Financial Reporting Council

Minutes of a meeting of the Accounting Council held on Thursday 11 September 2014 in the Boardroom at 8th Floor, 125 London Wall, London, EC2Y 5AS

Present:	
Roger Marshall	Chair
Richard Barker	Council Member
Chris Buckley	Council Member
Michael Gallagher	Council Member
Gunnar Miller	Council Member
Liz Murrall	Council Member
Veronica Poole	Council Member
Jeremy Townsend	Council Member
Mark Smith	Council Member
Pauline Wallace	Council Member
Observers:	
Mike Ashley	EFRAG Observer
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
Annette Davis	Project Director, Accounting & Reporting Policy Team
Jennifer Guest	Project Director, Accounting & Reporting Policy Team
Seema Jamil-O'Neill	Project Director, Accounting & Reporting Policy Team
Andrew Lennard	Director of Research
Melanie McLaren	Executive Director, Codes & Standards (from minute 2.4)
Susanne Pust Shah	Project Director, Accounting & Reporting Policy Team
Deepa Raval	Project Director, Accounting & Reporting Policy Team

Welcome and Apologies for absence

The Chair welcomed Michael Gallagher to his first Council meeting.
Apologies were noted from Ross Campbell (HMT Observer).

1. Minutes of the previous meeting and rolling actions

1.1 The Council approved the minutes of the Accounting Council meeting held on 17 July 2014 for publication and the note of the Accounting Council Strategy discussion as an accurate record.

1.2 The Council noted the rolling action log and that all actions were complete.

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

2.2 The Council noted:

- The IASB had issued the final version IFRS 9 *Financial Instruments* and that an IFRS Transition Resource Group (ITG) had been established to focus on potential implementation issues associated with the impairment requirements of IFRS 9. The Council also noted that the FRC would be assisting BIS in drafting a letter to the European Commission in relation to the commencement of the process for adopting IFRS 9 for use in Europe. The Council advised that the letter should: encourage the Commission to begin the process of adoption as soon as the new EFRAG Board is in place; to take into account the extent of outreach already undertaken by the IASB and the field testing conducted by EFRAG; and to provide certainty to European companies by providing a clear timetable to final adoption of the standard.
- The IASB had reaffirmed its 2013 ED proposal that, in relation to insurance contacts, it would only permit locked-in interest rates to be used for the purposes of re-measurement of contractual service margin for non-participating contracts subsequent to initial recognition. The Council noted that UK preparers had expressed concern about their ability to operationalise the proposal, particularly with regard to tracking locked in interest rates. UK preparers had also raised concerns about IASB staff's recent proposals on accounting for participating contracts. In particular, concerns were raised about the criteria being proposed for contracts to qualify for treatment as participating contracts. If adopted, these criteria would mean that the vast majority of UK participating contracts (e.g. with-profits contracts) would fail to qualify for this accounting treatment. The Council noted these concerns and urged the FRC to raise these concerns with the IASB at ASAF and urge it to reconsider the scope of the proposals.
- That ten responses had been received to the FRC, EFRAG / NSS consultation on the distinction between leases and services and preferences over the IASB and FASB approaches, with respondents demonstrating an even spilt of preference. The Council noted an outreach event has been scheduled in Brussels on 15 September to discuss the issues raised in the consultation as well as possible improvements.

EFRAG

2.3 The Council noted that:

- EFRAG had met on 3-5 September and the various documents that had been agreed and subsequently issued.
- The draft endorsement advice for IFRS 15 Revenue from contracts with customers is due to be considered by EFRAG in October and finalised by the new Board later in the year.

UK GAAP

2.4 The Council noted that:

- The consultation document *Accounting Standards for small entities – Implementation of the EU Accounting Directive* had been issued, alongside the BIS consultation on 1 September. The Council also noted that, to meet the EU implementation deadline of 20 July 2015, the FRC was intending to issue the final Exposure Drafts for a shorter consultation period of two months.
- Amendments to FRS 101 (2013/14 cycle) and FRS 102 (Basic financial instruments and hedge accounting) were issued on 23 July 2014.
- FRED 55 Draft amendments to FRS 102 – pension obligations was issued on 20 August 2014.

