Financial Reporting Council

Minutes of a meeting of the Accounting Council held on Thursday 15 July 2015 in the Boardroom at 8th Floor, 125 London Wall, London, EC2Y 5AS

Present:	
Pauline Wallace	Alternate Chair
Richard Barker	Council Member
Chris Buckley	Council Member
Michael Gallagher	Council Member
Gunnar Miller	Council Member
Liz Murrall	Council Member
Mark Smith	Council Member
Jeremy Townsend	Council Member
Observers:	
Michael Kavanagh	IAASA Observer
Lee Piller	FCA Observer
In attendance:	
Anthony Appleton	Director of Accounting and Reporting Policy
Francesca Carter	Council Secretary
Annette Davis	Project Director, Accounting & Reporting Policy Team
Andrew Lennard	Director of Research
Seema Jamil-O'Neill	Project Director, Accounting & Reporting Policy Team
Christoph Pelger	University of Innsbruck (by Skype - minute 3 only)
Susanne Pust Shah	Project Director, Accounting & Reporting Policy Team
Roz Szentpéteri	Project Manager, Financial Reporting Council

Welcome and Apologies for absence

Apologies were noted from Roger Marshall (Chairman), Veronica Poole (Council Member), Melanie McLaren (Executive Director, Codes & Standards) and Matt Blake (HMRC Observer)

1. Minutes of the previous meeting and rolling actions

1.1 The minutes of the meeting held on 4 June 2015 were approved for publication.

1.2 The minutes of the conference call held on 16 June 2015 were approved for publication subject to a minor amendment at paragraph 1.8.

1.3 The rolling action log was noted.

2. Director of Accounting Report

2.1 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 June meeting

2.2 The Council noted that the IASB had held two separate sessions on insurance contracts at its June meeting, an education session on the implications of deferral of IFRS 9 *Financial Instruments* for insurance companies; and a decision making session on the variable fee approach for participating contracts. Seema Jamil-O'Neill (SJON) reported that the general consensus at the education session was not in support of the proposed deferral of IFRS 9 and that members of the Board appeared amenable to amendments to IFRS 4. The Council noted that the July IASB meeting was scheduled to consider a paper setting out a range of possible solutions for the impact of the mismatch between implementation dates of IFRS 9 and the new standard on accounting for insurance contracts. SJON reported on discussions she had held with a number of UK investors and it was noted that whilst mixed views had been expressed in respect of the proposal to defer, concern over accounting volatility had been consistently expressed. It was also noted that a number of UK investors had expressed a desire for IFRS 4 Phase II to be issued as soon as possible.

2.3 The Council noted that the IASB had also considered IFRS 15 *Revenue from contracts with customers* and had modified the tentative decisions made at its May meeting in order to reach agreement with the FASB on a single set of proposed amendments.

ASAF

2.4 The Council noted that the FRC has not been reappointed to ASAF, and that European representatives on ASAF now include France, Italy, Germany and EFRAG.

IFRS Foundation Trustees' Review of Structure and Effectiveness

2.5 AA circulated a summary of the IFRS Foundation Governance Review and tentative views as to what the FRC response to the IFRS Foundations 'Request for views' could say. The Council noted that:

- The review does not suggest any significant changes from the current position and highlights the steps that have been taken over recent years.
- The 'Request for Views' invites comments on three areas, relevance of IFRS, consistent application of IFRS and the governance and financing of the IFRS Foundation. The FRC has previously identified, and commented on, these three issues.

2.6 The Council discussed the Request for views document and the tentative views proposed, the following observations and suggestions were made:

- The Council supported the goal of the IFRS Foundation to be publicly funded and that funding be shared amongst jurisdictions on the basis of GDP, highlighting the need for the funding structure to provide long-term stability.
- The Council expressed concern in respect of the proposal to push for greater funding from accounting firms, highlighting the potential, perceived or otherwise, threat to independence.
- The Council advised that the FRC should not support the European Commission's position which proposes that jurisdictions who fail to fund publicly should be excluded from the governance structure.
- The Council suggested that the IFRS Foundation could be encouraged to review the appropriateness of the current focus on geographical split. Whilst the Council acknowledged the importance of the geographical split at Trustee level it commented that, at the Technical Board level, geographical split is less relevant.

