Financial Reporting Council

Minutes of a meeting of the Accounting Council held on Thursday 17 December 2015 in the Boardroom at 8th Floor, 125 London Wall, London, EC2Y 5AS

Present:

Roger Marshall	Chair
Richard Barker	Council Member (from minute 4)
Chris Buckley	Council Member
Gunnar Miller	Council Member
Liz Murrall	Council Member
Veronica Poole	Council Member
Mark Smith	Council Member
Jeremy Townsend	Council Member

Observers:

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

In attendance:

Anthony Appleton	Director, Accounting & Reporting Policy
Francesca Carter	Council Secretary
Jenny Carter	Director of UK Accounting Standards, Accounting & Reporting Policy Team
Annette Davis	Project Director, Accounting & Reporting Policy Team
Jennifer Guest	Project Director, Accounting & Reporting Policy Team
Andrew Lennard	Director of Research
Melanie McLaren	Executive Director, Codes & Standards
Deepa Ravel	Project Director, Accounting & Reporting Policy Team
Rosalind Szentpéteri	Project Manager, Accounting & Reporting Policy Team

Welcome and Apologies for absence

Apologies were noted from Michael Gallagher and Pauline Wallace (Council Members).

1. Minutes of the previous meeting and rolling actions

1.1 The minutes of the meeting held on 12 November were approved for publication.

1.2 The rolling action log was noted.

2. Director of Accounting Report

2.1 The Council noted a paper that 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:

EFRAG

2.2 Anthony Appleton (AA) reported that the EFRAG Board had announced its decision to appoint Andrew Watchman as the new EFRAG TEG Chairman and CEO starting April 2016. It was noted that the exercise to appoint a new President continues and that a decision could be expected in March / April.

2.3 The Council noted the documents issued by EFRAG at its December meeting. AA highlighted that EFRAG had issued a letter to the European Commission explaining how it had reached its conclusion that IFRS 9 Financial Instruments is not contrary to the true and fair principle.

UK Matters

2.4 The Council noted that Local Authority Pensions Fund Forum (LAPFF) had written to the Chairs of the FTSE 350 companies. AA reported that main assertion made by the LAPFF is that distributable reserves should, under law, be disclosed. The Council noted that the FRC had issued a press statement and had written to preparers of large companies to clarify that the Companies Act 2006 does not require the separate disclosure of a figure for distributable reserves and that this has been confirmed by BIS. AA also reported that the Financial Reporting Lab had recently issued a report on the disclosure of dividend policy which also clarifies the point.

2.5 The Council noted that the FRC Board had approved FRED 63 *Draft amendments to FRS 101 – 2015/16 cycle* and FRED 64 *Draft amendments to FRS 103 – Insurance Contracts* for consultation as advised by the Council.

2.6 The Council noted that, from 1 January 2016, companies will be required to include the address of the registered office of each subsidiary or other significant holding in their annual accounts. MM reported that the FRC has drawn the issue to the attention of BIS on more than one occasion.

FRC matters

2.7 The Council noted that the UK GAAP Technical Advisory Group (TAG) had met on 26 November and discussed the requirement, for an entity intending to take advantage of reduced disclosures, to notify its shareholders in writing about the use of the disclosure exemptions. Whilst the group did not advise any action be taken at this stage it was highlighted that respondents to FRED 63 might highlight the issue.

2.8 AA reported that the Codes & Standards Committee had approved for informal consultation a draft revised ‘Policy on developing Statements of Recommended Practice’ (SORPs) with a view to extending the SORP framework to auditing and actuarial standards. Through discussion it was noted that revised Policy is aligned with the FRC strategy for 2016-19 to be collaborative and deliver market-driven solutions.

2.9 Melanie McLaren (MM) reported on a recent trip to the US she and Stephen Haddrill had recently taken to meet with counterparts in the US. The Council welcomed that consideration is being given to allowing US companies to file their accounts under US GAAP and IFRS.

3. FRC Realignment

3.1 MM introduced a paper setting out changes to the executive structure agreed by the FRC Board on 1 December. MM reported that the changes are necessary to support the efficient delivery of the 2016-19 strategy and enable the successful establishment of the FRC's role as the Single Competent Authority for audit. The Council noted that the review of the structure had been a recommendation of the recent externally led effectiveness review of the FRC and that further changes would include increased transparency in respect of the work of the Corporate Reporting Review (CRR) team.

