legislation, but rather by the International Integrated Reporting Framework. There is therefore discretion with respect to the type of information presented. Secondly, a number of companies state that their integrated report is their primary report to the providers of financial capital (refer to Appendix 1 for a list of such companies), and therefore an excellent source of information considered most relevant for decision making (ACCA, 2014).

The sample includes companies which are dual listed and do not prepare integrated reports. For these companies, the annual reports were used as the source of non-IFRS earnings information.

If the company presented their results in a currency other than South African Rands (i.e. a foreign currency), the analysis was conducted using the foreign currency amounts.

The IFRS earnings measure used as the basis of comparison with the non-IFRS earnings measure, was ‘earnings attributable to the parent equity holders’ in order to remove any effect of non-controlling interest on earnings.

Method

A four-step process was applied:

Step 1: Identification of non-IFRS earnings (APM)

Each company’s integrated report cover page; financial performance highlights; Chief Executive Officer (CEO) and Chairman’s reports were examined for presentation of a non-IFRS earnings measure. The analysis was limited to these two sections to focus on the main custodians of corporate governance as well as for consistency purposes, as some companies integrated reports did not Chief Financial Officer commentary. The search was limited to these sections of the integrated report, as company performance is addressed in at least one of these four sections (if not in all sections), and should therefore contain voluntarily-disclosed non-IFRS earnings measures (if disclosed at all). The term used to describe the non-IFRS earnings measure was recorded, and the results tabulated.

Step 2: Reconciliation and explanation

The financial statements were scrutinised to determine whether a reconciliation of non-IFRS earnings adjustments was provided. The types of adjustments made were captured in order to identify common adjustments.

Furthermore, if a reason for presenting the non-IFRS earnings was provided, the fact that such a reason was given was noted.

Step 3: Recording of the monetary value of non-IFRS earnings relative to IFRS-earnings

The monetary values of earnings attributable to parent equity holders ('IFRS earnings') and the non-IFRS earnings were recorded. A comparison of values was conducted using the following ratio:

- Non-IFRS earnings as a % of IFRS earnings

In some cases, there was some uncertainty as to whether the non-IFRS earnings measure used by management was an amount attributable to parent equity holders only, or to all equity holders (including non-controlling interest). In these cases, it was assumed that the non-IFRS measure was attributable to parent equity holders to facilitate the comparison and commentary of results.

Step 4: Recording of the monetary value of non-IFRS earnings relative to headline earnings

The monetary value of headline earnings was recorded. A comparison of values was conducted using the following ratio:

- Non-IFRS earnings as a % of Headline earnings

These ratios (described in steps 3 and 4) were used to provide insight into the relationship between these earnings measures as well as a basis for a brief comparison to previous studies conducted in other countries by PWC (2016) and CFA Society of the United Kingdom (2015).

RESULTS

In analysing the integrated reports of the Top 40 JSE listed companies, it was found that 21 of these companies (53%) presented a non-IFRS earnings measure for the 2015 financial year. Although this is less than the findings internationally (i.e. 88% of Standard and Poor companies and 95% of FTSE 100 companies), this study ignores headline earnings as a non-IFRS earnings measure, as it is required to be presented by the companies in the sample, and is therefore not discretionary. There is therefore an expectation that these results would be lower than what was found internationally.

These results are further analysed in the following four sections:

I. Common terms used to describe non-IFRS earnings

II. Common non-IFRS earnings adjustments

III. Comparison between non-IFRS earnings and IFRS earnings by company

IV. Comparison between non-IFRS earnings and headline earnings by company

Each section will be accompanied by a graph, discussion and insight regarding the results, after which a comparison of findings of similar international studies is provided where appropriate.