Other matters

2.5 The Council noted the following:

- ESMA is in the process of analysing comment letters in response to its consultation on Alternative Performance Measures and it is expected that the guidelines, which will be binding, will be published towards the end of 2014. The Council noted that the FRC continue to have concerns regarding the scope of the proposals which could extend to APMs in a range of investor communications, regarding their potential for increasing clutter and regarding their enforceability; these concerns were expressed in the FRC response.
- The European Commission has issued a consultation as part of its review of the IAS Regulation with a deadline of 31 October; responses, particularly from investor representatives, should be encouraged.
- Lord Hill has been appointed as commissioner for financial stability and regulation in the EU, which is positive news for the UK.

3. Macro Hedging – draft comment letter

3.1 Deepa Raval (DR) introduced a draft response to the IASB's discussion paper 'Accounting for Dynamic Risk Management: a Portfolio Revaluation Approach to Macro Hedging' for consideration by the Council. DR reported that, as discussed at the previous meeting, the Executive do not support the IASB's proposed Portfolio Revaluation Approach (PRA) to macro hedging and that the Executive is not convinced that an entirely new model for macro hedging is needed. The Council noted a summary of the key points that had been raised during discussion at the July Council meeting and a summary of further concerns that had been identified by the Executive.

3.2 The Council discussed the proposed response and agreed that the IASB should not be encouraged to pursue the PRA model on the basis that a) it goes beyond what is necessary and b) the implications arising from the proposals are contrary to general accounting principles. However, the Council made a number of suggested amendments to the response as follows:

- The response should place more emphasis on the fact that the majority of issues faced by users of IAS 39 can be solved through the application of IFRS 9 which calls in to question the justification for an entirely new approach. The response should be stronger in suggesting that the IASB articulate what the issues with the current model are and look at how those issues can be resolved more simply.
- The issue of scope should be brought to the beginning of the response letter and the FRC should challenge the IASB to consider whether the PRA approach would be

suitable for industries outside of the Banking sector, and whether there is an evidence base to support the suggestion that the proposed approach would be used.

- The response should suggest that the IASB consider renaming the standard 'portfolio hedge accounting' given that the approach is only suited to those industries that use a portfolio approach.
- The response should support the inclusion of behaviouralised transactions such as core demand deposits but acknowledged that this was difficult to justify on a conceptual basis.
- The response should urge the IASB to reconsider whether pipeline transactions should be included, given that this is a departure from the general principles in the Conceptual Framework as well as the requirements of IAS 39 and IFRS 9 Financial Instruments.
- The Executive should consider including wording similar to that expressed in the wording in the EFRAG response with respect to risk mitigation and the suggestion that accounting be aligned with an entity's risk management activities.
- The general sense of support for the proposals should be toned down given that the FRC does not support the PRA approach, however, the response should welcome the contribution and acknowledge that it is helpful that the IASB is tackling issues such as pipeline transactions.

3.3 The Council discussed the alternative approaches that had been considered by the IASB but did not consider any of the alternatives to be workable. DR reported that the IASB had expressed concern over the current 'patchwork' approach to hedge accounting and suggested that a 'tool kit', allowing a company to choose the type of hedge accounting that would most appropriately reflect its risk management strategy may be a better approach for the IASB to explore. The Council noted the proposal and suggested that the IASB should be encouraged to explore whether relaxing some of the hedge accounting requirements in IAS 39 could be a solution.

3.4 DR undertook to amend the response in light of the suggestions that had been made by the Council and to circulate the response to the Council by email prior to submission to the IASB.

4. Final comment letter: IFRS Investment Entities – Applying the consolidation exception – proposed amendments to IFRS 10 and IAS 39.

4.1 Anthony Appleton (AA) introduced a draft comment letter in response to the IASB Exposure Draft on 'Investment Entities – Applying the Consolidation Exception, proposed amendments to IFRS 10 and IAS 28' for approval. The Council noted that the proposed amendments address the following three issues submitted to the IFRS Interpretations Committee and the deadline for comment was 15 September 2014.

4.2 The Council discussed the proposed FRC response to the ED, through discussion the following observations were made and advice was given:

i) Exemption from preparing consolidated financial statements

- The Council was content that the response supports the proposal to apply the exemption from preparing consolidated financial statements set out in paragraph

4(a) of IFRS 10, to subsidiaries of an investment entity that are themselves, parent entities.

