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REVISION OF FRS 3

‘REPORTING FINANCIAL PERFORMANCE’

ACCOUNTING
STANDARDS
BOARD

FINANCIAL REPORTING
EXPOSURE DRAFT

For the convenience of respondents in compiling their responses, the text of the questions in the Preface on which particular comments are invited (pages 6-10) can be downloaded (in Word format) from the 'Reporting Financial Performance' page in the Current Projects section of the ASB Website (www.asb.org.uk).

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and should be dispatched so as to be received not later than 30 April 2001. All replies will be regarded as on the public record unless confidentiality is requested by the commentator.

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REVISION OF FRS 3

'REPORTING FINANCIAL PERFORMANCE'

ACCOUNTING STANDARDS BOARD

FINANCIAL REPORTING EXPOSURE DRAFT

[Draft] Financial Reporting Standard • is set out in paragraphs 1–125.

The Statement of Standard Accounting Practice, which comprises the paragraphs set in bold type, should be read in the context of the Objective as stated in paragraph 1 and the definitions set out in paragraphs 2 and 3 and also of the Foreword to Accounting Standards and the Statement of Principles for Financial Reporting currently in issue.

The explanatory paragraphs contained in the [draft] FRS shall be regarded as part of the Statement of Standard Accounting Practice insofar as they assist in interpreting that statement.

Appendix IV 'The development of the FRED' reviews considerations and arguments that were thought significant by members of the Board in reaching the conclusions in the [draft] FRS.

This draft is issued by the Accounting Standards Board for comment. It should be noted that the draft may be modified in the light of comment received before being issued in final form.

ISBN 1 85712 102 3

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PREFACE

Financial Reporting Exposure Draft (FRED) 22 addresses the presentation of information on the financial performance of reporting entities, in both the primary statements and supporting notes. The proposals are developed from a Discussion Paper on the subject, 'Reporting Financial Performance: proposals for change', which the Accounting Standards Board published in June 1999.

The proposals in the FRED are a natural progression from the requirements of the existing standard, FRS 3 'Reporting Financial Performance', issued in 1992. Nevertheless, the proposals, when implemented, would change the existing requirements on reporting financial performance to reflect the shift in views internationally towards reporting comprehensive income. The main developments from FRS 3 are:

(a) the profit and loss account and the statement of total recognised gains and losses are combined to form a single statement of financial performance.

(b) the performance statement shows all gains and losses recognised during the period that relate to that period.

(c) the statement is divided into three sections:

  (i) operating;

  (ii) financing and treasury; and

  (iii) other gains and losses.

(d) recycling of gains and losses between different sections of the performance statement is not permitted.

(e) dividends for the period are excluded from the performance statement as they represent transactions with owners as owners rather than expenses.

(f) a reconciliation of ownership interests is required to be presented as a primary statement.

The proposals retain the 'information set' approach of FRS 3. The FRED proposes that certain information on earnings per share, dividends for the period and prior period adjustments should be shown as memorandum items at the foot of the statement. Comprehensive notes to the single performance statement are also specified, including a reserves note and note of historical cost gains and losses, although the latter note has been made optional. In addition, new notes are added: a table of exceptional items reported over the last five years is required and a further optional note is suggested to illustrate the unusual tax implications of certain gains and losses.

The Board believes that the introduction of a single performance statement will allow users of accounts to view more easily the complete performance of a reporting entity, to the extent that an entity's performance is shown in the financial statements. The information accompanying the performance statement enables users to tie the information in the performance statement to the balance sheet changes in the period and increases comparability between reporting entities. The proposal also moves the performance statement format closer to a parallel of the cash flow statement format required by FRS 1 (Revised 1996), which should help users appreciate the cash effects of performance items.

Certain issues have been raised during the development of the FRED that may need to be addressed in order to put its proposals into force.

Gains and losses on investment properties

SSAP 19 requires recognised gains and losses representing the fair value changes arising on investment properties to be taken to the statement of total recognised gains and losses and the FRED follows this approach (ie these gains and losses are taken to 'other gains and losses'). However, using the logic of the proposals on performance reporting in the FRED, these gains and losses would instead be taken to the 'operating' section of the performance statement. The equivalent international standard would allow such a treatment and the Board will consider whether SSAP 19 should be revised in the light of the changes in international practice and the new approach to reporting financial performance.

The treatment of dividends

The FRED would not permit the inclusion of dividends for the period in the statement of financial performance because these represent transactions with owners as owners, rather than expenses of the entity. This conforms with the approach taken in the International Accounting Standard (IAS) 1 (revised) 'Presentation of Financial Statements'. However, the exclusion is contrary to UK companies legislation (although not to EC Directives). The Board has therefore raised with the Department of Trade and Industry the possibility of a change in the law.

Special industries and sectors

The FRED adapts the format of the basic statement of financial performance (as shown in the example in Appendix I) for those entities that report under special (and generally more complex) legislative regimes in the UK and the Republic of Ireland, ie banking and insurance entities and investment companies. The Board expects these and other industries and sectors to adapt the basic format as necessary through relevant Statements of Recommended Practice. Insurance entities may eventually be further affected by a review of insurance accounting that is taking place at the international level. No attempt is made in the FRED to anticipate the outcome of that review.

Particular issues on which comments are invited

The Board would welcome comments on any aspects of the FRED. Respondents' views are especially sought on the matters set out below. It would be helpful if respondents could support comments with reasons and, where applicable, preferred alternatives.

1 Do you agree with the proposal in the draft FRS (paragraphs 6 and 7) to introduce a single performance statement, in which would be reported all gains and losses recognised in a period that relate to that period? Do you agree that, as a consequence:

   (a) transactions with owners as owners, such as dividends paid, should not be shown in the performance statement (paragraphs 8 and 9)?

   (b) recycling between sections of the performance statement should not be permitted (paragraphs 10 and 11)?

2 Do you agree with the proposed structure of the performance statement of three sections ((a) operating, (b) financing and treasury, and (c) other gains and losses) as laid out in paragraphs 14-17?

3 Do you agree with the bases on which gains and losses are allocated to the different sections of the performance statement as described in paragraphs 18-29 of the draft FRS and explained in Appendix IV 'The development of the FRED' (paragraphs 23-41)?

4 For complex organisations, the single performance statement would contain a great deal of information. The Board does not wish to overburden the face of the statement, nor does it wish to see critical information relegated to the notes to the statement. Companies legislation offers some flexibility on this issue and views are therefore sought on how much information should be shown *on the face of the performance statement*:

(a) Should the FRS specify the minimum disclosure of items within each or any of the sections of the performance statement?

(b) Should the FRS specify the minimum disclosure for the results of discontinuing and continuing operations, for example turnover and operating result?

(c) Should the FRS specify the *maximum* permitted disclosure, thereby outlawing the provision of additional information or even formatting (at least on the face of the statement) that is provided at the discretion of management?

5 The Board has considered two different approaches to the allocation of gains and losses between the operating section and the financing and treasury section (paragraphs 21-24 and Appendix IV, paragraphs 28 and 29).

(a) Do you agree with the approach laid out in the FRED, under which gains and losses resulting from operating activities that are financial in nature are reported in the operating section, whereas gains and losses arising from the financing of all the entity's activities, whether financial or not, are reported in the financing and treasury section?

(b) Alternatively, do you prefer an approach under which all gains and losses arising on financial activities are reported in the financing and treasury section?

6 The FRED has moved from the notion in FRS 3 of 'discontinued' operations to the focus in the international standard* on 'discontinuing' operations (paragraphs 39-59). Do you agree that the proposed FRS should adopt the international requirement in this respect?

7 The FRED would amend FRS 15 'Tangible Fixed Assets' so that disposal gains and losses arising on fixed assets are reported in the same way as revaluation gains and losses and impairment losses (Appendix IV, paragraph 42). Do you agree that these gains and losses should be reported in the same way, regardless of whether they are realised in the period?

8 The Board is keen to elicit respondents' views in the light of experience in applying FRS 15 regarding the allocation of recognised losses on fixed assets between sections of the performance statement, and how (for revalued assets) recognised gains arising in subsequent periods should then be reported. On the arguments laid out in Appendix IV (paragraphs 43-48):

(a) do you believe that all falls in value of fixed assets from carrying amount to recoverable amount should be treated as impairments (whether those assets have previously been revalued or not)?

(b) do you believe that recognised increases in value arising in subsequent periods should be treated as revaluation gains or do you think they should be treated as reversals of previous impairment losses (to the extent of those previously recognised losses)?

Alternatively, do you believe that the existing treatment in FRS 15 is satisfactory?

* *IAS 35 'Discontinuing Operations'.*

9 Applying the logic of the proposals in the FRED, the fair value gains and losses arising on investment properties would be reported in the 'operating' section of the performance statement (see page 5 above and Appendix IV, paragraphs 49-51). This conforms to the approach taken in IAS 40 'Investment Property', but would necessitate an amendment to SSAP 19, which requires such gains and losses to be reported in 'other gains and losses'. Do you agree that the Board should consider such an amendment?

10 Do you agree with the proposals relating to:

(a) exceptional items (paragraphs 61-66)?

(b) extraordinary items (paragraphs 67-69)

11 The draft FRS sets out modified requirements in respect of certain entities in recognition of their regulatory environment and type of business.

(a) Do you agree with the proposals in relation to:

(i) banking companies and banking groups (paragraphs 79-81);

(ii) insurance companies and insurance groups (paragraphs 82-85); and

(iii) investment companies (paragraphs 86 and 87)?

(b) Do you agree that further guidance for these and other bodies can be provided in relevant Statements of Recommended Practice (SORPs), or do you think that additional guidance would be needed in a standard?

12 The Board considered how conglomerates might best report their diverse activities within a single performance statement. For such groups, further disaggregation of the primary results may be necessary, for which SSAP 25 'Segmental reporting' provides a framework. Do you believe that SSAP 25 is adequate for this purpose?

13 The FRED proposes (in paragraphs 93-100) that certain information should be shown as memorandum items at the foot of the performance statement on the basis that, although not gains and losses of the period, they provide valuable information about company performance:

- all earnings per share figures
- dividends paid and proposed for the period, both in total and per share
- cumulative adjustments recognised in the period that arise from prior period adjustments.

Do you agree that any, some or all of these items should be shown as memorandum items at the foot of the performance statement?

14 Do you agree that basic earnings per share, calculated as required by FRS 14 'Earnings per Share', should be based on 'operating and financing income after tax and minority interests' that is attributable to ordinary shareholders (paragraph 93)?

15 The Board is minded to delete the requirement in FRS 3 for a note of historical cost gains and losses because it believes that the note has limited informational content. However, user respondents to the Discussion Paper expressed support for retaining the note. The FRED proposes to make the note non-mandatory. Do you believe that the note of historical cost profits and losses, as drafted in the FRED, should be:

(a) mandatory (as in FRS 3 at present);

(b) optional (as proposed in the FRED); or

(c) not mentioned in the standard at all?

SUMMARY

a [Draft] Financial Reporting Standard • sets out the requirements for reporting financial performance.

The statement of financial performance

b A single statement of financial performance is required, in which all recognised gains and losses of the period are reported. This is part of a larger 'information set' on performance that includes notes and memorandum items.

c The performance statement is divided into three sections:

(i) operating;

(ii) financing and treasury; and

(iii) other gains and losses.

d The bulk of recognised gains and losses will appear in the operating section. Only those gains and losses specified by the [draft] FRS or other accounting standards and by UITF Abstracts will be reported in the other sections.

e Gains and losses arising on the financing of the entity, including income on the investment of surplus funds, are to be reported in the financing and treasury section.

f Holding gains and losses arising on long-term items held in order to carry out the activities of the entity are to be reported in other gains and losses.

g Recycling of gains and losses between sections of the performance statement is not permitted.

h Information is required on the results from acquisitions and continuing and discontinuing activities, at least in the operating section.

i Discontinuing operations are those that are distinguishable from the remaining continuing operations and for which a binding sale agreement has been signed or a comprehensive termination plan announced.

j All exceptional items are to be reported within the relevant line item, either on the face of the performance statement or in a note to the accounts.

k Two figures are to be given for taxation: one for the tax that is attributable to the operating and financing sections and one attributable to the items in other gains and losses.

Special industries

l The format of the performance statement is adapted for banking and insurance companies, and for investment companies, in line with statutory requirements.

Reconciliation of ownership interests

m A reconciliation of ownership interests is required as a primary statement that brings together the performance of the period (shown in the statement of financial performance) with all the other changes in ownership interests in the period, including capital contributed by or repaid to shareholders.

Other information

n The following memorandum information is to be presented at the foot of the performance statement:

- earnings per share
- dividends (both in total and per share)
- the cumulative gain or loss arising from a prior period adjustment.

o Earnings per share is calculated according to FRS 14 'Earnings per Share'. Any additional earnings per share calculated on another level of earnings is to be presented on a consistent basis over time and, wherever disclosed, reconciled to the amount required by FRS 14, which is at least as prominent as the additional version presented.

p Prior period adjustments are to be accounted for by restating the comparative figures for the preceding period in the primary statements and notes and adjusting the opening balance of reserves for the cumulative effect.

q The note of historical cost gains and losses becomes an optional memorandum item, the primary purpose of which is to present the profits or losses of reporting entities that have revalued assets on a more comparable basis with those of entities that have not.

r The [draft] FRS amends other accounting standards and UITF Abstracts.

[DRAFT] FINANCIAL REPORTING STANDARD •

OBJECTIVE

1 The objective of this [draft] FRS is to require reporting entities falling within its scope:

(a) to report all recognised gains and losses in a single performance statement; and

(b) to highlight a range of important components of financial performance to help users to understand the performance achieved by an entity in a period and assess future results and cash flows.

DEFINITIONS

2 The following definitions shall apply in the [draft] FRS and in particular in the Statement of Standard Accounting Practice set out **in bold type**.

Acquisition:–

A component of an entity that is acquired in the period.

Discontinuing operation:-

A component of an entity that:

(a) represents a separate major line of business or geographical area of operations;

(b) can be distinguished operationally and for financial reporting purposes; and

(c) pursuant to a single plan, is:

   (i) being disposed of substantially in its entirety, such as by selling the component in a single transaction or by demerger or spin-off of ownership of the component to the entity's shareholders;

   (ii) being disposed of piecemeal, such as by selling off the component's assets and settling its liabilities individually; or

   (iii) being terminated through abandonment.

Exceptional items:-

Material items that derive from events or transactions that fall within the ordinary activities of the reporting entity and which individually or, if of a similar type, in aggregate, need to be disclosed by virtue of their size or incidence if the financial statements are to give a true and fair view.

Extraordinary items:-

Material items possessing a high degree of abnormality that arise from events or transactions that fall outside the ordinary activities of the reporting entity and are not expected to recur. They do not include exceptional items nor do they include prior period items merely because they relate to a prior period.

Financial performance:-

The financial performance of an entity comprises the return it obtains on the resources it controls, the components of that return and the characteristics of those components, insofar as they can be captured by the accounting model.

Financial performance of an entity for a period encompasses all recognised gains and losses. As such, in mathematical terms it is the change in net assets of the reporting entity from the end of the previous period to the end of the present period, excluding distributions to and contributions from owners.

Financing and treasury section:-

The section of the statement of financial performance in which are reported gains and losses arising from the financing of the entity and its treasury activities.

Fundamental error:-

An error of such significance that it destroys the true and fair view and hence the validity of the entity's financial statements for the period.

Gains:-

Increases in ownership interest not resulting from contributions from owners.

The term includes items that are referred to as 'revenues'.

Initial disclosure event:-

With respect to a discontinuing operation, the occurrence of one of the following, whichever occurs earlier:

(a) the entity has entered into a binding sale agreement for substantially all of the assets attributable to the discontinuing operation; or

(b) the entity's board of directors or similar governing body has both:

(i) approved a detailed, formal plan for the discontinuance: and

(ii) made an announcement of the plan,

and the actions of the entity are such that they have raised a valid expectation in those affected that it will carry out the planned termination.

Losses:-

Decreases in ownership interest not resulting from distributions to owners.

The term includes items that are referred to as 'expenses'.

Operating section:-

The section of the statement of financial performance in which all the gains and losses arising on the activities of the entity are reported, other than those that are required to be reported in another section by this or another accounting standard.

Ordinary activities:-

Any activities that are undertaken by an entity as part of its business and such related activities in which the reporting entity engages in furtherance of, incidental to, or arising from, those activities. Such activities include the effects on the entity of any event in the various environments in which it operates, including the political, regulatory, economic and geographical environments, irrespective of the frequency or unusual nature of the events.

Gains and losses that are reported in 'other gains and losses' in the performance statement, as determined by this and other accounting standards, represent holding gains and losses that arise on items, held for the long term, that are connected with but incidental to the main activities of the entity. As such, they are not part of the entity's profit on ordinary activities.

Other gains and losses:-

The section of the statement of financial performance in which are reported holding gains and losses that arise from long-term items held for operating or financing purposes, rather than with a view to benefiting from changes in their value over time, and which therefore do not reflect directly the operating or financing and treasury activities of the entity.

Prior period adjustments:-

Material adjustments applicable to prior periods arising from changes in accounting policies (as defined by FRS 18 'Accounting Policies') or from the correction of fundamental errors. They do not include changes of estimation techniques (as defined by FRS 18).

