

AMENDMENT TO FRS 3

REPORTING FINANCIAL
PERFORMANCE



ACCOUNTING
STANDARDS
BOARD

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“Amendment to Financial Reporting Standard 3- Reporting Financial Performance” is issued by the Accounting Standards Board in respect of its application in the United Kingdom and by the Institute of Chartered Accountants in Ireland in respect of its application in the Republic of Ireland.

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PREFACE

Introduction

1. This amendment to Financial Reporting Standard (FRS) 3 *Reporting Financial Performance* clarifies its application to entities within the scope of FRS 26 (IAS 39) *Financial Instruments: Recognition and Measurement*.
2. In summary the changes to FRS 3 are:
 - (a) to reflect the exemption from certain paragraphs of FRS 3 for entities applying FRS 26 and FRS 23 (IAS 21) *The effects of changes in foreign exchange rates*; and
 - (b) to delete in paragraph 55, references to exemption from producing a profit or loss on an unmodified historical cost basis for certain market makers and other dealers of investments where marking to market is the industry practice.

The ASB's amendments

3. FRS 26 specifies the treatment of gains and losses on remeasurement and derecognition of financial instruments. Paragraphs 21, 26 and 31A of FRS 3 specify the treatment of such gains or losses for all assets and liabilities. It has been suggested that there is a conflict between the two standards. For example, unrealised gains and losses on available-for-sale financial assets of insurance entities within the scope of FRS 26 are required by that standard to be recognised in the statement of total recognised gains and losses and recycled through the profit and loss account on derecognition. Paragraph 31A of FRS 3, on the other hand, requires that all investment portfolio gains and losses be included as part of the investment return in the profit and loss account. Whilst FRS 26 is the latter and

more specific standard the ASB thinks that it would be helpful to clarify the situation.

4. On 2 January 2007 the Urgent Issues Task Force (UITF) issued UITF Information Sheet 81, recommending that the ASB make a limited amendment to FRS 3 which it considered, if implemented, would be applicable to UK entities within the scope of FRS 26.
5. The UITF's recommendation was that FRS 3 should clarify that paragraphs 21, 26 and 31A of the standard do not apply to the financial instruments of entities within the scope of FRS 26.
6. During its deliberations the ASB also noted a similar problem for entities complying with the requirements of FRS 23. On the disposal of a foreign operation paragraph 48 of FRS 23 requires that the cumulative amount of related exchange differences recognised in the STRGL be recycled through the profit and loss. Therefore, entities complying with the requirements of FRS 23 would need similar clarifications to that being proposed for entities within the scope of FRS 26, in relation to the foreign exchange gain or loss on sale of a foreign operation.
7. The ASB is against recycling as a principle and does not want to be seen to promote it as a concept. It does, however, acknowledge that a problem exists for entities within the scope of FRS 26 and FRS 23 as set out above. Accordingly, it has made a limited amendment to the scope of FRS 3 that allows an exemption from paragraphs 21 and 31A of the standard in respect of financial instruments of entities within the scope of FRS 26 and the foreign exchange differences on the sale of a foreign operation for entities within the scope of FRS 23.
8. Amendments are also made to the requirements relating to the note of historical cost profits and losses in

paragraphs 26 and 55 of FRS 3 to allow the omission of the effect of fair value accounting of all financial instruments under FRS 26, not just for market makers and other dealers in investments as is currently the case under FRS 3. The amendment to paragraph 26 also has the effect of requiring an additional disclosure to the note on historical costs profits and losses; namely the fact that the effects of fair value accounting for financial instruments and hyperinflationary adjustments have been excluded from the reconciliation of the reported profit on ordinary activities before taxation to the equivalent historical cost amount.

9. The ASB decided that it would be more appropriate to amend FRS 3 rather than FRS 23 and FRS 26 as they are standards which are converged with the equivalent International Financial Reporting Standards (IFRS).
10. The ASB has also taken this opportunity to amend the profit and loss account examples in FRS 3 to remove dividends as a line item, arising from changes in the requirements under company law. The amendment also has the effect of deleting an unrelated example in the 'Illustrative Examples' section which is no longer applicable in the UK as the related paragraphs in the standard had been removed previously.

Date from which effective

11. This amendment to the FRS is effective for accounting periods beginning on or after 1 January 2007. Early adoption is permitted.

FINANCIAL REPORTING STANDARD

Amendment to FRS 3 ‘Reporting Financial Performance’

1 Amend paragraph 12 as follows:

12 Subject to paragraphs 12A and 12B ~~the~~ FRS applies to all financial statements intended to give a true and fair view of a reporting entity’s financial position and profit or loss (or income and expenditure). Every such reporting entity should apply the requirements of the FRS except to the extent that these requirements are not permitted by the statutory framework (if any) under which the entity reports.

2 Insert new paragraph 12B as follows:

12B Paragraph 21 and the last sentence of paragraph 31A of the FRS do not apply to entities adopting FRS 26 (IAS 39) *Financial Instruments: Recognition and Measurement*, in relation to:

- a. financial instruments accounted for in accordance with FRS 26; and
- b. foreign exchange differences on disposal of a foreign operation in accordance with FRS 23 (IAS 21) *The effects of changes in foreign exchange rates*.

