

MEMORANDUM

CFA UK HEADLINE EARNINGS

In 1992 the Institute for Investment Management and Research (IIMR), the predecessor body of CFA UK, developed the concept of “Headline Earnings”. This was in response to a request by the Financial Times and others for a standard definition of earnings more appropriate to certain uses, especially for the calculation of price/earnings ratios, than the figure derived from the rules laid down in FRS3 which was in force in the UK at the time.

Since then “CFA UK Headline Earnings”, previously “UKSIP Headline Earnings”, has been used by the FT for the calculation of price/earnings ratios for its UK share service. The relevant price/earnings ratios appear in the FT every day.

Since the 1990’s the same calculation for Headline Earnings has been used as part of the listing requirements on the Johannesburg Stock Exchange (JSE). In this case the rules laid down lead to a per share figure (“Headline Earnings per share”, or HEPS).

Since inception the formula for Headline Earnings has proved very robust. However it is necessary to change the formula to take account of the fact that in both the UK and in South Africa listed companies are required to follow International Financial Reporting Standards (IFRS).

In the original approach, the document as generated by the relevant sub-committee of CFA UK was also applied in South Africa with appropriate comment. At the present stage, this procedure has been reversed and the basic document in use will be the South African Circular 8/2007 which forms part of the listing requirements on the JSE. This Circular, prepared in conjunction with the South African Institute of Chartered Accountants and the relevant CFA UK sub-committee, is attached.

The Circular contains in Sections A, B and C the background to the work and the detailed rules for the application of the formula. These rules apply equally and exactly in the UK as in South Africa.

The original formula made a distinction between changes in value of capital items, such as fixed assets (which form the “platform” on which the company operates) and trading items. The new formula adopts the approach of excluding from the calculation of Headline Earnings all remeasurements produced under IFRS, except for those affecting the current assets and current liabilities. The principle underlying the past and the present formula is identical. Although there may be some limited differences in practice, database continuity is maintained. A comment on these differences is shown in the JSE circular in paragraphs 26, 27 and 28. Otherwise Section D in the JSE circular is not relevant in the UK.

Also not relevant to practice in the UK are Sections E, F and G; Paragraphs 45 and 47; Paragraph 56; and Section I.

It should be noted that the formula now introduced explicitly excludes all changes in Fair Value from Headline Earnings, except those which affect the current position. It is therefore a figure which should meet the needs of those who do not believe that the earnings number should be affected by the changes in Fair Value of the non-current assets. Nevertheless, it is the view of CFA UK and of the CFA Institute that no single number encapsulates the performance of a company.

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