3 References to companies legislation mean:

(a) for a company:

(i) in Great Britain, the Companies Act 1985;

(ii) in Northern Ireland, the Companies (Northern Ireland) Order 1986; and

(iii) in the Republic of Ireland, the Companies Acts 1963-90 and the European Communities (Companies: Group Accounts) Regulations 1992;

(b) for an entity other than a company, the equivalent legislation.

SCOPE

4 **The [draft] FRS applies to all financial statements that are intended to give a true and fair view of a reporting entity's financial position and profit or loss (or income and expenditure) for a period. Every such entity should apply the requirements of the [draft] FRS except to the extent that these requirements are not permitted by the legislation (if any) under which the entity reports.**

5 **Reporting entities applying the Financial Reporting Standard for Smaller Entities currently applicable are exempt from the [draft] FRS.**

THE STATEMENT OF FINANCIAL PERFORMANCE

The single performance statement

6 **All gains and losses recognised in the entity's financial statements for the period should be included in the statement of financial performance.**

7 The financial performance of an entity is made up of components that exhibit differing characteristics in terms of, for example, their nature, cause, function, relative continuity or recurrence, stability, risk, predictability and reliability. All these components are relevant to an assessment of financial performance and therefore need to be reported on in the statement of financial performance, although their individual characteristics mean that some will carry more weight than others.

8 **Items that are not gains and losses should not be reported in the statement of financial performance.**

9 Only gains and losses as defined by the [draft] FRS are reported in an entity's statement of financial performance. For example, dividends paid and payable are not gains and losses and therefore are not part of financial performance; consequently, they are not reported in the statement of financial performance.*

10 Recycling† between sections of the statement of financial performance is not permitted.

11 Items that are not gains or losses are not included in the performance statement, which means that the notion of recycling is not consistent with the [draft] FRS. For example, a gain on the revaluation of a fixed asset should be reflected in other gains and losses in the period in which the revaluation takes place. The realisation, or part-realisation, of such a gain on the sale of the asset in a subsequent period is not itself a gain of that later period but, rather, confirmation of a gain that had already occurred by the time of the revaluation. Consequently, the gain or loss on the disposal of the asset is to be calculated as the difference between the net sale proceeds and the net carrying amount.

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* *This is not consistent with how dividends are dealt with at present. It is acknowledged that companies legislation requires dividends paid and payable to be shown on the face of the profit and loss account: see Appendix II, paragraphs 24-26 and Appendix IV, paragraphs 70 and 71.*

† *'Recycling' here means recognising a gain or loss in the performance statement in one period and then, in a later period, recognising some or all of that gain or loss under a different heading in either the same or a different section of the statement of financial performance because the nature of the item is deemed to have changed in some way. It does not refer to the allocation of gains and losses to different sections or components of the performance statement.*

12 **Gains and losses should generally not be offset in presenting information on financial performance, unless:**

(a) they relate to the same event or circumstance; and

(b) disclosing the gross components is unlikely to be useful in assessing either future results or the effects of past transactions and events.

13 If a transaction involves both a receipt and a cost (as is the case, for example, when an item of stock is sold), the transaction will usually be best presented by showing the revenue (the receipt) separately from the expense (the cost). If a profit is made on the disposal of a fixed asset, however, that profit is usually best presented by showing it as a gain rather than by showing the sales proceeds as a gain separately from the depreciated cost of the asset. In this latter case, users are not seeking information on the margins achieved on the sale of the fixed asset, whereas for the purchase and sale of an item of stock, the information on the sales margin is directly relevant to the assessment of the expected future performance of the entity.

The sections of the statement of financial performance

14 **An entity should divide its performance statement into the following three sections:**

(a) operating;

(b) financing and treasury;* and

(c) other gains and losses.

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* *Entities that belong to certain special industries should merge the first two sections of the performance statement and subdivide the resulting section as is appropriate for their industry: see paragraphs 77-85.*

15 **All gains and losses recognised in the financial statements for the period should be included in a section of the single performance statement.**

16 The various activities undertaken by an entity differ in stability, risk and predictability, and therefore components of financial performance need to be disclosed in different sections of the statement of financial performance. Disclosure of component information within distinct sections is designed to facilitate understanding of the performance achieved in a period and to help users judge how far past results are useful in assessing potential future results.

17 **Gains and losses should be allocated to the various sections of the performance statement on the basis of the requirements in the [draft] FRS and other accounting standards. Where a choice is permitted, any proposal to change the section(s) in which gains and losses are reported should be considered according to those requirements of FRS 18 'Accounting Policies' that relate to changes in accounting policy.**

The operating section

18 **Gains and losses may be excluded from the operating section of the performance statement only if they are permitted or required to be taken to another section by the [draft] FRS, other accounting standards or UITF Abstracts.**

19 Income from operating activities focuses on what a reporting entity earns for its output (revenue) and what it sacrifices to obtain that output (expenses) in its dealings with its customers. To provide information on the operating margins the entity achieves, the expenses charged in the operating section should comprise all costs incurred in

carrying out the entity's operations. This section should therefore include allocations reflecting the consumption of economic benefits of long-term items, for example the depreciation and impairment of fixed assets or the current service cost representing the increase in the actuarial liability expected to arise from employee service in the current period.

20 For most entities, the bulk of gains and losses recognised during a period will fall into this section. The presumption is that gains and losses recognised during the period arise from an entity's operating activities. Only by exception will certain gains and losses (those that arise from the financing of the entity, or represent holding gains or losses on long-term items) be reported in one of the other sections of the performance statement, as specified by accounting standards. Thus, the operating section will exclude the gains and losses arising from the financing of the operations of the entity, although it will include gains and losses arising from operating activities that are financial in nature (see paragraph 23).

The financing and treasury section

21 **Only gains and losses specified by the [draft] FRS, other accounting standards or UITF Abstracts should be reported in the financing and treasury section of the performance statement.***

* *The content of this section of the performance statement is likely to be affected by the outcome of the project on accounting for financial instruments and derivatives, proposals for which have been published by an international Joint Working Group of standard setters within an ASB consultation paper 'Financial Instruments and Similar Items'. Changes in fair value of financial instruments would be reported in this section on the basis of the JWG's approach.*

22 **The recognised gains and losses that should appear in this section are:**

(a) interest payable and receivable;

(b) the unwinding of the discount on long-term items, eg pensions;

(c) income from investments held as part of treasury activities;

(d) gains and losses arising on the repurchase or early settlement of debt (as determined in accordance with FRS 4 'Capital Instruments'); and

(e) any other recognised gain or loss identified for inclusion by another accounting standard or by a UITF Abstract.

The basis on which gains and losses arising on financial activities have been reported in the operating section of the performance statement should be disclosed and this should be applied consistently from period to period.

23 This section of the performance statement contains those gains and losses arising from the financing of the entity's operations.* This does not mean that all items of a financial nature will be reported here. Where some or all of an entity's trade with its external customers is financial in nature, gains and losses arising from those activities will be reported in the operating section of the performance statement.

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* *Contributors from and distributors to owners of the entity are not gains and losses and therefore should not be reported in the performance statement.*

Reporting entities that are part of special industries, such as banking and insurance companies, will adapt the formats required by the [draft] FRS.* Other entities will need to consider the extent to which their operating results should incorporate their financial activities.

24 **The items included in the financing and treasury section as specified in paragraph 22 should be disclosed in the notes if not presented on the face of the performance statement.**

Other gains and losses

25 **Only gains and losses specified by the [draft] FRS or other accounting standards or UITF Abstracts should be reported in other gains and losses within the performance statement.**

26 **The recognised gains and losses that should appear in this section are:**

(a) revaluation gains and losses on fixed assets (as determined in accordance with FRS 15 'Tangible Fixed Assets');

(b) gains and losses on disposal of properties in continuing operations (as determined in accordance with FRS 15);

(c) actuarial gains and losses arising on defined benefit schemes (as determined in accordance with FRS 17 'Retirement Benefits');

(d) profits and losses on disposal of discontinuing operations;

* *See paragraphs 77-85.*

(e) exchange translation differences on foreign currency net investments (as determined in accordance with SSAP 20 'Foreign currency translation');

(f) revaluation gains and losses arising on investment properties (as determined in accordance with SSAP 19 'Accounting for investment properties');*

(g) on the lapse of an unexercised warrant, the amount previously recognised in respect of that warrant (as determined in accordance with FRS 4 'Capital Instruments'); and

(h) any other recognised gain or loss as determined in accordance with or identified by another accounting standard or a UITF Abstract.

27 An entity is usually exposed to holding gains and losses that arise on items, held for the long term, that are connected with but incidental to its main trading activities. For example, holding gains and losses may arise on a manufacturing entity's factory, or currency fluctuations may arise on an investment in an overseas subsidiary. Although holding such items is necessary for the successful delivery of operating results, significant holding gains and losses arising from such assets are incidental to the main purpose for which they are held. Consequently, such gains and losses should be segregated from the results of both the operating and financing activities of the reporting entity, so that users may differentiate between their varying characteristics.

28 **The items included in other gains and losses as specified in paragraph 26 should be disclosed in the notes if not presented on the face of the performance statement.**

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* *See the reference to SSAP 19 in the Preface and in Appendix IV 'The development of the FRED', paragraphs 49-51.*

29 The extent to which disclosure is necessary on the face of the performance statement will vary according to the entity's circumstances. Accordingly, the [draft] FRS permits the individual items that make up the total gains and losses of both the financing and treasury section and other gains and losses to be disclosed on the face of the performance statement or by note where this would help users' understanding (for example, when the statement would otherwise be excessively long and complex).

Continuing and discontinuing operations

30 **The aggregate results of each of continuing operations, acquisitions (as a component of continuing operations) and discontinuing operations should be disclosed separately for the results of the operating section. The same information should be given in respect of the financing and treasury section and other gains and losses, unless it is impracticable to do so or the resulting information would be misleading. The results of acquisitions included in continuing operations should not include those that are also discontinuing in the same period.**

31 **In the operating section, the minimum disclosure required on the face of the performance statement in respect of continuing operations, acquisitions and discontinuing operations is the analysis of turnover and operating profit. The analysis into continuing operations, acquisitions (as a component of continuing operations) and discontinuing operations of each of the other format items between turnover and operating profit should be given by way of note where not shown on the face of the performance statement.**

32 **Where an entity presents information on continuing and discontinuing operations in either the financing and treasury section or in other gains and losses (or in both), the underlying assumptions used in making any allocations, for example of interest payable, should be disclosed.**

33 The objective of reporting separately the results of continuing operations, acquisitions (as a component of continuing operations) and discontinuing operations is to help users, first, in assessing the financial performance of these aspects of an entity's operations and, secondly, in forming a basis for the assessment of future income. Separate presentation assists analysis of the significance of the part of an entity's operations that is ceasing and of new operations that have been acquired.

34 The [draft] FRS requires each of the headings between turnover and operating profit to be analysed into continuing operations, acquisitions (as a component of continuing operations) and discontinuing operations. To avoid excessive data on the face of the performance statement, the minimum disclosure required there for continuing operations, acquisitions and discontinuing operations is the analysis of turnover and operating profit.

35 A similar analysis into continuing and discontinuing operations may be given for the financing and treasury section and for other gains and losses. However, the information need not be provided if it is impracticable to do so or if the resulting information would be misleading. For example, interest payable is often a reflection of an entity's overall financing policy, involving both equity and debt funding considerations on a groupwide basis, rather than an aggregation of the particular types of finance allocated to individual segments of the entity's operations. Any allocation of interest may involve so much subjectivity that the user is uncertain about the relevance and reliability of the information. If an entity wishes to provide such an allocation, the [draft] FRS requires the method and

underlying assumptions used in making the allocation to be disclosed. In addition, where practicable the analysis in the financing and treasury section and in other gains and losses should identify, either on the face of the performance statement or in the notes, the amounts arising in respect of acquisitions.

36 **The effect of acquisitions and of sales or terminations on major business segments should be disclosed and explained.**

Acquisitions

37 **The post-acquisition results for the period in which the acquisition occurs should be disclosed. Where it is not practicable to determine the post-acquisition results of an operation to the end of the current period, an indication should be given of the contribution of the acquisition to the turnover and operating profit of the continuing operations in addition to the information required by companies legislation.* If an indication of the contribution of an acquisition to the results of the period cannot be given, that fact and the reason should be explained.**

38 In some circumstances it may also be useful for the results of acquisitions for the first full financial year for which they are a part of the entity to be disclosed in the notes.

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* *In Great Britain, the Companies Act 1985, Schedule 4A paragraph 13.*
In Northern Ireland, the Companies (Northern Ireland) Order 1986, Schedule 4A paragraph 13.
There is no direct equivalent in the Republic of Ireland: however, Regulation 27 of the European Communities (Companies: Group Accounts) Regulations 1992 states: "If the composition of the undertakings dealt with in the group accounts has changed significantly in the course of a financial year, the group accounts must include information which makes the comparison of successive sets of group accounts meaningful."

Discontinuing operations

39 **A transaction or event that does not meet the definition of a discontinuing operation in the [draft] FRS should not be referred to as such in the statement of financial performance or related notes.**

40 Discontinuing operations are defined in paragraph 2. Under criterion (a), a discontinuing operation may be disposed of in its entirety or piecemeal, but always pursuant to an overall plan to discontinue the entire component.

41 If an entity sells a component substantially in its entirety, the result may be a net gain or a net loss. For such a discontinuance, there is a single date at which a binding sale agreement is entered into, although the actual transfer of possession and control of the discontinuing operation may occur at a later date. Also, payments to the seller may occur at the time of the agreement, at the time of the transfer, or over an extended future period.

42 Instead of disposing of a major component in its entirety, an entity may discontinue and dispose of the component by selling its assets and settling its liabilities piecemeal (individually or in small groups). For piecemeal disposals, whilst the overall result may be a net gain or a net loss, the sale of an individual asset or settlement of an individual liability may have the opposite effect. Moreover, there is no single date at which an overall binding sale agreement is entered into. Rather, the sales of assets and settlements of liabilities may occur over a period of months or perhaps even longer, and the end of a financial reporting period may occur part way through the disposal period. To qualify as a discontinuing operation, the disposal must be pursuant to a single co-ordinated plan.

43 For a plan to give rise to a valid expectation, when communicated to those affected by it, that the termination will be carried out, its implementation needs to be planned to begin as soon as possible and to be completed in a timeframe that makes significant changes to the plan unlikely. If it is expected that there will be a long delay before the termination begins or that the termination will take an unreasonably long time, it is unlikely that the plan will raise a valid expectation on the part of others that the entity is at present committed to the termination, because the timeframe allows opportunities for the entity to change its plans.

44 An entity may terminate an operation by abandonment without substantial sales of assets. An abandoned operation is a discontinuing operation if it satisfies the criteria in the definition. However, changing the scope of an operation or the manner in which it is conducted is not an abandonment because that operation, although changed, is continuing.

45 Entities frequently close facilities, abandon products or even product lines, and change the size of their workforce in response to market forces. Whilst such terminations generally are not, in and of themselves, discontinuing operations as that term is used in the [draft] FRS, they can occur in connection with a discontinuing operation. Examples of activities that do not necessarily satisfy criterion (a) of the definition, but might do so in combination with other circumstances, include:

(a) gradual or evolutionary phasing out of a product line or class of service;

(b) discontinuing, even if relatively abruptly, several products within an ongoing line of business;

(c) shifting some production or marketing activities for a particular line of business from one location to another;

(d) closing a facility to achieve productivity improvements or other cost savings; and

(e) selling a subsidiary whose activities are similar to those of the parent or other subsidiaries.

46 A component can be distinguished operationally and for financial reporting purposes if:

(a) its operating assets and liabilities can be directly attributed to it;

(b) its turnover can be directly attributed to it; and

(c) at least a majority of its operating expenses can be directly attributed to it.

47 Assets, liabilities, income, and expenses are directly attributable to a component if they would be eliminated when the component is sold, abandoned or otherwise disposed of. Interest and other financing costs are attributed to a discontinuing operation only if the related debt is similarly attributed.

48 As defined in the [draft] FRS, discontinuing operations are expected to occur infrequently. Some changes that are not classified as discontinuing operations may qualify as restructurings (see FRS 12 'Provisions, Contingent Liabilities and Contingent Assets'). Also, some infrequently occurring events that do not qualify either as discontinuing operations or restructurings may result in items of income or expense that require separate disclosure as exceptional items as defined in paragraph 2, because their size, nature, or incidence make them relevant to explain the performance of the entity for the period.

Initial disclosures

49 **An entity should include the following information relating to a discontinuing operation in its financial statements beginning with the financial statements for the period in which the initial disclosure event (as defined in paragraph 2) occurs:**

(a) a description of the discontinuing operation;

(b) the business or geographical segment(s) in which it is reported in accordance with SSAP 25 'Segmental reporting';

(c) the date and nature of the initial disclosure event;

(d) the date or period in which the discontinuance is expected to be completed if known or determinable;

(e) the carrying amounts, as at the balance sheet date, of the total assets and the total liabilities to be disposed of;

(f) the results of the discontinuing operations for the period as required by paragraphs 30-32; and

(g) the amounts of net cash flows attributable to the operating activities of the discontinuing operation during the current financial reporting period.*

* *See FRS 1 (Revised 1996), paragraphs 23 and 24.*

50 In measuring the assets, liabilities, revenues, expenses, gains, losses and cash flows of a discontinuing operation for the purpose of the disclosures required by the [draft] FRS, such items can be attributed to a discontinuing operation if they will be disposed of, settled, reduced or eliminated when the discontinuance is completed. To the extent that such items continue after completion of the discontinuance, they should not be allocated to the discontinuing operation.

