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THE STATE OF FINANCIAL REPORTING

Financial Reporting Council

Annual
Review
1994

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Financial Reporting Council Annual Review 1994

CONTENTS

OVERVIEW

The bodies and their functions

1. **The Financial Reporting Council** and its two operational bodies, **the Accounting Standards Board** and **the Financial Reporting Review Panel**, came into being in 1990 to replace the previous accounting standard-setting system and to secure enforcement of reporting requirements. Relevant changes in company law had been made in the Companies Act 1989. One-third of the funding for the three bodies comes from the accountancy profession, one-third from the City, and one-third from government.

2. **The Council** is the overarching body whose role is to give general guidance and support to the Board and Review Panel and to promote good financial reporting generally. The 30 members and observers of the Council are drawn at senior level from accountancy, industry and commerce, the City, trade unions, the academic world, the law, the Bank of England and government. The Council's chairman and its three deputy chairmen act as directors and deal with the Council's business affairs.

3. The function of **the Board** is to make, amend and withdraw accounting standards, having been recognised for that purpose under the Companies Act 1985. In this role it is autonomous. Its members, up to a maximum of ten, are appointed by the Council's Appointments Committee and are individuals with accountancy expertise and a wide spread of experience—in accountancy practice, industry and commerce, institutional investment, the academic world and elsewhere.

4. **The Review Panel** has been authorised under the Companies Act 1985 to review the annual accounts of companies and if they do not comply with the accounting requirements of the Act, including applicable accounting standards, to seek appropriate corrections. Its ambit is public and large private companies. The Panel is empowered to apply to the court for this purpose but endeavours to secure remedies by agreement with the companies concerned—an aim it has achieved in all cases so far. It has 20 part-time members, appointed by the Council's Appointments Committee from a range of experience and backgrounds, but operates through groups of five or six members for each individual case.

Review of the year

5. **The Review** outlines the work and future plans of the Council, Board and Review Panel respectively. The chapter on **the Council**, supplemented in Appendices 1 and 2, gives details of the constitution of the three bodies. It also reports on the work of the Council, including appointments made during the year, and its involvement with 'overload' and the Cadbury Committee, and reflects on the system as a whole.

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6. The chapter on **the Board** takes stock of the work so far completed, comments on the Board's current programme, and looks ahead to the future. Since the last Review, dated November 1993, the Board has issued four standards—on capital instruments, off balance sheet financing, acquisitions and mergers, and fair values in acquisition accounting—and published proposals for a standard on related party disclosures. It has also issued a draft of the final chapter of its Statement of Principles, and Discussion Papers on goodwill and intangible assets and on associates and joint ventures.

7. In the year ahead proposals for discussion are likely on deferred tax, pension costs, provisions, disclosures of financial instruments, associates and joint ventures, goodwill, the valuation of fixed assets and the Board's complete Statement of Principles. The only accounting standard likely is that on related party disclosures.

8. The chapter also reports on the work of the Board's Urgent Issues Task Force, which in the past year reached consensus on three topics, as set out in published abstracts on disclosure of directors' share options, issuer call options, and lessee accounting for reverse premiums and similar incentives. The chapter also refers to the Board's arrangements for dealing with Statements of Recommended Practice (SORPs), and responds to some criticism that has been made about the length of its standards.

9. The chapter on **the Review Panel** surveys the cases the Review Panel has dealt with during the past year, in particular the six cases on which it has issued public statements.

10. The Annual Review concludes with three detailed Appendices listing membership of the bodies and giving more details of their constitution, and listing all the current documents published by the Board.

Reader Survey

11. Finally there is a **Reader Survey**, the aim of which is to obtain systematic feedback about the utility and content of the Annual Review. The Council will much appreciate completion and return of this Survey to help it to shape future Annual Reviews to meet the needs of its readers.

Conclusion

12. In issuing this Review the Financial Reporting Council warmly commends the work of the Accounting Standards Board and the Financial Reporting Review Panel and emphasises the importance of the maintenance and improvement of standards of financial reporting and financial corporate governance. In this last context the Council notes the importance of arranging an appropriate successor to the Cadbury Committee.

