Financial Reporting Council

Minutes of a meeting of the Corporate Reporting Council held on Thursday 15 December 2016 at the Financial Reporting Council, 125 London Wall, London, EC2Y 5AS

PRESENT

Roger Marshall	Chair
Michael-John Albert	Council Member
Richard Barker	Council Member
Chris Buckley	Council Member
Michael Gallagher	Council Member
Sian Morgan	Council Member
Veronica Poole	Council Member
Mark Smith	Council Member
Jeremy Townsend	Council Member

OBSERVERS

Michael Kavanagh	IAASA
Lee Piller	FCA

IN ATTENDANCE

Anthony Appleton	Director, Accounting & Reporting Policy
Mei Ashelford	Project Director, Accounting & Reporting Policy Team
Jenny Carter	Director, UK Accounting Standards
Annette Davis	Project Director, Accounting & Reporting Policy Team
Paul George	Executive Director, Corporate Governance & Reporting
Andrew Lennard	Director of Research
Seema Jamil O'Neill	Project Director, Accounting & Reporting Policy Team
Deepa Raval	Project Director, Accounting & Reporting Policy Team
Rosalind Szentpeteri	Project Manager, Accounting & Reporting Policy Team
Matt Dent	Notetaker, Ubiqus

APOLOGIES FOR ABSENCE

Apologies were received from Liz Murrall.

1 Minutes of the meeting of the Corporate Reporting Council held on 17 November 2016

1.1 The minutes of the Corporate Reporting Council meeting held on 17 November 2016 were approved for publication

1.2 The rolling action log was noted.

2 Triennial Review of FRS 102 – general issues

2.1 Jenny Carter (JC) reported that there had been 48 responses to the request for implementation feedback, which was a good rate of response. There had been a lot of comments, however not many big issues had come through, suggesting a positive response to the standard.

2.2 Of the more general issues, the first was around consistency with IFRS, and the extent of guidance in FRS 102. FRS 102 had been intended to be short and succinct, with less guidance than in the past, and no requirement to revert to IFRS. It was accepted that this could lead to some different interpretations in practice. No changes were proposed in response to the feedback, but the FRC would explore ways of providing more informal guidance for entities applying FRS 102.

2.3 The Council considered feedback from a group of small/medium-sized audit firms, which highlighted a number of challenges. It was noted that preparers often relied on software to automate the process, and the impact of the software on the perception of the standard could be significant. It was noted that there is a dialogue with software providers, but that this needs to be regularised.

2.4 JC noted that there had been a question around dissemination of issues and views from UK GAAP TAG; concerns were raised that emerging consensuses were not filtering out from the TAG. The process for TAG is that when there are significant issues and change is felt to be needed, the issue is escalated and changes are proposed. A member of the Council expressed a concern about the TAG becoming an interpretation committee, but informal guidance could include issues emerging from the UK GAAP TAG.

2.5 A member of the Council asked whether there was any merit in doing a detailed review of why particular suggestions from stakeholders had not been taken up. JC advised that a detailed document containing all of the comments and the FRC's response would be sent to the Council for the next meeting, but there were not many commonly made comments where no change had been proposed.

2.6 JC noted issues raised around disclosure by charities. Some of this was about the complexity of the legal and regulatory framework, which could not be addressed by FRS 102. There had been some calls to allow the SORP-making body freedom to exempt charities from some of the FRS 102 disclosures, or not require comparatives, however it was fundamental to the SORP process that the standard could not be overridden. The Council advised retaining the existing SORP process.

2.7 JC noted that some of the issues had been around external users being unfamiliar with new information. A lot of outreach had been done, and was continuing, but it had been a big change and more difficult than anticipated. The Chair noted that this time around they were not proposing anything which would change the look and feel of financial statements.

2.8 JC noted that concerns had been raised about Section 1A *Small Entities*, and the extent of encouragement entities to consider further disclosure, or provide more specification. The present position reflected the legal requirements, but this might be an area to consider informal guidance.

2.9 A member of the Council noted that they needed to bear in mind that new generations of professionals were being taught IFRS, hence keeping as close as possible to that was important. A member of the Council noted that some of the comments spoke to a lack of understanding, and indicated that a broader piece around education was required.

2.10 JC noted that they were aiming to publish the FRED in March 2017. The documents of detailed stakeholder feedback and proposed amendments would be circulated that afternoon to Council members.