- The Council suggested that the IFRS Foundation could be encouraged to consider reducing the number of Trustees, which currently is 22, highlighting that the 'optimum number' for any Board is 8–12 members.
- The Council highlighted the need to ensure that any changes to the governance structure do not bring political, or other, influence into the standard-setting process. It was suggested the response could encourage the IFRS Foundation to consider establishing a governance structure whereby Trustees set the framework in which the Board operate and that the Board are accountable to the Trustees in achieving the objectives and outputs that the Trustees set.
- The Council noted that a significant number of narrow-scope amendments and IFRIC agenda decisions have been made over recent years and that this may lead to the impression that the standards are in a constant state of change. The Council supported the view that the IFRS Foundation should be encouraged to take a principle-based approach to standard-setting and avoid issuing so many narrow-scope amendments in the future.

2.7 The Council noted that the deadline for submitting a response to the 'Invitation to Comment' is 30 November 2015 and that a draft, reflecting the views expressed by the Council, would be presented to the Council for review in due course.

FRC

2.8 The Council approved the appointment of Colin Edwards as a member of the UK GAAP Technical Advisory Group.

3. Conceptual Framework – Academic Papers on Reliability and Fair Value

3.1 The Council received two presentations. The first from Christoph Pelger (CP) on an academic paper he had co-authored with Carsten Erb (Heinrich Heine University Dusseldorf) entitled '"Twisting words'? – a study of the construction and reconstruction of reliability in financial reporting standard setting'. The second from Richard Barker (RB) on an academic paper he had co-authored with Sebastian Schulte entitled 'Fair Value for Non-Financial Assets'. The presentations had been selected to inform the Council's thinking ahead of its discussions of the IASB's Conceptual Framework Exposure Draft.

'"Twisting words'? – a study of the construction and reconstruction of reliability in financial reporting standard setting'

3.2 The Council noted:

- That the academic paper addresses two research questions:
  a) how and why did reliability first emerge as a qualitative characteristic in standard-setting;
  b) why was reliability abolished and replaced with faithful representation.
- That the findings in respect of question (a) had been informed through and an analysis of literature and contributions from academics and standard-setters.
- That the findings in respect of question (b) had been informed through an analysis of documents published by the IASB / FASB, IASB and FASB Board meeting minutes, comment letters received by the IASB and FASB in response to relevant Discussion Papers (DP) and Exposure Drafts (ED) and through interviews with IASB members.
- An analysis of the history of the construction of the term 'reliability'. CP reported that:

  - Objectivity and verifiability are evolutionary characteristics of financial accounting.
  - A redefinition of objectivity was influenced by the natural sciences in the 1960s and resulted in a move away from a focus on evidence-based towards focus on the importance of ‘usefulness considerations’ and a few years later, ‘relevance’.
  - In the 1980’s a push towards current value accounting resulted in an amalgamation of reliability and verifiability with the new ‘academic’ concept of faithful representation.
- In 2006 the IASB issued a DP that proposed replacing reliability with faithful representation, suggesting that reliability ‘is not doing the job’ and there are many different understandings as to what it means. 73% of comment letters received in response to the DP rejected faithful representation and demanded stricter draft of ‘verifiability’, however, IASB staff interpreted the comment letters as continued confusion and misunderstanding of the concept of ‘reliability’ and reaffirmed the replacement of reliability with faithful representation.
- In 2009 an IASB discussion indicated unease with the replacement of reliability, however, as a result of underlying concerns in respect of the misinterpretation of ‘reliability’, particularly at staff level no action was taken to address the unease.
- The IASB has not moved into the direction of fair value since 2010.

3.3 The Council thanked CP for his presentation. In response to a query CP clarified that the comment letters received in response to the 2005 DP did not set out a clear view as to what ‘reliability’ means. CP also acknowledged that a drive towards the full fair value model of accounting was a backdrop to the IASB discussion.

Fair Value for Non-Financial Assets

3.4 RB presented a summary of his academic paper ‘Fair value for non-Financial Assets’. The Council noted:

- The concept of accounting as representation and the suggestion that the balance sheet is a representation of economic ‘reality’.
- That the accounting process is not neutral and what counts as accounting representation changes over time.
- That fair value measurement (FVM) has emerged as the preferred measurement model of the IASB. FVM is explicitly market orientated in contrast with the traditional, transaction based perspective. FVM in IFRS can be considered a shift between from the metaphorical construct of ‘accounting as history’ (a faithful record of the transactions of an enterprise that serve the function of social memory and provide an account of the stewardship of resources) to the metaphorical construct of ‘accounting as economics’ (the suggestion that accounting should mirror current economic realities and reflect basis economic principles and that accounting should be the benchmark of market signals and expected cash flows).
- IFRS 13 insists on the generality of a market perspective, whereby the objective to report market value holds whether or not markets themselves exist. At level 1, this objective could be considered appropriate, however, at level 3, where a market perspective is required when there is no market, the objective could be considered logically incoherent and could result in unstable representation.
- That the essence of faithful representation as established by IFRS results in the absence of a trade of between relevance and reliability.
- That case study evidence suggests there is an absence of institutional facts.