I) Common terms used to describe non-IFRS earnings

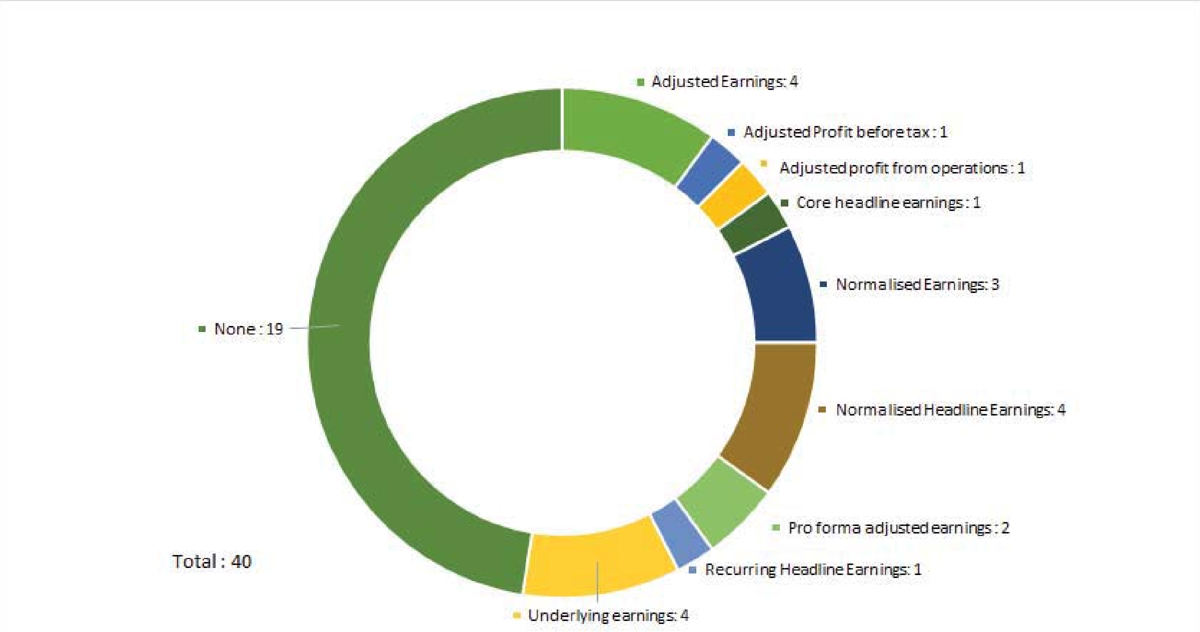


Figure 1: Non-IFRS earnings descriptions used by JSE Top 40

As shown in Figure 1, the research found that nine different terms were used by the 21 companies that presented non-IFRS earnings. The most commonly used terms were adjusted earnings (19%), normalised headline earnings (19%), underlying earnings (19%) and normalised earnings (14%).

In analysing the adjustments made to calculate these figures it is apparent that even when the same term is used to describe the non-IFRS earnings, the adjustments differed. An example of this is FirstRand Ltd ('FirstRand') and Rand Merchant Insurance Holdings Ltd ('RMIH'), both of whom presented Normalised Earnings as a non-IFRS earnings measure. Further examination of the adjustments made by these companies found that FirstRand made two adjustments compared to seven adjustments made by RMIH. FirstRand made adjustments for an IFRS *2 Share Based Payments* expense and an IAS 19 *Employee Benefits* remeasurement, whereas RMIH included and excluded amounts relating to items such as fair value adjustments, amortisation of intangibles, and restructuring expenses. This highlights the importance of presenting reconciliations for non-IFRS earnings measures, as without a detailed reconciliation, investors may potentially make inappropriate comparisons between commonly used descriptions.

The dispersion of commonly used terms to describe the earnings performance is similar to that found in the PWC (2014) study conducted on the FTSE 100 companies, which found that over eight different terms were used to describe the non-IFRS earnings. The variety of terminology and variability of adjustments made, may hinder an investor's understanding of such earnings measures, and require further financial statement analysis by such investors.

Company	Reconciliation	Chairman/CEO Report	Front Page	Non-IFRS Earnings explanation
Investec Plc	-	-	Yes	-
Sabmiller Plc	Yes	Yes	Yes	-
Glencore Plc	-	Yes	Yes	-
Old Mutual Plc	Yes	Yes	Yes	Yes
Woolworths Holdings Ltd	Yes	-	Yes	-
British American Tob Plc	Yes	Yes	Yes	Yes
Naspers Ltd	Yes	Yes	Yes	-
Firstrand Ltd	Yes	Yes	Yes	Yes
Rand Merchant Ins Hldgs	Yes	Yes	Yes	-
Rmb Holdings Ltd	Yes	Yes	Yes	-
Aspen Pharmacare Hldgs L	Yes	Yes	Yes	-
Sanlam Ltd	Yes	-	Yes	Yes
Discovery Ltd	Yes	Yes	Yes	-
Mediclinic Internat Ltd	Yes	Yes	Yes	Yes
Standard Bank Group Ltd	Yes	Yes	Yes	Yes
South 32 Ltd	Yes	Yes	Yes	Yes
PSG Group Ltd	-	Yes	Yes	Yes
BHP Billiton Plc	Yes	-	-	Yes
Intu Properties Plc	Yes	Yes	Yes	Yes
Capotal&Counties Prop Plc	Yes	Yes	Yes	-
Mondi Plc	Yes	Yes	Yes	Yes
	18/21	17/21	20/21	11/21
	86%	**81%**	**95%**	**52%**

