Setting the Standard

our Financial Reporting eNewsletter

February 2014 - June 2014

FRC

Editor's Note

Welcome to the latest edition of 'Setting the Standard', the FRC's electronic newsletter on financial reporting. Our mission is to promote high quality corporate governance and reporting to foster investment; financial reporting sits at the heart of that work. Developments in financial reporting have continued at a steady pace in 2014. The FRC's guidance on implementation of the new legislative requirements around the Strategic Report has been finalised and we have launched our consultation on XBRL accounts taxonomies. In Europe, there has been significant progress in relation to the restructuring of EFRAG as a result of the Maystadt recommendations, which we report on in this issue. The FRC is also working closely with BIS to implement the requirements of the new Accounting Directive, while the Financial Reporting Lab has launched a number of new initiatives. In other exciting news we have moved to new offices in the City at 125 London Wall, London,
EC2Y 5AP.

Anna Colban, Editor

Clear and Concise Reporting: The Strategic report

By Deepa Raval

The FRC has recently published its Guidance on the Strategic Report. The guidance is the first in a series of FRC initiatives promoting clear and concise reporting for investors. Deepa Raval, the Project Director leading the work on narrative reporting provides an overview of the main changes following the consultation on the guidance.

Introduction

On 10 June 2014, the FRC issued Guidance on the Strategic Report ('the guidance') https://www.frc.org.uk/Narrative-Reporting. The new Companies Act 2006 requirements for the Strategic Report, published by Government last year provide the foundation for the FRC guidance.

The guidance is non-mandatory and intended as best practice for all companies preparing a strategic report. In line with the Corporate Governance Code, the guidance emphasises the need for annual reports as a whole to be fair, balanced and understandable.

In this issue:

Consultation

The publication of the guidance follows a period of consultation by the FRC. The majority of respondents welcomed the clear, accessible, principles-based approach set out in the Exposure

Draft (ED) 'Guidance on the Strategic Report' and supported our efforts in moving the 'cutting clutter' agenda forward.

There were areas of the ED where respondents requested further clarification, most notably:

- the placement of information including the core and supplementary approach;
- the option to provide a strategic report with supplementary material; and
- legal aspects.

This article focuses on the main areas of change from the ED. Further details of the comments received on the ED are included in the Feedback Statement published alongside the guidance https://www.frc.org.uk/Narrative-Reporting.

Placement of information

The introduction of the Strategic Report presents an opportunity for companies to re-think the traditional structure of the annual report. This includes considering whether some information can be placed outside the annual report, for example online. The overarching aim is to ensure that annual reports communicate information in an effective manner.

The FRC has re-visited the draft guidance relating to the placement of information. The terms 'core and supplementary' have been removed but the concept is explained by focusing on the communication objectives. The main elements are set out below.

1. General principle: information should only be included in a component of the annual report if it meets the objective of that component.
2. Cross-referencing: this refers to information that is required by law to be included in a specific component of the annual report but is located in another part of the annual report and incorporated by cross-reference.
3. Signposting: this refers to the placement of complementary information, which should generally be placed outside the annual report but could be included within the annual report.

Legal aspects

The Department of Business, Innovation and Skills has clarified a number of legal points highlighted during the consultation https://www.frc.org.uk/Narrative-Reporting. Clarifications are provided on the application of materiality, safe harbour provisions, cross-referencing and the option to send shareholders a 'strategic report with supplementary material', which replaces the option to send shareholders summary financial statements.

What we have seen so far

Early indications from companies with 2013 year ends suggest that strategic reports are often longer than the business reviews that preceded them. We anticipate that 2014 will be the year where we expect to see more companies driving towards clear and concise reporting. We believe that this can be achieved with a sharper focus on materiality and by considering the placement of information.

Two questions that companies could focus on in the current year are:

1. Is there information in the annual report that is not material to shareholders and can it be excluded?
2. Is there scope for placing information that is not a required element of the annual report elsewhere?

Next steps

The FRC continues to monitor developments in narrative reporting. We are mindful of the new EU Directive on disclosure of non-financial and diversity information and will be considering the implementation of those requirements in the UK.