- The Council was content that the response also supports the proposed consequential change to paragraph 17(d) of IAS 38.

ii) A subsidiary that provides services that relate to the Parent's investment activities

- The Council was content that the draft response disagrees with the proposal to clarify the limited situations in which paragraph 32 of IFRS 10 applies, on the basis that it will reduce transparency and will result in a loss of decision useful information.
- The Council discussed and agreed the proposed alternative set out in the response, namely that an entity should consolidate subsidiaries that act as an extension of the operations of the investment entity parent irrespective of whether subsidiaries are themselves investment entities or not.
- The Council also highlighted the importance of Investors' views on the lack of transparency should the proposals be enacted.
- The Council noted that the draft EFRAG response to this amendment had been supportive and suggested that the FRC discuss the issue with EFRAG.

iii) Application of the equity method by a non-investment investor to an investment entity investee.

- The Council was content that the draft response should re-iterate the position taken in the FRC response to the original Investment Entities ED and disagree with the IASB proposal that a non-investment entity should retain, when applying the equity method, the fair value measurements applied by its investment entity joint venture when accounting for interests in subsidiaries.
- The Council agreed that the IASB should be encouraged to adopt the same pragmatic approach proposed for accounting for investment entity associates when accounting for investment entity joint ventures, noting that this approach would ensure consistency in the application of the equity method to associates and joint ventures.

4.3 Subject to the amendments discussed, and the repositioning of the final paragraph in the cover letter, the Council approved the final comment letter for submission to the IASB.

5. Cash flow statements

5.1 Andrew Lennard (AL) invited input from the Council on a paper that would be presented to a meeting of IFASS on 30 September, and subsequently developed for presentation to the IASB as part of its 'Principles of Disclosure' project. The Council noted that the paper had been informed by views expressed during outreach with investors and through extensive reading on the topic.

5.2 Through discussion of the draft paper the following observations and suggestions were made:

- It should be made clear that the FRC does not agree with the proposal that operating activities are the default;
- The paper should encourage the IASB to provide clarity on how net debt is defined;

- The paper should highlight that the difference between working capital and provisions needs to be clarified;
- The IASB should be encouraged to look at the definition of cash;
- It should be made clear that outreach was undertaken with German stakeholder and that the views presented are not just from a UK perspective.

5.3 AL undertook to revise the draft paper to reflect the suggestions made by the Council. The Council also suggested that it would be useful for AL to set out the proposals as a pro-forma cash flow statement to accompany the paper when it is presented to the IFASS and the IASB; AL undertook to do so.

6. Exposure Draft: Interim financial reporting and preliminary announcements

6.1 Susanne Pust Shah (SPS) introduced draft Financial Reporting Exposure Draft 56: FRS 104 *Interim Financial Reporting*. The Council noted that the FRED contains the proposed revised interim reporting requirements, which are based on IAS 34 *Interim Financial Reporting* and would replace the ASB statement on Half-yearly reports. In addition it will propose the withdrawal of the ASB statement on Preliminary Announcements, which, due to changes in the underlying Regulations, has become obsolete. SPS reported that the proposal had been discussed with contacts at the Financial Conduct Authority (FCA).

6.2 The Council discussed FRED 56 in detail, through discussion the following advice was given and points were noted:

- The Council agreed with the proposal that, on the basis of the FRC Principles for the development of Codes & Standards, FRED 56 is issued as a Standard (FRS 104), rather than best practice guidance. The Council noted that consequential amendments to the *Foreword to Accounting Standards* would be necessary.
- The Council agreed with the proposal that IAS 34, with some modifications, forms the basis of FRS 104, noting that the reporting requirements of IAS 34 and the ASB statement are not significantly different and that the application of IAS 34 should not be too onerous for preparers of interim reports.
- The Council agreed with the proposed modifications to IAS 34 and noted that the modifications had been considered and endorsed by the UK GAAP Technical Advisory Group (TAG) who had also suggested that the requirements set out in IAS 34 applying to generic interim reporting be retained.
- The Council noted that much of the disclosure recommended in the ASB Statement for inclusion in the management report are required disclosures in the notes to the interim financial statements in draft FRS 104 and therefore, the overall level of reporting requirements are broadly comparable between the ASB statement and draft FRS 104.
- The Council discussed the scope of the Standard and enforceability and agreed with the proposal that issuers making a statement of compliance in accordance with the Disclosure and Transparency rules (DTR) would be required to apply draft FRS 104, the Council also agreed the proposal from TAG that draft FRS 104 should include a reference that it constitutes the pronouncement by the FRC referred to in the DTRs. The Council suggested that the need for the compliance statement be included in the scope of draft FRS 104 and in the advice section.