Figure 2: Location of non-IFRS earnings and inclusion of reconciliation

An analysis of the location of the non-IFRS earnings within each company's integrated report is provided in Figure 2. Of the 21 companies that presented non-IFRS earnings, 95% were included on the front page of the integrated report within the company performance summary and 81% were further discussed within the CEO and/or Chairman's report. The inclusion of non-IFRS earnings measures within these first few key pages of the integrated report, is an indication of the usefulness that management perceives of these measures.

II) Common non-IFRS adjustments

It is encouraging that 17 of the 21 companies (81%) who reported a non-IFRS earnings measure also included a reconciliation that clearly outlined the adjustments made. This result is slightly lower than the 98% obtained by PWC (2014).

Zhang and Zheng (2011) found that the adjustments to non-IFRS measures that are not accompanied by an adequate reconciliation may mislead investors. In addition, the CFA Society of the United Kingdom (2015) found that investors lacked sufficient time to adequately understand the adjustments made by management, when these adjustments were not clearly explained. These studies emphasise the importance of presenting understandable reconciliations.

Investor understanding can be further supplemented when management provides an explanation of their rationale for presenting the non-IFRS earnings. Only 52% of companies provided an explanation of why the non-IFRS earnings were used. The 11 reports which did so were analysed to determine whether common phrases or trends were used by management. The results of this analysis identified three distinct yet common themes within each explanation:

1. Non-IFRS earnings were more representative of "overall business" operations (Glencore, 2015: 26), or the measures were a more accurate "reflection of its underlying performance" (Old Mutual, 2015: 184; South 32, 2015: 65). Further to this theme, Sanlam (2015: 155) described IFRS earnings as "not a true representation of earnings".
2. The second theme was the characteristic that non-IFRS earnings are a more accurate indicator of "long term performance" (Old Mutual, 2015: 152) and a "reliable indicator of sustainable operating performance" (Naspers, 2015: 18; PSG, 2015).
3. The final theme was that non-IFRS earnings avoid "artificial accounting mismatches" (Sanlam, 2015: 155) and that it allows investors to more accurately evaluate the performance of a company.

The common themes identified above are compatible with the findings of Entwist et al (2010), who found that managers believe that adjusted earnings measures provide more value-relevant information of a company's long term core operations.

