



# Setting the Standard

## our financial reporting eNewsletter

June - September 2013



### Editor's Note

Welcome to 'Setting the Standard', the FRC's quarterly 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. In a year in which the FRC has orchestrated major developments in UK accounting standards with the launch of new UK GAAP and embarked on new projects to improve the quality of annual reports and influence the development of IFRS, we are introducing 'Setting the Standard' with the aim of giving readers an insight into our key projects, outreach and consultation. **Anna Colban, Editor**

## Improving the quality of Annual Reports

### Narrative Reporting by Deepa Raval

Much has been said about the need for information in annual reports to be more relevant for investors. The FRC has a number of projects underway which contribute to this goal. Deepa Raval, the Project Director leading this work stream summarises recent developments.

#### **Narrative reporting – FRC Guidance on the Strategic Report**

##### *Introduction*

On 15 August 2013, the FRC published an Exposure Draft (ED) 'Guidance on the Strategic Report'. The guidance will replace the Reporting Statement: Operating and Financial Review (OFR).

The publication of the ED follows the issue of new narrative reporting

regulations by the Department of Business, Innovation and Skills (BIS) on 7 August 2013. The regulations first apply to companies with 30 September 2013 year ends.

BIS has asked the FRC to produce non-mandatory, best practice guidance on the Regulations.

The ED and a document setting out the main legal changes are available at <http://www.frc.org.uk/Our-Work/Codes-Standards/Accounting-and-Reporting-Policy/Ongoing-projects/Narrative-Reporting.aspx>

##### *Overview of the ED*

The requirement for companies to produce a strategic report as part of their annual report provides an opportunity for companies to take a fresh look at the structure of their annual report and review its content to ensure that it provides information that is relevant to shareholders.

The proposals in the ED are principles based and designed to encourage companies to experiment, innovate and tell their story.

The ED focuses on the strategic report and sets that report in the context of the

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annual report as a whole. The aim is to promote cohesiveness, recognising that information in the strategic report does not exist in isolation and is linked to other parts of the annual report.

The ED includes proposals for guidance on:

- placement of information;
- application of materiality to the strategic report;
- communication principles; and
- content elements for the strategic report.

##### *Placement of information*

The ED includes ideas for placement of disclosures in the annual report and encourages a 'core and supplementary'

approach whereby information that is important to shareholders is given prominence in the strategic report. The ED suggests that supplementary information could be provided in an appendix which would be a step towards moving some information online.

#### *Materiality*

The regulations use terms such as ‘to the extent necessary’, ‘key’ and ‘principal’ which all refer to the application of materiality. To be helpful and as a prompt to cutting clutter, the ED contains some guidance on the application of materiality.

#### *Communication principles*

The ED emphasises the importance of disclosures communicating relevant information to shareholders. The communication principles emphasise desirable qualities of annual reports including the key principle from the UK Corporate Governance Code for annual reports to be fair, balanced and understandable. Concise reporting and avoiding boilerplate disclosure are encouraged.

#### *Content elements*

The content elements in the ED are closely related to the Regulations. Most of the content of the strategic report is the same as for the business review which is replaced. There are additional disclosure requirements for business model, strategy, human rights and gender diversity. The disclosures relating to business model and strategy essentially mirror how many companies are already reporting in practice.

#### *Next steps*

The ED is open for comment until 15 November 2013. The FRC intends to publish the final guidance in 2014. In the meantime, the FRC is interested in hearing from preparers on their experiences of implementation of the regulations.

## Influencing IFRS

The FRC positions itself as a “critical friend” to the IASB. We will aim to:

- Continue to support international financial reporting standards, in accordance with EU requirements;
- Urge the IASB to prioritise high quality financial reporting standards above convergence
- Promote high quality financial reporting standards that are principles based, enabling pragmatic solutions to financial reporting issues;
- Seek to influence the development of IFRSs through:
  - Constructive engagement, outreach and research’
  - Effective use of IFRS implementation evidence from our monitoring and enforcement activity;
  - The development of UK FRS; and
  - Influencing the effectiveness of Europe’s voice.

## IASB Conceptual Framework

by Andrew Lennard

The IASB published a Discussion Paper ‘A Review of the Conceptual Framework for Financial Reporting’ on 18 July. Comments are requested by 14 January 2014. The Discussion Paper may be accessed at: <http://www.ifrs.org/Current-Projects/IASB-Projects/Conceptual-Framework/Discussion-Paper-July-2013/Documents/Discussion-Paper-Conceptual-Framework-July-2013.pdf>.

The Discussion Paper marks the first step in this phase of IASB’s work. IASB plans to publish a full exposure draft before a final statement. This suggests that preliminary views may well be revised before IASB adopts final positions. However, IASB’s target of completing the project by 2015 is challenging, particularly if complex issues are to be fully debated.

