



# Setting the Standard

## our Financial Reporting eNewsletter

October 2013 - January 2014



### Editor's Note

Welcome to the second 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. As we enter a new year, the FRC can look back on 2013 as a landmark year in more ways than one, with the launch of new UK GAAP, a consultation on new guidance on implementation of the new legislative requirements around the strategic report, a major project around the IASB's consultation on its conceptual framework, culminating in the FRC's response to the IASB in January 2014, and a major programme of outreach to our stakeholders. Looking forward, 2014 will bring changes in Europe, not least with elections for the European Parliament in May and a new Commission in October, but also closer to home, the implementation of the Maystadt recommendations for transforming EFRAG, will have a direct impact on the UK's influence on IFRS development. We will report on this in future editions. Other plans include launching a project designed to secure, over a three year period, a step change in the quality of reporting by smaller listed and AIM quoted companies, finalising guidance on the Strategic Report to support the new BIS Regulations, monitoring issues encountered in implementing new UK GAAP standards and delivering a major project to develop XBRL taxonomies. **Anna Colban, Editor**

## Influencing IFRS via stakeholder outreach

### FRC Views on the IASB's Conceptual Framework

by Andrew Lennard

The IASB's existing Conceptual Framework is, in some respects, dated and incomplete. The Discussion Paper 'A Review of the Conceptual Framework for Financial Reporting' sets out the IASB's preliminary views on how the Framework might be improved.

The FRC supports the IASB's work on the Framework, which plays a critical role in the development of accounting standards. The FRC has therefore prepared a

detailed response that it hopes will assist the IASB in developing a Conceptual Framework of the highest possible quality. In its response, the FRC commends the Discussion Paper, which provides a thoughtful overview of many complex issues, and supports a number of its proposals.

The FRC response may be accessed at: <http://frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/FRC-response-to-IASBs-A-Review-of-the-Conceptual.pdf>.

Some of the salient points are summarised below.

The FRC strongly believes that the Conceptual Framework should emphasise the importance of the exercise of caution, accountability (sometimes called stewardship) and reliability. These are fundamental to financial reporting and reflect the unique role of financial statements, which—because they are published regularly, comply with accounting standards and are audited—provide a credible frame of reference that investors can use to in their analysis and in their dialogue with management.

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In addition, the FRC advocates that the Framework should state that financial statements should assist an assessment of the entity's business model.

The FRC welcomes the IASB's preliminary view that a single measurement basis (for example fair value) should not be used for all assets. It is, however, concerned that the Discussion Paper does not explore measurement issues in sufficient depth to make the Conceptual Framework a useful guide in the development of accounting standards. Deeper analysis is required, for example, of the relationship between entity-specific and market values; entry and exit values: transaction costs; and price changes. The FRC does not agree that price changes only need to be considered in the context of hyper-inflationary economies, as the effect of even moderate inflation can be significant, and even where general prices are relatively stable, specific prices (such as those of commodities) are often volatile.

The Discussion Paper proposes that the amount of 'profit or loss' should continue to be reported, as it is widely used by investors, either as the starting point for their analysis or as the main indicator of an entity's performance. The FRC agrees, but argues that it is necessary for the Conceptual Framework to define or indicate the objective of the statement of profit or loss. This would ensure that the meaning of profit or loss is clearer, and is necessary to provide a rationale for reporting some items in 'other comprehensive income'. The FRC suggests that the Conceptual Framework might describe the objective of the statement of profit or loss as 'to present income and expenses for the period in order to report the returns of the period, and facilitate an assessment of accountability and future returns'.

The FRC generally welcomes the IASB's proposals on presentation and disclosure (which in some respects are similar to the FRC's own proposals). The FRC's response, however, suggests that presentation and disclosure are distinct topics—presentation is about the primary financial statements, whilst disclosure is about the notes to the financial statements. The FRC therefore suggests that presentation and disclosure should be dealt with in separate chapters of the Conceptual Framework. The FRC also urges the IASB to consider the boundary and interconnectivity between what is disclosed in financial statements and the information that is better disclosed elsewhere, for example in a narrative report.