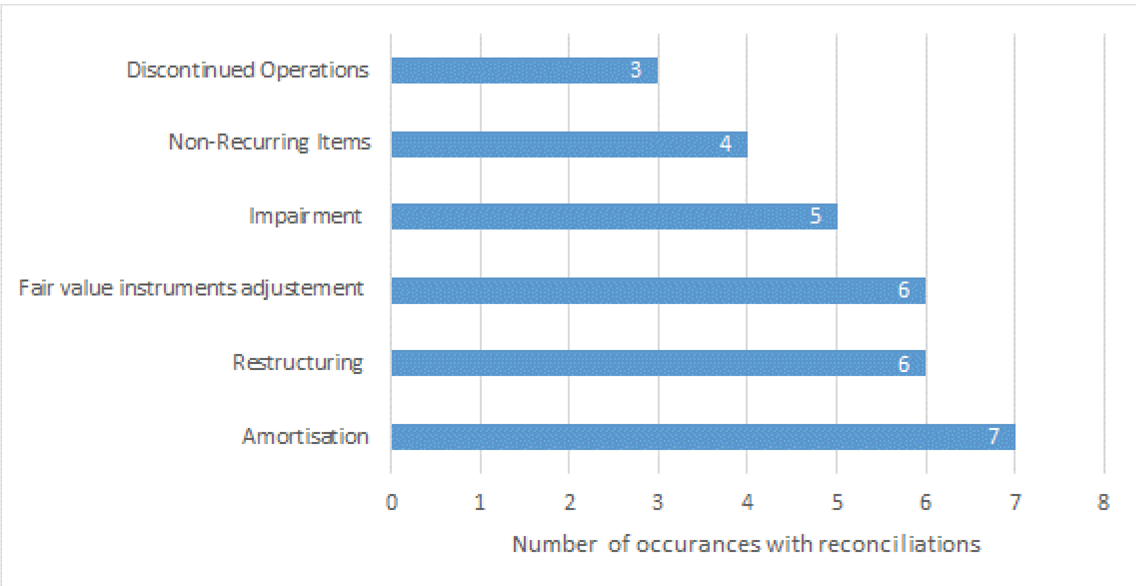


Figure 3: Most common non-IFRS earnings measure adjustments

Figure 3 shows that the most common adjustments to arrive at a non-IFRS earnings measure were those that related to amortisation (7 companies), restructuring (6 companies) and fair value financial instrument adjustments (6 companies). Adjustments for impairments, non-recurring items and the effects of discontinued operations were also reasonably common.

These results are similar to those of the CFA Society of the United Kingdom (2015) who found that the most frequent material adjustments were restructuring expenses, asset impairments and amortisation of intangibles. The restructuring expenses are non-recurring and considered a once-off expense, and amortisation and impairment are calculated using subjective inputs such as the estimated useful life of an asset. By excluding these items management may be aiming to provide an earnings figure that is more representative of future operations and a more accurate measure of performance (Standard and Poor, 2014).

To gain a more in-depth understanding of the prevalence of non-IFRS earnings within the JSE, the sample was sub-categorised into sectors, in an attempt to identify potentially common sector adjustments.

Figure 4: Non-IFRS Adjustment Analysis by Sector within the JSE Top 40

Sector	Companies within Sector	Non-IFRS Earnings Term Used	Most Common Non-IFRS term
Basic Materials	6	4	Underlying (2/4)
Consumer Goods	5	2	-
Consumer Services	4	2	-
Financials	19	11	Normalised (5/11)
Health Care	2	2	Normalised Headline Earnings (2/2)
Industrials	1	0	-
Oil & Gas Producers	1	0	-
Telecommunications	2	0	-
Total	**40**	**21**	

Figure 4 shows that companies within the Basic Materials and Financials sectors presented the largest number of non-IFRS earnings measures; four and 11 measures respectively. Of the 11 measures presented by companies in the Financials sector, five were 'normalised earnings'. The Financials sector was further analysed as follows:

Figure 5: Adjustment Analysis of Financial Sector

Company	Sub Sector	Non-IFRS Earnings Term	Sector
Barclays Africa Grp Ltd	Banks	-	Financials
Capitec Bank Hldgs Ltd	Banks	-	Financials
Nedbank Group Ltd	Banks	-	Financials
Standard Bank Group Ltd	Banks	Pro forma continuing operations headline earnings	Financials
Firstrand Ltd	Banks	Normalised Earnings	Financials
Rmb Holdings Ltd	Banks	Normalised Earnings	Financials
Rand Merchant Ins Hldgs	Equity Investment Instruments	Normalised earnings	Financials
Reinet Investments S.C.A	Equity Investment Instruments	-	Financials
Brait Se	Financial Services	-	Financials
Investec Plc	Financial services	Adjusted attributable earnings	Financials
Psg Group Ltd	Financial Services	Recurring Headline Earnings	Financials
Discovery Ltd	Life Insurance	Normalised Headline Earnings	Financials
Sanlam Limited	Life Insurance	Normalised Headline Earnings	Financials
Old Mutual Plc	Life Insurance	Adjusted operating earnings	Financials
Capital&Counties Prop Pl	Real Estate	Underlying Earnings	Financials
Intu Properties Plc	Real Estate	Underlying earnings	Financials
New Europe Prop Inv Plc	Real Estate	-	Financials
Growthpoint Prop Ltd	Real Estate	-	Financials
Remgro Ltd	General Industrials	-	Financials

All the life insurance companies in the sample presented a non-IFRS earnings measure, as did two of the three financial services companies, half of the banks, and half of the real estate companies. Apart from the use of normalised earnings, normalised headline earnings and underlying earnings were also commonly-used terms to describe non-IFRS earnings. Given the sample size limitation, this finding does not provide conclusive evidence of a commonly used non-IFRS measure.