- In response to a query SPS clarified that Draft FRS 104 is intended for use by entities that prepare the annual financial statements in accordance with FRS 102, and entities reporting in accordance with FRS 101 may also wish to apply FRS 104, because those entities would not be fully compliant with the disclosure requirements of IFRS, and applying IAS 34 may lead to providing disclosures in the interim financial reports not required by FRS 101 in the annual financial statements. SPS added that the FCA had undertaken to identify how many entities would be bought in to scope.
- The Council highlighted the need for it to be clarified that the report that will be prepared in accordance with FRS 104 will be a condensed management report and not a full interim management report.
- The Council agreed with the proposal that the Standard include detail as to where other items could be positioned in the accounts to encourage consistency and comparability.
- The Council agreed with the proposal to withdraw the ASB statement on preliminary announcements. It was noted that the FCA may be required to consult on withdrawal of the statement, consultation may be required to remove the Statement from Law in Ireland, and that consequential amendments to the UK Corporate Governance Code will also be required.
- The Council agreed the proposal that FRS 104 becomes effective for interim periods beginning on or after 1 January 2015; the same date as FRS 102 becomes effective, and that no transitional exemptions or relief be provided. However, the Council suggested that entities applying FRS 104 that are first-time adopters of FRS 102 be required to issue some form of reconciliation to make clear to users how the new figures have been arrived at.
- The Council noted the short timeframe in which FRS 104 would be developed, consulted upon and issued and noted that the FRC may face criticism in respect of this. However on the basis that application should not be burdensome, and the users should already be preparing for FRS 102, the Council agreed with the proposed timings.

6.4 SPS undertook to revise the documents that had been presented to reflect the suggestions made by the Council. Subject to those amendments the Council agreed to recommend FRED 56 to the Codes & Standards Committee and FRC Board to be issued in November.

7. Pension SORP

7.1 Jennifer Guest (JG) introduced a paper summarising the decisions that had been taken by the SORP Working Party (SWP) to amend the draft Pension Research Accountants Group (PRAG) SORP in light of responses to the PRAG SORP Exposure Draft. The Council noted that 55 responses to the Exposure Draft had been received, a number of which had expressed disagreement with the proposals. JG reported that the decisions taken by the SWP had been considered by the UK GAAP TAG, whose advice will be shared with the Council as the discussion progresses. The PRAG Board, who had also considered the decisions made by the SWP, were content with the general direction but had expressed concern over the length of the legislative timetable.

7.2 JG invited the Council to discuss and comment on the appropriateness of the decisions taken by the SWP given the requirements of FRS 102 and the appropriateness of the guidance. Through discussion the following observations were made:

Annuities

- It was noted that the majority of respondents expressed the view that the existing approach to allowing individual annuities to be reported at nil value should be continued, but as this approach is not compliant with FRS 102 the request could not be taken forward.
- The Council considered it to be appropriate for the SORP to allow greater flexibility in its approach to valuations by including a roll-forward approach on the basis that the approach is compliant with FRS 102 and it is similar to the FRS 102 approach for calculating the present value of a company's obligation to a Defined Benefit Scheme.
- The Council expressed concern in relation to the proposal that the SORP provide flexibility as to who may provide the valuation and Melanie McLaren (MM) suggested that the advice of the Actuarial Council or Actuarial Policy staff should be sought on the matter.

Investment risk disclosures

- The Council agreed that it is appropriate to minimise the cost of extra disclosures by recommending the asset class approach for pooled investment vehicles, rather than the 'look-through' approach and noted that the approach had been endorsed by UK GAAP TAG, who had considered the matter in detail, and that the approach is consistent with FRS 102.
- The Council noted the decision to, where possible, minimise additional numerical disclosures in the example financial statements provided in the PRAG SORP document and considered it appropriate

Fair value hierarchy

- The Council noted that UK GAAP TAG had considered in detail the recommendation from the SWP that the FRC amends FRS 102 to bring consistency with IFRS in relation to fair value hierarchy.
- The Council also noted that the SWP had taken the decision not to extend reporting requirements in relation to the fair value hierarchy beyond those required by FRS 102, but to make the extra disclosure requirement optional and that this is inconsistent with the approach taken to the IMA and AIC SORPS. Following a brief discussion, including acknowledgement that UK GAAP TAG had considered the inconsistency in detail, the Council concluded that the inconsistency could be justified.