51 **If an initial disclosure event occurs after the end of an entity's financial reporting period but before the financial statements for that period are authorised for issue or approved by the board of directors or similar governing body, those financial statements should include the disclosures specified in paragraph 49 for the period covered by those financial statements.**

52 For example, suppose that the board of directors of an entity whose financial year ends on 31 December 2005 approves a plan for a discontinuing operation on 15 December 2005 and announces that plan on 10 January 2006. The board approves the financial statements for 2005 on 20 March 2006. The financial statements for 2005 would include the disclosures required by paragraph 49.

Other disclosures

53 **When an entity disposes of assets or settles liabilities attributable to a discontinuing operation or enters into binding agreements for the sale of such assets or the settlement of such liabilities, it should include in its financial statements the following information when the events occur:**

(a) for any gain or loss that is recognised on the disposal of assets or settlement of liabilities attributable to the discontinuing operation, the amount of pre-tax gain or loss; and

(b) the expected proceeds of sale (after deducting the expected disposal costs) of those net assets for which the entity has entered into one or more binding sale agreements, the expected timing of receipt of those cash flows, and the carrying amount of those net assets.

54 The asset disposals, liability settlements, and binding sale agreements referred to in the previous paragraph may occur concurrently with the initial disclosure event, or in the period in which the initial disclosure event occurs, or in a later period. In accordance with SSAP 17 'Accounting for post balance sheet events', if some of the assets attributable to a discontinuing operation have actually been sold or are the subject of one or more binding sale agreements entered into after the financial year-end but before the board approves the financial statements for issue, the financial statements should include the disclosures required by paragraph 53 if non-disclosure would affect the ability of the users of the financial statements to make proper evaluations and decisions.

Updating disclosures

55 In addition to the disclosures in paragraphs 49 and 53, an entity should include in its financial statements for periods after that in which the initial disclosure event occurs a description of any significant changes in the amount or timing of cash flows relating to the assets and liabilities to be disposed of or settled and the events causing those changes.

56 Examples of events and activities that would be disclosed include the nature and terms of binding sale agreements for the assets, a demerger of the assets by spin-off of a separate equity security to the entity's shareholders, and legal or regulatory approvals.

57 **The disclosures required by paragraphs 49-56 should continue in financial statements for periods up to and including the period in which the discontinuance is completed. A discontinuance is completed when the plan is substantially completed or abandoned, though payments from the buyer(s) to the seller may not yet be completed.**

58 **If an entity abandons or withdraws from a plan that was previously reported as a discontinuing operation, that fact and its effect should be disclosed.**

59 For the purpose of applying the preceding paragraph, disclosure of the effect includes any reversal of prior impairment loss or provision that was recognised with respect to the discontinuing operation.

Associates and joint ventures

60 **An investing entity's share of the results of its joint ventures and associates should be reported in the performance statement as required by FRS 9 'Associates and Joint Ventures'.***

Exceptional items

61 **All exceptional items should be credited or charged by inclusion under the format headings to which they relate. They should be attributed to the relevant section of the performance statement and to continuing or discontinuing operations as appropriate. The amount of each exceptional item, either individually or as an aggregate of items of a similar**

* *As amended by this [draft] FRS: see paragraph 118.*

type, should be disclosed separately by way of note, or on the face of the performance statement if that degree of prominence is necessary in order to give a true and fair view. An adequate description of each exceptional item should be given to enable its nature to be understood.

62 Exceptional items are defined in paragraph 2. They are an inherent part of the normal activities of a reporting entity and are included in the relevant line item within each component of performance but, because of their exceptional size or incidence, require separate disclosure to explain the performance of a period. Exceptional items may arise from a variety of sources and for larger or more complex businesses they are likely to occur in one form or another in most periods. They should not be aggregated on the face of the statement under one heading of exceptional items but, rather, each should be included within its appropriate statutory format or other heading and separately disclosed as required by paragraph 61. The nature of exceptional items makes it necessary to distinguish exceptional profits from exceptional losses in the notes, if not on the face of the performance statement.

63 When exceptional items are reported in either the current year figures or those of a comparative period, a history of exceptional items reported should be shown in the notes to the statement. The note should show, for each of the last five years, a breakdown of the exceptional items reported with a description of each.

64 Exceptional items should, by definition, be infrequent. Therefore, where exceptional items are reported regularly, it is helpful for users to see both the pattern of exceptional items reported and the nature of them (particularly when more than one is reported in a period).

65 **In any references to the entity's financial performance as including or excluding exceptional items, an explanation should be given of the relevance of their inclusion or exclusion (as the case may be) in the context of considering the results of the period or assessing maintainable earnings.**

66 To facilitate such an explanation, it may be convenient to combine the breakdown of exceptional items over the previous five years required by paragraph 63 with the results over the same period that include or exclude exceptional items. Exceptional items may occur in either continuing or discontinuing operations and need to be identified individually as belonging to one or other category.

Extraordinary items

67 **Any extraordinary gain or loss should be shown separately on the face of the performance statement, after the profit or loss on ordinary activities after taxation and, in consolidated financial statements, after the figure for minority interests.* The amount of each extraordinary item should be shown individually either on the face of the performance statement or in a note and an adequate description of each extraordinary item should be given to enable its nature to be understood. The tax on an extraordinary gain or loss and, in consolidated financial statements, the extraordinary gain or loss attributable to minority shareholders should be shown separately as a part of the extraordinary item either on the face of the performance statement or in a note. Any subsequent adjustments to the tax on an extraordinary gain or loss in future periods should be shown as an extraordinary item.**

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* *ie after the total combined result of the 'operating' and 'financing and treasury' sections after tax and minority interests.*

68 Extraordinary items are defined in paragraph 2. They are extremely rare as they relate to highly abnormal events or transactions that fall outside the ordinary activities of a reporting entity and are not expected to recur. Although reporting of extraordinary items is provided for by companies legislation, the Board cannot envisage any circumstance in which extraordinary items might be reported under the definitions in the [draft] frs and, accordingly, no examples are provided. Items falling into the category of exceptional in accordance with the terms of the [draft] frs cannot, by definition, be extraordinary.

69 The [draft] frs follows companies legislation in requiring the tax on extraordinary gains or losses and, in consolidated financial statements, the minority shareholders' interest in an extraordinary gain or loss, to be shown separately.

Taxation

70 The tax arising from items in the operating section and the financing and treasury section should be shown after the statutory line of profit on ordinary activities before taxation.* The tax charge or credit arising on items in other gains and losses should be shown as a single item within that section.

71 Where the tax relating to each of the items within other gains and losses can be identified clearly with the item, disclosure may be made of the individual tax effects in the notes to the statement.

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* *ie, after the total combined result of the 'operating' and 'financing and treasury' sections.*

72 **Any special circumstances that affect the overall tax charge or credit for the period, or may affect those of future periods, should be disclosed by way of note to the performance statement and their individual effects quantified. The effects of a fundamental change in the basis of taxation should be included in the tax charge or credit for the period and separately disclosed in the notes to the performance statement.**

73 **The tax on items in other gains and losses or on an extraordinary gain or loss should be determined by computing the tax on the profit or loss on ordinary activities* as if the items did not exist, and comparing this notional tax charge with the total tax charge for the period (ie including the tax on other gains and losses and extraordinary items). Any additional tax charge or credit (including deferred tax) arising should thus be attributed to the items. If there are both items in other gains and losses and an extraordinary gain or loss in the same period, the tax on the items combined should be calculated, then apportioned between the two in relation to their respective amounts, unless a more appropriate basis of apportionment is available. If a more appropriate basis is adopted the method of apportionment should be disclosed.**

74 Companies legislation† requires disclosure in the notes of the details of any special circumstances that affect any liability to taxation, whether for the financial year in question or for future years, and whether in respect of profits, income or capital gains. Such special circumstances could include, for example, the effect on the tax charge of losses whether utilised or carried forward. This disclosure can be useful in

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* *ie on the total combined result of the 'operating' and 'financing and treasury' sections.*

† *In Great Britain, the Companies Act 1985, Schedule 4 paragraph 54(2).*
In Northern Ireland, the Companies (Northern Ireland) Order, Schedule 4 paragraph 54(2).
In the Republic of Ireland, the Schedule to the Companies (Amendment) Act 1986, paragraph 40(2).

understanding the period's charge or credit in respect of taxation, particularly when there are items of the type specified in other gains and losses.

75 It is recognised that analysing an entity's total taxation charge into the component parts of its result for a period can involve arbitrary allocations that tend to become less meaningful the more components or sections there are. However, for items such as disposal profits or losses, the tax can often be identified with the item concerned and the relationship between the gain or loss and the attributable tax may be significantly different from that in respect of gains or losses arising on items in the operating section and the financing and treasury section. In such circumstances, it is relevant to identify the tax charge or credit more specifically. Disclosure of special circumstances can also be useful in assessing likely future amounts of taxation. Therefore, the [draft] FRS suggests that the information required by companies legislation might be provided in a note that discloses the existence of any special circumstances and quantifies their individual effects.

76 Consistency requires that the tax effects of an extraordinary item should themselves be treated as extraordinary. This principle would apply even where an extraordinary item and its tax effects are recognised in different periods, such as where the tax relief in respect of an extraordinary loss is not recognised until it is utilised in a subsequent period.

SPECIAL INDUSTRIES

77 The [draft] FRS requires a single statement of financial performance, divided into sections to which all gains and losses recognised in the period should be allocated, based on their inherent characteristics as described in the [draft] FRS. This will allow users of the financial statements to consider and give due weight to all the components of performance

of the period. This approach applies to all types of entity, although the precise form in which financial performance is reported will vary for industries and sectors that are subject to special reporting requirements and whose business has unusual features.

78 The [draft] FRS applies to entities that prepare their accounts under (in Great Britain) Schedules 4 and 4A to the Companies Act 1985.* Banking and insurance companies and groups are required under companies legislation to prepare their accounts under different provisions,† which specify special formats for the balance sheet and profit and loss account. In addition, investment companies as defined in companies legislation are the subject of specific requirements.◊ Requirements on the application of the [draft] FRS to reporting entities within these sectors are given in paragraphs 79-87. Subject to those requirements, banking and insurance entities and investment companies, as well as entities in other special industries and sectors whether or not subject to separate statutory requirements, should look to relevant Statements of Recommended Practice (SORPs) for additional guidance on the application of the [draft] FRS.

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* *In Northern Ireland, Schedules 4 and 4A to the Companies (Northern Ireland) Order 1986. In the Republic of Ireland, the Schedule to the Companies (Amendment) Act 1986 and the European Communities (Companies: Group Accounts) Regulations 1992.*

† *In Great Britain, Schedule 9 to the Companies Act 1985 for banking entities and Schedule 9A for insurance entities.*
In Northern Ireland, Schedules 9 and 9A to the Companies (Northern Ireland) Order 1986 for banking and insurance entities respectively.
In the Republic of Ireland, the European Communities (Credit Institutions: Accounts) Regulations 1992 for banking entities and the European Communities (Insurance Undertakings: Accounts) Regulations 1996 for insurance entities.

◊ *In Great Britain, section 266 of the Companies Act 1985.*
In Northern Ireland, Article 274 of the Companies (Northern Ireland) Order 1986.
In the Republic of Ireland, section 47(3), (4) and (7) of the Companies (Amendment) Act 1983.

Banking companies and banking groups

79 Banking companies and banking groups, as defined by companies legislation,* should prepare a single statement of financial performance that includes a section 'other gains and losses'.

80 The draft [frs] does not specify how the upper part of the performance statement should be divided up but it would be consistent with existing practice to show separately:

(a) income and expenses; and

(b) adjustments to provisions.

81 Banking entities operate in a highly regulated sector, and the basis on which they report their performance is more complex than for most other entities. The substantial difference between banking and most other industries is acknowledged in companies legislation by special reporting requirements and formats for banking entities. The reduced specification in paragraph 79 for the performance statement for banking entities satisfies the requirement of the [draft] frs for a single performance statement while taking account of the sector's particular business, regulatory and legal environment. As noted in paragraph 78, further guidance on application of the [draft] frs to banking entities will be included in a SORP.

* *In Great Britain, sections 744 and 255A of the Companies Act 1985.*
In Northern Ireland, the Companies (Northern Ireland) Order 1986, Articles 2(3) and 263A.
In the Republic of Ireland, the Companies (Amendment) Act 1986, section 2(3) and the European Communities (Companies: Group Accounts) Regulations 1992, Regulation 6(2)(a).

Insurance companies and insurance groups

82 **Insurance companies and insurance groups, as defined by companies legislation,* should prepare a single statement of financial performance divided into the following sections:**

(a) technical: general business;

(b) technical: long-term business;

(c) non-technical account; and

(d) other gains and losses.

83 Insurance entities operate in a highly regulated sector, and the basis on which they report their performance is more complex than for most other entities. The substantial difference between the insurance sector and other industries is acknowledged in companies legislation by special reporting requirements and formats for insurance entities. The format required in paragraph 81 for the performance statement for insurance entities satisfies the requirements of the [draft] FRS for a single performance statement while taking account of the sector's particular business, regulatory and legal environment. The operating section and the

* *In Great Britain, sections 744 and 255A of the Companies Act 1985.*
In Northern Ireland, the Companies (Northern Ireland) Order 1986, Articles 2(3) and 263A.
In the Republic of Ireland, the European Communities (Credit Institutions: Accounts) Regulations 1992 and the European Communities (Companies: Group Accounts) Regulations 1992, Regulation 6(2)(g).

financing and treasury section are, in effect, merged and then split into new sections that more appropriately reflect the insurance environment. As noted in paragraph 78, further guidance on application of the [draft] FRS to insurance entities will be included in a SORP.

84 **Insurance entities should report both realised and unrealised investment gains or losses on investments held as part of their investment portfolios in one or more of the following accounts: (a) technical: general business; (b) technical: long-term business; and (c) non-technical account, according to the allocation policy adopted.**

85 For insurance entities, investment returns on investments held as part of the investment portfolios form a particularly important element of their performance. Such investment returns, realised and unrealised, are therefore required to be shown in one or more of the sections (a)-(c) set out in paragraph 81. The allocation policy adopted needs to take into account the requirements of companies legislation and the recommendations of the Statement of Recommended Practice 'Accounting for Insurance Business'.

Investment companies

86 **Investment companies as defined in companies legislation* should prepare a single performance statement with three sections as required by the [draft] FRS:**

(a) operating;

(b) financing and treasury; and

(c) other gains and losses.

Only profits available for distribution should be included in the first two sections of the performance statement.

87 Investment companies are subject to special legal provisions regarding the recording of unrealised capital losses, with the result that their statements of financial performance are not comparable with those of other entities. For investment companies, all recognised gains and losses of a capital nature should be shown in other gains and losses, leaving the first two sections to be confined to revenue profits that are available for distribution. An example of a statement of financial performance for an investment company is given in Appendix I.

CONGLOMERATES

88 **Reporting entities that have a wide range of operating activities should, when preparing consolidated accounts, allocate gains and losses to sections of the performance statement to reflect the performance of the group as a whole, rather than its constituent parts.**

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* *In Great Britain, section 266 of the Companies Act 1985.*
In Northern Ireland, Article 274 of the Companies (Northern Ireland) Order 1986.
In the Republic of Ireland, section 47(3), (4) and (7) of the Companies (Amendment) Act 1983.

89 The requirement to consolidate may, in the case of groups with diverse operating activities, lead to a level of aggregation on the face of the performance statement that users find unhelpful. This should not prevent the proper allocation of gains and losses at a group level. However, such groups should consider the extent to which disaggregated and segmental information should be given to users in the notes to the accounts and possibly on the face of the performance statement.

90 For example, a manufacturing group may own an insurance company. In such circumstances, neither the basic three-section format that would suit a manufacturing company, nor the more complex insurance company format (required in order to satisfy companies legislation, as shown in paragraph 81) is likely to enable the performance of the group as a whole to be reported fairly on the face of the performance statement. The structure of the performance statement may need to be adapted in such circumstances, or additional breakdowns of information may be required. Where guidance on a particular problem of this nature is not provided in either an accounting standard or a SORP, the choice of approach to resolve the issue rests with management, in consultation with the auditors and in consideration of particular statutory obligations and the requirement to show a true and fair view. Nevertheless, a reporting entity should follow the requirements of the [draft] FRS insofar as that is possible.

RECONCILIATION OF OWNERSHIP INTERESTS

91 **A primary statement should be presented reconciling the opening and closing totals of ownership interests of the period. Certain reconciling items, namely the results of the period as reported in the performance statement, dividends for the period (broken down into equity and non-equity dividends as required by FRS 4 'Capital Instruments'), and the cumulative effect of prior period adjustments, should be disclosed separately in the reconciliation.**

92 There are changes in ownership interests, other than those reported in the performance statement, that are important in understanding the change in the entity's financial position over the period. The purpose of the reconciliation of ownership interests is to highlight those other changes. It should be shown as a primary statement, separately from the statement of financial performance.