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FINANCIAL REPORTING COUNCIL

Chairman's Report

FINANCIAL REPORTING COUNCIL

Chairman's Report

This is my first Annual Report as chairman of the Financial Reporting Council. It is four years since the establishment of the Council and its associated bodies. In that period much has occurred, and it may therefore be useful to recapitulate the role of the Council and the operational bodies—the Accounting Standards Board and the Financial Reporting Review Panel—before referring to developments in the field of financial reporting.

This Annual Review covers a period of thirteen months in order to put its end-date and future Reviews on a calendar-year basis.

The FRC structure

The Financial Reporting Council was created in 1990 to activate the proposals made in the 1988 report of the Review Committee on the making of accounting standards, and in particular to bring into being, guide, and secure financing for, the executive bodies the Committee proposed. The rationale for their creation was the widespread belief that the institutional framework underpinning the provision of sound and reliable financial information needed strengthening. The creation of the Council was one of the measures taken by the financial and business community and by government to achieve this.

The broad role of the Council and the bodies it has established is the improvement of financial reporting, primarily through the strengthening of the system of accounting standards. This is achieved through the Accounting Standards Board, which guides directors and auditors in financial reporting, and through the Financial Reporting Review Panel, which investigates material departures from accounting standards and other reporting requirements such that the accounts in question may not give a true and fair view.

The Council

The role of the Council is

- to promote good financial reporting, and in that context from time to time to make public its views on reporting standards; and to make representations to government on the workings of current legislation when appropriate
- to provide guidance to the Accounting Standards Board on work programmes and on broad policy issues
- to verify that the arrangements under the Council's umbrella are conducted with efficiency and economy and that they are adequately funded.

As a body concerned with the high-level monitoring of financial reporting it was important that the Council should be broadly representative of those with a key interest in sound and accurate reporting, and that its membership should extend beyond the accountancy profession itself. In addition to accountancy profession representation, therefore, the Council membership reflects a wide range of interests, including industry and commerce, the City, institutional investors, the trade unions, academia, the law, the Bank of England and government. The Council has been fortunate in securing representation from individuals in these sectors who can bring a high-level and independent perspective to its work.

It is particularly important that the Council should enjoy the support of three key sectors—the accountancy profession, the City, and industry and commerce. It is welcome therefore that the three deputy chairmen who support the independent chairman of the Council should normally be drawn from the Consultative Committee of Accountancy Bodies, the London Stock Exchange and the Confederation of British Industry; and it is pleasing that the current deputy chairmen are also the current chairmen of those three bodies.

Accounting Standards Board

The role of the Accounting Standards Board is to make, amend and withdraw accounting standards, having been recognised for this purpose by statutory instrument.

The main changes in the standard-setting framework, as compared with the former regime, are

- accounting standards are now given statutory recognition under the Companies Act 1985, and the Board has been prescribed as the standard-making body for this purpose
- unlike its predecessor, the Board is totally independent, and needs no outside approval for its actions, either from the Council, from government, or from any other source
- the Board is very much smaller than its predecessor, has a full-time chairman and full-time technical director, and is supported by greater staff resources.

Appointments to the Board are made by the Council's Appointments Committee. In constituting its maximum membership of ten—two full-time and eight part-time—the Appointments Committee has regard to the need to provide an input from accountancy practitioners, industry and commerce, users of accounts, and others with an interest in financial reporting, and to select people who by virtue of their standing, accountancy knowledge and breadth of experience can best contribute to the Board's objectives.

Financial Reporting Review Panel

The Review Panel is the new element in the financial reporting scene. It came into being following amendments to the Companies Act 1985. These amendments, introduced by the Companies Act 1989, made possible the voluntary revision of defective accounts and a court order compelling such revision if no voluntary action were taken.

The Review Panel is concerned with material departures from the accounting requirements of the Act in annual accounts, including compliance with applicable accounting standards. The Secretary of State for Trade and Industry has authorised the Review Panel to use the powers in the Act to apply to the court for a declaration of non-compliance with the Act and for an order compelling revision.