3.2 The Council noted that the Board had discussed consequential changes to the governance structure and agreed to maintain the existing structure for a 12 month period whilst work to develop of a new suite of Technical Actuarial Standards and revise the Auditing Standards and Ethical Auditing Standards concludes. MM reported that through preliminary discussion the Board had highlighted the value the advisory Councils add and indicated a desire to retain the Councils, however, as a result of the introduction of the ARD and restrictions relating to the role of practitioner in standard setting, consideration would need to be given to how the Councils advice is taken by the Board.

3.3 The Council noted the changes set out and welcomed that, given the breadth of its work, from 1 April it would be renamed the 'Corporate Reporting Council' and that a review of the ToR for all three Councils would be necessary as part of the governance structure review in 2016.

3.4 The Council discussed the changes set out and the following observations were made:

- It was noted that the changes to executive structure are intended to strengthen communication and collaboration between the various corporate reporting teams, whilst maintaining the current working relationship between the Audit Quality Review and CRR teams.
- The FRC will be cautious in the approach taken when writing to those whose accounts have been reviewed and where no action is considered necessary and the process will be thoroughly considered by the Conduct Committee before it is initiated. The FRC will continue undertaking thematic reviews and a thematic review in respect of tax disclosures is scheduled for 2016.

4. Director of Research Report

4.1 The Council noted an update on accounting research activities covering the IASBs Conceptual Framework, a paper for *Accounting Horizons*, research on cash flow statements and planned work with the Corporate Financial Information Environment. The Council also noted that Andrew Lennard would be taking up a part time secondment to the IASB to join the Conceptual Framework team.

5. IASB Disclosure Initiative - Update

5.1 Rosalind Szentpéteri (RS) introduced a paper that provided an update on progress of the various projects that comprise the IASB's disclosure initiative (DI). RS reported the FRC whilst the FRC strongly supports the DI the FRC is concerned that the DI has become fragmented into a number of narrow scope amendments which has resulted in slippage in the timetable for various projects including the Principles of Disclosure (PoD) discussion paper (DP), which was originally scheduled for publication in Q2 2015 and has been postponed to March 2016. The Council echoed the concern of the executive and agreed that the executive should seek to encourage the IASB to focus on completion of the PoD DP.

5.2 RS invited the Council to comment on a presentation prepared by the New Zealand Accounting Standards Board (NZASB) on how to approach the disclosure requirements of IAS 16 *Property, Plant and Equipment* and IFRS 3 *Business Combinations* for inclusion as a chapter in the PoD DP. The Council highlighted that the approach set out is broadly consistent with the principles developed by the FRC (for example, in the *Guidance on the Strategic Report*) and welcomed the direction of travel, however, there was some concern that approach is too 'woolly' and that the NZASB should seek to be clearer on how to distinguish between the requirements and the points to consider. The Council also discussed the reference to alternative performance measures (APMs) and noted that the intention is to identify principles as to how APMs should be presented when they are used in the financial statements.

6. IFRS Practice Statement: Application of Materiality to the Financial Statements Materiality

6.1 RS introduced a draft response to the IASB's Exposure Draft (ED) ED/2015/8 IFRS Practice Statement: *Application of materiality to the Financial Statements*. RS reported that the draft had been informed by the initial lines to take agreed by the Council in November, input from colleagues across the FRC and discussion with stakeholders and reflects the consensus view that further work is necessary to make the document more practicable.

6.2 The Council discussed the response and supported the general tone and messages set out. However, the Council highlighted that there was value to the content of the ED and suggested that our response encourages the IASB to retain the document as it currently stands as educational material summarising existing IFRS literature on materiality, while producing a separate Practice Statement to achieve the original objective of assisting with the application of materiality.

6.3 RS undertook to update the response to reflect the advice of the Council.

7. IFRS 9 Endorsement – IASB amendments to IFRS 4

7.1 Seema Jamil-O'Neill (SJON) introduced a paper setting out the key proposals of the IASB Exposure Draft (ED) *Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts (Proposed Amendments to IFRS 4*) and developments in Europe relevant to the ED. SJON highlighted that the ED had been issued on 10 December and that the comment period would close on 8 February. As a result of the short comment period the Council would be asked to consider and approve the draft response at its January meeting.