OTHER INFORMATION

Earnings per share

93 **The earnings figure used to calculate basic earnings per share (which is adjusted for the calculation of diluted earnings per share) should be the combined total of the operating section and the financing and treasury section, after related taxation and minority interests (identified as the statutory format line 'profit for the financial year'), and after deduction of preference dividends as required by FRS 14 'Earnings per Share'.***

94 **If provided, an additional earnings per share figure calculated at any other level of performance should be presented on a consistent basis over time and, wherever disclosed, reconciled to the amount required by FRS 14. Such a reconciliation should list the items for which an adjustment is made and disclose their individual effect on the calculation. The earnings per share required by FRS 14 should be at least as prominent as any additional version presented and the reason for calculating the additional version should be explained. The reconciliation and explanation should appear adjacent to the earnings per share disclosure, or a reference should be given to where they can be found.**

* *FRS 14 is amended accordingly: see paragraph 120.*

95 It is not possible to distil the performance of a complex organisation into a single measure. Undue significance, therefore, should not be placed on any such measure that purports to achieve this aim. To assess the performance of an entity during a period, all components of its activities must be considered. The basic earnings per share figure required by FRS 14 can therefore be used as a starting point for further analysis.

Dividends

96 **Dividends for the period should be shown as memorandum items at the foot of the performance statement, both in total and per share. The information should be given for each class of share as required by FRS 4 'Capital Instruments'.***

Prior period adjustments

97 **Prior period adjustments should be accounted for by restating the comparative figures for the preceding period in the primary statements and notes and adjusting the opening balance of reserves for the cumulative effect. The cumulative effect of the adjustments should also be given as a footnote to the performance statement of the current period. Where practicable, the effect of a prior period adjustment on the results for the preceding period should be disclosed. Where it is not practicable to make this disclosure, that fact, together with the reasons, should be stated.**

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* *FRS 4, paragraph 59. Also see Appendix IV, paragraphs 70 and 71.*

Changes in estimation techniques and changes in accounting policies

98 FRS 18 'Accounting Policies' defines estimation techniques and accounting policies and lays down rules for the treatment of changes to both, such that, in general:

(a) a change to an estimation technique is not accounted for as a prior period adjustment, unless:

(i) it represents the correction of a fundamental error; or

(ii) companies legislation, another accounting standard or a UITF Abstract requires otherwise; and

(b) a change to an accounting policy is treated as a prior period adjustment, unless companies legislation, other accounting standards or UITF Abstracts require otherwise.

*Fundamental errors**

99 **The correction of fundamental errors should be accounted for by prior period adjustment.**

100 Fundamental errors are defined in paragraph 2. In exceptional circumstances it may be found that financial statements of prior periods contain errors that are so significant as to destroy the true and fair view and hence the validity of those financial statements. The correction of such fundamental errors and the cumulative adjustments applicable to prior periods have no bearing on the results of the current period and are therefore not included in arriving

* *As noted in Appendix IV of FRS 18 (paragraph 27), when an FRS is developed from this FRED the Board may decide to transfer to FRS 18 the material on the correction of errors.*

at the results for the current period. They are accounted for by restating prior periods, with the result that the opening balance of retained profits will be adjusted accordingly, and highlighted in the reconciliation of ownership interests. The cumulative adjustments so recognised should be shown as a footnote to the performance statement of the current period, in order to highlight the occurrence of a prior period adjustment.

Comparative figures

101 Comparative figures should be given for all items in the primary statements and such notes thereto as are required by the [draft] FRS. The comparative figures in respect of the performance statement should include in the continuing category only the results of those operations included in the current period's continuing operations.

102 Comparative figures should be given for all items in the primary statements and such notes to them as are required by the [draft] frs. To aid comparison, the comparative figures in respect of the performance statement should be based on the status of an operation in the financial statements of the period under review and should, therefore, include in the continuing category only the results of those operations included in the current period's continuing operations. The comparative figures appearing under the heading 'continuing operations' may include figures that were shown under the heading of acquisitions in that previous period; no reference need be made to the results of those acquisitions, since they are not required to be presented separately in the current period. Where, however, information on acquisitions is provided voluntarily in respect of the first full accounting period, it may be helpful to provide comparative figures for those acquisitions.

103 **Comparative information for prior periods that is presented in financial statements prepared after the initial disclosure event for a discontinuing operation should be restated to segregate continuing and discontinuing assets, liabilities, income, expenses, and cash flows, as required by paragraphs 49-59.**

Note of historical cost gains and losses

104 Where there is a material difference between the result as disclosed in the statement of financial performance and the result on an unmodified historical cost basis, a note of the historical cost gains and losses for the period may be presented if such information would help users to understand the entity's performance. An example format of such a note is shown in Appendix I.

105 A note of historical cost gains and losses is a memorandum item that is an abbreviated restatement of the statement of financial performance, adjusting the reported gains and losses, if necessary, to disregard the effect of any asset revaluations. Adjustments are made for:

(a) gains and losses recognised in prior periods in the statement of financial performance that are realised in the current period: for example, the difference between the profit on the disposal of an asset calculated on depreciated historical cost and that calculated on a revalued amount; and

(b) the difference between a historical cost depreciation charge and the depreciation charge calculated on the revalued amount included in the statement of financial performance of the period.

106 **Where a note of historical cost profits and losses is provided with consolidated financial statements, the performance statement figures for minority interests should be amended for the purposes of the note to reflect the adjustments made where they affect subsidiary companies with a minority interest.**

107 For the purpose of paragraph 105 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) the practice of market-makers and other dealers in investments of marking to market where this is an established industry practice.

DATE FROM WHICH EFFECTIVE AND TRANSITIONAL ARRANGEMENTS

108 **The accounting practices set out in the [draft] FRS should be regarded as standard in respect of accounting periods ending on or after [date to be inserted after exposure]. Earlier adoption is encouraged.**

109 **Comparative figures in the financial statements of the accounting period in which the [draft] FRS is implemented should be restated to comply with the formats and information required in the [draft] FRS.**

WITHDRAWAL OF FRS 3 AND AMENDMENT OF OTHER STANDARDS AND UITF ABSTRACTS

110 **The [draft] FRS supersedes FRS 3 'Reporting Financial Performance' [following publication in final form].**

Amendment of other accounting standards and UITF Abstracts: general *[following publication in final form]*

111 **General references in accounting standards and UITF Abstracts to the profit and loss account statement should be read as references to the statement of financial performance as required by the [draft] FRS.**

112 **Other than as required by the amendments detailed in paragraphs 113-126, the following general rules should be followed:**

(a) Where an accounting standard or a UITF Abstract requires a gain, loss, revenue or expense to be reported, charged or recognised in the profit and loss account, the item should be reported in the operating section of the performance statement in accordance with the [draft] FRS.

(b) Where an accounting standard or a UITF Abstract requires a gain, loss, revenue or expense to be reported in reserves or in the statement of total recognised gains and losses, the item should be reported in other gains and losses in the performance statement under the requirements of the [draft] FRS.

(c) References in accounting standards and UITF Abstracts to the 'reconciliation of shareholders' funds' are replaced by 'reconciliation of ownership interests'.

Amendment of other accounting standards and UITF Abstracts: specific [following publication in final form]

113 **In SSAP 21 'Accounting for leases and hire purchase contracts', the following is added to the end of paragraph 39:**

"The finance charge for each accounting period should be reported in the financing and treasury section of the performance statement."

114 **In SSAP 24 'Accounting for pension costs', the reference in paragraph 81 to** "requirement of paragraph 18 of FRS 3 'Reporting Financial Performance'" **is replaced by** "requirements of FRS 12 'Provisions, Contingent Liabilities and Contingent Assets'"**.**

115 **In SSAP 25 'Segmental reporting':**

(a) the reference to "result" **in paragraph 34(b) is replaced by** "result of the operating section of the performance statement"**;**

(b) the last three sentences of paragraph 34 are replaced by:

"Segment result will normally be restricted to the operating section of the performance statement and consequently net assets will consist of non-interest bearing operating assets less non-interest bearing operating liabilities. However, to the extent that part or all of the contents of the financing and treasury section are included in the segmental analysis, the relevant interest-bearing assets and liabilities should be included in net assets."

116 **FRS 4 'Capital Instruments' is amended as follows:**

(a) The text of paragraph 28 is replaced by:

"The finance costs of debt should be allocated to periods over the term of the debt at a constant rate on the carrying amount. All finance costs should be charged in the financing and treasury section of the performance statement, except in the case of investment companies, which are addressed in paragraph 52."

(b) The text of paragraph 32 is replaced by:

"Gains and losses arising on the repurchase or early settlement of debt should be recognised in the financing and treasury section of the performance statement in the period during which the repurchase or early settlement is made."

(c) In paragraph 43, the last sentence is replaced by:

"All dividends should be reported as appropriations of profit in the reconciliation of ownership interests."

(d) The text of paragraph 44 is replaced by:

"Where the finance costs for non-equity shares are not equal to the dividends the difference should be accounted for in the reconciliation of ownership interests as an appropriation of profits."

117 **In FRS 6 'Acquisitions and Mergers', the words in paragraph 19 from "**as reorganisation**" to the end are deleted.**

118 **FRS 9 'Associates and Joint Ventures' is amended as follows:**

(a) the text of paragraph 22 is replaced by:

"Except for items below operating and financing income before taxation in the performance statement, any supplemental information given for joint ventures, either in the balance sheet or in the performance statement, must be shown clearly separate from amounts for the group and must not be included in the group totals."

(b) after paragraph 26, the headings and paragraphs 27 and 28 are deleted and replaced by:

"*The investor's consolidated performance statement*

27 **The group operating result for the period must be shown on the face of the investor's consolidated performance statement, excluding the investor's share of its associates' operating results and its**

share of the results of its joint ventures, if any. The investor's share of its associates' operating results should be included immediately after group operating result (but after the investor's share of the results of its joint ventures, if any). Any amortisation or write-down of goodwill arising on acquiring the associates should be charged at this point and disclosed. The investor's share of interest and other items reported in the financing and treasury section of the performance statement should be shown separately from the amounts for the group.

28 **At and below the level of operating and financing income before taxation, the investor's share of the relevant amounts for associates should be included within the amounts for the group, although for items below this level, such as taxation, the amounts relating to associates should be disclosed. Where it is helpful to give an indication of the size of the business as a whole, a total combining the investor's share of its associates' turnover with group turnover may be shown as a memorandum item in the profit and loss account but the investor's share of its associates' turnover should be clearly distinguished from group turnover. Similarly, the segmental analysis of turnover and operating profit (if given) should clearly distinguish between that of the group and that of associates.**

28A **The investor's share of other gains and losses reported by its associates should be included, shown separately under each heading, if the amounts included are material, either on the face of the statement or in a note that is referred to in the statement."**

119 In FRS 10 'Goodwill and Intangible Assets', a new heading and new paragraphs are inserted after paragraph 51 as follows:

"Disposal of intangible assets and goodwill

51A Immediately before the disposal of an intangible fixed asset (other than goodwill), a revaluation should be carried out. Any revaluation gains and losses arising should be reported in other gains and losses and impairment losses should be reported in the operating section of the performance statement.

51B The revaluation exercise required by paragraph 51A should be performed on an intangible fixed asset immediately before disposal, whether it is held at historical cost or at a revalued amount. The disposal proceeds, if any, will represent the revaluation amount.

51C Goodwill that is sold will be accounted for as part of the profit or loss on disposal of the related business as required under FRS 3. Any write-down in goodwill that arises without a sale of the related business or company should be written off in the operating section as an impairment loss."

120 In FRS 12 'Provisions, Contingent Liabilities and Contingent Assets', the text of paragraph 48 is amended as follows:

"The unwinding of the discount should be reported in the financing and treasury section of the performance statement. It should be shown adjacent to interest but separately from other interest either on the face of the performance statement or in a note."

121 **FRS 14 'Earnings per Share' is amended as follows:**

(a) paragraphs 9-11 are replaced by:

"9 Basic earnings per share should be calculated by dividing the income from operating and financing activities for the period attributable to ordinary shareholders by the weighted average number of ordinary shares outstanding during the period.

Earnings - basic

10 For the purpose of calculating basic earnings per share, the income from operating and financing activities for the period attributable to ordinary shareholders should be the operating and financing income for the period after deducting dividends and other appropriations in respect of non-equity shares.

11 The income from operating and financing activities for the period attributable to ordinary shareholders is determined after taking account of appropriations in respect of non-equity shares, which include, but are not restricted to, preference dividends as detailed in FRS 4."

(b) other references in the FRS to "net profit or loss for the period" and "net profit" are replaced by "income from operating and financing activities for the period" and "income from operating and financing activities".

122 **In FRS 15 'Tangible Fixed Assets', paragraphs 72 and 73 are replaced by the following:**

"72 Immediately before the disposal of a tangible fixed asset, a revaluation should be carried out and the revaluation gains and losses and impairment losses arising therefrom should be reported according to paragraphs 63-71.

72A Where the revaluation gains or losses calculated in accordance with paragraph 72 are in effect no more than marginal adjustments to depreciation previously charged, they should be reported in the operating section of the performance statement.

73 The revaluation exercise required by paragraph 72 should be performed on a tangible fixed asset immediately before its disposal, whether it is held at historical cost or at a revalued amount. The disposal proceeds, if any, will represent the revaluation amount."

123 FRS 16 'Current Tax' is amended as follows:

(a) paragraphs 5-7 are replaced by the following:

"5 Current tax should be recognised as part of the tax on operating and financing income for the period, except to the extent that it is attributable to a gain or loss that is or has been recognised in 'other gains and losses'.

6 Where a gain or loss is or has been recognised in 'other gains and losses', the attributable tax should be recognised as 'tax on other gains and losses'.

7 In some circumstances it may be difficult to determine the amount of current tax that is attributable to other gains and losses. In such circumstances, the attributable tax is based on a reasonable pro rata allocation, or another allocation that is more appropriate in the circumstances."

(b) the text of paragraph 17 is replaced by the following:

"The following major components of the current tax expense (or income) for the period included in the tax on operating and finance income and the tax on other gains and losses should be disclosed separately:

(a) UK or Republic of Ireland tax (depending on the companies legislation in accordance with which the entity is reporting); and

(b) foreign tax.

Both (a) and (b) should be analysed to distinguish tax estimated for the current period and any adjustments recognised in respect of prior periods. The domestic tax should be disclosed both before and after double taxation relief."

124 **FRS 17 'Retirement Benefits' is amended as follows:**

(a) the text of paragraph 56 is replaced by the following:

"The net of the interest cost and the expected return on assets should be included in the financing and treasury section of the performance statement. It should be shown adjacent to interest but separately from other interest either on the face of the performance statement or in a note."

(b) in paragraph 66, the last sentence is replaced by the following:

"Gains and losses arising from such events are part of the employer's operating results for the period."

(c) paragraphs 71 and 72 are replaced by the following:

"71 When current tax relief arises on contributions made to the defined benefit scheme, it should be allocated to tax on operating and financing income or the tax on other gains and losses on the basis that the contribution covers first the items reported in the operating and financing and treasury sections and then any actuarial losses reported in other gains and losses, unless it is clear that some other allocation is more appropriate. To the extent that the contribution exceeds these items, the current tax relief attributable to the excess should be allocated to the tax on operating and financing income, again unless it is clearly more appropriate to allocate it to the tax on other gains and losses.

72 Current tax relief is usually available on contributions paid to the scheme and deferred tax usually arises on the balance of the charges/credits. The tax follows the relevant item, ie tax on the service cost, interest cost and expected return on assets will be recognised in the tax on operating and financing income and tax on the actuarial gains and losses will be recognised in the tax on other gains and losses. FRS 16 'Current Tax' requires disclosure of the current tax recognised as taxation on operating and financing income and other gains and losses. The question arises of where the current tax relief arising on contributions should be deemed to belong. Sometimes it will be clear what the contribution relates to, for example when a special contribution is made to fund a deficit arising from an identifiable cause, say an actuarial loss, in which case the current tax relief should be allocated to the tax on other gains and losses. In the absence of a clear link between the contribution and the items recognised in the performance statement, the allocation in paragraph 71 should be followed."

(d) paragraph 83 is deleted.

125 FRS 19 'Deferred Tax' is amended as follows:

(a) after paragraph 33, the heading and paragraphs 34-36 are replaced by the following:

"RECOGNITION IN THE PERFORMANCE STATEMENT

34 Deferred tax should be recognised as part of the tax on operating and financing income for the period, except to the extent that it is attributable to a gain or loss that is or has been recognised in 'other gains and losses'.

35 Where a gain or loss is or has been recognised in 'other gains and losses', attributable deferred tax should be recognised as 'tax on other gains and losses'.

36 In some circumstances it may be difficult to determine the amount of deferred tax that is attributable to other gains and losses. In such circumstances, the attributable deferred tax is based on a reasonable pro rata allocation, or another allocation that is more appropriate in the circumstances."

(b) The text of paragraph 60 is replaced by:

"The notes to the financial statements should disclose the amount of deferred tax charged or credited within:

(a) tax on operating and financing income, separately disclosing material components, including those attributable to: [(i) and (ii) remain unchanged] ...

(b) tax charged or credited on other gains and losses, separately disclosing material components, including those listed in (a) above."

(c) In paragraph 61(c) the reference to the "profit and loss account" should be replaced by a reference to "tax on operating and financing income" and the phrase "directly in the statement of total recognised gains and losses" should be replaced by "in tax on other gains and losses".