Like the Board, the Review Panel is completely independent—of the Council, the Board, and any other source. By agreement with the Department of Trade and Industry the Review Panel's ambit is large companies—broadly public and large private companies. For any particular enquiry the Review Panel operates by means of a group of five or so of its members, the other members having no involvement in, or knowledge of, it.

The Review Panel has available to it a legal costs fund of £2 million, should it need to take court action, but to date all its cases have been settled by agreement without the involvement of the court. The Review Panel has a part-time chairman, a part-time deputy chairman, and at present 18 other part-time members. Appointments to the Review Panel are made by the Council's Appointments Committee. The aim is to secure membership from a range of business backgrounds, selecting individuals who have the necessary experience, standing and independence of mind to bring to bear on the issues that come before them.

The operation of the system so far

The new system has now been in place for over four years, and has become a pivotal element of the financial reporting regime. During this time the Accounting Standards Board has played a significant and authoritative role. It has introduced a number of important new standards, including one that reshaped the profit and loss account and one that substituted a cash flow statement for the old source and application of funds statement. Most recently it has introduced standards in the field of acquisitions and mergers and one that has tackled in a comprehensive way the issue of off balance sheet finance and other novel forms of financial transaction. Work is well advanced on its Statement of Principles, which is intended to provide a consistent underpinning of its standards. It has also enabled companies significantly to extend the scope of their financial reporting by providing for the introduction of a non-mandatory statement on Operating and Financial Review.

The Financial Reporting Review Panel has also had a significant effect on the financial reporting scene. The presence for the first time of an effective enforcement body, prepared if necessary to seek recourse to the court, has undoubtedly helped to raise standards of financial reporting and to weed out abuses. During its period of operation the Review Panel has looked at the accounts of a significant number of companies and considered a wide variety of accounting issues. Since the Review Panel makes a public statement only when there is a matter that requires remedial action the full extent of its operations does not come into the public eye.

It has been particularly pleasing that in all cases so far where the Review Panel has sought remedial action it has been able to achieve this through the agreement of the companies concerned and recourse to the court has not proved necessary.

The ultimate objective of the whole system is to maintain and improve standards of financial reporting; and in the light of experience and the constructive comments they receive, the Board and the Review Panel will continue to seek improvements in the way that their respective operations are conducted.

The Council has also made its own contribution—through the support and guidance it has given to the Board and Review Panel and the appointments it has made to them; through its sponsorship of the Cadbury Committee; through its work on 'overload'; through the publication of its Annual Reviews; and by its very presence on the financial reporting scene.

Overall, I hope it could be said that the new system has had an influence for good that extends well beyond the visible and tangible output of the operational bodies.

International co-operation

As is indicated in the chapter on the Accounting Standards Board, the Board has continued to pay full regard to the international implications of its task and is playing a leading part in developing an international consensus on a number of key issues.

Other initiatives in the financial reporting field

The Council, the Board and the Review Panel are of course not the only players in the field of financial reporting. Their work is supported by the parallel work of the Auditing Practices Board, the Committee on the Financial Aspects of Corporate Governance (the Cadbury Committee) and by others concerned with financial regulation. The Council and its companion bodies are conscious of the need to take account of work in other areas. One particular initiative, referred to below, is the action taken by the Council to deal with the problem of possible 'overload' arising from the timing of various accounting and auditing requirements.

I now turn in more detail to the events of the past year.

Review of the year

Financial Reporting Council

There were two full Council meetings during the year. The FRC Limited directors (the chairman and the deputy chairmen) met a number of times to deal with business matters such as the Council's forward budget and its annual accounts. The Council's Appointments Committee met on several occasions to consider appointments to the Board and the Review Panel. Four Council members served on the Cadbury Committee. In fulfilling their duties throughout the year the chairman and the deputy chairmen were able to draw on the experience and advice of individual Council members.

As has been the practice since the Council came into being, a major element of each Council meeting has been a progress report and outline of future plans from the chairman of the Accounting Standards Board. During the year this part of the meeting has included discussion on the international dimension and on the Board's policy towards the development of Statements of Recommended Practice (SORPs)—statements of guidance for, and developed in conjunction with, particular industries.