3 Insert a new sentence into paragraph 26 as underlined:

26 Where there is a material difference between the result as disclosed in the profit and loss account and the result on an unmodified historical cost basis, a note of the historical cost profit or loss for the period should be presented. Where full historical cost information is unavailable or cannot be obtained without

unreasonable expense or delay, the earliest available values should be used. The note of the historical cost profit or loss should include a reconciliation of the reported profit on ordinary activities before taxation to the equivalent historical cost amount and should also show the ~~retained~~ profit for the financial year reported on the historical cost basis. The effects of fair value accounting under FRS 26 and hyperinflation adjustments under FRS 24 (IAS 29) *Financial Reporting in Hyperinflationary economies* and UITF Abstract 9 *Accounting for Operations in Hyper-inflationary Economies* are not required to be included in this reconciliation, but this omission should be noted. The note should be presented immediately following the profit and loss account or the statement of total recognised gains and losses.

- 4 **Insert a new sentence into paragraph 55 as underlined and delete the last sentence after “paragraph 26” as follows:**

55 Two reasons for disclosing the profit or loss for a period on the unmodified historical cost basis of accounting are commonly cited. The first is, that for as long as discretion exists on the timing or scale of revaluations included in financial statements, the unmodified historical cost basis will give the reported profits or losses of different reporting entities on a more comparable basis. The second is the wish of certain users to assess the profit or loss on sale of assets based on their historical cost, rather than, as the FRS requires, on their revalued carrying amount. In acknowledgement of these concerns, the Board has made the provision of a note of historical cost profits and losses a requirement of the FRS in those circumstances where there is a material difference between the result as disclosed in the profit and loss account and the result on an unmodified historical cost basis. Where full historical cost information is unavailable or cannot be obtained

without unreasonable expense or delay, the earliest available values should be used. The note of historical cost profits and losses should be presented immediately following the profit and loss account or the statement of total recognised gains and losses. In consolidated financial statements, the profit and loss account figure for minority interests should be amended for the purposes of this note to reflect the adjustments made where they affect subsidiary companies with minority interest. For the purpose of paragraph 26 the fair value accounting adjustments necessary under FRS 26 and hyperinflation adjustments under FRS 24 and UITF Abstract 9 are not required to be included in the reconciliation, but this omission should be noted. the following are not deemed to be departures from the historical cost convention: (a) adjustments necessarily made to cope with the impact of hyper-inflation on foreign operations and (b) and the practice of market makers and other dealers in investments of marking to market where this is an established industry practice.

- 5 **Insert a new footnote at the end of paragraph 56 as follows:**

ASB footnote: However, for entities applying FRS 23 based on the International Accounting Standard 21 *The Effect of Changes in Foreign Exchange Rates* and FRS 26, based on the International Accounting Standard 39 *Financial Instruments: Recognition and Measurement*, exchange differences and gains and losses (and the tax thereon) on remeasurement of certain categories of financial instruments are initially recognised in the STRGL and the related cumulative gain or loss recognised in the profit and loss account at a different date e.g. when the instrument is derecognised.

- 6 **The Profit and Loss account examples 1 and 2 are amended so that the illustrative profit and loss accounts end at ‘profit for financial year’ and**

dividends as a line item are removed. The last example in the Illustrative Examples section headed ‘Companies Act investment company’ is deleted.

- 7 **The following subheading and paragraph is added to the Development of the Standards section**

2007 Amendment

xii During 2007 the ASB set out to clarify the relationship between FRS 3 requirements and those contained in FRS 23 and FRS 26. FRS 26 specifies the treatment of gains and losses on remeasurement and derecognition of financial instruments. Paragraphs 21, 26 and 31A of FRS 3 specify the treatment of such gains or losses for all assets and liabilities, including financial instruments. Similarly, entities complying with FRS 23 are required by paragraph 48 of the standard to recycle the cumulative amount of exchange differences relating to a foreign operation, recognised in the STRGL, through the profit and loss on the disposal of that foreign operation. In contrast, although FRS 3 does not specifically prohibit recycling of these gains and losses through the profit and loss account, it appears to do so by analogy to the treatment of other gains and losses recognised in the STRGL which are not permitted to be recycled. Whilst FRS 23 and FRS 26 are the latter and more specific standards the ASB decided to clarify the situation by amending the scope of FRS 3.

- 8 **An entity shall apply this Amendment to FRS 3 for accounting periods beginning on or after 1 January 2007. Early adoption is permitted.**

**ADOPTION OF AMENDMENT TO
FRS 3 BY THE ACCOUNTING
STANDARDS BOARD**

Amendment to Financial Reporting Standard 3 ‘Reporting Financial Performance’ was approved for issue by the eleven members of the Accounting Standards Board.

| | |
|----------------------|--------------------|
| Ian Mackintosh | Chairman |
| David Loweth | Technical Director |
| Michael Ashley | |
| Edward Beale | |
| Marisa Cassoni | |
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