(d) The text of paragraph 64(a) is replaced by:

"a reconciliation of the current tax charge or credit for the period reported in 'tax on operating and financing income' to the current tax charge that would result from applying a relevant standard rate of tax to the reported operating and financing income. Either the monetary amounts or the rates (as a percentage of operating and financing income) may be reconciled.

126 **In UITF Abstract 13 'Accounting for ESOP Trusts', paragraph 8(g) is replaced by:**

"8(g) Any dividend income arising on the shares should not be recognised in the performance statement, but should be deducted from dividends for the period in the reconciliation of ownership interest. The deduction should be shown on the face of the reconciliation, if material, or in a note. Until such time as the shares vest unconditionally in employees, the shares should also be excluded from earnings per share calculations as, under FRS 14 'Earnings per Share', they are treated as if they were cancelled."

APPENDIX I

ILLUSTRATIVE EXAMPLE

The example set out in this appendix is provided for general guidance only and does not form part of the [draft] FRS.

The example on pages 66–75 includes two statements of financial performance, a reconciliation of ownership interest and certain related notes that are required or suggested by the [draft] FRS. The following matters should be noted:

- the entity is a group of companies.
- the group has made acquisitions and disposals of operations during the year under review.
- the statements of financial performance include the disclosure of earnings per share numbers and a pro-forma reconciliation statement for adjusted earnings per share numbers is shown.
- dividends for the period and the cumulative effect of prior period adjustments are shown at the foot of the performance statements.

The (first two sections of the) performance statements have been prepared using Format 1 as contained (for Great Britain) in Schedule 4 to the Companies Act 1985.*
Equivalent information should be shown if any of the other statutory formats are used.

The example shown on pages 74 and 75 is one of a Companies Act investment company.

* *In Northern Ireland, Format 1 in Schedule 4 to the Companies (Northern Ireland) Order 1986.*
In the Republic of Ireland, Format 1 in the Schedule to the Companies (Amendment) Act 1983.

APPENDIX I EXAMPLE FORMATS AND NOTES

STATEMENT OF FINANCIAL PERFORMANCE (Example 1)

	2001		2000 Restated
	£m	£m	£m
Operating			
Turnover			
Continuing operations	600		525
Acquisitions	50		
	650		
Discontinued operations	175		190
		825	715
Cost of sales		(650)	(570)
Gross profit		175	145
Net operating expenses		(124)	(93)
Operating profit			
Continuing operations	60		40
Acquisitions	6		
	66		
Discontinued operations	(15)		12
Operating income/profit		**51**	**52**
Financing and treasury			
Interest on debt		(26)	(15)
Financing relating to pension provision		20	11
Financing and treasury income/profit		**(6)**	**(4)**
Operating and financing income before taxation		**45**	**48**
Taxation on operating and financing income		(5)	(10)
Operating and financing income after taxation		40	38

Minority interests	(5)	(4)
Income from operating and financing activities for the period*	**35**	**34**
Other gains and losses		
Revaluation gain on disposal of properties in continuing operations	6	4
Revaluation of fixed assets	4	3
Actuarial gain on defined benefit pension scheme	276	91
Profit on disposal of discontinued operations	3	-
Exchange translation differences on foreign currency net investments	(2)	5
Other gains and losses before taxation	**287**	**103**
Taxation on other gains and losses	(87)	(33)
Other gains and losses after taxation	200	70
Minority interests	(30)	(10)
Other gains and losses of the period	**170**	**60**
Total gains and losses of the period	**205**	**94**
MEMORANDUM ITEMS		
Earnings per share	39p	41p
Adjustments [to be itemised and described]	Xp	Xp
Adjusted earnings per share	Yp	Yp
Diluted earnings per share	Zp	Zp
Dividend per share: equity	3.0p	1.8p
preference	0.6p	0.6p
Total dividend for the period: equity	£6.7m	£0.7m
preference	£1.3m	£1.3m
Prior period adjustment recognised during the period (see note X)	(£10m)	-

*Any extraordinary items would be shown after this line, with a subsequent subtotal for the statutory 'profit for the financial year' after extraordinary activities.

STATEMENT OF FINANCIAL PERFORMANCE (Example 2)

	Continuing operations 2001	Continuing operations Acquisitions 2001	Discontinued operations 2001	Total 2001	Total 2000 restated
Operating	£m	£m	£m	£m	£m
Turnover	600	50	175	825	690
Cost of sales	(445)	(40)	(165)	(650)	(555)
Gross profit	155	10	10	175	135
Other expenses	(95)	(4)	(25)	(124)	(83)
Operating income/ profit	**60**	**6**	**(15)**	**51**	**52**
Financing and treasury					
Interest on debt				(26)	(15)
Financing relating to pension provision				20	11
Financing and treasury income/profit				**(6)**	**(4)**
Operating and financing income before taxation				**45**	**48**
Taxation on operating and financing income				(5)	(10)
Operating and financing income after taxation				40	38
Minority interests				(5)	(4)
Income from operating and financing activities for the period*				**35**	**34**
Other gains and losses					
Revaluation gain on disposal of properties in continuing operations				6	4
Revaluation of fixed assets				4	3
Actuarial gain on defined benefit pension scheme				276	91

Profit on disposal of discontinued operations	3	-
Exchange translation differences on foreign currency net investments	(2)	5
Other gains and losses before taxation	**287**	**103**
Taxation on other gains and losses	(87)	(33)
Other gains and losses after taxation	200	70
Minority interests	(30)	(10)
Other gains and losses of the period	**170**	**60**
Total gains and losses of the period	**205**	**94**
MEMORANDUM ITEMS		
Earnings per share	39p	41p
Adjustments [to be itemised and described]	Xp	Xp
Adjusted earnings per share	Yp	Yp
Diluted earnings per share	Zp	Zp
Dividend per share: equity	3.0p	1.8p
preference	0.6p	0.6p
Dividend for the period: equity	£6.7m	£0.7m
preference	£1.3m	£1.3m
Prior period adjustment recognised during the period (see note X)	(£10m)	-

*Any extraordinary items would be shown after this line, with a subsequent subtotal for the statutory 'profit for the financial year' after extraordinary activities.

RECONCILIATION OF OWNERSHIP INTERESTS

	2001	2000 as restated
	£m	£m
Recognised gains and losses relating to the period	205	94
Dividends	(8)	(2)
	197	92
New share capital subscribed	20	1
Net addition to ownership interests	217	93
Opening shareholders' funds (originally £517m before deduction of £10m prior period adjustment)	508	415
Closing ownership interests	725	508

NOTES TO THE FINANCIAL STATEMENTS

Note required in respect of Example 1

	2001			2000 (as restated)		
	Continuing	Discontinued	Total	Continuing	Discontinued	Total
	£m	£m	£m	£m	£m	£m
Cost of sales	485	165	650	400	170	570
Net operating expenses						
Distribution costs	61	13	74	51	5	56
Administrative expenses	46	12	58	39	3	42
Other operating income	(8)	0	(8)	(5)	0	(5)
	99	25	124	85	8	93

The total figures for continuing operations in 2001 include the following amounts relating to acquisitions: cost of sales £40m and net operating expenses £4m (namely distribution costs £3m, administrative expenses £3m and other operating income £2m).

Note required in respect of Example 2

	2001			2000 (as restated)		
	Continuing	Discontinued	Total	Continuing	Discontinued	Total
	£m	£m	£m	£m	£m	£m
Turnover				525	190	715
Cost of sales				400	170	570
Net operating expenses						
Distribution costs	61	13	74	51	5	56
Administrative expenses	46	12	58	39	3	42
Other operating income	(8)	0	(8)	(5)	0	(5)
	99	25	124	85	8	93
Operating profit				40	12	52

The total figure for net operating expenses for continuing operations in 2001 includes £4m in respect of acquisitions (namely distribution costs £3m, administrative expenses £3m and other operating income £2m).

Reserves

	Share premium account	Revaluation reserve	Profit and loss account Excluding pension asset	Profit and loss account Pension reserve	Total
	£m	£m	£m	£m	£m
At beginning of period as previously stated	44	200	120	143	507
Prior period adjustment			(10)		(10)
At beginning of period as restated	44	200	110	143	497
Premium on issue of shares (NV £7m)	13				13
Transfer from performance statement					
Operating and financing			35		35
Other gains and losses		4	(27)	193	170
Dividends paid and payable			(8)		(8)
Transfer of realised profits		(14)	14		0
At end of period	57	190	124	336	707

Note: Nominal share capital at end of period £18m (2000 £11m)

Five-year information on exceptional items

	2001	2000	1999	1998	1997
	£m	£m	£m	£m	£m
Exceptional items					
Restructuring costs					
Redundancy payments	(5)				
Loyalty bonuses	(1)				
IT integration and upgrade costs	(2)			(2)	
Rebranding	(3)				
Inventory obsolescence write-down	(1)	(4)		(3)	
VAT refund				21	
Total exceptional items reported	(12)	(4)	0	16	0

Operating and financing					
Pre-exceptional result	47	38	27	29	31
Post-exceptional result	35	34	27	45	31
Other gains and losses	170	60	145	(35)	(71)
Total result	205	94	172	10	(40)

Note: the shaded area denotes the information required by the [draft] FRS (paragraph 63).

Tax effects of items in other gains and losses (optional)

	Pre-tax Amount £m	**Tax (expense)/ benefit £m**	**Post-tax Amount £m**
Revaluation gain on disposal of properties	6.0	(1.3)	4.7
Revaluation of long-term assets	4.0	(1.2)	2.8
Actuarial gain on defined benefit pension scheme	276.0	(84.0)	192.0
Profit on disposal of discontinued operations	3.0	(1.0)	2.0
Exchange translation differences	(2.0)	0.5	(1.5)
	287.0	(87.0)	200.0

Note of historical cost gains and losses (optional)

	2001	2000 as restated
	£m	£m
Gains and losses arising in period as reported		
Operating	51	52
Financing and treasury	(6)	(4)
Other gains and losses	287	103
	332	151
Add back:		
Revaluation surplus recognised	(4)	(3)
Exchange translation differences on foreign currency net investments	2	(5)
	330	143
Realisation of property revaluation gains of previous periods	9	10
Difference between a historical cost depreciation charge and the actual depreciation charge of the period calculated on the revalued amount	5	4
Historical cost gains and losses for the period	344	157

COMPANIES ACT INVESTMENT COMPANY

	2001	2000
	£m	£m
Operating		
Revenues	35	30
Expenses	(11)	(10)
Operating income/profit	**24**	**20**
Financing and treasury		
Interest payable	(5)	(7)
Financing and treasury income/profit	**(5)**	**(7)**

Operating and financing income before taxation	**19**	**13**
Taxation on income	(4)	(3)
Operating and financing income after taxation	15	10
Minority interests	(1)	(1)
Income from operating and financing activities for the period	**14**	**9**
Other gains and losses		
Capital profit on investments		
Realised gains and losses	52	70
Unrealised gains and losses	138	75
	190	145
Tax	(16)	(22)
Minority interest	(1)	(4)
	173	119
Unrealised surplus on revaluation of tangible fixed assets	4	2
Other gains and losses for the period	**177**	**121**
Total gains and losses arising in the period	**191**	**130**
Distributable profits		
Revenue profit available for distribution	14	9
Dividends	(13)	(8)
Transfer to distributable reserves	1	1
Non-distributable profits		
Transfer to non-distributable reserves	177	121
	178	122

APPENDIX II

NOTE ON LEGAL REQUIREMENTS

GREAT BRITAIN

1 The relevant statutory requirements are set out in the Companies Act 1985. The requirements of Schedules 4 and 4A to the Act relating to the form and content of company and group financial statements set out formats for the profit and loss account, allowing some flexibility in the manner in which the information is presented. The provisions of the [draft] FRS supplement those legal requirements, while remaining within their bounds.*

2 Schedule 4 does not apply to banking and insurance companies and groups. Banking companies and groups are dealt with in Schedule 9 and insurance companies and groups are dealt with in Schedule 9A. The requirements of these entities are addressed separately by the [draft] FRS, along with investment companies as defined by the Act (see paragraphs 77-87 of the [draft] FRS).

The requirement to present a profit and loss account

3 Section 226 of the Act requires the following (subsections in brackets):

(a) The directors of every company to prepare a profit and loss account (1)(b).

(b) The profit and loss account to give a true and fair view of the profit or loss of the company for the financial year (2).

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* *Subject to the discussion on dividends in paragraphs 24-26, which refer to Schedule 4, Part I, paragraph 3(5).*

(c) The form and content to comply with the Schedule 4 formats (3).

(d) Additional information to be given if necessary to show a true and fair view (4).

(e) Departure from the provisions if necessary to show a true and fair view (5).

4 The [draft] FRS is consistent with section 226 of the Act in that the first two sections of the single performance statement (ie the 'operating' section and the 'financing and treasury' section, with the subsequent subtotals and related tax charge) represent the statutory profit and loss account.

5 One tax figure is given for these two sections, allowing 'profit before tax' and 'profit after tax' figures to be disclosed, as required by Schedule 4, paragraph 3(6):

> "Every profit and loss account of a company shall show the amount of the company's profit or loss on ordinary activities before taxation."

The format of the profit and loss account

6 Schedule 4, Part I, paragraphs 1-3 state that the profit and loss account should show the items listed in any one of the given profit and loss account formats in the order and under the headings and subheadings given in the format adopted, and:

(a) once a format is adopted, it should be followed consistently (paragraph 2(1));

(b) in relation to (a), any change in the format adopted in preparing a profit and loss account should be disclosed, with reasons (paragraph 2(2));

(c) any item may be shown in greater detail than required by the format adopted (paragraph 3(1));

(d) any additional item may be shown that is not given in the formats (paragraph 3(2));

(e) the arrangement, headings and subheadings which are assigned an Arabic number in the format adopted should be adapted where required by the special nature of the company's business (paragraph 3(3));

(f) items assigned Arabic numbers may be combined if not material, or the combination facilitates assessment by the reader (with additional note disclosure) (paragraph 3(4)); and

(g) the profit and loss account must show the company's profit or loss on ordinary activities before taxation (paragraph 3(6)).

7 Paragraph 4 requires comparatives to be given, restated as necessary for comparability.

8 The [draft] FRS requires a format for a single performance statement that appears different in some respects from the requirements of the Act. However, the Board believes that the legislation offers a substantial amount of flexibility in the formats of the profit and loss account in the way that line items can be expanded or merged.*

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* *Subject to the discussion on dividends in paragraphs 24-26, which refer to Schedule 4, Part I, paragraph 3(5).*

Reporting revaluation gains and losses on fixed assets

9 A revaluation gain is required by the [draft] FRS to be recognised in other gains and losses in the single statement, unless it reverses a previous revaluation loss that has been recognised in the operating section (ie within the statutory profit and loss account). This requirement is consistent with paragraph 34(1) of Schedule 4, which requires the "amount of any profit" (ie gain) "or loss" calculated under the alternative accounting rules to be "credited to a separate reserve (the revaluation reserve)". The requirement for a revaluation gain to be recognised in the operating section (ie within the statutory profit and loss account) to the extent that it reverses a revaluation loss previously recognised in the operating section is consistent with paragraph 34(3) of Schedule 4, which explicitly authorises transfers to take place between the revaluation reserve and the profit and loss account provided that the relevant amount was previously charged to that account.

10 The [draft] FRS requires all revaluation losses that are clearly due to the consumption of economic benefits to be recognised in the operating section. This requirement is consistent with paragraph 19(2) of Schedule 4, which requires provisions for depreciation or permanent diminution in value to be recognised in the profit and loss account.

11 For other revaluation losses where it can be demonstrated that the recoverable amount of the asset is greater than its revalued amount, the [draft] FRS requires the difference between recoverable amount and revalued amount to be recognised in 'other gains and losses'. In this situation there has been no permanent diminution in value under paragraph 19(2) of Schedule 4 and therefore the loss can remain in the revaluation reserve in accordance with paragraph 34(1) of Schedule 4.

12 For other revaluation losses, where it cannot be demonstrated that the recoverable amount of the asset is greater than its revalued amount, an impairment loss arises. Where a fixed asset is impaired, it will always be the case that both the value in use and the net realisable value will be below the carrying amount. In the case of a revalued fixed asset, it would be reasonable to reflect the uncertainty as to the permanence of any impairment by treating it as a reversal of any revaluation previously recognised. Such an impairment would be dealt with through other gains and losses (ie as a revaluation reserve movement). However, if the impairment results in a carrying amount below depreciated historical cost, then, as in a pure historical cost context, it would be reasonable to treat that part of the impairment as being of a permanent nature and charge it to the operating section (ie within the statutory profit and loss account).

Reporting disposal gains and losses on fixed assets

13 The [draft] FRS requires disposal gains and losses on fixed assets to be reported in the same way as revaluation gains and losses and impairment losses on fixed assets. All companies are therefore required by the [draft] FRS (through its amendment of FRS 15) to use the alternative accounting rules (Schedule 4, Part II, paragraphs 29-34) immediately before the disposal of fixed assets, where the known sales proceeds represent the revaluation amount. Any loss will be assessed as an impairment or revaluation loss as required by FRS 15. Those companies that have a policy of revaluing assets are merely required to extend that policy to the disposal transaction.

14 Companies that carry fixed assets at depreciated historical cost should apply the alternative accounting rules for one transaction only, ie the disposal of the asset. The Act makes no reference to any consistency of application of the alternative accounting rules in this context. Indeed, selective

application of the alternative accounting rules has been carried out for many years by companies, a practice only recently outlawed by FRS 15. The Board is therefore of the view that there is no impediment to the use of the alternative accounting rules in the manner adopted in the [draft] FRS.