3 Triennial Review of FRS 102 – financial instruments

3.1 Seema Jamil-O'Neill (SJON) reported that the first issue for consideration was the classification of financial instruments. Feedback from TAG had been incorporated in this final draft. A further consideration was any possible conflict between the new principle and the existing conditions; it should not be necessary to re-assess existing financial instruments, and the drafting provided a mechanism for this.

3.2 In relation to the drafting of the principle, a member of the Council queried whether volatility and risk were the same thing; volatility could be overlooked and so was highlighted here. A member of the Council noted that a lot of the comments received were around difficulties in regards to financial instruments, and he understood the concerns. What was not clear was what Section 11 was trying to achieve; what was the point of the distinction between basic and complex. It was noted that this review focused on incremental improvements and clarifications whilst changing the overall approach to financial instruments was perhaps an issue for a more radical review. A member of the Council noted that the irony was that FRS 102 had landed in a different place on this, and that nobody had been taught to think in these terms, and it could not be extrapolated from IFRS. It was suggested that an explanatory preamble be included in Section 11.

3.3 A member of the Council queried whether they could take out the 'not used' tags. This had been considered this, but it would require rewriting and renumbering of a vast amount of literature, however, consistent terminology of 'deleted' would be used throughout.

3.4 A member of the Council noted references to both basic debt instruments and basic lending arrangements, this would be reviewed for consistency.

3.5 A member of the Council noted that on 1 January 2018 IAS 39 will be superseded by IFRS 9, and the FRC was currently consulting on retaining the option to apply IAS 39 for the time being. The option to apply IFRS 9 would be retained. The only issue was how to address entities using the EU carve-out. It could either be made applicable to all entities, or grandfathered for those who might be using it. The Council advised that the better option was to grandfather the carve-out.

3.6 Looking ahead there may be a transition issue for entities moving from IAS 39 to IFRS 9. When the option to apply IAS 39 is withdrawn transition arrangements would allow hedges to be treated as continuing hedges, so long as documentation was in place. The Council supported this. On macro hedging, the Council advised cross-referring to the IAS 39 rules on macro hedging, as IFRS 9 does.

3.7 The Council noted a proposal to refer directly to derivatives and update terminology in relation to equity instruments.

4 Annual Review of SORPs

4.1 JC said that they had allowed some of the SORP-making bodies to take a bit longer for their reviews this year, to reflect March or July year-ends. However, four had been received. The only potential issue was around fair value hierarchy disclosures, where FRS 102 had been updated, in response to feedback, including from the SORP-making bodies. One SORP proposed editorial amendments to reflect this change, whilst others did not.

4.2 The Council noted that the standard would take precedence, but the SORPs had originally included a work-around to allow reporting consistent with both FRS 102 and IFRS 13, it would be possible to comply with the SORP, expanded disclosure as well as FRS 102. As the changes for FRS 102 were only mandatory from 2017, the Council advised SORP-making bodies could update the SORP at a later date, although earlier attention would be preferable.

4.3 The Council advised the Codes and Standards Committee to issue the FRC's statement on the factual changes proposed by the AIC.

5 Draft LLP SORP

5.1 Mei Ashelford (MA) reported that the CCAB had consulted on changes to the SORP resulting from regulatory changes, to introduce the new small and micros regime for LLPs. The consultation had closed on 1 November 2016, with six responses. Generally the responses were supportive. No significant issues have been identified. The Council agreed to recommend that the Codes and Standards Committee approved the FRC Statement on the SORP for issue.

6 Director of Accounting and Reporting Report

6.1 Anthony Appleton (AA) presented his report. IFRS 9 had been endorsed, and the next issue is the endorsement of its deferral by insurers. There were concerns around the extent of implementation of IFRS 9 for banks, as well as different views on how diverse the accounting outcomes would be. SJON noted that the PRA's view was that banks should be applying a consistent model.

6.2 AA highlighted the question around FRS 103 and insurance contracts, where HMRC had updated references to the old insurance directive without telling anyone, and whether this led to any accounting changes. A roundtable with the firms indicated a view that a legal change was needed, but if it was not forthcoming it was preferred for the FRC to issue something to remove remaining uncertainty. Having spoken to HMRC and BEIS, the FRC were optimistic about a legislative change or other formal response in a short period.

6.3 On climate change, the online consultation had been published. The aim was to bring a version for discussion at the February meeting, and it would need to go through the Codes and Standards Committee at the same time via email. Rosalind Szentpeteri (RS) noted that the document was 200 pages long, with a lot of specific and general guidance, and a supplement on scenario analysis. A member of the Council noted that it had been done through the investor lens. RS noted that documents could be submitted alongside the questionnaire, and the FRC were considering structuring their response as a standard letter.