Influencing the Conceptual Framework

By Andrew Lennard

The IASB is actively debating issues that will be addressed in its Exposure Draft on the Conceptual Framework (the Framework). In the last issue of Setting the Standard we summarised some of the key points in the FRC's response to the IASB's Discussion Paper, including prudence (or caution), accountability (or stewardship) and the importance of reliability.

The FRC is participating energetically in the debates on these issues. In particular, we have been developing views on prudence and have benefitted from thoughtful input from a number of investors. This has reinforced our view that investors value robust financial information.

Prudence has two main aspects—recognising all losses (for example impairment of assets) promptly, while not recognising profits that will be earned from future sales; and ensuring that care is taken that estimates are prepared with a proper degree of caution to avoid over-optimistic results. This is compatible with the use of fair values where required by accounting standards.

Such a prudent approach also does not conflict with neutrality (as described in the Framework) as it does not involve a deliberate attempt to mislead or distort the financial statements. Indeed, it is important that the Framework should explicitly prohibit the deliberate overstatement of liabilities and losses, as it did before the revisions made in 2010. We are encouraged by the degree of consensus that has emerged when we have discussed these issues with EFRAG and with other standard-setters.

We prepared a paper for the June meeting of the IASB's Accounting Standards Advisory Forum. The paper argues that approaches to the measurement of assets and liabilities that are similar to the preliminary views in the IASB's Discussion Paper can be justified by drawing on the ideas of the business model and prudence. In particular, where a business involves buying and selling on different markets, there is a strong case for using cost, as this results in profit reported when such assets are sold. In contrast, where the business model is to hold assets in order to benefit from price changes, the use of current values will provide the most relevant financial information. This underlines the importance of including in the Framework specific reference to the ideas of prudence and the business model, and may also help the IASB in providing a cogent basis for its approach to measurement.

At its May meeting, the IASB made a number of tentative decisions, some of which are consistent with our views:

- Stewardship - The IASB has tentatively decided to increase the prominence of stewardship within the overall objective of financial reporting.
- Prudence - The IASB has tentatively decided that this concept will be included in the Conceptual Framework but it will be limited to one aspect of prudence: that it is the exercise of caution when making judgments under conditions of uncertainty. However, another aspect of prudence - the more timely recognition of losses than of gains (asymmetry in recognition) - has not been taken up by the IASB.
- Reliability - The IASB has tentatively decided to retain faithful representation instead of reliability.

Business Combinations

by Jennifer Guest

In January this year the IASB issued a Request for Information on the experiences of users, preparers and others from the application of IFRS 3 Business Combinations. This request arose as part of the IASB's Post-implementation Review of the standard.

The FRC, in conjunction with the ICAEW, held an outreach event in March to gather views on the standard and to stimulate debate. The event was attended by some 45 participants, representing a mixture of views from investors, analysts, preparers and their auditors. We have also held a number of individual discussions with investors and preparers to gather further views, and our reponse to the IASB has been supplemented further by research we performed on investor views on the accounting for intangible assets (see below).

A common response was to highlight the difficulties in determining many of the fair value measurements required by the standard, from valuing intangible assets that are not separable from the business to previously held equity interests on gaining control. Investors also understand these difficulties and are often sceptical of the reliability of the information provided; this scepticism often results in investors making significant adjustments to the information provided under IFRS 3.

It was striking in our outreach event that preparers highlighted the costs of separately identifying and measuring all intangible assets and auditors noted the significant challenge in auditing these valuations, whilst many investors said they then ignored the financial information provided, removing it from their assessments of performance and position. This does highlight significant doubts that the separate recognition and measurement of intangible assets, particularly those that are not separable from the business, would satisfy a cost/benefit assessment.

A number of respondents appear to challenge the way the standard was developed, given its 2008 revision resulted in a number of highly detailed changes, such as the treatment of non-controlling interests and piecemeal acquisitions, which did not appear to result from investor demands for such information

Concerns were also raised in respect of the disclosures required by the standard; it was noted that it requires many detailed disclosures but does not encourage the presentation of an holistic view of the investment and its subsequent performance that would aid an assessment of management's stewardship and decision making.