The profit and loss account and realised profits

15 In Schedule 4, paragraph 12 states that:

> "The amount of any item shall be determined on a prudent basis, and in particular—
>
> (a) only profits realised at the balance sheet date shall be included in the profit and loss account; and
>
> (b) all liabilities and losses which have arisen or are likely to arise in respect of the financial year to which the accounts relate or a previous financial year shall be taken into account, including those which only become apparent between the balance sheet date and the date on which it is signed on behalf of the board of directors in pursuance of section 233 of this Act."

16 Section 262(3) states that:

> "References in this Part to "realised profits" and "realised losses", in relation to a company's accounts, are to such profits or losses of the company as fall to be treated as realised in accordance with principles generally accepted, at the time when the accounts are prepared, with respect to the determination for accounting purposes of realised profits or losses."

17 The Board's view is that it does not follow from the legislation regarding the availability for distribution of accumulated profits and losses that all realised profits and all realised losses must be reported in the statutory profit and loss account statement (under the proposals of the [draft] FRS, the operating section and the financing and treasury section, including the related taxation charge) for either the current or another period; it may be sufficient to adjust the retained profit and loss reserves instead.[*]

Realised profits and the statutory profit and loss account

18 Under the [draft] FRS, some realised profits will bypass the statutory profit and loss account, in particular the disposal gains on fixed assets. The Board believes that this is an acceptable practice under the law: there are transactions in financial reporting under which gains previously recognised outside the profit and loss account are not reported therein once realised:

(a) Under SSAP 20, on disposal of an investment in a foreign subsidiary, foreign exchange translation gains built up through reserves over time that are now realised are not reported in the profit and loss account.

(b) Under FRS 15 (and FRS 3), when a revalued asset is sold at more than book value, the revaluation gain, although realised, is not reported in the profit and loss account.[†]

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* *See Appendix IV 'The development of the FRED', paragraph 26.*

† *As noted in paragraphs 9-12, this situation will be extended to all gains on disposal through the requirement to carry out 'deathbed' revaluations for assets whether held at historical cost or at revalued amounts.*

(c) As in (b), the same applies to investment properties under SSAP 19.

(d) Under FRS 17, actuarial gains previously recognised in the statement of total recognised gains and losses are not reported again in the profit and loss account when realised.

(e) Gains representing the cumulative effect of prior period adjustments are not reported in the current period profit and loss account, but are shown as a movement on reserves (and hence within the statement of total recognised gains and losses under FRS 3).

19 The realisation of such gains is generally accounted for by a transfer in reserves between the undistributable reserve where the amounts previously recognised have been recorded (such as the revaluation reserve) and the profit and loss account reserve.

20 The [draft] FRS does not propose that any gains that are unrealised should be taken to the statutory profit and loss account.

Realised losses and the statutory profit and loss account

21 Paragraph 12(b) of Schedule 4 requires all liabilities and losses to be taken into account but does not state that they must taken into account in the profit and loss account. Indeed it would clearly be impossible for liabilities to be taken into account in the profit and loss account. Further, the relevant part of the Fourth Directive (Article 31, paragraph 1(c)(bb)) from which this requirement is taken also makes no reference to the profit and loss account.

22 Again, there are transactions in financial reporting under which losses recognised outside the profit and loss account are not reported therein even when realised:

(a) Under SSAP 20, on disposal of an investment in a foreign subsidiary, foreign exchange translation losses built up through reserves over time that are now realised are not reported in the profit and loss account.

(b) Under FRS 15 (and FRS 3), when an asset that has been revalued downwards (but is not impaired under FRS 11) is sold at book value, the previously recognised revaluation loss, although realised, is not reported in the profit and loss account.*

(c) As in (b), the same applies to investment properties under SSAP 19.

(d) Under FRS 17, actuarial losses previously recognised in the statement of total recognised gains and losses are not reported again in the profit and loss account when realised.

(e) Losses representing the cumulative effect of prior period adjustments are not reported in the current period profit and loss account, but are shown as a movement on reserves (and hence within the statement of total recognised gains and losses under FRS 3).

* *As noted in paragraphs 9-12, this situation will be extended to all revaluation losses on disposal through the requirement to carry out 'deathbed' revaluations for assets whether held at historical cost or at revalued amounts. However, any losses representing impairment losses will be reported in the profit and loss account.*

23 Thus, 'taking into account' does not necessarily require that all these gains and losses should be reported in the statutory profit and loss account statement for a period; they can instead be shown as a movement on reserves (ie in other gains and losses in the proposed single performance statement).

Dividends

24 The [draft] FRS states that dividends should not be treated as items of financial performance, but rather as appropriations of profit. They would therefore not be shown in the single statement of financial performance, either within or outside the identified statutory profit and loss account.

25 The Fourth Directive does not require dividends to be shown on the face of the profit and loss account, or even disclosure of such information by way of a note. However, Article 6 gives authority for Member States to do so. The Act duly takes up the authority and requires dividends (and amounts set aside to or withdrawn from reserves) to be shown on the face of the profit and loss account:

> "(7) Every profit and loss account of a company shall show separately as additional items—
>
> (a) any amount set aside or proposed to be set aside to, or withdrawn or proposed to be withdrawn from, reserves;
>
> (b) the aggregate amount of any dividends paid and proposed;
>
> (c) if it is not shown in the notes to the accounts, the aggregate amount of any dividends proposed." (Schedule 4, paragraph 3(7))

26 As explained in Appendix IV 'The development of the FRED', the Board has approached the Department of Trade and Industry to request an amendment to the Companies Act in this respect.

Taxation

27 In Schedule 4, paragraph 54(2) states that:

> "Particulars shall be given of any special circumstances which affect liability in respect of taxation of profits, income or capital gains for the financial year or liability in respect of taxation of profits, income or capital gains for succeeding financial years."

28 The Board's view is that the requirements of the [draft] FRS in relation to taxation are consistent with the law.

Groups

29 Schedule 4A states that:

> "15 Where during the financial year there has been a disposal of an undertaking or group which significantly affects the figures shown in the group accounts, there shall be stated in a note to the accounts—
>
> (a) the name of that undertaking or, as the case may be, of the parent undertaking of that group, and

(b) the extent to which the profit or loss shown in the group accounts is attributable to profit or loss of that undertaking or group.

16 The information required by paragraph .. 15 above need not be disclosed with respect to an undertaking which—

(a) is established under the law of a country outside the United Kingdom, or

(b) carries on business outside the United Kingdom,

if in the opinion of the directors of the parent company the disclosure would be seriously prejudicial to the business of that undertaking or to the business of the parent company or any of its subsidiary undertakings and the Secretary of State agrees that the information should not be disclosed."

30 The Board's view is that the requirements of the [draft] FRS in relation to disposals of operations are consistent with the law.

Banking companies and banking groups

31 Under the proposals in the [draft] FRS in relation to banking entities, the first three sections of the performance statement represent the statutory profit and loss account as required by Schedule 9.

Insurance companies and insurance groups

32 Under the proposals in the [draft] FRS in relation to insurance entities, the first three sections of the performance statement represent the statutory profit and loss account as required by Schedule 9A.

Investment companies

33 Section 266 states:

> "(1) In section 265 "investment company" means a public company which has given notice in the prescribed form (which has not been revoked) to the registrar of companies of its intention to carry on business as an investment company, and has since the date of that notice complied with the requirements specified below.
>
> (2) Those requirements are—
>
> (a) that the business of the company consists of investing its funds mainly in securities, with the aim of spreading investment risk and giving members of the company the benefit of the results of the management of its funds,
>
> (b) that none of the company's holdings in companies (other than those which are for the time being in investment companies) represents more than 15 per cent by value of the investing company's investments,
>
> (c) that subject to subsection (2A), distribution of the company's capital profits is prohibited by its memorandum or articles of association,
>
> (d) that the company has not retained, otherwise than in compliance with this Part, in respect of any accounting reference period more than 15 per cent of the income it derives from securities.

(2A) An investment company need not be prohibited by its memorandum or articles from redeeming or purchasing its own shares in accordance with section 160 or 162 in Chapter VII or Part V out of its capital profits."

34 Paragraphs 86 and 87 of the [draft] FRS require investment companies to report performance so as to comply with these statutory requirements.

NORTHERN IRELAND

35 The statutory requirements in Northern Ireland are set out in the Companies (Northern Ireland) Order 1986. Those requirements are identical to the legislation for Great Britain cited above.

REPUBLIC OF IRELAND

36 The statutory requirements in the Republic of Ireland that correspond to those cited above for Great Britain are shown in the following table.

Great Britain	*Republic of Ireland*
Companies Act 1985:	
section 226	section 3(1) of the Companies (Amendment) Act 1986
section 262(3)	paragraph 72 of the Schedule to the Companies (Amendment) Act 1986
section 266	section 47(3), (4) and (7) of the Companies (Amendment) Act 1983

Schedule 4	The Companies (Amendment) Act 1986:
paragraph 1	section 4(1) and (2)
paragraph 2	section 4(3) and (4)
paragraph 3(1)	section 4(5)
paragraph 3(2)	section 4(12)
paragraph 3(3)	section 4(13)
paragraph 3(4)	section 4(6) and (7)
paragraph 3(5)	section 4(9)
paragraph 3(6)	section 4(14)
paragraph 3(7)	section 4(15)
paragraph 4	section 4(8)
paragraph 12	section 5(c)
	The Schedule
paragraph 19(2)	paragraph 7(2)
paragraphs 29-34	paragraphs 17-22
paragraph 34(1)	paragraph 22(1)
paragraph 34(3)	paragraph 22(4)
paragraph 54(2)	paragraph 40(2)
Schedule 4A	European Communities (Companies: Group Accounts) Regulations 1992

paragraphs 15 and 16	No direct equivalent: however, paragraph 27 of the European Communities (Companies: Group Accounts) Regulations 1992 states: "If the composition of the undertakings dealt with in the group accounts has changed significantly in the course of a financial year, the group accounts must include information which makes the comparison of successive sets of group accounts meaningful."
Schedule 9	European Communities (Credit Institutions: Accounts) Regulations 1992
Schedule 9A	European Communities (Insurance Undertakings: Accounts) Regulations 1996

APPENDIX III

COMPLIANCE WITH INTERNATIONAL ACCOUNTING STANDARDS

1 The requirements relating to reporting financial performance are included in the following International Accounting Standards (IASs):

(a) IAS 1 (revised 1997) 'Presentation of Financial Statements';

(b) IAS 8 (revised 1993) 'Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies';

(c) IAS 35 'Discontinuing Operations'; and

(d) IAS 33 'Earnings per Share'.

2 The treatment of disposal gains and losses in IAS 16 'Property, Plant and Equipment' is also relevant as the [draft] FRS revises FRS 15 'Tangible Fixed Assets' in some respects.

3 The approach to reporting financial performance is more developed in the UK and the Republic of Ireland than under IASs. Nevertheless, the [draft] FRS is broadly consistent with the relevant IASs. The main differences are of emphasis and are as follows.

Presentation of primary statements

4 IAS 1 requires the presentation of an income statement and a separate statement of changes in equity; the latter includes the net profit or loss for the period as reported in the income statement, but it is not described as a performance

statement. In contrast, the [draft] FRS requires all gains and losses to be reported in a single primary performance statement. The [draft] FRS structures the statement into sections and sets out requirements for the allocation of gains and losses to those sections. IAS 1 offers no particular order or groupings for gains and losses (only minimum disclosures on the face of the income statement) and no rationale as to why some gains and losses are reported in the income statement while some are reported in equity.

5 IAS 1 allows information that reconciles ownership interests between the beginning and end of the period to be disclosed in either a primary statement (of changes in equity) or the notes to the accounts. The [draft] FRS requires a reconciliation of ownership interests as a primary statement in its own right.

Extraordinary items and ordinary activities

6 In the [draft] FRS, the definition of extraordinary items is so restrictive and that of ordinary activities so wide that extraordinary items are, to all intents and purposes, non-existent. IAS 8 is not as specific in this respect.

Discontinuing operations

7 The [draft] FRS defines discontinuing operations in the same way as IAS 35. The IAS 35 definition of the initial disclosure event for classification of operations as discontinuing has been adapted by the [draft] FRS. For a termination to be classified as a discontinuing operation, as well as the provision of a detailed plan and the announcement of the plan, the actions of the reporting entity must have raised a valid expectation in those affected that it will carry out the termination. This will only occur if the plan is carried out within a reasonable timeframe.

Reporting disposal gains and losses on fixed assets

8 The [draft] FRS requires that, under its approach to reporting financial performance, disposal gains and losses on fixed assets should be reported in the same way as revaluation gains and losses and impairment losses. The result is that gains on disposal (that are not reversals of previous impairments) and losses on disposal (that are not impairments), will be reported in other gains and losses (while impairments and their reversal will be reported in the operating section). An amendment to FRS 15 that would adopt this approach is included in the [draft] FRS. IAS 16 requires gains or losses on disposal to be reported as income or expense in the income statement for the period, while revaluation gains (that are not reversals of previous impairments) and revaluation losses (that are not impairments) are reported directly in changes in equity.

APPENDIX IV

THE DEVELOPMENT OF THE FRED

Background

History

1 In the UK and the Republic of Ireland, reporting financial performance is governed by FRS 3 'Reporting Financial Performance', which was issued in October 1992. FRS 3 superseded SSAP 6 'Extraordinary items and prior year adjustments', which was originally developed by one of the Board's predecessor bodies, the former Accounting Standards Steering Committee, and issued in 1974.

SSAP 6

2 Although SSAP 6 was revised several times, there were problems with its interpretation in practice, particularly in respect of the variety of treatments of apparently similar events as either ordinary or extraordinary items in the profit and loss account. Users of financial statements, as well as many preparers and auditors, pressed for further change.

3 The Board responded by proposing a radical change to the presentation of financial performance both in the profit and loss account itself and for items passing through reserves. This culminated in the issue of FRS 3.

FRS 3

4 The Board's aim in FRS 3 was to shift the emphasis away from a single performance indicator. The Board believed then (as it does now) that the performance of complex organisations cannot be summarised in a single number. FRS 3 therefore follows an 'information set' approach that highlights a range of important components of performance. One of the main developments it introduced was an additional performance statement—the statement of total recognised gains and losses—which brings together all the gains and losses recognised by a reporting entity. It was acknowledged at the time that this approach inevitably meant that financial statements would sometimes appear more complex than they did under SSAP 6. However, it was widely accepted that certain totals in the profit and loss account, such as profit before tax and earnings per share, had been used too simplistically and had obscured the significance of relevant underlying components of financial performance. The presentation and disclosure requirements introduced by FRS 3 have provided a framework that has facilitated the analysis and interpretation of the various aspects of performance.

5 In contrast to SSAP 6, earnings per share under FRS 3 is more inclusive, with the result that significant variations from one period to another or the absence of expected variations, whatever the cause, demand some explanation. However, the FRS also gives preparers of financial statements the opportunity to present additional versions of earnings per share provided that (a) the assumptions on which they are based are explicitly disclosed, (b) the reasons for presenting the additional versions are explained and (c) there is consistency in the approach adopted. Preparers have taken advantage of this so that, although earnings per share has tended to be more volatile than under SSAP 6 (because, for example, it includes all restructuring profits and losses), FRS 3 has facilitated both management explanation and user assessment of earnings per share by requiring the provision of a range of relevant information.

Reasons for a review of FRS 3

6 The Board believes that FRS 3 was an important step towards providing users with information in a form designed to assist a mature understanding and analysis of financial performance. It is for users to identify particular components that they regard as significant in varying circumstances. This is a feature of the 'information set' approach. For the reasons stated above, it is not appropriate for users to fasten on to any 'headline' number on the face of the profit and loss account or statement of total recognised gains and losses without considering the number's composition. Using the information required by FRS 3, either on the face of the financial statements or in the notes, users may adapt any headline number to give the performance measure required.

7 Despite the success of FRS 3, by 1997 the Board concluded that a revision of the standard was appropriate for the following reasons:

(a) The FRS had been in place for a while and a review was timely, in accordance with paragraph 33 of the Foreword to Accounting Standards.

(b) The draft Statement of Principles for Financial Reporting was under development, which gave the Board the opportunity to reconsider its approach to reporting financial performance.

(c) The development of standards on recognition and measurement for certain items was being hampered by the lack of an articulated conceptual approach to reporting financial performance.

(d) Since FRS 3 was issued, various other national standard-setters, as well as IASC, had issued new standards or revised existing standards on reporting financial performance.

Discussion Paper 'Reporting Financial Performance: proposals for change'

8 Since FRS 3 was issued, other countries have moved towards reporting total financial performance, sometimes called 'comprehensive income'. In view of these developments, and following the Board's policy of international co-operation, a new project on reporting financial performance was begun within the G4+1* group of standard-setters. Its preliminary conclusions were reported in a paper 'Reporting Financial Performance: Current Developments and Future Directions', published in January 1998. The paper examined alternative methods of reporting comprehensive income, and subsequent discussion within the G4+1 led to the development of a further paper, 'Reporting Financial Performance: proposals for change'. This was published in June 1999 by the Board as a Discussion Paper and by other members of the G4+1 in their own jurisdictions.