One of the important functions of the Conceptual Framework is to ensure that

all assets and liabilities are reported in financial statements—but only when doing so is useful. It may not be useful, for example, to recognise all the intangible assets of an acquired business, or a liability for a lawsuit that will probably be rejected by the courts. The IASB has suggested a number of changes to the definitions and recognition criteria in this area. The FRC broadly supports those changes, but notes that some of the new words, (such as 'source of value' and 'capable of') may be interpreted broadly. It therefore suggests that the intentions and implications of these changes should be spelt out by the IASB.

The Discussion Paper puts forward fairly radical proposals for the accounting for equity instruments (which might include, for example, options on shares and non-controlling interests). These appear to be more appropriate for a future accounting standard than for the Conceptual Framework and, in the FRC's view, further detail is required to form a view of their merits. However, the FRC does not believe that classes of equity should be remeasured to market value. It also urges the IASB to provide a discussion of whether an entity or a proprietary perspective should be used in IFRSs.

The IASB plans to issue an Exposure Draft for a new Conceptual Framework, which will reflect its consideration of the responses to the Discussion Paper later this year. The FRC will continue to promote dialogue with its stakeholders, the IASB and other accounting standard-setters on issues relating to the Conceptual Framework as this work continues.

## FRC response to the IFRS for SMEs consultation

by Jenny Carter

The FRC published its draft response to the IASB's IFRS for SMEs consultation in December 2013, inviting comments by 24 January 2014. The draft letter highlights the need for the IASB to ensure that the IFRS for SMEs is fit for purpose, and that the stated scope accurately reflects the scope intended by the IASB. By focusing on the smaller end of the SME scale, the IASB runs the risk of issuing a standard that is not fit for purpose as many large (and potentially complex) entities fall within its scope. More clarity over the scope of the standard and review might

have resulted in a more comprehensive update. The letter also highlights the FRC's concern over the IASB's principles on how the standard might change as a result of amendments made to full IFRS. The principles do not provide robust nor sufficient guidance to stakeholders as to when amendments might be expected and a set of clearer principles is needed. The draft response also highlights some technical issues that the FRC has identified in implementing FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* (which is based on the IFRS for SMEs) namely around hedge accounting and the classification of financial instruments. The draft response will be finalised and submitted by 3 March 2014.

## Accounting Standards Advisory Forum

by Andrew Lennard

Roger Marshall, FRC Board Member and Chairman of the FRC's Accounting Council, participated in the meeting of the IASB's Accounting Standards Advisory Forum held on 5-6 December. The meeting discussed stewardship and reliability, based on the Bulletins produced by the FRC in partnership with other European bodies under the 'Getting a Better Framework' initiative. The Bulletins were introduced by Andrew Lennard, Director of Research at the FRC. Further information on 'Getting a Better Framework' may be accessed at <http://frc.org.uk/Our-Work/Codes-Standards/Accounting-and-Reporting-Policy/Ongoing-projects/Getting-a-Better-Framework.aspx>

ASAF also discussed a paper on liabilities, published by the Australian Accounting Standards Board, and another on profit or loss/other comprehensive income prepared by the Accounting Standards Board of Japan. Other agenda items included the IASB's Post-implementation Review of IFRS 3 'Business Combinations', leases and rate-regulated activities.

The IASB's summary of the meeting is available from its website. <http://www.ifrs.org/The-organisation/Advisory-bodies/ASAF/Documents/ASAF-Dec-13.pdf>

# Financial Reporting Lab

## Are you meeting the needs of investors?

by Thomas Toomse-Smith

Are you meeting the needs of investors? This is the key question which the Financial Reporting Lab (the Lab) is trying to answer. The Lab was set up by the FRC in 2011 to help improve the effectiveness of corporate reporting.

The Lab takes a collaborative approach to research. Through interviews and round table discussions we engage with companies and investors to understand which areas of corporate reporting require improvement and then work with the participants to road test practical improvements to disclosure.

In the last 18 months we have worked with more than 45 companies and investor groups addressing reporting in a number of areas.

Highlights from our reports include:

- Audit committee (AC) reporting is an area which is continually developing in the face of both recent changes to the UK Corporate Governance Code and investor demands. In October 2013 the Lab published a report which provided insight from companies and investors on what makes for effective AC reporting. The report provided practical examples of effective reporting and highlighted some key themes for AC chairs to think about when drafting this year's report. Key themes are:
  - What is the underlying issue?
  - What is the nature of the judgement being made?
  - What was the conclusion, and the factors and reasons considered to reach the final outcome?
  - Does the outcome affect the scope of activities included in the consolidated financial statements; an amount recorded as an asset, a liability and/or a measure of performance or cash flows; the extent of disclosure
  - Are there any other aspects

of the issue necessary to convey its context clearly?

