

REPORTING PERFORMANCE

by Neil Stein

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This article looks at the other elements of financial statements required by FRS 3, Reporting Financial Performance and IAS 1, Presentation of Financial Statements other than the income statement/profit and loss account.

UK REQUIREMENTS

We'll look first at the UK requirements:

1. statement of total recognised gains and losses
2. note of historical cost profits and losses
3. reconciliation of movements in shareholders' funds.

STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES

FRS 3 argues that the profit and loss account is not sufficient on its own as a report of a company's financial performance. The statement of total recognised gains and losses (STRGL) is an attempt to present details of the other elements making up a company's total performance.

The STRGL presents:

- profit for the financial year before dividends
- unrealised gains and losses on revaluation of assets
- currency translation differences
- prior year adjustments.

The profit for the year is, of course, the figure in the profit and loss account. This will already include any realised gains or losses arising on the disposal of assets. That leaves the unrealised gains and losses to be disclosed as the second item in the STRGL. As this article is addressed primarily to candidates taking Paper F3, we'll ignore the currency translation differences.

Finally, the STRGL presents prior year adjustments (something in the current period that affects the previous period) eg the discovery of a fundamental error or a change in accounting policy.

There are two ways we could deal with these. We could include them in the current period's profit and loss account or we could adjust the opening balance of profit brought forward so that the correction does not affect the current year's figures. UK standards require the latter treatment - adjustment on the opening balance of profit brought forward.

This means that the adjustment does not appear in the current profit and loss account, but it does feature in the STRGL and, as we shall see, in another statement - the reconciliation of movements in shareholders' funds.

Please refer to Figure 1 for the format of the Statement, slightly simplified from FRS 3.

FIGURE 1: STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES

	£m
Profit for the financial year	29
Unrealised surplus on revaluation of properties	4
Unrealised loss on trade investment	(5)
Total recognised gains and losses relating to the year	28
Prior year adjustment	(10)
Total gains and losses recognised since last annual report	18

NOTE OF HISTORICAL COST PROFITS AND LOSSES (NO INTERNATIONAL EQUIVALENT)

Financial statements in the UK are usually prepared on the historical cost basis, but with the proviso that fixed assets - especially land and buildings - are often revalued to keep balance sheet values more in line with reality.

FRS 3 requires this note to state what the profit would have been if the financial statements had been prepared on a strict historical cost basis, with no asset revaluations. The note is only required if the difference between the reported profit and the historical cost profit is material. There are two main possible causes of difference:

1. If assets are revalued, depreciation is based on the revalued amount. Using strict historical cost accounting, the depreciation would be based on original cost.
2. If a revalued asset is sold, the profit coming through in the profit and loss account is the difference between the proceeds of sale and the carrying amount in the records allowing for the revaluation. On strict historical cost accounting, the amount would be the difference between the proceeds and cost less depreciation, so that a larger profit (or a smaller loss) would emerge.

The note should be presented immediately following the profit and loss account or the STRGL, as illustrated in Figure 2. Note that the opening figure is profit before taxation. (1) refers to a revaluation gain recognised in an earlier year.

It is added to the reported profit because under strict historical cost accounting the gain on the disposal this year would be £9m more than the gain based on the revalued amount.

FIGURE 2: NOTE OF HISTORICAL COST AND LOSSES

	£m
Reported profit on ordinary activities before taxation	45
1. Realisation of property revaluation gains of previous year	9
2. Difference between a historical cost depreciation charge and the actual depreciation charge of the year calculated on the revalued amount	5
	59

Historical cost profit for the year after taxation and dividends (retained profit)

Why have the note? FRS 3 cites two reasons:

1. Companies have discretion as to when to make revaluations - and to what extent - so historical cost figures may make profits and losses of different reporting entities more comparable.
2. Some users may wish to know the historical cost based profit on the sale of an asset.

RECONCILIATION OF MOVEMENTS IN SHAREHOLDERS' FUNDS

This statement overlaps somewhat with the STRGL, because naturally everything in the STRGL affects shareholders' funds and therefore has to appear in this reconciliation. However, it also includes issues or redemptions of shares during the year. The information in the reconciliation could be picked up from the company's balance sheet, but it is convenient to have a separate statement summarising the movements. Refer to Figure 3.

FIGURE 3: RECONCILIATION OF MOVEMENTS IN SHAREHOLDERS' FUNDS

	£m
Profit for the financial year	29
Dividends	(8)
	21
Other recognised gains and losses relating to the year (net)	(1)

New share capital subscribed	20
Net addition to shareholders' funds	40
Opening shareholders' funds (originally £375m before deducting prior year adjustment of £10m)	365
Closing shareholders' funds	405

In addition to these FRS 3 statements, the disclosure of movements on reserves is required. This is presented in tabular form in Figure 4. The difference between this £387m and the £405m with the reconciliation of shareholders' funds closed is, of course, the £18m of share capital.

FIGURE 4: MOVEMENTS IN RESERVES

	Share premium account	Revaluation reserve	Profit and loss account	Total
	£m	£m	£m	£m
At beginning of year as previously stated	44	200	120	364
Prior year adjustment	-	-	(10)	(10)
	44	200	110	354
Premium on issue of shares (nominal value £7m)	13			13
Transfer from profit and loss account of the year			21	21
Transfer of realised profit		(14)	14	0
Decrease in value of trade investment		(5)		(5)
Surplus on property revaluations	-	4	-	4

At end of year	57	185	145	387
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That is the end of the coverage of the UK position.

INTERNATIONAL REQUIREMENTS

The main supplementary statement required by IAS 1, Presentation of Financial Statements is the statement of changes in equity. This is similar to the UK reconciliation of movements in shareholders' funds, and it also includes the statement of movements in reserves. It shows, in columnar form, the equity share capital and reserves, with details of all the movements that have taken place during the period.

IAS 1 also illustrates a statement of recognised gains and losses that may be used as an alternative to the statement of changes in equity. Figures 5 and 6 show the statements, broadly presented as in IAS 1 (slightly abridged to exclude matters outside the scope of Paper F3).

FIGURE 5

	Share capital	Share premium	Revaluation reserve	Accumulated profit	Total
	\$m	\$m	\$m	\$m	\$m
Balance from previous period	X	X	X	X	X
Changes in accounting policy - prior year adjustment*	-	-	-	(X)	(X)
Restated balance	X	X	X	X	X
Deficit on revaluation of properties			(X)		(X)
Surplus on revaluation of properties			X		X
Net gains and losses not recognised in the income			(X)		(X)

statement

Net profit for the period				X	X
Dividends paid				(X)	(X)
Issue of share capital	X	X	-	-	X
Balance at end of period	X	X	X	X	X

* The change in accounting policy is treated as a prior year adjustment. This is the treatment required in IAS 8 if the change is to be applied retrospectively - in other words, as if the new policy had always been in use. A change can also be applied prospectively - applied only to transactions after the change, with no adjustment to the opening balance of retained earnings. A fundamental error affecting prior periods would also normally be treated as a prior period adjustment as shown here.

FIGURE 6: STATEMENT OF RECOGNISED GAINS AND LOSSES

	\$m
Surplus/deficit on revaluation of properties	X
Surplus/deficit on revaluation of investments	X
Net gains not recognised in the income statement	X
Net profit for the period	X
Total recognised gains and losses	X

If this second presentation is adopted, the reconciliation of opening and closing balances of share capital, reserves and accumulated profit included in the statement of changes in equity would be shown in the notes to the financial statements.

Neil Stein is former examiner for Paper 1.1