9 Respondents to the Discussion Paper, both in the UK and elsewhere, were generally supportive of the proposals for a single performance statement, but had some misgivings:

(a) Financial performance was not defined in the Discussion Paper despite its central role in the development of a new standard.

(b) The concept of realisation was held by some to be of continuing importance, particularly in the context of UK (and European) companies legislation.

(c) The choice of the three components was not explained in sufficient detail, given that different components might have been chosen.

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* *The G4+1 comprises representatives of the national standard-setters of Australia, Canada, New Zealand, the UK and the USA, and of IASC.*

(d) The suggested basis on which standard-setters would allocate gains and losses to the different components of performance was thought by many to be self-contradictory and unhelpful.

10 These criticisms have been addressed in developing the FRED, which seeks to offer greater insights into the reasoning underlying the Board's approach to reporting financial performance. In particular, the Board hopes that the exposition of the issues within this Appendix will offer a significant contribution to the international debate on performance reporting (at the date of publication, an IASC Steering Committee also has this topic under discussion).

Definitions

11 The definitions of gains, losses and financial performance are all based on those in the Statement of Principles for Financial Reporting, issued by the Board in December 1999. The topic of performance reporting is somewhat undeveloped in the Statement of Principles (as the Statement acknowledges), because it was under separate review at the time. Nevertheless, these definitions are taken as a starting point for the draft FRS, along with the occasional guidance offered on the subject within the Statement of Principles, because the Board has accepted them as the basis of performance reporting.

12 The definition of financial performance is important: it emphasises the 'all-inclusive' nature of financial performance and hence the need to show a complete picture of an entity's recognised gains and losses in the performance statement. This does not mean that the Board rejects all notions of 'earnings'; as with FRS 3, the draft FRS sets an earnings line for a standard earnings per share calculation, but allows other figures for earnings per share to be calculated, with the same provisos mentioned in paragraph 5 above.

13 Ordinary activities are defined in order to distinguish them from extraordinary items and to satisfy the requirements of companies legislation.

The statement of financial performance

A single performance statement

14 As stated in the Statement of Principles for Financial Reporting, investors require information on financial performance because such information:

(a) provides an account of the stewardship of management and is useful in assessing the past and anticipated performance of the entity;

(b) is useful in assessing the entity's capacity to generate cash flows from its existing resource base and in forming judgements about the effectiveness with which the entity has employed its resources and might employ additional resources; and

(c) provides feedback on previous assessments of financial performance and can therefore assist users in modifying their assessments for, or in developing expectations about, future periods.

15 As noted above, FRS 3 created a framework for reporting financial performance that largely addresses these points. The Board believes that the proposals in the FRED offer an incremental development of the approach adopted by FRS 3, which could not be taken at the time FRS 3 was issued because it would have represented too great a move at one time.

16 The Statement of Principles suggests that whether information is given in one performance statement or more is not relevant. Whilst this is true in theory, in practice users and preparers appear to attach different levels of significance to gains and losses reported in different performance

statements, simply because they are reported in different statements. Experience of applying FRS 3 suggests this is the case, given that it offers no justification for taking some gains and losses to the statement of total recognised gains and losses rather than the profit and loss account, and yet users tend to downgrade the statement of total recognised gains and losses and hence the information reported in it. The Board therefore concluded that it would be preferable to require a single performance statement for all recognised gains and losses.

17 As the Statement of Principles makes clear, the statement of financial performance should deal only with gains and losses and items that are not gains and losses should not be recognised in it. This has two major implications:

(a) The notion of recycling, whether between or within sections of the statement, is not consistent with the draft FRS. By definition, gains and losses shown in the performance statement under the recognition criteria of the Statement of Principles cannot be recognised again anywhere in the performance statement in a later period.

(b) Transactions with owners as owners will not be reported in the statement of financial performance. For example, dividends paid and payable are not gains and losses and so the draft FRS envisages that they will not be included in the performance statement. Although that seems logical—dividends are not a component of financial performance—it is not consistent with how such dividends are dealt with at present. It is also a legal requirement to show such dividends on the face of the profit and loss account (see Appendix II).*

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* *The FRED makes no effort to distinguish dividends on equity and non-equity shares. Under FRS 4 'Capital Instruments' all such dividends must be reported as appropriations of profit and the FRED maintains that approach. However, the outcome of two current projects, on accounting for financial instruments and the distinction between debt and equity, may cause this approach to be altered.*

The sections of the performance statement and allocation of gains and losses

Statement of Principles

18 The Statement of Principles states that information on financial performance needs to be presented in a way that focuses attention on the components and on their key characteristics. The presentation—including the headings used and the items that appear under each heading—is important. Good presentation of financial performance information typically involves:

(a) recognising only gains and losses in the statement of financial performance.

(b) classifying components by reference to a combination of function (such as production, selling and administrative) and of the nature of the item (such as employment costs, interest payable and amounts written off investments).

(c) distinguishing amounts that are affected in different ways by changes in economic conditions or business activity (for example, by providing segmental information or by presenting income from continuing and discontinuing operations as separate components).

(d) identifying separately:

(i) items that are unusual in amount or incidence judged by the experience of previous periods or expectations of the future.

(ii) items that have special characteristics, such as financing costs and taxation.

(iii) items that are related primarily to the profits of future, rather than current, accounting periods, such as some research and development expenditure.

19 The Statement of Principles does not attempt to specify the order of importance of the different criteria under which items of financial performance might be distinguished from each other in the primary performance statement. Some ordering of priorities is required, however, to deal with the circumstances in which the distinction of items on different bases is contradictory. It will also help to prevent too much disaggregation forcing itself onto the face of the performance statement.

1999 Discussion Paper

20 The Discussion Paper took a specific approach to how a single statement of financial performance should be broken down into components or sections, which was the favoured option of the earlier G4+1 paper. (This issue is closely tied to the issue of the basis on which gains and losses should be allocated to the chosen components or sections, and so both are considered together here.) The Discussion Paper suggested that the performance statement should be divided into three sections:

- operating (or trading) activities
- financing and other treasury activities
- other gains and losses.

The Discussion Paper went on to consider the basis on which standard-setters would determine the allocation of gains and losses between the sections, noting that the content of the financing and treasury section was likely to be affected by the international project on accounting for financial instruments. The Discussion Paper then suggested that, while the operating (or trading) activities section would be the default category, standard-setters would use the following matrix to determine which gains and losses should be left in the operating (or trading) activities section and which should be reported in the other gains and losses section:

Characteristics more typical of operating items	**Characteristics more typical of other gains and losses**
Operating activities	Non-operating activities
Recurring	Non-recurring
Non-holding items	Holding items
Internal events (eg value adding activities)	External events (eg price changes)

21 The respondents to the Discussion Paper tended to the view that the matrix was contradictory and could not be applied consistently, and some were also critical of the choice of sections. However, they expressed such a wide variety of views on which components should be required and which was the most important criterion for distinguishing items in the performance statement, that no clear consensus emerged (not surprisingly, given the number of ways in which the issue might be tackled).

22 The Board has therefore decided to adopt an approach, laid out in the main body of the draft FRS and explained below, that it believes will at least allow some progress, even if further refinements will be necessary in the future, perhaps when the treatment of financial instruments has been resolved. For example, the Board believes that disposal gains and losses on fixed assets have the same characteristics as revaluation gains and losses (and impairment losses) and should therefore receive the same treatment. However, the Board's approach does not exclude the possibility of developing alternative categorisations of financial performance for the purposes of disclosure on the face of the statement, in the notes to the accounts or in narrative accompaniments to the financial statements.

Approach in the FRED

23 Given that the reporting of recognised gains and losses, as defined in the Statement of Principles, involves no measurement or recognition issues, it could be argued that the grouping and order of those gains and losses in a statement of financial performance are irrelevant. This may be true conceptually, but it is of little help to the user of the financial statements, who must attempt to make some kind of judgement about the performance of the reporting entity (to the extent that it is shown in the financial statements). It is therefore necessary to order the information in some way. However, if each reporting entity did so as it wished, the user would struggle to compare the results of the entity with those of other entities in that or other sectors. Some consistency of approach is therefore also required.

24 The Board's primary consideration is to provide a framework that users find helpful. The framework must be capable of encompassing the financial results of the majority of entities, but also flexible enough to be adapted for unusual or special circumstances. The Board believes that the suggested format for the single performance statement in the draft FRS meets these criteria.

25 The first suggestion the Board considered was simply to combine the existing profit and loss account and statement of total recognised gains and losses in one statement. However, it emerged that, in spite of legal requirements regarding what can and cannot be included in the profit and loss account, the basis on which gains and losses are allocated to each statement is confused and ill-defined and is not applied consistently.

26 Gains and losses are nominally allocated to the profit and loss account on the basis of whether they are 'realised'. The Statement of Principles moves away from the notion of realisation as a basis for recognising gains and losses for reporting performance, because of the certainty of existence and measurement that can be established for gains and losses in today's environment, without a disposal taking place. There is, however, a continuing role for the realisation concept in relation to the distribution of corporate profits. Companies legislation ties realisation to the distribution of profits through the presentation of company results. In practice, not all 'realised' gains and losses are reported in the profit and loss account.* This dual use of realisation, ie as a criterion for reporting performance and for the estimation of distributable profits, has placed severe pressure on the concept, to the extent that it is becoming generally discredited. The Board believes that an approach to performance reporting is required that accepts that the move away from realisation as a criterion for distinguishing items of financial performance is already under way. It therefore concluded that gains and losses should be grouped in sections of the performance statement according to their inherent nature, not whether they are realised or not. Information on realisation may be shown as ancillary to the primary statement, indicating that its importance is only part of the total picture of a reporting entity's performance.

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* *See Appendix II, paragraphs 15-23.*

27 The Board considered the view, frequently expressed by users of financial statements, that it is not helpful in performance reporting to mix an entity's operating results with gains and losses arising on items held for the long term, where those gains and losses essentially reflect the length of time the item happens to have been held and the price changes that have taken place over that period, ie they are holding gains and losses. Under the historical cost convention, such gains and losses may be recognised only in the year of disposal and so represent accumulated gains and losses from previous periods. The Board therefore decided that a section, 'other gains and losses', should be used to report these holding gains and losses.

28 The Board then turned to the remaining gains and losses that an entity recognises in a period. Two aspects of these seemed to be of relevance—the results of the operating activities of a reporting entity and the results of any financing activities (including treasury income arising on investment of surplus cash) in support of those operating activities. These two parts of an entity's activities are closely interlinked, to the extent that some entities may regard the treasury function as an integrated part of their operating activities. However, the Board believes that it is possible to distinguish between operating activities that are in the financial sphere (such as banking) from activities relating to the financing of the entity. The gains and losses on the former will be reported in the operating section, while those arising on the latter will be reported in the financing and treasury section.*

* *In any case, special provision is made for companies and groups that are banking and insurance entities.*

29 An alternative view to this approach was put forward during the Board's deliberations, which found favour with some Board members. It was suggested that the allocation of gains and losses should be between an operating section and a *financial* section. This would mean that the results of all activities that are financial in nature would be reported in the financial section. For example, a clothing retailer might have a financial operation that, as well as offering an in-store credit card to customers, also sold financial services (eg insurance) to customers. If this view of the allocation of gains and losses were applied, the results of the clothing retail operation would be shown in the operating section, while the results of the financial division, including the in-store credit card profits and losses and the gains and losses on selling financial products, would appear in the financial section. The financial section would also include interest payable by the entity on its financing and all the other similar items that the draft FRS requires to be reported there. The Board is keen to obtain views on these different approaches to what should be reported in a financing/financial section and a question has been included in the Preface.

30 The sections of the performance statement might be ordered differently, for example the financing and treasury section might be shown last of the three. In considering the ordering of the sections, the Board concluded that, in theory, there is no reason why the sections should not be shown in a different order from that proposed in the Discussion Paper. In practice, however, the following considerations led to the conclusion that the suggested order should be required:

(a) Consistency of presentation is necessary to allow users to compare entities' results.

(b) This order is reasonably familiar to users in that it changes little in the present ordering of the performance statements.

(c) The requirements of the statutory formats for companies mean that it will still be necessary to identify a profit and loss account, which would be possible only with this ordering of the components (see Appendix II).

(d) Although reporting entities are permitted to report earnings per share figures on the basis of any 'earnings' figure they wish, the Board believes that, for the sake of comparability, it is still necessary to specify a standard line total for earnings per share within the performance statement, to which other calculations must be reconciled and the proposed format allows this to be done in a straightforward way (see paragraph 69 below).

31 In reaching these conclusions, the Board has adapted the approach of the matrix given in the Discussion Paper (see paragraph 20 above). The Board believes that a recurring/non-recurring distinction can be helpful to users. However, because of the subjectivity inherent in deciding what is non-recurring for different entities, such a distinction should be available only as a means of identifying such items within the components or sections specified by standard-setters, rather than by grouping them together as a separate component. Thus, exceptional items should be shown only within the line item to which they relate (see paragraphs 58-61 below). The boundary between internal and external events was thought to be too blurred to be made operational, although some accounting standards (such as SSAP 19 'Accounting for investment properties') use a type of internal/external distinction for definitional purposes.

32 In certain instances the non-holding/holding distinction discussed above needs to be modified to reflect rather an operating/non-operating divide.

(a) Some short-term holding gains, for example on inventories, will arise for many entities. Under the non-holding/holding distinction, these gains would be reported in other gains and losses. However, such gains are much more closely associated with the entity's operating result. It may therefore be of more value to users to show them within the operating section so that the cost or benefit of holding the stock can be reflected in the entity's operating margins. Exclusion of such gains and losses from the operating result margin would mislead users.

(b) Some entities, as their main activity, trade on gains arising on price movements of certain investment assets, some of which may, incidentally, be held for a long time. Although in other types of business investment assets would be treated as fixed assets, in the circumstances described they are in effect trading stock. If the non-holding/holding distinction was to be applied rigidly to such trading stock, the gains and losses arising would be reported in other gains and losses. However, it may be appropriate, for certain types of entity, to require such gains and losses to be reported in the operating section, where this is the nature of the entity's operations (see paragraphs 49 and 50 below).

33 The Board has therefore decided that it will use the non-holding/holding distinction to determine which gains and losses should be reported in other gains and losses. However, some holding gains and losses on what are generally short-term operating items will remain in the operating section. In addition, certain reporting entities may be required to report in the operating section certain holding gains and losses that would normally appear in other gains and losses. The circumstances will be specified by accounting standards and approved industry-specific guidance.

34 The Board considered the extent to which the structure of the performance statement should match the structure of the other primary statements. In particular, it was suggested that it would be helpful to align the performance statement more closely with the cash flow statement, so that users could judge more easily the impact on cash flows of different aspects of performance. The Board believes that the first priority is to structure the performance statement properly. In any case, the proposed performance statement in many ways is already quite closely aligned with the cash flow statement as required by FRS 1 (Revised 1996) 'Cash Flow Statements'. The first two sections of the performance statement match (except for non-cash items) the first two components of the cash flow statement, ie 'cash flows from operating activities' and 'returns on investment and servicing of finance'.

35 Moreover, there is a limit to the extent to which the cash flow statement can be aligned with the performance statement:

(a) The cash flow statement reflects the cash effect of capital transactions and transactions with owners, as well as performance statement transactions.

(b) In the performance statement, it is possible to provide a certain level of meaningful allocation of the tax effects relating to the various sections; the tax charge bears a direct relationship to the current period results shown in the performance statement. FRS 1* makes it clear that allocation of the tax cash flows to the cash flow statement sections does not provide any useful information and may in fact be misleading.

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* *FRS 1 (Revised 1996), paragraph 61.*

36 The Board's view is that the differing functions of the performance statement and the cash flow statement mean that the two cannot be completely aligned. Nevertheless, there is a degree of alignment between the proposed performance statement and the cash flow statement required under FRS 1 and the Board will keep this in view during the further development of the standard on reporting financial performance and any subsequent amendment to FRS 1.

37 A further issue considered by the Board was the extent to which the figures within the performance statement are adjusted by users for certain purposes and whether a standard should address provision of such adjusted figures by the entity, including their disclosure within the performance statement and their calculation. For example, it has been suggested that the EBITDA measure (earnings before interest, tax, depreciation and amortisation) is useful for projecting future earnings forward from the current period and that reporting entities should be required or permitted to incorporate such a figure in the performance statement.

38 The Board believes that, at present, it would not be helpful to address such issues in a standard on reporting financial performance for the following reasons:

(a) Different measures will be favoured by different investor groups and the measures favoured may change over time. The draft FRS already provides a standard measurement figure (earnings per share) that can be adjusted by both preparers and users of accounts as they wish.

(b) The primary statement of performance should reflect the proper sales margin information for the reporting entity's operating activities; the margin represents an item of information in its own right to all user groups.

(c) Those who wish to disaggregate an entity's results in order to use sophisticated projection models will be catered for as long as sufficient information is disclosed within the rest of the financial statements to allow the desired adjustment of the figures in the primary statements.

39 The Board does not seek to prevent the provision of additional information in the performance statement or related notes (provided the requirements of this and other accounting standards and companies legislation are met). The proposed requirements in the draft FRS are framed to allow a reasonable amount of flexibility to management regarding the information it can provide and the emphases it chooses to make. This may involve disclosure of performance information, whether on the face of the performance statement or in the notes, that is disaggregated in alternative ways to the approach taken in the draft FRS. The provision of such information may, in the view of management, be necessary to provide users with what it regards as the full 'information set' regarding the entity's performance. As the circumstances of each entity, as well as the views of management, are likely to be different in each case, it would not be appropriate for the Board to comment on or favour any particular disaggregation or presentation methodology.