Legislative disclosure requirements

- The Council noted the recommendation from the SWP that the FRC continues to encourage the DWP to make legislative changes as soon as possible and that the appendix would be removed following implementation of the requirements.
- The Council noted that, in response to the forthcoming change in annuity drawdown rules, that the revised SORP should make reference to how income drawdown should be accounted for in a pension scheme.

Concentration of investment

- The Council suggested that the SWP should be encouraged to retain the reference to concentration of investment risk in the SORP. They recognised that, whilst the current wording in FRS 102 does not specifically require disclosure of concentration of investment risk, it is in the spirit of paragraph 34.43 of FRS 102, which requires disclosure on the nature and extent of market risk a schemes faces in respect of its investments. The Council noted that, given schemes already require disclosure of this risk, there is arguably no extra cost in retaining this disclosure which many find to be helpful.

Other issues

- It was further noted by the Council that, whilst the responses to the draft PRAG SORP indicated that the recommended disclosures in relation to transaction costs, where appropriate (with the exception of 4 respondents who considered they were onerous), that given the high profile of the transaction costs issues, that it is important to ensure that the disclosures on transaction costs in the PRAG SORP, are consistent with those in the other investment related SORPs, unless there is good reason, for them not to be so.

7.3 The Council noted that the SWP are working to finalise the draft SORP for consideration by the Council and UK GAAP TAG in October and that the comments made by the Council would be reported to the SWP.

8. PIR IFRS 3, Goodwill amortisation and intangible assets

8.1 AA introduced the draft FRC response to the IFRS3 Post-implementation review of IFRS 3. The Council noted that the comment letters and feedback from outreach events would be presented at the IASB meeting on 22 September and that a summary of the issues identified would be presented to ASAF on 25/26 September by the Chair. AA also introduced a draft response to the EFRAG / OIC / ASBJ research request into accounting for goodwill.

8.2 The Council was content with the suggested responses to the IASB as set out. The Council noted that the key messages from the IASBs post-implementation responses findings are broadly consistent with the points raised by the FRC in its response to the request for information, subject to a small number of differences including the suggestion that intangible assets should be recognised only if there is a market for them when the FRC had recommended removal of the presumption that all intangible assets are capable of reliable measurement.

8.3 The Council was content with the suggested responses to the EFRAG / OIC / ASBJ research paper but suggested the following points be raised / acknowledged:

- The response should agree that changes to the accounting for intangible assets be investigated further and suggest that there is a need to identify which intangible assets need to be valued.
- The response should encourage the IASB to take a pragmatic approach in determining the appropriate model for accounting for goodwill, weighing investor preferences against the costs and practical difficulties of implementation.
- The response should encourage the IASB to consider accounting for contingent liabilities.
- The Council noted that the issues associated with fair value on acquisition of operational assets are under consideration by EFRAG.

8.4 AA undertook to revise the responses to reflect on the comments raised by the Council.

9. Discount rates

9.1 AL introduced a set of slides that had been prepared by the IASB for presentation to ASAF at its meeting on 25-26 September. AL reported that, disappointingly, the objectives of the research proposal were less ambitious than had been hoped and that the FRC had not been taken up on its offer to assist the IASB in developing the research proposal.

9.2 The Council discussed the presentation and the questions staff had identified to raise at the ASAF meeting; through discussion the following observations were made:

- It was highlighted that there is no consideration as to the appropriateness of discount rates; accordingly, the Council suggested that the IASB be encouraged to revisit the concept of discounting before attempting to develop proposals relating to the use of discount rates.
- The Council highlighted that the research does not address the issues associated with tax and agreed that a question on how to adjust a post-tax rate to obtain the pre-tax rate should be asked.
- The Council suggested that the performance objective of the cash flow statement needs to be articulated properly, and once this has been achieved, a balance sheet objective would follow.
- The Council agreed that the IASB should be encouraged to consider how risk should be reflected in the cash flows and the discount rate and what adjustments are appropriate when adjusting a comparable market rate for differences in risk.

9.3 AL undertook to consider the points raised by the Council in finalising the presentation for ASAF.

10. Overview of FRC organisational risk matrix

10.1 The discussion on the FRC risk matrix was deferred to the October meeting.

11. Any other business

11.1 There was no other business.