- Understanding debt and cash flows remains one of investors' primary areas of focus. In October the Lab released a summary of points from three projects on cash flow and debt disclosures. The summary asked some key questions of companies' disclosure and considered the relevance of each piece of information to investors. This summary provides useful reminders for companies to consider for the reporting season; and
- Reporting of Directors Remuneration remains an area of contention for users of accounts. The Lab added to the debate by working with companies on projects on a single figure for remuneration, scenario charts and CEO performance graphs. The findings of these projects influenced the final BIS regulations.

All of the reports produced by the Lab are available online on the Lab website: <http://frc.org.uk/Our-Work/Codes-Standards/Financial-Reporting-Lab.aspx>

The Lab is currently working on a number of new projects designed to assist companies in understanding what investors want. We have started a project looking at accounting policies (position, content, accessibility) and one looking at integration of business reviews with financial statements. We expect to issue reports on these topics in the spring.

We also intend to carry out a number of Lab case studies on progress on cutting clutter.

We are also in the early stages of looking at a longer term project on electronic reporting, its use and some of the challenges and opportunities that it may present.

We are always interested in hearing from companies or user groups who have a specific interest in one of our on-going projects or who have ideas for future projects.

Please feel free to contact us using the Lab's email address: [FinancialReportingLab@frc.org.uk](mailto:FinancialReportingLab@frc.org.uk)

# UK Accounting Standards

by Jenny Carter

It is now less than 12 months until the effective date of FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*, which is 1 January 2015. We encourage everyone who will be applying FRS 102 to consider, as soon as possible, what the implications will be for them and start to make any accounting policy choices or elections and collect any new or different data for the comparative period.

Although our aim is that FRS 102 will be a relatively stable platform and subject to review only every three years, in the next year as we approach first-time implementation for the majority of entities there are a number of pieces of on-going work to be completed, which we aim to address as quickly as possible in order to give certainty over the requirements. The New UK GAAP On-going projects page on our website should give you information about these projects <https://www.frc.org.uk/Our-Work/Codes-Standards/Accounting-and-Reporting-Policy/The-future-of-UK-GAAP/On-going-Projects.aspx>.

## FRED 49 Draft FRS 103 Insurance Contracts

FRED 49 was issued in July 2013 and the comment period closed on 31 October 2013. The FRC has been considering the responses received and is aiming to issue FRS 103 *Insurance Contracts* by the end of Q1 2014. It will be effective from 1 January 2015 for entities with insurance contracts that are applying FRS 102. Feedback to the ED was very positive and we expect to make limited changes.



## ***FRED 50 Draft FRC Abstract 1 – Residential Management Companies' financial statements***

FRED 50 was issued in August 2013 and the comment period closed on 11 November 2013. Most Residential Management Companies will be small companies, the accounting requirements will need to comply with the new EU Accounting Directive. Therefore, we propose to take this project forward as part of our review of the FRSSSE and the requirements for small companies more generally (see below).

## ***FRED 51 Draft amendments to FRS 102 – Hedge accounting***

FRS 102 contains hedge accounting requirements, but they are restrictive in terms of when hedge accounting is available. In line with the views of many constituents, the FRC intended to amend the hedge accounting requirements prior to the issue of FRS 102, in order to align them as much as possible with what were then, the expected new requirements in IFRS and to make them easier to apply. However, at the time of publication of FRS 102, the IASB was still deliberating its new hedge accounting proposals and it was therefore not possible to make the amendments prior to issue.

In November 2013, the FRC published its proposed amendments to hedge accounting in FRS 102 (FRED 51), which are based on the revised hedge accounting requirements in IFRS, but are a much simplified set of requirements with fewer conditions attached. The FRC has, since the publication of FRED 51, been approached regarding the transitional requirements applicable to hedging arrangements existing on 1 January 2014. We have clarified the proposed position in a statement on our website, which can be found at:

<https://frc.org.uk/Our-Work/Codes-Standards/Accounting-and-Reporting-Policy/The-future-of-UK-GAAP/On-going-Projects.aspx>.

