

FRC Updates Company Guidance on Reporting Exceptional or Similar Items and Alternative Performance Measures

May 26, 2020

On May 20, the Financial Reporting Council (FRC) published an updated version of its [guidance for companies on corporate governance and reporting](#) during the COVID-19 crisis to include new sections on exceptional or similar items and alternative performance measures (APMs).

For further information on the FRC's guidance for companies on corporate governance and reporting, please refer to [our recent alert](#).

Exceptional or similar items

As required by International Accounting Standard 1 (IAS 1), many companies disclose individually material items on the face of their income statements or in the notes to their accounts.

The FRC notes that companies should consider whether additional items of income and expenditure arising from the COVID-19 crisis should be separately disclosed in accordance with their existing policies for "exceptional" or other similar items, and expects them to:

- Assess the materiality of items such as restructuring costs, impairment charges, incremental health and safety costs, and the costs of onerous contracts
- Present the nature and amounts of any such items in a way that is helpful to readers (e.g., by giving them all in a single note or linking them with cross-references)
- Provide information about the effect of these or similar items on cash flows and their timing and tax
- Be even-handed in identifying any gains as well as losses
- Not describe amounts as "non-recurring" or "one-off" if they are also expected to arise in future periods
- Not disclose costs (sometimes described as "stranded", "sunk" or "excess") as exceptional solely because of a reduction in, or elimination of, the related revenue streams due to the COVID-19 crisis
- Not identify incremental costs as exceptional if they result in incremental revenue that is not also described as exceptional (e.g., additional staff costs related to managing unusually high levels of sales of in-demand items)

Given that some effects of the COVID-19 crisis will be pervasive and hard to quantify, the FRC observes that it would be helpful for companies to provide narrative disclosures explaining the nature of the items and the uncertainties around them. However, splitting discrete items on an arbitrary basis in an attempt to quantify the portion relating to the COVID-19 crisis is unlikely to provide users with reliable information. The FRC discourages companies from disclosing these in their accounts.

Some companies present sub-totals on the face of their income statements which adjust for exceptional or similar items. IAS 1 permits sub-totals to be presented if they are relevant to understanding a company's financial performance. These must only be

comprised of line items made up of amounts recognised and measured in accordance with International Financial Reporting Standards (IFRS). Accordingly, presenting a sub-total derived on a hypothetical or "pro-forma" basis (e.g., by adding back an estimate of "lost" revenue), either as a line item or in a "third column" format, would be inconsistent with the requirements of IAS1.

APMs

Companies often use APMs in their interim financial results and annual reports and accounts to supplement information provided under IFRS.

Companies are expected to provide APM disclosures that:

- Have clear and accurate labelling
- Have an explanation of their relevance and use
- Are reconciled to the closest IFRS measure
- Are not given more prominence than the equivalent IFRS measures

Examples of APMs include: operating earnings, cash earnings, earnings before onetime charges, EBITDA, net debt, autonomous growth or similar terms denoting adjustments to line items of statements of comprehensive income, statements of financial position or statements of cash flow.

By definition, APMs exclude financial measures defined or specified in accordance with the applicable financial reporting framework (such as IFRS).

The FRC observes that APMs should also be presented consistently year-on-year, but that there may be circumstances where the COVID-19 crisis has, for instance, resulted in a company's making changes to its operations or business model which may result in changes to the APMs used to run and monitor the business. In these circumstances, readers should be informed of any such changes and provided with an explanation of why they provide reliable and more relevant information.

APMs which attempt to provide a measure of "normalised" or "pro-forma" results, excluding the estimated effect of the COVID-19 crisis, are likely to be highly subjective and, therefore, potentially unreliable. In addition to the subjectivity arising around which costs to exclude, in most cases COVID-19 is likely to have resulted in reductions in revenues. Any adjustment for lost revenues would be hypothetical and could not be reflected reliably in an APM. The FRC does not expect companies to provide these measures (e.g., by including them in a "third-column" income statement presentation).

For details on the European Securities and Markets Authority's guidance on APMs in the context of the COVID-19 crisis, please refer to [our recent alert](#).

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Key Contacts

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|-------------------------------|---|
| Claire Keast-Butler London | ckeastbutler@cooley.com +44 20 7556 4211 |
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