The most widely expressed suggestions for improving the standard were:

- require the separate recognition and measurement of fewer intangible assets – this could be done by re-introducing the reliable measurement recognition criteria, particularly in respect of intangible assets that are not separable from the business;
- reduce complexity and the use of judgemental valuations in areas such as stepped acquisitions, the treatment of non-controlling interests and partial disposals; and
- move to a model of disclosures that concentrates on high level objectives and providing a holistic view of the investment and its performance, rather than identifying a list of detailed requirements.

Our response to the IASB can be viewed here:

https://frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/FRC-responds-to-IASB-RFI-Post-Implementation-Revie.pdf

Intangible Assets

by Seema Jamil-O'Neill

In March 2014 the FRC published a paper detailing the results of research into investor views on accounting for intangible assets under International Financial Reporting Standards (IFRSs).

The report reflects the views of 27 investors on the accounting treatment of different classes of intangible assets in the statement of financial position and their amortisation in the income statement. Investors were asked to provide their views on accounting for:

- intangible assets acquired in a business combination
- internally generated intangible assets
- separately acquired intangible assets; and
- on the adequacy of presentation and disclosure.

The full report can be accessed here.

Transforming EFRAG

by Annette Davis

The main role of EFRAG is to assess whether proposed international accounting standards (IAS or IFRS) meet the criteria for adoption by the European Union set out in the IAS Regulation and provide endorsement advice on IFRSs to the European Commission. It also influences the development of IFRSs through its participation in the IASB's consultation process and its proactive work to stimulate the accounting debate in Europe.

The changes to the structure and operation of EFRAG are one part of an initiative to enhance the European Union's role in international accounting standard setting. The new EFRAG will also have a wider mandate whereby, in addition to considering technical aspects of a standard, it will assess the economic and financial stability implications of the proposed standard.

Key changes to the governance of EFRAG include:

- The formation of a new Board that will be the decision-making body of EFRAG. It will approve all EFRAG's positions, endorsement advice letters to the European Commission and comment letters to the IASB. The Technical Expert Group (TEG), which is the current decision-making body, will become an advisory group to the Board.

- Representation on the new Board for Member States' national standard setters, which collectively provide the bulk of EFRAG's funding. The FRC makes the UK's contribution and will become a member of the EFRAG Board.

The new Board:

- will be responsible for all EFRAG positions with the objective of Europe speaking with one voice, facilitated by a consensus-based decision-making process. If, exceptionally, no consensus can be reached, the Board will use a voting procedure;

- will comprise two pillars, with eight members being nominated by stakeholder organisations, such as Business Europe, and eight members nominated by national standard setters whereby the national standard setters of France, Germany, Italy and the UK are guaranteed a seat;

- will be chaired by a President, who will be nominated by the European Commission, with the approval of the European Parliament and of the Council of the European Union; and

- will have observers (with speaking rights) from the European Supervisory Authorities (ESMA, EBA and EIOPA), ECB and European Commission.

It is expected that the new structure will be approved by the governing body of EFRAG in June and will be implemented in September/October once a President has been appointed.

The technical work of EFRAG will continue to be done in the TEG until the new structure is implemented. Any work in progress will be transferred to the new Board when it commences operations.

The FRC welcomes these changes to the governance of EFRAG and is actively involved in the implementation process. The changes will give the FRC a much larger role in EFRAG than it currently has and will therefore have a direct impact on the UK's ability to influence EFRAG's activities and, by extension, IFRS development.

Financial Reporting Lab

New projects and survey launched

By Carl Renner & Thomas Toomse-Smith

The Financial Reporting Lab (the Lab) is continuing to work on its project 'Accounting Policy Disclosures and Integration of Related Financial Information', which was highlighted in the January edition of Setting the Standard. In addition, the Lab is working on 'Clear and Concise' case studies and a thematic review, and has launched two new projects and a survey (see below).

Clear and Concise Reporting Case Studies and Thematic Review

The Lab is currently approaching companies that have made or are looking to make improvements to their Annual Reports (and/or discreet areas of the report), about the possibility of conducting case studies on the process undertaken and the improvements achieved. The Lab is also planning to publish a thematic review on the same topic, highlighting the approaches companies have taken in their latest reports to make them more clear and concise.