Similarly the Council received at each meeting a progress report from the chairman of the Review Panel.

The Council also considered a report of the activities of the informal 'overload' group that was established by the then chairman last year to coordinate the timing of the issue of new financial reporting proposals by various bodies. Those taking part are the Hundred Group of Finance Directors, the Institute of Chartered Accountants in England and Wales, the Auditing Practices Board, the Accounting Standards Board and the Cadbury Committee. All parties concerned believe that the existence of the informal group has been helpful; and while the problems that led to its establishment seem to have been overcome it will continue to meet as necessary in the year ahead.

One important task for the Council in the year ahead is to set in motion the mechanism for the creation of a successor to the Cadbury Committee, as was recommended in that Committee's Report.

Appointments

(a) Financial Reporting Council

During the year Roger Lawson, the current chairman of the Consultative Committee of Accountancy Bodies, succeeded his predecessor Michael Chamberlain as a deputy chairman of the Council, and John Kemp-Welch, chairman of the London Stock Exchange, similarly succeeded his predecessor, Sir Andrew Hugh Smith, as a deputy chairman. Sir Andrew had served as a deputy chairman since the Council's formation in 1990.

The full membership of the Council is given in Appendix 1.

Appointments to the Accounting Standards Board and the Financial Reporting Review Panel are made by the Council's Appointments Committee, details of which are given later in this chapter and in Appendix 1.

(b) Accounting Standards Board

During the year the Appointments Committee made five appointments to the Board: David Allvey, Raymond Hinton, Huw Jones, Geoffrey Whittington and Ken Wild. These appointments arose from the completion of the terms of office on the Board of Robert Bradfield, Sir Bryan Carsberg and Graham Stacy CBE, the resignation of Roger Munson and an increase in Board membership from nine to ten to facilitate a greater contribution from industry and commerce.

Donald Main completed his term of office as a Board member at the end of 1994 and action is in hand by the Appointments Committee to appoint a successor.

The membership of the Board and its committees is given in Appendix 1.

(c) Financial Reporting Review Panel

Richard Gillingwater and Peter Goldsmith QC were appointed as members of the Review Panel in December 1994.

The membership of the Review Panel is given in Appendix 1.

Accounting Standards Board

As the Accounting Standards Board chapter of this Review indicates, the Board has had a busy and productive year; and the benefits of its earlier efforts are, I believe, beginning to show through. In particular the reform of the profit and loss account brought about by FRS 3 is now well-established and is resulting in clearer and more informative accounts.

The Board's most recent standards—FRS 6 'Acquisitions and Mergers' and FRS 7 'Fair Values in Acquisition Accounting'—have not been universally welcomed. In such a difficult area—and there are inevitably more of that kind on the Board's agenda—it is not to be expected that the Board can please everyone, nor should it attempt to do so. Unambiguous decisions do need to be made. In such circumstances what is important is that the Board should seek and consider carefully all points of view. The Board's processes are designed with this consideration in mind.

There has recently been some criticism of the length of the standards produced by the Board. While some of this criticism can only be described as over-simplistic, it does point to a real problem. As Sir David Tweedie makes clear in the Accounting Standards Board chapter, the Board would much like to produce shorter standards, based on principle rather than detailed rules. The pressure for the detail comes from outside the Board, as is well illustrated by the Board's experience with FRS 5. It is frankly unrealistic for shorter standards to be called for unless there are good grounds to expect that companies and the accountancy profession would fully honour an approach limited to basic principles. It has to be said that past experience has not been encouraging. Nevertheless this is an area that should and will be kept under review.

Last year the Council was one of a number of bodies giving its warm endorsement to the Board's Statement on Operational and Financial Review (OFR). It is encouraging to see that a number of companies have taken up the opportunity that the OFR offers to present to the readers of their annual reports a clear and informative amplification of the material contained in the statutory accounts. I hope that many others will follow suit. The OFR presents a challenge to directors to set out a discriminating, clear and straightforward analysis of their company's performance and financial position. The evidence is that this challenge is being increasingly taken up and that the standard of OFRs is improving as those concerned learn from each other and from their own past experience.