The FRC has begun its discussions of the issues raised, so far considering the Discussion Paper’s treatment of definitions of elements and recognition criteria; measurement; and the presentation of income and expenses in profit or loss and other comprehensive income.

Tentative views are:

1. The Framework should clearly acknowledge the importance of prudence (or caution); accountability (or stewardship); and reliability. The FRC’s response to the IASB should demonstrate the implications of these concepts for the issues addressed in the Framework.
2. Prudence does not necessarily result in financial information that is improperly biased, in the sense that it is presented in a way that will favour a particular decision.
3. Prudence should be reflected in recognition: some losses and liabilities should be recognised in circumstances where gains or assets should not.
4. Setting accounting standards requires the exercise of judgement in determining the optimal balance to be struck between different qualitative characteristics for each standard. The Conceptual Framework should not be expected to replace the need for such judgements.
5. The Discussion Paper’s treatment of measurement fails to provide the depth of conceptual analysis that is necessary if the Conceptual Framework is to provide useful guidance to the IASB in the development of accounting standards.
6. In the absence of a definition of ‘profit or loss’ it is difficult to form a view on what income and expenses should be reported in other comprehensive income (‘OCI’) and in particular what principles should govern whether items originally reported in OCI should be ‘recycled’ to profit or loss.
7. The Conceptual Framework should not be ‘reverse engineered’ to provide a justification for existing standards and practices. It should instead set out the principles that will assist in the development of future standards.

The FRC, in partnership with EFRAG and the French, German and Italian accounting standards setters has produced a series of thought leadership bulletins, under the title “Getting a Better Framework”, to draw attention to some of the issues of importance. Seven bulletins have been published so far on:

- Prudence
- Uncertainty
- Reliability of financial information
- The role of the business model in financial reporting
- The Role of a conceptual framework
- The asset/liability approach

- accountability (stewardship) and the objective of financial reporting

We welcome views on the issues discussed in these bulletins, which can be viewed on the FRC's website at: <http://frc.org.uk/Our-Work/Codes-Standards/Accounting-and-Reporting-Policy/Ongoing-projects/Getting-a-Better-Framework/Bulletins.aspx>.

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## UK Financial Statements

### FRED 49: Draft FRS 103 Insurance Contracts

By Jenny Carter

In July 2013 the FRC issued FRED 49 draft FRS 103 *Insurance Contracts*. Draft FRS 103 applies to entities within the scope of FRS 102 that issue insurance contracts, or financial instruments with a discretionary participation feature. When FRS 102 was issued it cross-referred to FRS 103, so entities were aware that this part of the suite of standards was still outstanding.

Draft FRS 103 does not only apply to regulated insurance businesses, but to any entity applying FRS 102 that issues insurance contracts, so a variety of entities may need to consider whether it is relevant to them.

Draft FRS 103 allows entities, generally, to continue with their existing accounting policies for insurance contracts (including the appropriate measurement of long-term insurance business), whilst permitting limited improvements to accounting by insurers. The FRC was aiming to provide entities with a single source of financial reporting requirements for insurance contracts, and has developed draft FRS 103 from IFRS 4 (consistently with its overall objective for consistency with international accounting standards unless an alternative clearly better meets the overriding objective) and has incorporated, either in the draft standard or the accompanying draft implementation guidance, requirements taken from FRS 27 *Life Assurance* and

the ABI SORP. Most of the material drawn from the ABI SORP is included in the non-mandatory draft implementation guidance.

Although entities can generally continue with their existing accounting policies for insurance contracts there some areas where FRS 102 and draft FRS 103 may lead to changes. This is consistent with FRS 102 more generally, where improvements were made in relation to accounting for financial instruments. FRS 102 introduced a definition of an insurance contract to which draft FRS 103 then applies, and entities that have not previously applied FRS 26 *Financial instruments: Recognition and measurement* may find they have contracts they previously thought of as 'insurance' that do not meet the definition. These will be accounted for as financial instruments in accordance with FRS 102. Draft FRS 103 will also require entities to provide some additional disclosures about insurance contracts to those required previously. The exposure draft is open for comment until 31 October 2013. The FRC will be aiming to finalise the standard as soon as it can, taking into account the feedback from consultation, because the standard is expected to be effective for accounting periods beginning on or after 1 January 2015, the same as FRS 102.

The FRC is aware of future regulatory change for insurers and also that the IASB has issued an exposure draft of its proposals to revise IFRS 4. The FRC intends to return to insurance accounting once the IASB has completed its project and consider whether changes should be made to FRS 103 so that it remains consistent with international accounting standards. Any changes would be subject to further due process, including consultation.