III) Comparison between non-IFRS earnings and IFRS earnings by company

Of the 21 companies that presented non-IFRS earnings, 19 companies were analysed and included in Figure 6 below. South 32 Limited and Capital & Counties Plc were excluded due to being outliers within the sample. South 32 Ltd presented non-IFRS earnings that was 2% in relation to its IFRS earnings whereas Capital & Counties presented non-IFRS earnings that were 728% in relation to its IFRS earnings.

The reason for the significant earnings difference within South 32 (2015) was due to an impairment loss recognised in IFRS earnings being reversed for the purpose of calculating the non-IFRS earnings measure.

Capital & Counties Plc excluded a gain on the revaluation and sale of investment property to "remove unrealised and other one-off items and therefore represent the recurring, underlying performance of the business", decreasing non-IFRS earnings significantly compared to IFRS earnings.

Within the remaining 19 companies, Figure 6 illustrates that 11 (58%) of the non-IFRS earnings presented were greater than each company's respective IFRS earnings.

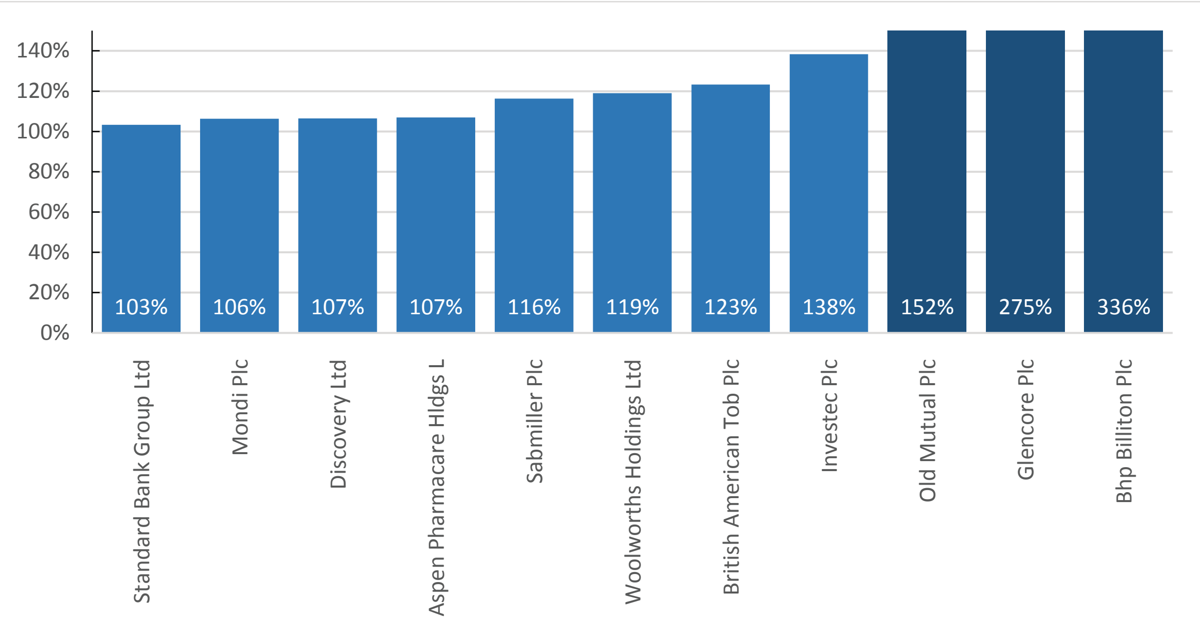


Figure 6: Company specific non-IFRS earnings as a % of IFRS earnings

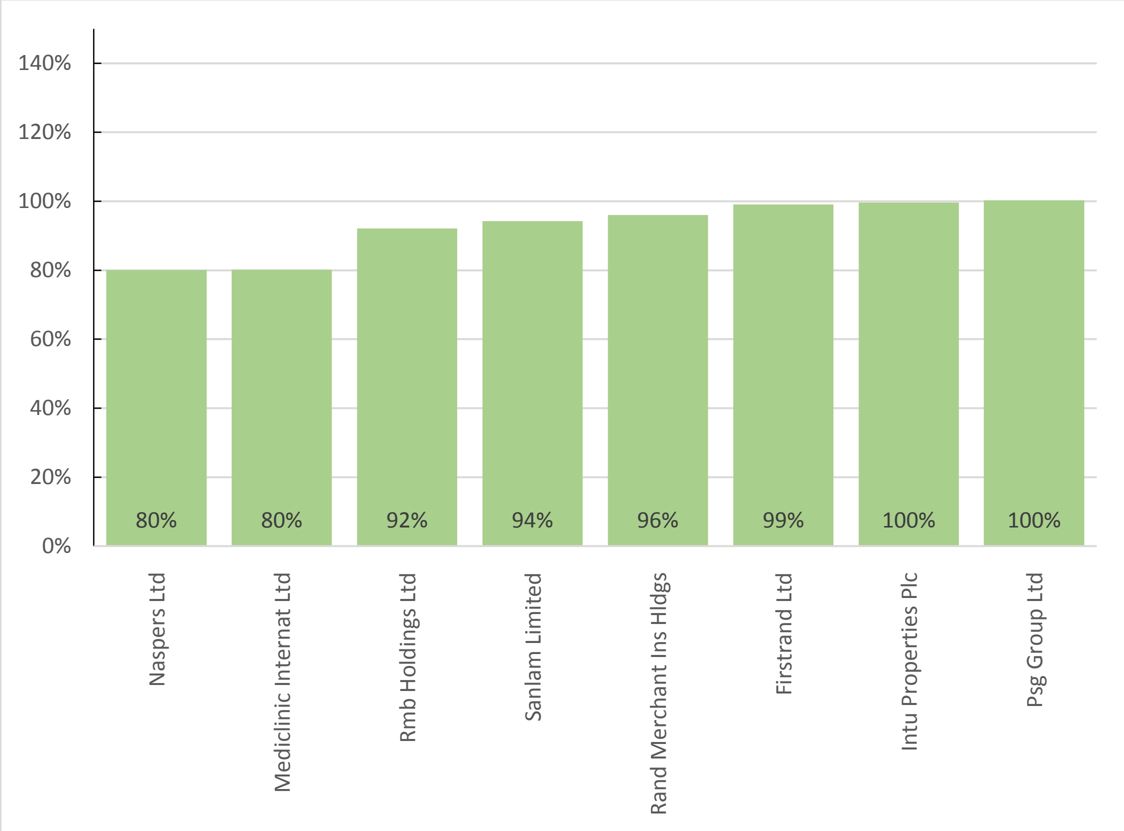


Figure 7: Company specific non-IFRS earnings as a % of IFRS earnings