6.4 AA noted the point around the gender pay gap. Deepa Raval (DR) noted that the Gender Equality Office was due to publish regulations on gender pay gap reporting in early January 2017, which needed to be implemented by companies from April 2017. The disclosures were very detailed, with no exemptions for groups, applying to employers with more than 250 employees. A member of the Council queried whether this was part of the annual report. DR confirmed that it was outside of the annual report, as the intended audience was employers, employees and government, rather than investors. The idea was to stimulate behavioural change, by companies identifying this information.

6.5 DR noted that the other area of note was a follow up on prompt payment. The government had published a response and draft regulations, applying to large companies with no group exemptions. These also needed to be in place by April 2017. DR noted that the information had to be entered onto a government portal, and the FRC felt that all of these requirements should be focused on the same portal.

7 Director of Research Report

7.1 Andrew Lennard (AL) reported that the research consultation document had been published the previous week, and comments requested by 31 March. The Academic Panel had met at the end of November, which had gone well.

7.2 AL reported that the conceptual framework had been discussed by the IASB the previous day. On three topics, they had decided to remain where they had been in the exposure draft: capital maintenance, treatment of long-term investments, and derecognition. A redraft of the chapter on measurement had been discussed, which had changed from the exposure draft and now flowed better. The implications had been discussed, as the ED had only said that characteristics of the asset and the contribution it makes to future cashflows should be considered, without saying what to do with those factors. Although there had been detailed comments, the draft had gone down well.

7.3 A Council member noted that they had previously mentioned writing to the IASB regarding prudence. The Chair said that they had written a slightly different letter in the end. The IASB were trying to decouple prudence and asymmetry. The letter welcomed this, but felt that asymmetry required more discussion to say when it would and would not be used. This would be taken over by the EFRAG Board, which would carry more weight than the UK alone. A copy of the draft letter would be circulated to Council members.

8 Initial views on updating the Guidance on the Strategic Report

8.1 DR said the purpose of the paper was to provide an update on the UK implementation of the Non-Financial Reporting Directive, and to gather views on how the FRC's guidance should be updated.

8.2 On non-financial reporting, the government would soon be publishing the final regulations, incorporating environmental, employee, social, human rights and anti-corruption and bribery matters. The content was similar to the pre-existing strategic report requirements, and the way BEIS had implemented it included a lot of complexity; there would be two sets of near-identical requirements in company law. Large public interest entities (PIEs) with more than 500 employees would need to follow the non-financial reporting requirements set out in the Directive, and others would have to apply requirements in the strategic report. Both would need to satisfy the broader requirements of the strategic report. The NFR directive requires disclosure on business model, non-financial risks, non-financial KPIs, etc. There were some subtle changes in wording that the FRC needed to consider, including the requirement to the extent necessary applying the materiality filter, and to provide information to the extent necessary considering the impact of the company's activities. There were two differing views on materiality: the Commission's view was that this was the impact on the wider group of stakeholders, whereas the BEIS' view was that it should be read in the overall purpose of the strategic and annual reports. This may be addressed in the Commission's guidance on NFR but the timing of publication of this guidance is unclear.

8.3 On the FRC's update to the strategic report guidance, they were keeping in mind the desire to be helpful to companies, and to update the guidance in the simplest way possible. A number of options were under consideration. The first option was to leave the guidance unamended, as many companies were already providing approximately 90% to of the information as part of their strategic reports. The second option was to update the guidance for the additional content required from the Directive, covering bribery and corruption; we would recommend as this as best practice for all companies , whilst specifying those elements which are mandatory depending on the type of company. The third option would be to add a new section within the guidance covering the requirements of the Directive, applying to large PIEs, duplicating some of the existing guidance. The fourth option would be to issue separate guidance on the NFR Directive. The downside here was that other guidance would still need to be referred to. The Chair asked whether DR's recommendation was the second option. DR confirmed that it was.

