Financial Reporting Council

Minutes of a meeting of the Accounting Council held on Thursday 19 June 2014 in the Boardroom at 8th Floor, 125 London Wall, London, EC2Y 5AS

Present:

Roger Marshall	Chair
Chris Buckley	Council Member
Gunnar Miller	Council Member
Liz Murrall	Council Member
Veronica Poole	Council Member
Pauline Wallace	Council Member

Observers:

Alison Ring	HMRC Observer (in place of Matt Blake)
Michael Kavanagh	IAASA Observer

In attendance:

Anthony Appleton	Director of Accounting and Reporting Policy
Mei Ashelford	Project Director, Accounting & Reporting Policy Team
Jenny Carter	Director of UK Accounting Standards, Accounting & Reporting Policy Team
Francesca Chittenden	Council Secretary
Rosalind Clarke	Project Manager, Accounting & Reporting Policy Team
Annette Davis	Project Director, Accounting & Reporting Policy Team
Andrew Lennard	Director of Research
Melanie McLaren	Executive Director
Seema Jamil-O'Neill	Project Director, Accounting & Reporting Policy Team
Susanne Pust Shah	Project Director, Accounting & Reporting Policy Team
Deepa Raval	Project Director, Accounting & Reporting Policy Team
Mariela Isern	Technical Advisor, IASB (Minute 1 only)
Yuji Yamashita	Fellow, IASB (Minute 1 only)

Welcome and Apologies for absence

Apologies were noted from Richard Barker (Council Member), Mike Ashley (EFRAG observer) and Ross Campbell (HMT Observer).

1. Macro-hedging education session

1.1 Mariela Isern (MI) introduced a presentation on the IASB Discussion paper 'Accounting for Dynamic Risk Management (DRM): a portfolio approach to macro hedging'. The Council noted that the objective of the IASB project is to develop a macro-hedge accounting solution that reflects the risk management strategies adopted by entities, and that, for illustrative purposes the discussion paper (DP) uses dynamic interest rate risk management by banks.

1.2 The key points noted by the Council were as follows:

- The IASB is exploring an accounting approach to better reflect dynamic risk management (DRM) activities in entities financial statements.
- The current hedge accounting requirements (IAS 39 and IFRS 9) are not conducive to the application of DRM.
- DRM is a continuous process undertaken for open portfolio(s) to which new exposures are frequently added and mature and is a process that is updated frequently in reaction to the changes in net risk position.
- The Portfolio Revaluation Approach (PRA), as proposed by the IASB, permits exposures within open portfolios to be revalued in respect of the risk being managed.
- The objective of PRA is to reflect, in the financial statements the offset between the revaluation adjustment relating to the managed exposures and the fair value changes of the hedging instrument that are reflected in profit and loss.
- PRA is not a full fair value model.
- A number of improvements can be expected following the application of the PRA, including enhanced information about DRM, reduced operational complexities such as tracking and amortisation. The model captures the dynamic nature of risk management on a net basis, and considers behavioural factors. The intention is that the approach could be applied to different types of risks managed in open portfolios.
- Under the PRA core demand deposits are deemed to be fixed rate deposits which are likely to have longer maturities. Banks usually hedge these positions for risk management purposes (behaviouralisation)
- The scope of the PRA will have significant implications for the information provided for users of financial statements in relation to the statement of financial position and the statement of comprehensive income.
- The scope will have significant implications on how operationally feasible the application of the PRA will be for an entity, concerns raised include a concern over the move away from a sub-portfolio approach and a move away from a proportional approach.
- The IASB is seeking specific input on whether, and if so how, the PRA could be applied to DRM other than interest rate risks in banks, and whether there is a need for an accounting approach for other risks.
- The IASB is considering two scope alternatives, a focus on DRM and a focus on risk mitigation (sub-portfolio approach).

1.3 In response to the presentation the following queries and observations were made:

- The Council queried whether a ‘one size fits all’ solution would be appropriate, or acceptable, given the varying economic situations of different countries and the varying business models and risk management approaches of different banks.
- The Council expressed concern over the proposal to prohibit fair value hedging, highlighting that a move away from fair value hedging would require banks, and potentially many other entities, to change their approach to risk management.
- The Council also expressed concern over the operational implications and the scope of the proposals, whilst it was noted the approach would provide for a ‘holistic’ approach to risk management, the Council was unsure whether the expected benefits would outweigh the costs.
- It was noted that a decision on whether or not the IAS 39 implementation guidance would be withdrawn would be taken once the scope of the project had been agreed.