As the chapter on the Board indicates, there are some formidable problems ahead. Not unexpectedly the responses to the Board's Discussion Paper on goodwill and intangible assets have confirmed the wide division of opinion on this thorny subject. The Council hopes that the Board's next round of consultation will go some way to closing the gap. Clearly, what is needed above all on this subject from everyone concerned is a constructive approach to a difficult but necessary debate.

There are likely to be differences of view also when the Board unveils its Discussion Papers on pensions costs in company accounts and on deferred tax. Once again goodwill will be needed if the optimum solution is to be found. The Council is in no doubt that these difficult subjects need to be tackled—it would be no service to users of accounts to shirk them.

The Council also endorses the Board's decision to begin work on two other particularly difficult areas—provisions and accounting for derivatives. In both these projects the Board will be drawing on international experience.

The increasing use and complexity of financial instruments, particularly derivatives, are perhaps among the most significant developments in today's financial world. While such instruments perform a valuable role in financial management they also have the potential to be misused or misunderstood. The accounting treatment of derivatives is only one aspect of the whole picture, but it is an important one that clearly deserves attention.

The Council has noted with interest that in the EU Accounting Advisory Forum the Board has been working on environmental issues in financial reporting. This is a matter that will undoubtedly assume growing prominence in the future, and the Council will be watching developments. There is, however, a limit to the pace at which financial reporting can be improved to solve problems arising from emerging issues such as these when evolving practices have not yet matured.

Urgent Issues Task Force

The Council strongly supports the role the Urgent Issues Task Force is playing in helping to tackle problems that need to be solved in a shorter timescale than that in which an accounting standard can be developed. But if the Task Force is to be truly effective it needs to consider the problem areas early, before undesirable practices get into the system. There has been some disappointment that early notification of such issues has not always been forthcoming. The Council hopes that all concerned will not hesitate to bring cases to the Task Force's attention at an early stage.

Financial Reporting Review Panel

As the relevant chapter in this Review demonstrates, the Review Panel has continued to play a key role in maintaining high standards of financial reporting. The Council's thanks are due to Edwin Glasgow QC, the Review Panel's chairman, and to all who play a part in its activities.

Cadbury Committee

I succeeded Sir Ron Dearing as a member of the Committee during the year and, with colleagues from the Council who are Cadbury Committee members, have helped to take forward the work it commissioned on going concern and internal control.

As is noted above, one important task for the Council in the year ahead will be to play its part in the formation and work of the successor to the Cadbury Committee.

Audit

Audit as such is not within the Council's remit, but effective audit is of course a crucial element in the maintenance of high standards of financial reporting. As in past years the Council will therefore continue to take a close and supportive interest in developments in this field.

People

My first task must be to record the debt that all those interested in financial reporting owe to my predecessor, Sir Ron Dearing CB, who played such a vital part in the establishment and development of the Financial Reporting Council and its associated bodies.

The success of all three bodies—the Council, the Board and the Review Panel—turns critically on the personal contributions made by all those who serve on them. At the risk of being invidious, since very many people play their part, it is right that this Review should single out for special note the efforts of three of that number.

First, I should like to record the Council's thanks to Sir Andrew Hugh Smith, until recently the chairman of the London Stock Exchange, for his service as a deputy chairman of the Council from its inception in 1990 until mid-1994. Sir Andrew played a key part in getting the new system launched and in steering it towards today's fully established state. We are fortunate also in securing his successor to take his place.

Secondly, the Council's warm congratulations are extended to Sir David Tweedie on the award to him of a knighthood in the Birthday honours list. It is very good news for financial reporting, and an entirely deserved recognition of the personal efforts that Sir David has made to that cause.

Thirdly, our thanks are also due to Sir Bryan Carsberg, who served as a member of the Accounting Standards Board from its inception until spring 1994, much of that time as its vice-chairman. I know that Sir David much valued the wise support that Sir Bryan gave him in that role. We wish Sir Bryan well in his new and important task at the International Accounting Standards Committee.