3.5 The Council discussed the presentation and the messages set out. The following observations and comments were made:

- It was commented that verifiability is a critical factor for stewards who want to be confident that the information presented has been verified, this verifiability cannot be provided for level 3 transactions under IFRS 13.
- It was noted that the comment letters submitted in response to the IASB's 2006 DP referred to in the previous presentation highlighted the importance of verifiability and reliability.
- It was suggested that 'value in use' might be a more appropriate measure than FVM.
- It was commented that the term 'faithful representation' is misunderstood and that preparers should simply be encouraged to have consideration of relevance, reliability, completeness and neutrality.

3.6 The Council thanked RB for his presentation.

4. Negative Interest Rates

4.1 SJON introduced a paper setting out a number of key accounting considerations arising from the economics of low or negative interest rates and details of a potential project led by EFRAG on the topic. SJON reported that the current IASB project on discount rates does not address the issue.

4.2 The Council discussed the proposed EFRAG project and noted an EFRAG Board request that the scope of the project be clarified and widened to include consideration of the impact of low interest rates. Through discussion the following observations and comments were made:

- The Council noted the output of the project is likely to be the issuance of a discussion paper by EFRAG.
- The Council noted that whilst there is a strong possibility that current accounting standards would not adequately deal with negative interest rates it is difficult to make this assumption in respect of low interest rates.
- The Council acknowledged that a number of difficulties will arise in attempting to widen the scope to address the impact of both 'low' and 'negative' interest rates and highlighted that conceptually, 'low' interest rates and 'negative' interest rates are two different issues that should not be confused.
- The Council expressed concern that widening the scope to include both 'low' and 'negative' interest rates could result in an overlap with the IASB's discussion on discount rates.
- The Council expressed some support for the executive's proposal to encourage EFRAG to go beyond mere technical analysis and to consider the impact of 'negative' and 'low' interest rates on both financial and non-financial instruments. The Council noted that the executive suggest this broader review would highlight a need for consideration of discount rates and help the IASB in considering how best to address this issue in its own research paper.
- The Council supported the proposal that EFRAG should be encouraged to engage with preparers and users of financial statements to ensure the analysis reflects their experiences and expectations. The Council suggested that EFRAG should also be encouraged to explore practice in both the public and private sectors.

4.3 The Council noted that the executive will continue to influence the EFRAG project along the lines discussed and will provide updates to the Council as appropriate.

5. Conceptual Framework – Exposure Draft

5.1 Andrew Lennard (AL) introduced a paper commencing the Accounting Council's development of the FRC response to the IASB's Exposure Draft (ED): Conceptual Framework for Financial Reporting. The Council noted that, for each issue identified, the paper sets out:

- the comments made by the FRC in its response to the Discussion Paper (DP);
- what is proposed in the ED; and
- a possible 'line to take' in the FRC response.

5.2 AL confirmed that in developing the proposed 'line to take', consideration had been given to the view expressed at the June meeting to welcome proposals that respond to concerns the FRC raised in response to the DP and to FRC objectives.

5.3 The Council noted that EFRAG had issued two invitation to comment documents relating to the IASB Conceptual Framework, one inviting comments on the ED itself and a second inviting comments on the Conceptual Framework – Bulletin: Profit or Loss versus OCI. AL reported that EFRAG have set the deadline for responses to its invitation comments at the same date as the IASB comment period end date and had requested the IASB extend its deadline. The Council noted that, due to time constraints, it is likely that the FRC response to the IASB would also be submitted to EFRAG rather than a formal comment on its discussion documents.

5.4 The Council discussed the paper and 'possible lines to take' in detail, the following observations and suggestions were made:

Stewardship

- The Council noted that the IASB has, as advocated by the FRC, enhanced the emphasis on stewardship information. Whilst the Council agreed this should be acknowledged in the response, the Council did not consider it satisfactory for stewardship to be considered within the decision useful objective.
- Through discussion the Council highlighted that stewardship perspective and the decision-useful perspective are two very different perspectives that should be given equal prominence. It was commented that the stewardship perspective provides equity shareholders with information that enables them to make an assessment on the delivery of the business model and the creation of long-term shareholder value which is in contrast to the decision-useful perspective which is forward looking.
- The Council also discussed whether the definition of 'primary users' as set out in the ED is appropriate. One suggestion was that the 'primary users' of financial statements should be equity investors.
- The Council suggested the response should not repeat the comments set out in the response to the DP but that, in order to promote the importance of the stewardship perspective, the response should encourage reflection on what the financial statements are for and who in practice uses the information presented in the financial statements - noting the financial statements are backwards looking.