8.4 The Council discussed this matter, and the following views were expressed.

a. The Chair noted that the NFR Directive went beyond the UK requirement s, to consider the impact on a broader group of stakeholders, and therefore there was a fundamental difference between the two pieces of legislation. DR said that the actual text of the implementation was identical to the wording of the Directive, though the primary audience of the strategic report was the company's members. AA said that there had been very different views on the endpoint, throughout the negotiations on the NFR Directive. The BEIS interpretation of the wording was that it was still viewed through the eyes of investors, and the level of information that they needed. The Chair queried, in light of this, why they should have the NFR Directive in the first place. AA noted the UK had been at the vanguard, and the rest of Europe had never had any reporting requirements relating to non-financial matters. A member of the Council noted that some within the Commission would insist upon the multi-stakeholder approach, and hence would interpret the materiality requirements through that lens. The Chair asked what the FRC stance should be. A member of the Council noted that they were in an investor-focused environment.

b. One member of the Council queried whether s172 spoke about only shareholders. DR said that it started off talking about members, but said that companies should give due regard to other stakeholders. AA said that it set a duty to serve the needs of members, having regard to other stakeholders. A member of the Council noted it was still a capital markets focused perspective, but via consideration of broader factors. Paul George (PG) said that corporate lawyers had interpreted it as being permissive of directors. DR noted that the strategic reporting was, in law, only addressed to members. The Chair asked whose responsibility a public policy concern with public reporting of impact would be. A member of the Council said that the change to the law would be required before the Council could address that matter.

c. The Chair noted that most of the Directive, as far as the UK was concerned, reflected the situation as it was, with some extra parts added in. AA said that in the UK it did not create a need for broader legislative change. The strategic reporting regulations did not give any specific report on how well s172 had been complied with; what the FRC could do is say, via guidance, that people should be more direct in their reporting against responsibilities.

d. The Chair queried when they should consult on this, as the Commission would be issuing mandatory guidelines sometime in 2017. If those guidelines said that it was viewed with the wider lens, would the FRC have to reissue their draft guidance. DR said that the first reporting under the guidelines would be December 2017 year-ends. The FRC could carry on with their timeline whilst they wait for the Commission guidelines. DR said that they could do an education piece whilst they were waiting, to bridge the gap. The Chair noted that a note drawing attention to the minor differences would be helpful. DR agreed that it would be beneficial to communicate that this was not going to be something entirely new.

e. A member of the Council expressed concern that they did not know when the Commission would produce its guidance, and they could be stuck waiting. A member of the Council felt that broadening the stakeholder focus would require a different governance code, and a conflict between broader stakeholder and capital markets interests. Legislative definition of whose directors are being protected would be required. There was no evidence of multi-stakeholder reporting in other European countries.

f. The Chair noted that this was more of a political issue, and they should inform the FRC Board of the situation. DR said that the timing they had envisioned was an ED being issued in Q2 2017, and they were considering whether more clarity needed to be provided on s172 in the strategic report guidance,

8.5 DR noted that the Corporate Governance reform green paper had been out for a few weeks and was open for comment until mid-February. There were three levers available to implement the government's proposals. One of which was legislative change, which was not likely to happen soon. The other mechanisms were to effect change through the UK Corporate Governance Code or through the Guidance on the Strategic Reporting. The FRC was still waiting to see where the government would land with this, but one of the fundamental questions which had been picked up as part of discussions in this area was whether they needed to rethink the purpose of the annual report.

8.6 The Council discussed this and the following views were expressed:

a. A member of the Council noted that by trying to cover broader and broader reporting, the annual report was diverging from a summary of what the company had done in the year, so should the annual report be narrowed and everything else separated out into a separate report? It was noted that this would require legislation.

b. DR felt that more discussion was needed around the purpose of the annual report. It was noted that considering interests of a broader group of stakeholders was important. However, careful positioning was needed for the strategic report guidance that it was around explaining how s172 was applied.

c. A member of the Council queried why the guidance needed changing at all. AA explained that the guidance at present did not sufficiently clarify the links between s172 and the detailed disclosure requirements. It was suggested that they wait until they were clear of the government's direction of travel. The Chair said that it would be good to see practical examples of disclosures to discuss, rather than wait for the government to come out with something. PG said that in the meantime they should issue a note to provide clarity.

8.7 The Council discussed the possible future work of the IASB in narrative reporting. The Chair noted that a member of the Council had been sceptical about encouraging the IASB to get involved in narrative reporting. The Council expressed similar scepticism. AA said that the most tangible achievement would be to look at their management commentary practice statement again. A member of the Council noted that the IASB, with its international focus was in a good position to be the competent body to bring together the broader developments in non-financial reporting.

9 Any Other Business

9.1 AA informed the Council that SJON would be going on secondment to BEIS for a year, to fill a gap in accounting expertise.

9.2 The Council expressed its gratitude to the Chair for service, as he was standing down from the Chairman role.

9.3 The meeting closed at 11.49.