Disclosure of Dividend Policy and Capacity

This project is exploring communication by companies at the group/holding company level, in respect of:

- any significant constraints on dividends, such as structural, legal or other considerations that could limit the conversion of profits to a flow of cash dividends to shareholders;
- the nature of the company's dividend policy and how the policy relates to its strategic objectives; and
- the company's capacity to pay dividends under the policy.

Since the announcement at the end of March, we have been speaking to a number of investors and companies. If interested in participating, please contact us on the email address below.

Corporate Reporting in a Digital World

The Lab will explore how companies and investors are, and want to be, utilising the opportunities that digital media offers for communicating with shareholders. The series of projects will cover:

- Digital Present: looking at how and investors companies are using digital media now;
- Digital Challenges: looking at the barriers (real and perceived) which stop companies and investors from making the most of the digital opportunity; and,
- Digital Future: looking at how companies and investors might use digital media in the future.

The Lab is looking for participants in Digital Present.

Lab Survey

The Lab has launched an on-line survey of stakeholders and interested parties to obtain feedback on project reports published to date, views of project participants on their experience, and to help set the priorities of the Lab going forward. Please do help us by completing the survey, if you haven't done so already.

The survey can be found at: https://www.surveymonkey.com/s/FPGSNZ2.

To indicate your interest in participating in any of our projects or to contact the Lab on anything else please use the Lab's email address: FinancialReportingLab@frc.org.uk.

UK GAAP update

by Jenny Carter

With new UK GAAP mandatory for accounting periods beginning on or after 1 January 2015, for many entities the transition date to new UK GAAP has now passed (1 January 2014 for entities with a December year end). We continue to encourage entities to familiarise themselves with the new standards, how their accounting may change and what the implications of that might be, for example in how they communicate with stakeholders.

We intend FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland, to be a stable platform with a review every three years. However, as we move towards first-time adoption for most entities, there are a few improvements to finalise. We don't take a decision to make amendments to a standard close to implementation lightly, but we consider that the current proposals will be of benefit to preparers and users of financial statements, including on first-time adoption.

Since the last edition of Setting the Standard in January, we have issued the following:

- FRED 54 Draft Amendments to FRS 102 – Classification of debt instruments;
- Three editorial amendments to FRS 102;
- FRS 103 Insurance Contracts;
- Amendments to the FRSSE – Micro-entities; and
- Revised Policy and Code of Practice on SORPs.

These documents are all available on our website; the new UK GAAP page contains links to all of these aspects of our work.

Looking forward to forthcoming pronouncements, the closing date for comments on FRED 51 Draft Amendments to FRS 102 – Hedge accounting, FRED 53 Draft Amendments to FRS 101 (2013/14 cycle) and FRED 54 have all passed. We are working to finalise all of these amendments so that they can be issued this summer. One aspect we are paying close attention to is the transitional arrangements; as noted above we recognise that for many the transition date to FRS 102 has now passed and this will be reflected by some flexibility being available for first-time adopters.

Small entities and micro-entities

In the last edition of Setting the Standard we outlined our tentative plans for the future of the FRSSE in the light of the significant changes to the small companies' regime that are expected to take place when the new EU Accounting Directive is implemented. We have continued to develop our thinking in this area. As the legal changes to the small companies' regime will be significant, retaining the FRSSE in its current form is not a realistic option, nor really is having accounting standards for small companies that are based on standards for larger companies that have been withdrawn. We have been giving more thought to how we will replace the FRSSE for small entities and micro-entities, as we develop a consultation document that will seek formal stakeholder feedback. We expect to issue this in the summer, alongside a consultation from the Department for Business, Innovation and Skills (BIS) which will discuss its proposals for implementing the Accounting Directive in the UK.

As well as seeking stakeholders' views on our outline plans for bringing small entities within the scope of FRS 102 (with reduced disclosures), we also expect to propose a new Financial Reporting Standard for Micro-entities (FRSME). This will be based on the new micro-entities regime, which has now been reflected in the FRSSE, and may include recognition and measurement simplifications that are appropriate to the very smallest entities.