The Business Model

- The Council noted that whilst ED does not acknowledge the importance of providing information that assists an assessment of the entity's business model it does identify the main implications of the desirability of reflecting the entity's business model in relation to specific topics.
- The Council supported the proposal that the response should highlight the importance of the business model in making an assessment of stewardship and to suggest that the coherence of the Conceptual Framework would be improved if the chapters of the objectives or qualitative characteristics noted the importance of information that is relevant to an assessment of the business.

Prudence

- Whilst the Council welcomed the reintroduction of the concept of prudence in to the ED the Council expressed disappointment that prudence had been characterised as the exercise of caution when making judgements under conditions of uncertainty and does not reflect, in the body of the Conceptual Framework (CF), the notion of 'asymmetric prudence'. The Council discussed the reasons set out in the 'Basis for Conclusions' for excluding asymmetric prudence and agreed with the view that these arguments should be rebutted. The Council agreed that the IASB should be encouraged to include asymmetric prudence in the CF on the basis that it is a fundamental feature of financial reporting. The Council also suggested it would be useful to highlight in the response that the inclusion of asymmetric prudence in the CF would not require that future standards would invariable reflect asymmetric prudence but that this would be a matter of judgement made in the development of standards.
- The Council noted that, in the ED, the term prudence is consistent with neutrality and discussed whether the term 'neutrality' is consistently interpreted given that the CF definition is inconsistent with the definition in plain English. The Council concluded that the use of the term 'neutrality' may lead to confusion and suggested that the IASB should consider replacing the term with 'unbiased'.

Reliability and faithful representation

- The Council noted that the description of faithful representation set out in the ED does not include the idea that the information presented 'can be depended upon by users' and agreed that the response should highlight this and encourage the IASB to reinstate the concept.
- The Council noted that the ED groups measurement uncertainty under the heading of 'relevance' and suggested that this positioning not only diminishes the important trade-off between relevance and reliability but also lessens the focus on verifiability.
- The Council discussed whether the umbrella term 'faithful representation' is helpful suggesting that that the term does not provide a sufficient filter. One suggestion was that the provision of a list of matters to consider when addressing an accounting issue would be more useful in practice.

The Statement of Profit or Loss (P&L) and Other Comprehensive Income (OCI)

- The Council noted that the ED sets out two views, the majority view of IASB members and an 'alternative view' proposed by two IASB members.
- The Council noted that the CF addresses the distinction between P&L and OCI and provides a description of the purpose of the statement of P&L; the Council agreed this is a useful step and that the response should acknowledge this.

- The Council suggested that response should encourage the IASB to review the definition of OCI, suggesting there is a lack of clarity over the term.
- The Council agreed that the response should support the presumption set out in the ED that all income and expenses are to be reported in profit or loss, expect where their exclusion would enhance the relevance of profit or loss.
- The Council agreed that the response should support the proposal in the ED that income and expenses that are excluded from profit or loss are likely to be changes in value rather than the result of transactions of events and supported the suggestion that it would be preferable to draft the CF in that way.
- The Council discussed the proposals set out in the ED with respect to recycling and expressed concern with the presumption set out in the ED that all income and expenses initially reported in OCI will be recycled.
- The Council highlighted that cash flows are not mentioned in the CF.
- The Council expressed disappointment that a holistic and fundamental analysis of the issues relating to the reporting of financial performance has not been undertaken and suggested that, as a result, there is a lack of conceptual basis for some of the assumptions made in the ED. The Council suggested that the response should reflect this disappointment and whilst the Council agreed the response should provide support for the ED as an interim step, the Council suggested that, if its comments are reflected, the response should emphasise there are still a number of issues to be addressed and therefore further work on the reporting of performance is needed.

5.5 AL thanked the Council for their comments and reported that a document setting out the 'tentative view' of the Council would be published on the FRC website. AL confirmed that the document would be circulated to the Council by email for comment before publication.

5.6 The Council also noted that a joint FRC / ICAEW stakeholder outreach event would be held on 3 September.

6. Any other business

6.1 There was no other business.