We are inviting comments on FRED 51 by 14 February 2014.

## ***FRED 52 Draft amendments to the FRSSSE – Micro-entities***

FRED 52 was issued in December 2013. The FRED proposes amendments to the FRSSSE to reflect the reporting exemptions available to micro-entities in *The Small Companies (Micro-Entities' Accounts) Regulations 2013* (SI 2013/3008). The change in the law was effective in respect of financial years ending on or after 30 September 2013 for companies filing their accounts on or after 1 December 2013. FRED 52 is not proposing any amendments other than those arising from the new regulations, and generally does not require changes in the recognition or measurement of amounts recognised in the financial statements, but micro-entities taking advantage of the exemptions will be able to prepare fewer notes to the financial statements.

Some companies are excluded from the definition of a micro-entity, but otherwise a micro-entity is a company which on its balance sheet date does not exceed the limits of two of the three following criteria:

- (a) turnover: £632,000;
- (b) balance sheet total: £316,000; and
- (c) average number of employees during the financial year: 10.

We are inviting comments on FRED 52 by 12 February 2014.

## ***FRED 54 Classification of financial instruments***

FRS 102 sets out conditions that a loan or other financial instrument has to meet in order to be measured at amortised cost, instead of fair value (which represents a market value or is based on valuation

models). Loans and other secured and unsecured debt that meet the conditions are classified as basic, which generally includes instruments with simplistic interest and repayment features. Feedback from early implementation is that conditions for measurement at amortised cost are overly restrictive and a large number of such instruments, even though not overly complex, would have to be measured at fair value. The FRC is currently reviewing the conditions in FRS 102 to classify a financial instrument as 'basic' and expects to issue an exposure draft of limited scope amendments to FRS 102 to address this issue in February 2014.

## ***FRS 102 – Editorial amendments and clarification statements***

In response to implementation queries relating to FRS 102 the FRC may issue editorial amendments and clarification statements. To date we have issued three clarification statements, set out in one compendium for ease of reference. It can be accessed at:

<http://www.frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/FRS-102-%E2%80%93-Editorial-amendments-and-clarification-s.pdf>

Should any further editorial amendments or clarification statements be deemed necessary they will be added to the same compendium.

## ***FRS 102 – Staff Education Notes***

The FRC Staff have prepared 15 Staff Education Notes for the convenience of users of FRS 102. These Staff Education Notes aim to illustrate certain requirements of FRS 102, but should not be relied upon as a definitive statement on the application of the standard. The illustrative material is not a substitute for reading the detailed requirements of FRS 102.

The Staff Education Notes are available <http://www.frc.org.uk/Our-Work/Codes-Standards/Accounting-and-Reporting-Policy/The-future-of-UK-GAAP/Staff-Education-Notes.aspx>

## FRED 53 Amendments to FRS 101

FRED 53 was issued in December 2013. The FRED proposes amendments to FRS 101 *Reduced Disclosure Framework* to update the framework for changes that have been introduced to IFRS 10 *Consolidated Financial Statements*, IAS 27 *Separate Financial Statements* and IAS 36 *Impairment of Assets*, to aim to ensure that FRS 101 is maintained as a cost-effective option for groups. The exposure draft also proposes an editorial amendment to paragraph 6 of FRS 101.

We are inviting comments on FRED 53 by 21 March 2014.

## Future of the FRSSE

We have started a major project to review the FRSSE in light of the new EU Accounting Directive, which significantly revises the small companies regime, and to consider how the FRSSE is aligned with the new UK GAAP framework.

Initial discussions have been held over a number of high-level issues and the tentative view is that the FRSSE should be withdrawn and instead small entities and micro-entities brought within the scope of FRS 102, so that a consistent framework and principles apply to all entities. FRS 102 would be revised to include specific requirements for small entities and micro-entities to reflect the differing legal requirements, particularly in relation to disclosure. This would include there being no requirement for small companies to prepare a cash flow statement or group accounts.

We would like to hear from users of the FRSSE. We anticipate that an exposure draft will be issued in June 2014 for consultation.

Please contact Mei Ashelford on [m.ashelford@frc.org.uk](mailto:m.ashelford@frc.org.uk) to inform our thinking.