2. Minutes of the previous meeting and rolling actions

2.1 The Council approved the minutes of the Accounting Council meeting held on 15 May 2014 as an accurate record of the meeting subject to the addition of the final bullet at paragraph 10.2.

2.2 The rolling action log was noted.

3. Director of Accounting Update

3.1 The Council noted a paper which provided an update on developments relating to UK and international accounting standards, matters of policy and an overview of staff activities since the last meeting. Particular attention was given to the following matters:

IASB

3.2 The Council noted that the IASB had published IFRS 15 *Revenue from contracts with customers* on 28 May 2014, effective for periods on or beginning 1 January 2017. The Council also noted that the FASB had published its equivalent standard.

3.3 In relation to the Conceptual Framework it was also noted that the IASB had:

- As encouraged by the FRC, tentatively decided to increase the prominence of stewardship within the overall objective of financial reporting.
- As encouraged by the FRC, tentatively decided to reintroduce a limited concept of prudence (being the exercise of caution when making judgements under conditions of uncertainty).
- Despite encouragement by the FRC to reconsider the replacement of reliability with faithful representation, had tentatively decided to retain faithful representation in the Conceptual Framework.

3.4 The Council noted that the IASB and FASB had reached a number of decisions in relation to their leases proposals and that the decisions taken do not reflect the recommendations put forward by the FRC to make the proposals less burdensome and to exclude from the scope of the project contracts that are essentially the provision of services. The Chairman reported that as a consequence of the tentative decisions the European Members of ASAF would be preparing a paper for discussion at a round table event in September, to address two issues:

- Whether contracts for services should be outside of the scope of the leases standard; and,
- Whether the FASB or IASB model should be adopted.

The Council welcomed the approach of ASAF Members and suggested that the paper should ‘go back to basics’ and set out clearly what the objective of making amendments to the accounting for leases should be.

EFRAG

3.5 Annette Davis (AD) provided a verbal update on the meeting of the EFRAG TEG held on 11-13 June 2014. AD reported that:

- IFRIC 21 Levies had been endorsed and a paper would be considered at the July meeting of EFRAG to discuss the implications for IAS 7.

- Consideration was being given as to whether IFRS 15 Revenue Recognition requires further review.
- An expert group, established by the Commission to review IAS Regulation had been established and was due to meet on 15 July. The Council noted that Melanie McLaren (MM) has been appointed to the Group and that Anthony Appleton (AA) would be her deputy; Liz Murrall reported that she had also been appointed to the group.

3.6 AD also reported that the EFRAG Reform Assembly had approved the amended statute and internal rules regarding the governance of the reformed EFRAG. The Council noted that the changes would take effect from 31 October 2014 and that the Commission would nominate the President of the EFRAG Board whose appointment would need to be approved by the European Parliament.

UK Reporting

3.7 The Council noted that the Guidance on the strategic report had been published on 9 June 2014.

4. Amendments to FRS 102 – Classification of financial instruments (FRED 54)

4.1 Seema Jamil-O'Neill (SJON) introduced a paper that set out proposed Amendments to FRS 102, relating to the classification of financial instruments as 'basic' or 'other' arising from the responses to FRED 54. The Council noted that the Amendments had been drafted in light of the Council discussion in May and to reflect comments made by the UK GAAP Technical Advisory Group (TAG).

4.2 SJON summarised the outstanding issues that had been identified by respondents to the consultation and the recommended approach for responding to those issues. Through discussion the following observations were made and advice was given:

- In order to address the issue identified at the May Council meeting regarding an inconsistency between FRS 102 and Companies Act 06, an exception should be included in Section 12 (and the Accounting Council's advice amended accordingly) in respect of non-basic financial instruments where the Regulations would not permit the use of FVTPL, instead, requiring them to be measured at amortised cost. The Council considered that the inclusion of the exception would be the most sensible solution and noted that it would only be applicable to small number of entities under a narrow set of circumstances.
- A sentence should be added to paragraph 11.9(c) for clarification purposes and the sentence should read 'the inclusion of contractual terms that, as a result of the early termination, require the issuer to compensate the holder for the early termination, does not in itself, constitute a breach of this condition'.
- Clause 11.9 (aB) should be amended to specify that, for loans(which arise in the Social Housing Sector), the variation of returns must be determinable and a unilateral option by the lender to change the terms of the contract are not considered determinable for this purpose. The Council also approved the inclusion of a paragraph in the advice section summarising the Council's views on Social Housing Sector loans and requested that the decision and the associated reasons should be relayed to the Housing SORP working party.