After considering the feedback to the consultation document we will develop Exposure Drafts setting out proposals in more detail.

XBRL Accounts Taxonomies Consultation

by Jennifer Guest

Following transfer of responsibility to the Financial Reporting Council (FRC), the XBRL accounts tagging conventions ("taxonomies") have been updated and on 8 May the FRC announced a public consultation on three of the taxonomies to enhance the quality of financial reporting in the UK and Ireland.

The consultation documents can be viewed on the following FRC website page: https://xbrl.frc.org.uk/

Taxonomies are used when tagging accounts for electronic filing and for other analytical purposes. Electronic tagging helps users of financial information in corporate reports to extract the information they want and analyse it more efficiently.

The FRC's objective is to improve the quality of electronic tagging of accounts and reflect UK reporting using EU adopted IFRS as well as the new financial reporting standards for the UK and Ireland (FRS 101 and FRS 102).

HMRC and Companies House are expected to adopt the taxonomies in due course. The Irish Revenue Commissioners also expect to adopt these taxonomies once the appropriate Irish extensions are available.

Subject to the outcome of the consultation the FRC is targeting release of the final versions of the taxonomies in September 2014 for implementation from 1 January 2015 to coincide with implementation of FRS 102.

The three taxonomies are:

- FRS 101 – with key information document
- FRS 102 – with key information document
- Full EU adopted IFRS – with key information document

The above proposed taxonomies follow a similar approach in content, design and style to the existing UK GAAP and IFRS taxonomies that are currently used by UK organisations in submitting their accounts in iXBRL format. However, they contain some design improvements which should allow easier, fuller and more accurate tagging of accounts data in XBRL. Their content has been carefully developed to reflect expected reporting under the relevant standards.

Expected consumers of XBRL information

The taxonomies are intended to support XBRL tagging of accounts which will meet the needs of a variety of users and consumers of financial reports, including:

1. Government departments which require business data for policy, statistical and other official purposes.
2. HMRC, which requires accounts information for tax risk analysis and for tax policy analysis and planning.
3. Investors, information companies, banks, credit agencies, other organisations and the public who may require company financial data in an efficient way from Companies House.

The design and content of the taxonomies are thus intended to meet the requirements of a broad range of consumers of financial information who may benefit from the availability of XBRL data, and to support increasing use of XBRL in future years – from 2105/2016 onwards.

Many companies may not be using the taxonomies until 2016, although some early adopters of FRS102 may use them well before that.

Taxonomy development and comments

The taxonomies have been developed by a project team at the FRC with guidance from a technical task force and with input from BIS, HMRC, Companies House and the Institute of Chartered Accountants in England and Wales. XBRL UK has also been involved.

The taxonomies may be viewed on the internet through the 'Yeti' viewer at https://uk-taxonomies-tdp.corefiling.com/yeti.

Yeti provides access to each individual taxonomy plus an overview (through the 'core' view) showing the combined content of all three taxonomies. The latter view is purely for the convenience of those reviewing the taxonomies. No log in is required to see the taxonomies and the Yeti viewer is intuitive to use. A user guide is available via the FRC website.

Comments are invited in writing on all aspects of the draft taxonomies. Comments are sought in particular on the following four questions:

1. Does the content of the taxonomies accurately reflect expected reporting under the relevant standards?
2. Is the content clear and unambiguous?
3. Does the Design Document explain changes to the accounts taxonomies which are useful and pertinent?
4. Would it be helpful to have the taxonomies supported by 'consistency checks' and, to what extent are those seen as necessary rather than desirable?

Comments may be provided through the 'Yeti' viewer, which is best suited to detailed feedback, or by emailed comment letter to the FRC at j.guest@frc.org.uk

Yeti enables comments to be made on individual data items (tags) in the taxonomies. Comments are attached to the specific taxonomy being viewed but, where appropriate, they will be understood to apply across all taxonomies. It is not necessary to repeat comments across all taxonomies. The Yeti viewer shows the general content of the taxonomies but does not show the dimensions attached to individual tags or all technical details. (These dimension links can only been seen by viewing the taxonomy files through appropriate software).

