FRC Financial Reporting Council

FRC seeks consistency in the reporting of exceptional items

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The Financial Reporting Council (FRC) has today issued a reminder to Boards on the need to improve the reporting of additional and exceptional items by companies and ensure consistency in their presentation.

The Financial Reporting Review Panel (FRRP) of the FRC has identified a significant number of companies that report exceptional items on the face of the income statement and include subtotals to show the profit before such items (sometimes referred to as "underlying profit"). The FRC today reminds boards of what they should consider when they present exceptional or similar items and encourages them to improve reporting in this area.

Many companies present additional line items in the income statement to provide clear and useful information on the trends in the components of their profit in the income statement, as required by IAS 1 "Presentation of financial statements". The FRC, however, has identified a number where the disclosure falls short of the consistency and clarity required, with a consequential effect on the profit reported before such items.

Richard Fleck, chairman of the FRC's Conduct Committee and chair of the FRRP, said:

> *“It is essential that investors should be able to understand and rely on the trends in the profitability of companies. This announcement draws attention to the importance of providing information in a way that enables users to assess the quality of a company's profitability. It is a timely reminder as directors consider their response to the Corporate Governance Code principle that the annual report and accounts as a whole should be fair, balanced and understandable. ”*

The FRRP has considered the relevant principles in the law and IFRS, and has reflected on improvements agreed with companies regarding the provision of information that is relevant to an understanding of trends in components of profit. Based on those considerations, the FRRP believes that, in judging what to include in additional items and underlying profit, companies should have regard to the following:

- The approach taken in identifying additional items that qualify for separate presentation should be even handed between gains and losses, clearly disclosed and applied consistently from one year to the next. It should also be clearly distinguished from alternative performance measures used by the company that are not intended to be consistent with IFRS principles.
- Gains and losses should not be netted off in arriving at the amount disclosed unless otherwise permitted.
- Where the same category of material items recurs each year and in similar amounts (for example, restructuring costs), companies should consider whether such amounts should be included as part of underlying profit.
- Where significant items of expense are unlikely to be finalised for a number of years or may subsequently be reversed, the income statement effect of such changes should be similarly identified as additional items in subsequent periods and readers should be able to track movements in respect of these items between periods.
- The tax effect of additional items should be explained.
- Material cash amounts related to additional items should be presented clearly in the cash flow statement.
- Where underlying profit is used in determining executive remuneration or in the definition of loan covenants, companies should take care to disclose clearly the measures used.
- Management commentary on results should be clear on which measures of profit are being commented on and should discuss all significant items which make up the profit determined according to IFRS.

Notes to editors:

1. The FRC is responsible for promoting high quality corporate governance and reporting to foster investment. We set the UK Corporate Governance and Stewardship Codes as well as UK standards for accounting, auditing and actuarial work. We represent UK interests in international standard-setting. We monitor and take action to promote the quality of corporate reporting and auditing. We operate independent disciplinary arrangements for accountants and actuaries; and oversee the regulatory activities of the accountancy and actuarial professional bodies.
2. The Conduct Committee is a body authorised under the Companies Act 2006 ("the Act") to review and investigate the annual accounts and directors' reports of public and large private companies to see whether they comply with the requirements of the Act, including applicable accounting standards. Following implementation of the Accounting Regulation (EC) No. 1606/2002, this may mean compliance with UK or International Financial Reporting Standards.
3. Where breaches of the Act are discovered, the Conduct Committee seeks to take corrective action that is proportionate to the nature and effect of the defects, taking account of market and user needs. Where a company's accounts or directors' report are defective in a material respect, the Conduct Committee will, wherever possible, try to secure their revision by voluntary means. Should this approach fail, the Conduct Committee is empowered to make an application to the court under section 456 of the Act for an order for revision. To date, no court applications have been made.
4. The Conduct Committee maintains a Financial Reporting Review Panel. The Chairman is Richard Fleck and the Deputy Chairs are Joanna Osborne and Ian Wright. There are currently 24 other members drawn from a broad spectrum of commerce and the professions. Individual cases may be dealt with by a specially constituted Review Group of the FRRP.
5. The 2013 report of the FRC's Corporate Reporting Review activity, which embraces the work of the FRRP, drew attention to the need for investors to understand the quality of profits reported by companies, citing exceptional provisions as one source of concern. The comments published today stem from that concern while also reflecting the results of further monitoring activity.