7.2 The Council noted that:

- The EFRAG Board issued its final endorsement advice to ARC on 15 September recommending that the standard is conducive to the European public good, except for the impact on the insurance industry.
- The ED was issued to address concerns raised by 'some interested parties' regarding the lack of alignment between the effective date of IFRS 9 and the new insurance contracts standard and proposes two solutions, a temporary exemption from IFRS 9, the 'deferral

approach' and an adjustment to the profit or loss to present it on an IAS 39 basis, the 'overlay approach'. The IASB believes that these solutions would address the concerns relating to the accounting mismatches arising from the non-alignment of the effective dates of IFRS 9 and IFRS 4 (revised) and the resulting volatility in the profit or loss.

- The IASB's intention is that only 'pure' insurers should be permitted to defer the application of IFRS 9 and that the proposed deferral approach would only be a temporary solution available for entities whose predominance activity is issuing contracts within the scope of IFRS 4.
- On 4 December 2015 EFRAG responded to a Commission request for an update on the preliminary analysis of the IASB's progress on the remedy for the non-alignment of the effective dates of IFRS 4 and IFRS 9. The appendix to that EFRAG letter included an analysis of the percentage of IFRS 4 liabilities to total the liabilities that would permit the largest European 'insurance' companies to pass the predominance test. The analysis suggests that, under the proposed predominant criteria in the ED, only five of the largest 20 European Insurance Companies would be able to defer IFRS 9.
- Some preparers have argues for an expansion of the predominance criteria to investment contracts which are bifurcated as a result of the application of IFRS 4. Whilst the analysis by EFRAG suggests this widening would mean that seven of the 20 largest 'insurance' companies would meet the threshold there are a number of consequences that would require further consideration.
- The EFRAG Board is also considering amendments to the ED and its preferred solution would be the predominance criteria for deferral approach on the basis that entities are permitted to assess predominance below the reporting entity level.
- The IASB's preferred solution is the overlay approach and within that approach the IASB would permit two options for the presentation of the income statement. Whilst a number of insurance preparers have raised concerns with the costs associated in implementing this approach, other financial institutions in Europe consider that the benefits of the approach would outweigh those costs. To address the concerns raised, the IASB has asked for qualitative and quantitative information to better inform its understanding of those costs.

7.3 The Council discussed the paper and points raised in detail. It was highlighted that finessing the predominance criteria would be overly complex and likely result in unnecessary confusion. Accordingly it was suggested that, the response encourage the IASB to consider removing the predominance test and simply permit deferral for those entities who meet the definition of an 'insurance' entities and that this should be applicable at the lowest operating level at which the regulated entity sits.

7.4 The Council also suggested that the IASB should be encouraged to seek further evidence on what the costs associated with the overlay approach would be and whether the concerns expressed by some prepares are valid. The Council agreed with the view of the executive that, should the IASB adopt the overlay approach, the IASB should restrict presentation of the income statement to option A, whereby profit or loss is determined in accordance with IFRS 9 before an adjustment is made to eliminate additional accounting mismatches. The Council suggested option A would lead to more understandable information and that offering two options for the presentation of the income statement would result in unnecessary confusion

7.5 SJON thanked the Council for its input and undertook to draft a response based on that input for the Council to consider in January. SJON reported that the FRC is looking to schedule a roundtable event with insurance companies, banks, auditors and investors to discuss their views on the ED in January.

8. Annual Review of SORPs

8.1 Jenny Carter (JC) introduced a paper setting out annual reviews completed in respect of:

- Association of Investment Companies (AIC) SORP for Investment Trust Companies and Venture Capital Trusts;
- Charities SORP (FRS 102);
- Consultative Committee of Accountancy Bodies (CCAB) SORP for LLPs;
- Investment Association SORP for Authorised Funds; and
- Pensions Research Association Group (PRAG) SORP for Pension Schemes.

8.2 The Council noted that SORP-making bodies are required by the FRC *Policy and Code of Practice on SORPs* (the 'Policy') to consider annually whether there:

- are any implications for the SORP in respect of new or proposed accounting standards;
- is any evidence of widespread or significant failure to follow the SORP in the relevant industry / sector;
- are any developments in the sector which suggest further guidance is desirable; and
- is a continuing need for the SORP.

8.3 JC reported that a number of initial queries raised as a result of the reviews and raised by UK GAAP TAG members had been resolved and that, with the exception of the two issues set out in the paper for discussion, the FRC considers the SORP-making bodies are proposing appropriate responses to those issues. Through discussion of those two issues the following advice was given:

IA SORP – Master-feeder arrangements.