40 The above reasoning gives the basis on which items will be required to be reported in each of the proposed three sections of the performance statement. However, as the draft FRS demonstrates, it is the standard-setter, rather than individual preparers, that will determine which items should or may be presented in the financing and treasury section and in other gains and losses. Thus all other reported gains and losses will be assumed to arise on the operating activities of the entity and so should be reported there. This approach will encourage comparability and consistency from period to period.

41 However, the circumstances of specific entities or industries will sometimes dictate that gains or losses that would normally be reported in the financing and treasury section or other gains and losses should be taken to the operating section instead. The draft FRS gives some flexibility on this issue and it will be open to other accounting standards on particular measurement issues to specify where the resulting gains or losses should be reported. The FRS that is developed from this draft would amend existing standards as necessary (as shown in the text).

Reporting gains and losses on fixed assets

42 One of the main changes to existing practice proposed by the draft FRS is that gains and losses arising on the disposal of fixed assets should be reported in the same way as revaluation gains and losses and impairment losses, ie so that the gains and losses are reported according to their nature rather than whether they are realised or not. Thus depreciation, adjustments to depreciation and impairments will all be shown in the operating section, while revaluation gains and losses, which are holding gains and losses, will be reported in other gains and losses, segregated from the operating result. The event of a disposal of a fixed asset will not affect this analysis, ie the gains or losses crystallised by the disposal will be treated in the same way as a revaluation gain or loss or impairment according to FRS 15 (which would be amended accordingly). This proposal is made in the draft FRS and is independent of, for example, the issue of how revaluation losses are distinguished from impairments.

43 A further proposal was made in the Discussion Paper in relation to fixed assets, and in particular revalued fixed assets. Paragraphs 65-70 of FRS 15 deal with how losses arising from falls in value of fixed assets are reported. That standard distinguishes between an impairment and a holding loss along the somewhat arbitrary line of depreciated historical cost, in order to determine the relative proportions of the loss to be reported in the profit and loss account (as an impairment and hence an operating loss) and the statement of total recognised gains and losses (as a holding loss). The Discussion Paper considered whether it was possible to introduce an approach to these losses that was conceptually purer. It proposed that *all* losses arising from a fall in value from carrying amount to the higher of net realisable value and value in use should be treated as an impairment and the loss reported as an operating loss.

44 Although not mentioned in the Discussion Paper, taking this approach to its logical conclusion would result in the treatment of any subsequently recognised *increases* in value, whether reversing a previously recognised loss or not, as a revaluation gain, which would be reported in the statement of total recognised gains and losses (or, in a single performance statement, in other gains and losses).

45 Many respondents to the Discussion Paper were unhappy with this approach. They suggested that this would produce skewed reporting of gains and losses for fixed assets. In particular, in some industries the value in use and net realisable value of fixed assets tend to stay very close to each other (for instance, for pubs and hotels, whose market value is often based on future trading potential). In such cases all gains would be reported in other gains and losses, while all losses would be reported in the operating section. Respondents suggested that this could not be right when some falls in value obviously reflected price movements and were therefore holding losses.

46 In considering the responses to the Discussion Paper, the Board discussed this issue in depth. There was some support for the view in the Paper that every loss arising from a fall in value from carrying amount to the higher of net realisable value and value in use should be treated as an impairment and the loss reported as an operating loss. It was argued that this would be appropriate for many types of operational asset, since impairment was essentially a form of accelerated depreciation.

47 As a modification of this approach it was suggested that a subsequently recognised increase in value could be treated as the reversal of an impairment (rather than a revaluation gain) to the extent that it represented a correction of the estimate of the impairment loss, which should be recognised in the same place as the original impairment. Just as a depreciation charge can be re-estimated through revisions to the economic life or residual value of the asset, so an impairment charge should also be capable of revision. Conditions could be laid down to assist in distinguishing between the reversal of an impairment and a revaluation gain, for example:

(a) both the impairment and the reversal or part-reversal should hinge on the same event or factor (similar to the rules for recognition of a reversal of impairment of goodwill and intangible assets under FRS 11 'Impairment of Fixed Assets and Goodwill', paragraph 60); and

(b) the amount of the reversal should be restricted to the amount of the originally recognised impairment.

48 Although its discussions raised points (such as those mentioned in paragraphs 43-47) that might be developed further, the Board has come to the view that, at this time, the debate on the nature of revaluations and impairments of assets has not moved forward far enough since frs 15 was issued to justify a significant shift from that standard. However, it is keen to solicit the views of respondents in order to move the debate forward both in the UK and the Republic of Ireland and on an international level. A question has been included in the Preface to the fred for this purpose.

Reporting gains and losses on investment properties

49 Under ssap 19, fair value gains and losses arising on the revaluation of investment properties are treated in a similar way to revaluation gains and losses arising on operational fixed assets under frs 15. However, the Board believes that the cases are very different, as illustrated by the present definition of investment properties. As noted in paragraph 32(b) above, some entities, as their main activity, trade on gains arising on price movements of certain investment assets, some of which may, incidentally, be held for a long time. Although in other types of business investment assets might be treated as fixed assets, if they meet certain definitional criteria they are in effect trading stock. Using the logic of the fred's approach to reporting financial performance, the fair value gains and losses should therefore be reported in the operating section—these are operating gains and losses and this treatment reflects this aspect of the entity's operations.

50 It does not follow that all groups that run a property division or company would report the gains and losses arising on property in the operating section. For example, a high street retailer may have a property management division or company that manages the properties from which the retail operations trade. At the entity level of the property management company (at least for internal reporting purposes), the operating section of the performance statement might reflect all the gains and losses arising on the properties it manages.* However, at the group level, the property management division is subordinate to the retail operation; it exists merely to ensure that the reporting entity takes appropriate advantage of any long-term holding gains and losses on the retail outlets, where possible. The holding gains and losses arising on such assets will, at the group level, be shown in other gains and losses, with depreciation and impairment losses charged to the operating section. Conversely, where properties represent the trading stock of the reporting entity at the group level (ie in the dealings of the group with external customers, as required by the definition of investment properties), it would be appropriate to require the fair value gains and losses on them to be shown in the operating section.

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* *On the assumption that a revised SSAP 19 required gains and losses on investment properties to be reported as operating items.*

51 SSAP 19 requires the gains and losses arising on revaluation of investment properties to be reported outside income (and hence through other gains and losses in the single performance statement). However, IAS 40 requires fair value changes (where a fair value model is adopted) to be taken through income. Given this analysis, the Board is minded to consider a revision to SSAP 19: see the Preface.

Continuing and discontinuing operations

52 FRS 3 requires separate disclosure of the aggregate results of each of continuing operations, acquisitions (as a component of continuing operations) and discontinued operations down to the operating profit level. A majority of respondents to the Discussion Paper agreed that this information was very useful and should continue to be provided.

53 Respondents to the Discussion Paper expressed reservations about whether this information should be required for any section of the statement other than the operating section. In the Board's view, such information is often useful, but there may be significant practical difficulties in providing it, and the information produced can be less than meaningful in certain circumstances. For example, where a treasury function supports the entire reporting entity, any allocation of financing costs to discontinued or discontinuing operations may be arbitrary and ultimately misleading. In other circumstances, however, the split will be clear-cut along operational lines. The draft FRS therefore encourages the provision of continuing and discontinuing activities information across the financing and treasury section and other gains and losses where the information is meaningful and its provision is relatively straightforward. In such circumstances, the bases on which items have been allocated (as opposed to being directly attributable to) the continuing and discontinuing components must be disclosed.

54 The draft FRS retains the FRS 3 requirement for a certain minimum of information on continuing and discontinuing results to be shown on the face of the statement, ie in the operating section the analysis of turnover and operating profit should be given. The remainder of the information on continuing and discontinuing results may be shown in the notes to the statement, as shown in the example in Appendix I.

Discontinuing operations

55 FRS 3 includes a stringent definition of discontinued operations, such that operations may be classed as discontinued only if the discontinuation is completed either in the period or close to the period-end, any sale must be irrevocable and every termination permanent. By contrast, the international standard, IAS 35, requires such operations to be shown as discontinu*ing* from the time a binding sales agreement has been signed or a decision to sell/terminate has been made and announced and it allows that decision to be reversed. Respondents to the Discussion Paper generally agreed with the view that a decision to sell or terminate should be irrevocable; however, some support was expressed for relaxing the FRS 3 requirement that the operations must be sold or termination completed in the reporting period or very shortly after the period-end. The view was expressed that discontinuations representing a material reduction in operating facilities could take place over quite a long time and that a move towards the international approach would be appropriate.

56 The Board believes that these arguments have some merit. In addition, the Board's usual process is to consider international standards in the development of its own standards. As a result, the Board decided that the FRED should be drafted to incorporate most of the requirements of IAS 35, with one main difference. The Board believes that the circumstances in which a discontinuation could be reversed, once announced under the initial disclosure event defined by IAS 35, should be exceedingly rare. The Board could envisage such circumstances, however, for example if market conditions make a termination no longer the appropriate course of action. The draft FRS therefore does not require the decision to sell or terminate to be irrevocable, as the term might imply that it cannot be reversed. Instead it requires that a sale agreement has been signed; or that the actions of the reporting entity are such that they have raised a valid expectation in those affected that it will carry out a planned termination. Such a valid expectation will be raised only when formal announcement of the plan has been made and the timeframe for implementing the plan is such that major change to the plan is unlikely.

57 The Board is keen to obtain views on this change and a question on the issue has therefore been included in the Preface.

Exceptional items

58 The definition of exceptional items is the same as that in FRS 3. FRS 3 requires the majority of exceptional items to be reported within the line item to which they relate and this requirement has also been adopted in the draft FRS.

59 Paragraph 20 of FRS 3 requires certain exceptional items to be reported after operating profit. These are:

(a) profits or losses on the sale or termination of an operation;

(b) costs of a fundamental reorganisation or restructuring having a material effect on the nature and focus of the reporting entity's operations; and

(c) profits or losses on the disposal of fixed assets.

Under the proposals in the FRED, items (a) and (c) will now be reported in other gains and losses. Item (b) will be included in the operating section as part of continuing operations, although it will be disclosed as an exceptional item within that component. The attributable tax and minority interests will follow the required treatment within each respective section.

60 Concerns were raised by the Board in relation to the prominence given to exceptional items by preparers and users of financial statements. The Board reinforced the view in FRS 3 that exceptional items should not be transferred to a single heading of 'exceptional', because profit before exceptional items could then become the focus of financial statement presentation, with the implication that no exceptional items are expected in the future. As well as requiring all exceptional items to be included in the income or expense heading to which they relate (as with FRS 3), the draft FRS proposes that information on reported exceptionals over the previous five years should be required where an entity reports one or more in the current or previous period. This will enable users to judge the extent to which different types of exceptional items are reported year on year and thus gain a more informed expectation about future results and cash flows.

61 The FRED proposes that the provision of a table of exceptional items should be mandatory, but the text indicates that this may be incorporated into other information about the entity's results. In particular, some may wish to show the table in conjunction with explanations about the levels of pre- and post-exceptional results over time, as recommended in paragraph 60 of the draft FRS. The example given in Appendix I demonstrates such an approach.

Taxation

62 There are various practical problems in allocating the taxation charge to more than two components or sections of the performance statement. However, the Board believes that the tax attached to the items reported in other gains and losses will be relatively easy to identify. The relationship of such items to tax is often unusual and disclosure of the tax arising is therefore of benefit in helping users to understand post-tax results and cash flows.

63 This leaves the remaining taxation charge, representing charges on items in the other two sections of the statement, to be reported as a single figure on the face of the statement. The Board's usual policy is to report items gross in the performance statement and the Board takes the view that any further breakdown of the tax charge would be arbitrary and unhelpful. This also fulfils the requirement in companies legislation to report profit on ordinary activities before taxation.

Special industries

64 The Board believes that the proposals in the FRED for a single performance statement with the three proposed sections can be adapted to most, if not all, reporting entities. Where necessary, additional guidance can be provided in approved Statements of Recommended Practice. Nevertheless, the Board also recognises that special requirements are needed for entities in certain industries, some of which are highly regulated. The FRED therefore deals, albeit briefly, with how the performance statement should be adapted for banking and insurance entities and investment companies, these being identified in particular by companies legislation.

65 The exemptions given to insurance entities in the draft FRS reflect the present UK reporting regime. However, insurance accounting is under review at an international level and any change in approach resulting from the review may remove the need for the particular exemptions proposed by the FRED.

Conglomerates

66 The FRED makes clear that it is performance at the group level that should be accurately reflected in the consolidated accounts. For groups with diverse operating activities, disaggregation of the different classes of business may be shown on the face of the statement but, where this is not feasible, the segmental information on the results of different classes of business will be of great importance. The Board may therefore consider, in the light of responses to the FRED, whether SSAP 25 'Segmental reporting' requires amendment.

Reconciliation of ownership interests

67 The Board believes that changes in ownership interest other than those included in the performance statement can be important in understanding the change in the financial position of an entity and concluded that this additional information should be required in a reconciliation of ownership interests. Although specified as a primary statement, in order not to divert attention from the performance of the period, the reconciliation should be shown separately from the performance statement.

Other information

68 The FRED supplements the 'information set' within the primary statements with a wide range of additional information in the form of:

(a) footnotes to the performance statement, ie of earnings per share, dividends and prior period adjustments; and

(b) notes to the performance statement.

Earnings per share

69 The FRED nominates the total of the operating section and the financing and treasury section, after tax and minority interests, as the earnings line for the calculation of basic earnings per share (EPS) and proposes an appropriate amendment to FRS 14 'Earnings per Share'. The Board recognises that this facilitates comparison of entity results; as noted above, however, the Board believes that users should not rely on a single number or indicator to judge an entity's performance. The FRED therefore continues the approach taken in FRS 3 by allowing additional EPS figures to be presented, along with appropriate explanation for the approach taken and a reconciliation to the 'standard' earnings per share figure. This facilitates both management explanation and users' assessment of earnings per share by requiring the provision of a range of relevant information.

Dividends

70 Dividends represent transactions with owners as owners and therefore should not be reported in the performance statement, but rather as movements in ownership interest for the period (see paragraph 17(b) above). However, although they are not gains and losses of the period, dividends represent an important part of the 'information set' relating to performance envisaged by the FRED. Disclosure of both the total dividend and per share amounts are required as memorandum items at the foot of the performance statement. The breakdown required by paragraph 59 of FRS 4 between dividends on different classes of share should be given.

71 FRS 4 requires dividends on non-equity shares to be reported in the same way as equity dividends (paragraph 43). In time, this approach may be affected by the outcome of the project on accounting for financial instruments and derivatives, proposals for which have been published by an international Joint Working Group, and the Board's current project on the distinction between debt and equity. The FRED does not seek to pre-empt the debate within those projects on where dividends on non-equity shares (as currently defined by FRS 4) should be reported.

Prior period adjustments

72 Some concern was expressed by respondents to the Discussion Paper that prior period adjustments might be overlooked by users if the cumulative adjustments arising from them are shown only as an adjustment to opening reserves rather than on the face of the performance statement. However, it will always be the case that the comparative figures for the previous period will be indicated as restated and it is therefore unlikely that prior period adjustments would be missed by users. These adjustments do not represent performance of the current period and are therefore not shown on the face of the current period performance statement. Nevertheless, in order to aid users, the draft FRS requires prior period adjustments to be given as a footnote to the performance statement, after other gains and losses, along with other footnote information (such as earnings per share).

73 FRS 18 'Accounting Policies' distinguishes between a change in an accounting policy and a change in an estimation technique; the former is accounted for as a prior period adjustment, the latter within the results of the current period. The Board also reconsidered the treatment of the correction of errors and whether all material errors should be corrected by prior period adjustments or only those that are 'fundamental'. In the Board's view it is often difficult to distinguish between errors and changes in estimation techniques except in very clear-cut cases. To indicate when such clear-cut cases arise, a definition of a fundamental error has been given. In all other cases the correction of an error should be dealt with in the current period results in the relevant section of the performance statement, disclosed separately if exceptional.

Note of historical cost gains and losses

74 Two reasons for disclosing the performance of an entity 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 gains and 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 draft FRS requires, on their revalued carrying amount.

75 In acknowledgement of these concerns, the Board has suggested the provision of a note of historical cost gains and losses in the draft FRS in those circumstances where there is a material difference between the result as disclosed in the performance statement and the result on an unmodified historical cost basis. The provision of the note is optional, rather than mandatory, because of the Board's reservations regarding its usefulness:

(a) The extent to which the unmodified historical cost information facilitates comparisons between reporting entities is open to question; historical cost gains or losses on assets are only truly comparable when the same sorts of assets were bought and are sold at the same points in time.

(b) Full historical cost information may not be available or cannot be obtained without unreasonable expense or delay (in which case the earliest available values should be used where the note is provided).

76 In response to a question in the 1999 Discussion Paper, user respondents expressed support for the note's retention. The FRED therefore proposes merely to make the note non-mandatory, but a further question has been asked in the Preface on whether the note should be mandatory, optional or not mentioned in a standard at all.

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