All comments should be sent before close of business on 8 July. The FRC's policy is to make publicly available through Yeti or on its website, all responses to formal consultations issued by the FRC unless the respondent explicitly requests otherwise. A standard confidentiality statement in an e-mail message will not be regarded as a request for non-disclosure.

Corporate Reporting Review

by Carol Page

The FRC has published a consultation paper proposing a number of changes to the Conduct Committee's Operating Procedures for its review of reports and accounts.

The most substantive change is to formally introduce the concept of a 'Conduct Committee reference'. Where an FRC enquiry gives rise to a correction or improvement in a company's report or accounts, the company is sometimes asked to refer to the intervention of the FRC in the report in which it makes the change.

Although the reference is in the public domain, it is generally only known to those who read that particular set of accounts. The consultation paper proposes that companies who have published an FRC reference in the past year be identified in the CRR's next annual report.

Other changes to the Operating Procedures are intended to provide more information about how the Conduct Committee manages complaints and note the fact that while the Conduct Committee is prompted to write to companies in respect of their compliance with reporting requirements, approaches may also include comments about other aspects of their reporting, for example observations intended to assist companies to make their reports and accounts clearer and more concise.

Corporate Governance Code 2014: Going Concern Basis of Accounting

by Anthony Appleton

The FRC has published a consultation paper proposing a number of changes to the Corporate Governance Code 2014. The FRC is proposing that companies should state in their financial statements whether they consider it appropriate to adopt the going concern basis of accounting and identify any material uncertainties to their ability to continue to do so over the following twelve months. The FRC is also proposing that boards be required to make a statement on the viability of the company.

The FRC is therefore seeking views on whether to:

- retain existing Code Provision C.1.3 but amend the wording to clarify that it refers to the assessment of going concern for accounting purposes. The suggested wording is:

  "In annual and half-yearly financial statements, the directors should state whether they considered it appropriate to adopt the going concern basis of accounting in preparing them, and identify any material uncertainties to the company's ability to continue to do so over a period of at least twelve months from the date of approval of the financial statements"; and

- add a new Provision C.2.2 to introduce a requirement to make an explicit statement on the board's broader assessment of the company's ongoing viability. The suggested wording of the new provision is:

  "The directors should state whether, taking account of the company's current position and principal risks, they have a reasonable expectation that the company will be able to continue in operation and meet its liabilities as they fall due, drawing attention to any qualifications or assumptions as necessary. They should indicate the period covered by this statement, and why they consider that period to be appropriate".

The proposed wording attempts to deal with the matters to be considered when making the assessment, the time horizon that it covers, and the degree of certainty that can be attached to it in a way that would encourage companies to provide meaningful disclosure tailored to the specific circumstances of the company rather than producing standardised or heavily qualified statements.

The FRC welcomes comments on this proposal. The consultation closes on 27 June 2014. The full text of the consultation paper can be viewed here:

https://frc.org.uk/Our-Work/Publications/Corporate-Governance/Proposed-Revisions-to-the-UK-Corporate-Governance-File.pdf

Spotlight on our UK GAAP Team

Jenny Carter is our Director of UK Accounting Standards. She leads our work on UK GAAP and on the implementation of the recently agreed EU Accounting Directive. She can be contacted at j.carter@frc.org.uk .

Mei Ashelford is a Project Director in the UK GAAP team. Mei's projects include FRS 101 amendments, liaison relating to public benefit entity SORPs and general FRS 102 issues. She can be contacted at m.ashelford@frc.org.uk .

Susanne Pust Shah is a Project Director in the UK GAAP team. Susanne works mainly on financial instrument related projects for FRS 102 and on the liaison relating to the LLP SORP. She can be contacted at S.PustShah@frc.org.uk.

Open for Comment

UK GAAP

XBRL Accounts Taxonomies	comment period ends **8 July 2014**

IFRS

IASB Discussion Paper *Accounting for Dynamic Risk Management: a Portfolio Revaluation Approach to Macro Hedging*	comment period ends **17 October 2014**