- The Council agreed not to address the issues identified by respondents in relation to the treatment of investments in preference shares that are also debt instruments at this stage, given that the issue is unlikely to lead to difficulties for a significant majority of constituents. The Council noted that the issue was due to be discussed by TAG and that it was intended that the issue would be picked up as part of the 3-year post-implementation review.
- The definition of 'variable rate' should be included directly under the related paragraph rather than in the glossary, given that the definition provided is specific to the circumstances of the related paragraph. The Council agreed not to provide definitions of 'market rate', 'leverage' or 'derivative'.
- Either paragraph 11.9a (A) or the definition of 'variable rate' should be taken out of the body of the text and added as a footnote as the two deal with similar (but not identical) requirements and situating them together could be confusing.
- One, illustrative example, per classification rule should be included in the body of the amendment document.
- The Council noted that, as agreed at the previous meeting, an amendment had been made to the transition provisions to allow an early adopter to designate financial instruments at fair value from the transition date.
- The Council also noted that the issue of the fair value hierarchy, as identified by various SORP making bodies had not been addressed but that it would be considered as part of the three-year post implementation review, the Council suggested that this should be made clear in the feedback statement.

4.3 Subject to the minor amendments suggested at minute 4.2 the Council approved its advice to the Codes & Standards Committee and FRC Board that the amendments to FRS 102 – *Classification of Financial Instruments* are issued.

5. Amendments to FRS 102 – Hedge Accounting (FRED 51)

5.1 Susanne Pust Shah (SPS) introduced a paper that set out the final draft Amendments to FRS 102 – *Basic Financial Instruments and Hedge Accounting*, the Impact Assessment and the Feedback Statement.

5.2 The Council noted a table that set out the advice decisions previously given by the Council in respect of hedge accounting and feedback given by the TAG. The Council noted, and expressed content, with the manner in which its advice had been reflected in the Amendments.

5.3 The Council noted that a number of respondents to FRED 51 had requested that the Amendments include examples to demonstrate how ineffectiveness is accounted for. Following a brief discussion the Council concluded that examples should be provided, so as to respond to the request and to highlight that ineffectiveness is a common occurrence; the Council advised that whilst it would be acceptable to include simple examples, to be of use it must be clear what the cause of the ineffectiveness is. The Council also suggested that the current 'example two' be revised so that it is better described.

5.4 The Council noted the issues raised by the TAG in relation to transitional provisions, but was content that, as recommended in the paper, no transitional exemptions should be given, and that on transition amounts deferred should be removed from the balance sheet with an adjustment to retained earnings. The Council also agreed with the recommendation that designation both at fair value through profit and loss and the application of hedge accounting for early adopters should be permitted.

5.5 Subject to the amendments suggested by the Council and the inclusion of examples of ineffectiveness, the Council approved its advice to the Codes & Standards Committee and FRC Board that the Amendments to FRS 102 – *Basic Financial Instruments and Hedge Accounting* are issued. The Council also agreed the Impact Assessment and Feedback Statement.

6. Amendments to FRS 101 (2013/14) (FRED 53)

6.1 Mei Ashelford (MA) introduced the final version of Amendments to FRS 101 Reduced Disclosure Framework (2013/14 Cycle) (Amendments to FRS 101) which included proposed amendments to:

a) IFRS 10 Consolidated Financial Statements and IAS 27 Separate Financial Statements (required as a result of the IASB's project *Investment Entities)* and
b) IAS 36 Impairment of Assets (required as a result of the IASB's project *Recoverable Amount Disclosures for Non-Financial Assets*.

The Council noted that the Amendments had been drafted to reflect the discussion of the Council at the May meeting and the feedback from the TAG.

6.2 The Council approved its advice to the FRC Board to issue the Amendments to FRS 101 Reduced Disclosure Framework (2013/14 cycle), the Impact Assessment and the Feedback Statement.

7. FRED 55 – Draft Amendments to FRS 102 – Pensions obligations

7.1 Jenny Carter (JC) introduced an amendment to FRS 102 *The Financial Reporting Standards applicable in the UK and Republic of Ireland* that had been drafted in response to requests for clarification as to whether or not IFRIC 14 *IAS 19 – The Limit on a Defined Benefit Asset, Minimum funding requirements and their interaction* might be relevant to their circumstances.