Non-IFRS earnings were found to be on average 128% greater than that of IFRS earnings. Four companies' ratios above this average, these being Investec (138%), Glencore (275%), Old Mutual (152%) and BHP Billiton (336%). In contrast, as shown in figure 7, eight of the 19 companies presented a non-IFRS earnings value that was less than that of IFRS earnings, but not less than 80% of the value of IFRS earnings[38].

These findings show that when companies do present non-IFRS earnings greater than that of IFRS earnings, the difference between these earnings values is larger than the difference that arises when non-IFRS earnings are less than IFRS earnings. This finding is not necessarily unexpected as management may be more prone to identifying and adjusting for the exceptional items that negatively affected business performance, as opposed to those that helped performance (Standard & Poor, 2014).

Coulton et al (2016) found that 52.4% of the 500 ASX Australian listed companies analysed disclosed a higher value of non-GAAP earnings than GAAP earnings leading up to 2002. The study found that 55-61% of non-GAAP earnings were reported higher than GAAP earnings from years 2010 to 2014.

A fairly similar result was found by Standard and Poor on a sample of 82 companies on the FTSE 100, where 79% of these companies disclosed non-IFRS earnings that were greater than IFRS earnings for 2012/2013 fiscal year, an increase from 72% in the 2011/2012 fiscal year (Standard & Poor, 2014).

[38] Refer to Appendix 2 for a detailed breakdown of the results.