It is right that those mentioned above should be singled out for special mention, but our thanks are also due to all those who have served on the Board, the Urgent Issues Task Force and the Review Panel and who have so willingly and enthusiastically given of their time to contribute to the success of the system over the past year. Thanks are equally due to those who have served on the Council itself, and particularly to the deputy chairmen Roger Lawson (and his predecessor Michael Chamberlain), Sir Bryan Nicholson and John Kemp-Welch. I should also like to give special mention to the Council members who, together with the deputy chairmen, serve on the Appointments Committee—Brandon Gough, Geoffrey Maitland Smith and Mark Sheldon—and thus help to share one of the Council's key tasks—the identification of those who can best contribute to the aims of the Board and the Review Panel.

I should also like to thank Sydney Treadgold, the secretary of the Council, and all the other staff members of the Council and the operational bodies for their unstinting and effective efforts over the year and their invaluable contribution to their success.

Feedback from readers

As I noted at the start of my remarks, this is the fourth Annual Review that the Council has produced. The Council believes that previous Reviews have been found welcome and useful but that it should seek to ascertain more systematically whether this impression is correct and whether readers think that any changes to the Review's format and content would be helpful. A questionnaire has therefore been included at the end of the Review for those who would like to comment. I hope that readers of the Review will spare the time to complete it.

SYDNEY LIPWORTH

ACCOUNTING

STANDARDS

BOARD

Chairman's Report

Report by the Chairman of the Board

The period since the last Annual Review has seen the culmination of much of the Board's initial phase of operations. Four large projects were completed, resulting in accounting standards—on capital instruments, reporting the substance of transactions, acquisitions and mergers, and fair values in acquisition accounting. Preparers of accounts—upon whom falls the burden of implementing the changes—will undoubtedly be relieved to know that this rate of output will not be continued: only one FRS is expected to be published in 1995.

A list of all the Board's current publications is given in Appendix 3.

When the Board began its work it identified the need for action in each of the three main areas of accounting:

(a) measures of performance
(b) the balance sheet
(c) group accounts

Performance

Performance measures

Performance measures received the Board's early attention, the first result being the publication of FRS 1 'Cash Flow Statements' (September 1991). The standard replaced the source and application of funds statement with a cash flow statement, similar to those used overseas. FRS 3 'Reporting Financial Performance' (October 1992) transformed the profit and loss account, bringing UK practice more into line with that in North America by dividing income into continuing and discontinued streams and removing the problem of extraordinary items. In addition, it introduced the statement of total recognised gains and losses—a statement that has attracted interest in a number of other countries.

The Operating and Financial Review (OFR) (July 1993) was modelled on the Management Discussion and Analysis required in the USA but adapted to UK circumstances. Unlike its US model the Review is not mandatory but offers directors a framework within which to discuss the performance of their company by commenting on the performance statements and balance sheet and gives them a structure within which to highlight matters that have occurred during the year and are reflected in the financial statements but are not likely to recur (and vice versa). It also gives directors an opportunity to discuss issues such as the level of the tax charge, liquidity, solvency and the manner in which any problems in those areas will be overcome. In producing the OFR the Board was greatly assisted by input from a number of senior finance directors, analysts and fund managers, and it was issued with the endorsement of the Financial Reporting Council, the Hundred Group of Finance Directors and the London Stock Exchange.

The Board does not believe that these pronouncements on performance measures are the final word; indeed, it is already re-examining FRS 1 for the purpose of ensuring that the standard more closely reflects the views of the preparer and user community.

The Board's request for comments on FRS 1 'Cash Flow Statements' attracted over a hundred responses. These showed that the main change introduced by FRS 1—replacing the requirement for a statement of source and application of funds by one for a cash flow statement—was widely acknowledged to have achieved an improvement in financial reporting. However, the Board also received many suggestions to improve the FRS 1 cash flow statement, particularly from preparers who thought that the current statement did not correspond with how they defined and managed the liquidity and financial adaptability of their businesses. A large majority believed that the definition of cash and cash equivalents needed revision, and many requested a greater focus on net debt. The Board is at present consulting on the issue.

It is likely that in a year or two a similar review will be undertaken of FRS 3.

The balance sheet

The Board identified three main issues affecting the balance sheet: the distinction between debt and equity; valuation; and off balance sheet financing.