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### FRED 50: Residential Management Companies

By Mei Ashelford

In August 2013 the FRC issued FRED 50: Draft FRC Abstract 1 Residential Management Companies' Financial Statements and Consequential Amendments to the FRSSSE

(FRED 50).

FRED 50 addresses how residential management companies (RMCs) should recognise transactions with third party suppliers in their financial statements. When discharging their duties to manage and arrange maintenance of a property, RMCs must account for such transactions in accordance with the legal opinions that all RMCs act as principals (not agents) in these transactions.

The FRED proposes a new draft FRC Abstract (to be applied by RMCs that apply FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland) and consequential amendments to the Financial Reporting Standard for Smaller Entities (FRSSE) (for RMCs that are applying the small company regime) setting out the following requirements:

- The cash balance and other assets (representing service charge monies received by a residential management company in accordance with the terms of the lease agreement are held in a statutory trust under Section 42 of the Landlord and Tenant Act 1987) are not assets of a residential management company and shall not be recognised in a residential management company's balance sheet.
- A residential management company shall recognise the relevant service charge expense arising from the management and arrangement of maintenance of a property and concurrently recognise income by drawing from the service charge monies. This income and expense shall not be offset.
- A residential management company shall disclose:
  - the fact that a statutory trust is imposed over service charge monies received under Section 42 of the Landlord and Tenant Act 1987 and that the residential management company acts as a trustee in this capacity; and
  - the closing balance of cash and other assets held in trust by the residential management company. For residential management companies that are trustees over more than one trust, this information should be disaggregated on a trust by trust basis.

FRED 50 is open for comment until 11 November 2013.

UITF Draft Abstract 49 Residential Management Companies' Financial Statements is withdrawn and replaced with FRED 50.

## Spotlight on our IFRS Team

The FRC has a team of financial reporting experts under the leadership of Michelle Sansom, Director of Accounting. After 12 years with the FRC, Michelle will leave us at the end of October. We will greatly miss her contributions and experience.

The team are working on a range of IFRS-related projects which contribute to our effort to influence the IASB and engage with stakeholders.

Andrew Lennard is our Director of Research and Conceptual Framework lead. He can be contacted at [a.lennard@frc.org.uk](mailto:a.lennard@frc.org.uk).

Annette Davis is a Project Director and has responsibility for European liaison and IFRS projects such as leases and rate regulated activities. She can be contacted at [a.davis@frc.org.uk](mailto:a.davis@frc.org.uk).

Jennifer Guest is a Project Director and leads on a number of IFRS projects and on the XBRL project. She can be contacted at [j.guest@frc.org.uk](mailto:j.guest@frc.org.uk).

Seema Jamil O'Neill is a Project Director and leads on financial instruments and insurance. She can be contacted at [s.jamiloneill@frc.org.uk](mailto:s.jamiloneill@frc.org.uk).

Deepa Raval is a Project Director and the lead on annual reports and hedge accounting. She can be reached at [d.raval@frc.org.uk](mailto:d.raval@frc.org.uk).

## Outreach

The FRC is planning a number of outreach events to promote an awareness of the Conceptual Framework and to provide a mechanism for our constituents' to contribute their views. Details of these events can be found in the Outreach section of this newsletter on page 5 and on the FRC's website.

We will also be placing regular updates on the FRC's website.

Recent responses to IASB proposals include:

[Regulatory Deferral Accounts Leases](#)  
[Bearer Plants](#)  
[Financial Instruments](#)

**22 October:** Narrative Reporting. This event is fully subscribed.

**26 November:** [Joint event with ICAEW on the IASB's Conceptual Framework](#). 9.30 – 1 pm at Chartered Accountants Hall

**27 November:** [Joint event with CBI on the IASB's Conceptual Framework](#), aimed at preparers of financial statements. 1-4 pm at Centrepoint

To sign up for either event follow this link: <https://frc.org.uk/News-and-Events/Events.aspx>

Open for Comment	comment period ends
<b>UK GAAP</b>	
FRED 50 <i>Residential Management Companies' Financial Statements</i>	11 November 2013
Exposure Draft <i>Guidance on the Strategic Report</i>	15 November 2013
<b>IFRS</b>	
IASB <i>Conceptual Framework</i>	14 January 2014
IASB <i>Insurance Contracts</i>	25 October 2013
IASB <i>Bearer Plants</i>	28 October 2013
<i>Getting a Better Framework: The Asset/Liability Approach Bulletin</i>	15 November 2013
<i>Getting a Better Framework: Accountability and the Objective of Financial Reporting Bulletin</i>	15 November 2013