7.2 In introducing the draft amendment JC reported that the initial solution discussed by the Council at the May meeting to remove the asset ceiling had not been pursued as, following further consideration of the solution particularly in cases where the pension plan trustees can unilaterally decide to increase benefits or can distribute any surplus to charities, it would be appropriate to restrict the asset to be recognised.

7.3 The Council considered the newly proposed solution to the issue and agreed that the insertion of a paragraph into FRS 102 to clarify that, for entities with defined benefit plans applying FRS 102, there is no need to consider whether a 'schedule of contributions' gives rise to a liability in addition to the asset or liability recognised as the net total of the present value of the obligations and the fair value of plan assets would be the most pragmatic solution. The Council noted that the proposed solution had been considered and supported by members of the TAG.

7.4 Through discussion of FRED 55 and the Advice the following suggestions were made:

- To improve clarity, the second sentence of paragraph 2.7 should be revised to simply state that 'for the avoidance of doubt a schedule of contributions shall not be regarded as an onerous contract'.
- The Advice Statement should be revised to emphasise more clearly that the solution proposed is a practical one. To achieve this, the Council suggested that paragraph 13 of the draft Advice should be removed.

7.5 Subject to the amendments set out at 7.4 and discussion of the proposals with the FRC Conduct Committee, the Council approved its advice to the Codes & Standards Committee and FRC Board that the Exposure Draft, FRED 55 *Draft Amendments to FRS 102 – Pension Obligations* be issued for a three month comment period.

8. Draft Consultation document: Accounting Directives

8.1 JC introduced a revised draft Consultation Document on the implications for accounting standards of the new Accounting Directive. JC reported that the FRC intends to issue a Consultation Document alongside the BIS Consultation over the summer, and that a further, more detailed Consultation would be undertaken later.

8.2 The Council noted that the Consultation document had been updated to reflect the Council's conference call, held on 4 June, and accordingly, greater prominence had been given to the need for directors of small entities to consider whether additional disclosures are required for a true and fair view.

8.3 The Council approved its advice to the Codes & Standards Committee and FRC Board to issue the Consultation Document, subject to any minor changes necessary for consistency with the BIS consultation. The Council requested that should any significant changes be required, those changes be circulated to the Council for consideration.

9. Disclosure Initiative (Amendment to IAS 1)

9.1 Rosalind Clarke (RC) introduced a paper that provided an overview of the IASB Exposure Draft 'Disclosure initiative (Proposed amendments to IAS 1)'. The Council noted that aim of the proposed narrow-scope amendments to IAS1 is to 'help alleviate some of the problems that have been identified with disclosure in financial reporting' and that some aspects of the project are closely related to the IASB's work to review the Conceptual Framework. RC highlighted that the ED forms part of the IASB's broader 'Disclosure Initiative' project through which the IASB intends to conduct a more thorough review of IFRS disclosure requirements, and that further sub-projects on 'reconciliation of liabilities from financing activities', 'materiality', 'principles of disclosure' and 'general disclosure review' are planned.

9.2 The Council discussed the FRC's draft response to the consultation, noting that comments were also being sought from the Corporate Reporting Review team and the Financial Reporting Lab given its ongoing project on accounting policy disclosure. Through discussion the following observations and suggested amendments to the response were made:

- The IASB has not succeeded in its attempt to separate and define the concepts of 'presentation' and 'disclosure'; examples should be provided to highlight the confusion arising from their definitions of the concepts, and the inconsistencies in the Exposure Draft between the definitions and the use of the concepts therein.
- In relation to materiality, the IASB should be encouraged to take a principles based approach and be discouraged from taking a rules based approach.
- The IASB should be encouraged to give prominence to understandability rather than consistency; this would reflect the approach promoted in the FRC Guidance on the strategic report.

9.3 The Council requested that the cover letter accompanying the response to the IASB and the letter to EFRAG be amended to reflect the views of the Council as set out at 9.2. Subject to the amendments listed at minute 9.2 the Council approved the issue of the draft response, the accompanying cover letter and the letter to EFRAG.

10. Any other business

10.1 The Council noted that an Accounting Council away day would be held on the 17 July and requested that an agenda for the day be circulated in advance of the papers.

10.2 There was no other business.