Distinction between debt and equity

In the late 1980s many kinds of instruments were, on occasion, classified as equity or reported in an ambiguous way that failed to make clear their status as debt or equity, sometimes on the flimsiest of grounds. FRS 4 'Capital Instruments' (December 1993), largely based on North American practice, was designed to remove any doubt by requiring all instruments to be appropriately classified either as part of shareholders' funds or as liabilities. In turn shareholders' funds were to be analysed into equity and non-equity amounts.

Valuation

A Discussion Paper, 'The Role of Valuation in Financial Reporting', was issued in March 1993 in an attempt to deal with the problem that arises under the modified historical cost system with its irregular valuation of assets and resulting lack of comparability. The Board's proposal that if revaluation is to be permitted in accounts then valuations must be kept up to date, as is required in the International Accounting Standard, was generally accepted. Very few respondents preferred a historical cost or a current cost system.

The scope of a standard requiring valuation of particular assets, the extent to which valuations should be mandatory and the type of valuation to be undertaken (bearing in mind both the benefits and the cost of valuations) are being actively debated by the Board. Consultations are being undertaken with preparer and user groups and the Royal Institution of Chartered Surveyors. It is hoped that a further Discussion Paper will be issued in 1995.

Off balance sheet financing

FRS 5 'Reporting the Substance of Transactions'—a standard based on proposals inherited in an advanced state of development from the Board's predecessor body, the Accounting Standards Committee (ASC)—was published in April. The ASC's draft was a complex document dealing with highly technical issues, and it raised questions about the level of guidance required. The Board fiercely debated whether, in the interests of brevity, the standard could be issued without its application notes and took soundings from representatives of the large accounting firms, who urged the retention of the notes.

The Board was concerned that the type of standard that emerged might be regarded as a 'cookbook' even though, as the Board is at pains to point out, the application notes simply indicate how particular situations are to be dealt with by applying the principles already set out in the standard. Whilst the inclusion of the voluminous application notes has led to a much longer document than any others issued by the Board, the statement of standard accounting practice itself is concise, extending to no more than 29 paragraphs.

Group accounts

Subsidiaries

One of the Board's early standards—FRS 2 'Accounting for Subsidiary Undertakings' (July 1992)—updated accounting standards to take account of changes introduced by the Companies Act 1989 in implementing the EC Seventh Directive.

Business combinations

Substantial changes to accounting for business combinations came in September 1994 with the publication of FRS 6 'Acquisitions and Mergers' and FRS 7 'Fair Values in Acquisition Accounting'. These two standards moved the UK more into line with international practice. FRS 6 is based largely on International Accounting Standards and Canadian standards, whereas FRS 7 prohibits the previous practice of providing on acquisition for expected future losses of the acquired company and for its reorganisation.

In North America provisions for reorganisation are allowed where facilities in the acquired company that duplicate those of the acquiring company are closed, but not where the duplicate facilities that are closed are those of the acquiring company. The Board could not see the logic for this rule, which has indeed been condemned by commentators in the USA. The Board's view is that companies should account at the time of acquisition only for the liabilities and assets they acquire and not for those costs they may choose to incur later as they reorganise the company after the acquisition. If the acquiring company were to reorganise one of its own divisions the charge would be made through the profit and loss account. If the acquired company had reorganised itself, it too would have charged the costs to the profit and loss account. The Board believes, therefore, that it is entirely logical that reorganisation costs relating to acquired businesses should also be charged post-acquisition to the profit and loss account.

Associates and joint ventures

In July 1994 the Board issued a Discussion Paper on group accounts, 'Associates and Joint Ventures'. The Board's initial position is that associates and joint ventures are strategic alliances enabling one company to operate through the medium of another and that associates and joint ventures should be accounted for in a similar way. As the Board is concerned that profit and loss accounts should reflect income and expenses that relate to cash flows, the Discussion Paper proposes to restrict equity accounting to those cases where the investor exercises sufficient influence over the operating and financial policies of the company in which it has invested to enable the investor to fulfil its role as a partner in the business. It argues that if the investor is to bring into its accounts its share of the profits or losses of an associate or joint venture it must have the ability, other than by disposing of its interest, to obtain access in the long run to its share of the associate's or joint venture's cash flows. In the Board's view, the investor's interest must also provide it with some protection from policy changes that would affect the benefits it expects for the risk to which it is exposed. The Board will of course examine carefully the comments on the Discussion Paper before deciding how matters should be taken forward.