8.4 The Council noted that, consistent with FRS 102, the IA SORP requires that all investments are measured on the balance sheet at their fair value and that the SORP-making body does not consider this to be appropriate for master / feeder relationships. Following a brief discussion the Council expressed support for the proposal from the SORP-making body to include in the SORP Guidance a derogation from paragraphs 2.18-2.19 to state that the investment in a master fund should equate to the NAV of the feeder. The Council also agreed that it would be acceptable to include the derogation in the SORP Guidance without consultation.

Definition of a related party

8.5 JC reported on the SORP-making body responses to the change in a definition of a related party in FRS 102. JC reported that whilst the responses may appear inconsistent the executive consider that the approaches will ensure consistency in the way in new related party definition should be applied. Through discussion it was noted that:

- The AIC SORP did not copy out the definition of a related party and therefore the reference to Section 33 of FRS 102 as set out in the SORP does not require amendment.
- In the case of the IA SORP the new definition has the effect of widening the scope because the manager is an Authorised Corporate Director and sole director of the fund and therefore a related party under the new definition. The Council supported the provision of guidance to clarify this position.
- The Council noted that the guidance accompanying the PRAG SORP would need to be updated to reflect the change in definition and considered the PRAG working party proposal to recommend disclosure of entities that provide key management personnel services to the entity. Through discussion the Council suggested that proposed approach is not sufficient and that the executive should request that the working party amend

paragraph 3.32.6 to distinguish between the entity and the person and to set out that it is the entity that is the related party and not the director of the corporate trustee.

8.6 JC drew the Councils attention to a number of issues identified during the approval process for the FRS 102 SORPs, including transaction cost disclosures, executive remuneration disclosures and the impairment of social housing property. It was noted that whilst no further action is considered necessary at present, the position would be reviewed again in 2016.

8.7 The Council noted that Policy also requires SORP-making bodies to provide a note of the SORP-making body membership. The Council noted the membership lists set out and, in noting that SORP-making bodies should be representative of the wider public interest and of users, advised that the AIC SORP-making body be encouraged to appoint a user. It was also suggested that the FRC clarify the membership of the IA SORP for authorised funds.

9. Charity SORP amendments

9.1 JC introduced a paper setting out proposed amendments to the *Charities SORP* (*FRS 102*) to reflect recent amendments to FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*. JC reported that the Charity Commission and Office of the Scottish Charity Regulator (OSCR) had consulted on the proposed changes and had taken account of the feedback received, the most significant change being the withdrawal of the FRSSE SORP and the decision that all charities should apply the same SORP.

9.2 JC invited the Council to consider two issues that had been identified in respect of the SORP. The following observations were made and advice was given:

Merger accounting

9.3 The Council noted that as a result of changes in company law further restrictions have been placed on the application of merger accounting and that a public benefit entity combination cannot apply merger accounting if it is not permitted by the statutory framework. In practice, this restriction means that charity combinations meeting the criteria for a merger involving a company cannot user merger accounting whereas charities with other legal structures can.

9.4 The Council discussed Update Bulletin 1 prepared by the SORP-making body that reflects the discussion included in Appendix IV: *Note on legal requirements* reminding public benefit entities that the true and fair override is available if a company considered it justified. Whilst the Council noted that Update Bulletin 1 is consistent with the changes made to FRS 102 which encourages charities in this situation to apply judgement in determining the nature of their combination and the appropriate combination, the Council acknowledged with the view expressed by a member of the Committee on Accounting for Public Benefit Entities (CAPE) that the drafting could appear to encourage the use of the true and fair override. Accordingly, the Council advised that the Bulletin be redrafted to adopt a neutral tone and simply draw the attention of charities that are in the situation to the relevant section of the Legal Appendix.

Larger Charities (as defined by the SORP)

9.5 The Council noted that the Charities SORP (FRS 102) includes a definition of a larger charity and that it refers to those charities subject to audit under charity law in their jurisdiction. JC reported that, as a result of changes to the audit threshold in England and Wales, but not in other jurisdictions, the Update Bulletin proposes to remove the link to the audit threshold and that the definition instead be based on gross income from 1 January 2016.

9.6 The Council noted that as result of changes to the audit threshold from March 2015 there would be a short period when some charities in England and Wales will become ‘small’ and be required to provide fewer disclosures only to fall within the scope of a ‘large’ charity again from 1 January 2016. Whilst the Council acknowledged the unfortunate timing the Council noted that the additional disclosures are required by the SORP and not accounting standards and supported the SORP-making body’s Committee’s desire to have a single effective date for all the amendments in the Update Bulletin in order to reduce confusion.

10. Any other business

10.1 There was no other business.