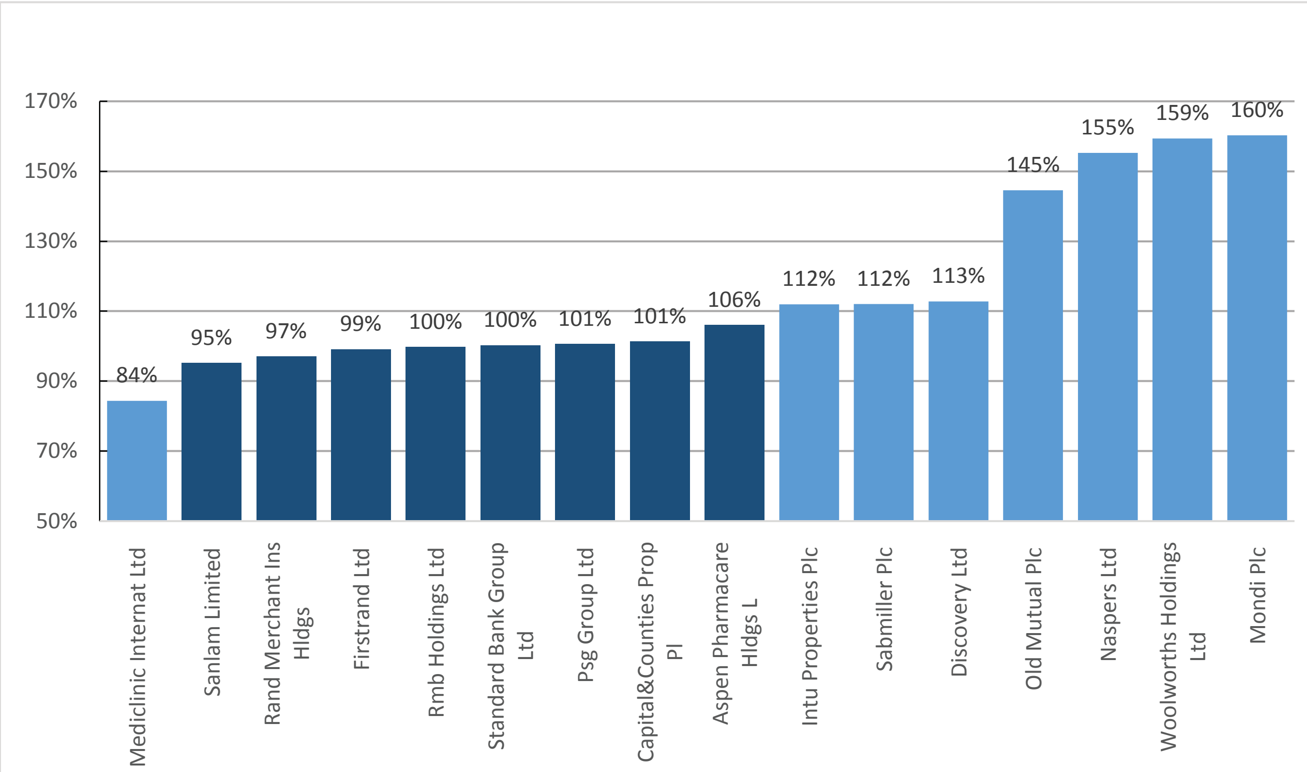
The results of this study are therefore similar to those of Coulton et al (2016), and slightly lower than those of Standard and Poor (2014). These results relate solely to the 2015 financial year. An extension of the study may look to include a range of financial years. This will allow for a better understanding of whether non-IFRS earnings being greater than that of IFRS earnings is a trend over financial years, or specific to the 2015 financial year used within this research report.

IV) Comparison between non-IFRS earnings and Headline Earnings by company

As previously mentioned, headline earnings is a mandatory disclosure item for JSE listed companies. A comparative analysis of the value of non-IFRS earnings and headline earnings is contained in Figure 8.

The companies used in the data set were the 16 companies that provided non-IFRS earnings in addition to that of headline earnings. The 5 companies that were excluded from the analysis were four dual listed companies that did not include a headline earnings figure in the integrated report, as well as Glencore (2015) that reported non-IFRS earnings that was 20 times greater in value than headline earnings, and was therefore regarded as an outlier. Figure 8 below plots the non-IFRS earnings as a percentage of headline earnings. Ten companies (63%) reported non-IFRS earnings measures that were higher than headline earnings. In contrast to this, four companies reported non-IFRS earnings measures that were less than headline earnings, and two companies reported non-IFRS earnings and headline earnings that were equal in value. This may suggest that similarity exists in the nature of the adjustments made in calculating headline earnings and non-IFRS earnings, which was briefly investigated and the results discussed below.