## SORPs

A number of SORPs will be finalised over the forthcoming months. Please refer to the appropriate SORP-making body for more information on the expected timetable for each publication.

At the time of writing the consultations on the following SORPs have closed and the SORP-making bodies are considering the feedback received:

- the SORP for Further and Higher Education Institutions;
- the IMA SORP for Authorised Funds;
- the CCAB SORP for LLPs; and
- the Charities SORP.

In addition exposure drafts of the AIC SORP for Investment Trust Companies and Venture Capital Trusts and the SORP for Registered Providers of Social Housing are out for comment.

The exposure draft on the AIC SORP can be viewed via this link:

<http://www.theaic.co.uk/sites/default/files/hidden-files/AICSORPExposureDraftDec2013doc.pdf>.

The exposure draft of the Social Housing SORP can be viewed via this link:

<http://www.housing.org.uk/policy/policy-news/housing-sorp-2014-invitation-to-comment-1/>

## Corporate Reporting Review

### FRC seeks consistency in the reporting of exceptional items

By Carol Page

In December 2013, the FRC issued a reminder to Boards about the need to improve the reporting of additional and exceptional items and to ensure their consistent presentation.

The FRC's Financial Reporting Review Panel (FRRP) has identified a significant number of companies that report exceptional items on the face of the income statement and include subtotals to show the profit before such items (sometimes referred to as "underlying profit"). The FRC reminded boards of what they should consider when they present exceptional or similar items and encouraged them to improve reporting in this area.

Many companies present additional line items in their income statements to provide clear and useful information about the trends in the components of their profit, as required by IAS 1 "Presentation of financial statements". The FRC, however, has identified a number where the disclosure falls short of the consistency and clarity required, with a consequential effect on the profit reported before such items.

The FRC believes it is vital that investors should be able to understand and rely on the trends in the profitability reported by companies. Companies need to ensure they are providing information in a way that enables users to assess the quality of the company's profitability. This principle is set out clearly in the Corporate Governance Code which requires that the annual report and accounts as a whole should be fair, balanced and understandable.

## FRC challenges the reporting of companies classifying pension liabilities as equity

By Carol Page

The FRC has highlighted it has concerns regarding the accounting treatment of arrangements that turn pension obligations into equity instruments.

The FRRP has, over recent years, considered the annual reports and accounts of companies which have put in place arrangements to provide additional collateral to their pension schemes in exchange for reduced annual contributions and a longer period to fund the pension scheme deficit. The FRRP has focused on companies that have reclassified pension liabilities as equity instruments.

Specifically, some of these arrangements, usually involving the establishment of a Scottish Limited Partnership which holds the collateral, have included additional features which appear to have been introduced in order to achieve an accounting outcome whereby the company's obligation to make future payments to its pension scheme is

transformed into an equity instrument in the company's consolidated accounts. This change has a favourable impact on financial solvency, gearing and reported comprehensive income despite the company retaining the obligation to fund the pension deficit.

Following enquiries by the FRRP, each of the companies approached has revised either the arrangements or the amounts recognised with the result that the concerns of the FRRP have been addressed for the future from the date of the change.

## Spotlight on our new Director of Accounting and Reporting Policy



Anthony Appleton joined the FRC in January 2014 as Director of Accounting Policy.

Anthony has joined the FRC from BDO where he was a Director within their Financial Reporting Advisory team, having previously held senior technical advisory roles at Group A firms. He had also been a member of the FRC's Accounting Council since May 2013. Anthony brings a wealth of experience in financial reporting matters and has been an active contributor to the debates on the development of UK GAAP and IFRS for a number of years.

### Open for Comment

#### FRC Draft Plan and Budget and Levy Proposals 2014/15

comment period ends 28 February 2014

#### UK GAAP

FRED 51 *Draft Amendments to FRS 102*

comment period ends 14 February 2014

FRED 52 *Draft Amendments to the FRSSE*

comment period ends 12 February 2014

FRED 53 *Draft Amendments to FRS 101*

comment period ends 21 March 2014

#### IFRS

IFRS for SMEs

comment period ends 3 March 2014

IASB Exposure Draft *Equity Method in Separate Financial Statements*

comment period ends 3 February 2014

IASB Exposure Draft *Annual Improvements to IFRS 2012-2014 Cycle*

comment period ends 13 March 20