Figure 8: Company specific Non-IFRS earnings as a % of Headline Earnings



The items adjusted for in calculating headline earnings include impairment of assets, gains and losses on the disposal of discontinued operations, and gains and losses on the disposal of assets and certain fair value adjustments. Eight of the sixteen companies provided a reconciliation of the adjustments made in calculating non-IFRS earnings and those made in calculating headline earnings. The nature of these adjustments was compared, in order to investigate the extent of similarity. Figure 9 below illustrates that of the 47 adjustments made to calculate headline earnings, only 3 of the non-IFRS earnings adjustments were similar. Contrary to initial expectations therefore, the lack of similar adjustments implies that different considerations are given to the calculation of non-IFRS earnings; however, further research using a larger sample is recommended.

Company	Headline Earnings adjustments	Non-IFRS Earnings Adjustments	Similar Adjustments
Aspen	4	4	0
Capital&Counties Prop Pl	8	9	1
PSG Group Ltd	N/A	No Reconciliation provided	N/A
Standard Bank Group Ltd	7	1	1
RMB Holdings Ltd	12	6	0
First Rand	7	2	0
Rand Merchant Ins Holdings	6	7	0
Sanlam Limited	3	3	1
Total	**47**	**32**	**3**

Figure 9: Analysis of Headline earnings and non-IFRS earnings adjustments

SCOPE FOR FURTHER RESEARCH

The shortcomings of this report relate to the scope of the research conducted. The scope of the research included only 40 companies within the JSE. In addition to this, only the 2015 integrated reports were analysed, which may not be reflective of the status of non-IFRS earnings reporting amongst all South African companies.

A further study should incorporate a larger sample size that includes an analysis of the use of non-IFRS earnings measures over a longer period and in other reports (such as the financial statements). Extending the research to include a range of financial years will also provide insight into the rate at which companies are adopting non-IFRS earnings measures as a performance indicator.

This paper briefly comments on the similarities between non-IFRS earnings and that of headline earnings. A further study could be conducted that investigates in greater detail the adjustments made in calculating headline earnings in comparison to that of the adjustments made to calculate non-IFRS earnings.

There is no evidence to suggest that value relevance of reported non-IFRS earnings has been investigated within the South African context. This paper has reviewed the extent to which non-IFRS measures are being used by companies in South Africa, but does not analyse the ability of these measures to predict future earnings or cash flow predictions.

The IASB has identified the need for a solution that enhances the comparability of non-IFRS measures. An area for future research would be a study that investigates whether a standardised set of non-IFRS earnings measures per sector assists in achieving greater comparability.

CONCLUSION

The purpose of this paper was to provide initial exploratory evidence into the extent to which non-IFRS earnings measures are used by companies within South Africa. A review of previous literature on the rationale for management choosing to use non-IFRS earnings measures was provided and contrasted with the major concerns and criticisms of the measures. Managers have stated that non-IFRS earnings measures are more representative of the company-specific operations and future operations as opposed to the IFRS regulated earnings. The IASB have acknowledged that there has been great leniency surrounding the regulation of non-IFRS earnings measures and that the greater value relevance of non-IFRS earnings to IFRS earnings is becoming a concern, as is the lack of comparability of such measures.

The findings show that the majority (53%) of companies within the JSE top 40 companies are presenting non-IFRS earnings measures in their integrated reports. The analysis of the literature reviewed provided evidence that this phenomenon was not isolated to South Africa.

Furthermore, this study found that there is currently a large dispersion of non-IFRS earnings descriptions being used by companies, both within each sector and for the sample as a whole, although the more popular descriptions were found to be 'adjusted earnings', 'normalised headline earnings' and 'underlying earnings'. The adjustments made when calculating non-IFRS earnings also differed across the sample, although amortisation, impairment and fair value adjustments were amongst the more common. Most companies included a clear, understandable reconciliation of non-IFRS to IFRS earnings measures, but the large differences in the types of adjustments made provides preliminary non-statistical evidence that non-IFRS earnings measures may lack comparability across companies.

This paper did not attempt to determine whether there is a correlation between non-IFRS earnings and future performance of the company. Instead, an examination into the relationship between IFRS earnings and non-IFRS earnings was provided. It was found that the majority of the non-IFRS earnings measures were greater in value than the IFRS earnings values. This provides preliminary evidence that managers may be choosing predominantly income-increasing adjustments to report an artificially better financial performance. Finally, the majority of non-IFRS earnings measures were also marginally greater than headline earnings, and the findings suggest that different adjustments are made in calculating these measures.

The lack of research surrounding the topic of non-IFRS earnings provides much scope for future research. The findings of this paper can therefore be used as a foundation for further research on non-IFRS earnings measures, both within South Africa and internationally.

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