Goodwill and intangible assets

Comments on 'Goodwill and Intangible Assets', a Discussion Paper issued in December 1993 (along with FRED 7, the exposure draft that preceded FRS 7), sharply reflected the absence of consensus on this subject throughout the financial community. In essence, the Board sought comments on whether purchased goodwill should be set off against reserves or whether some assessment of impairment of the underlying investment should be used when the economic life of the goodwill was indeterminate.

There are only three possible policies for goodwill:

1. Goodwill is treated as an asset and written off over an arbitrary period. Standard-setters in other countries have specified maximum write-off periods—40 years in Canada and the USA and generally 20 years in other countries. Perhaps inevitably, those maximum periods have tended to be regarded as the norm. This approach is based on the view that purchased goodwill gradually diminishes and is replaced by the self-generated goodwill of the acquirer.

2. Goodwill is set off against reserves. This treatment has the advantage of consistency with internally generated goodwill, which is of course not shown in accounts.

3. Goodwill is treated as an asset, and assessed for impairment and written down when the value of the underlying investment has diminished. The argument for this approach is that in the parent company's accounts the investment is shown as a single asset. In consolidated accounts this amount is dissolved into assets, liabilities and the residue (goodwill). Any impairment approach would simply seek to ensure that the underlying investment had retained value and therefore that no write-off of goodwill was required.

While a write-off to reserves (shown separately from other reserves) was the single most popular method favoured by respondents to the Discussion Paper, a majority preferred goodwill to be shown as an asset, their views being divided between the impairment approach and the arbitrary depreciation approach. The Board's view that intangible assets should simply be subsumed within goodwill was not generally supported.

The Board is now re-examining its position on goodwill. It is considering whether it would be possible to record intangibles as separate assets and, if so, under what circumstances. It is also seeking to determine whether any consensus exists on how to deal with these assets and with the residual goodwill. The Board hopes to publish another document in 1995, possibly after having had the benefit of public hearings on the issue.

Other current topics

The Board is now considering a number of topics that, with one exception, have not yet reached the stage of publication for public discussion.

Related party disclosures

The exception is FRED 8 'Related Party Disclosures' (published in March 1994), on which the Board is at present considering the responses.

Comments received on FRED 8 focused on three aspects: the volume of disclosures that would result from the proposals; possible breaches of banker/client confidentiality; and the case for exempting small companies and all—not merely wholly-owned—subsidiaries from the disclosures proposed by the FRED. Consultation with the banks is taking place with a view to reaching a solution to the banker/client problem. The remaining issues will be given further consideration by the Board in drafting the final FRS. It is hoped to issue a standard in the summer of 1995.

Two large projects on which the Board is engaged are the accounting for pension costs and for deferred tax. It was the standards on these two topics (SSAP 24 and SSAP 15 respectively) that emerged as being most in need of revision when the Board studied the review of existing standards prepared for it by the accountancy bodies in 1992.

Pension costs

Internationally there has been a trend, especially in Australia and the USA, for the company's pension cost for the year to be determined by reference to changes in the market value of the pension scheme's assets and in the present cost of buying annuities for the benefits earned by the employees at the balance sheet date. Such values are, of course, subject to the vagaries of stock market prices and interest rates, and great volatility in the charges to income can result. This has been countered in the USA, but not in Australia, by complex mechanisms designed to smooth the fluctuations over a short period.

The Board is considering whether the demand to change SSAP 24 'Accounting for pension costs' should be met by removing some of the options available in the present standard or alternatively by a version of the internationally accepted market value approach. In either case existing disclosures would be changed to show the composition of the pension charge for the year. A Discussion Paper will be issued in early 1995.

Deferred tax

In the same period a Discussion Paper on deferred taxation will also be published. International influences are also affecting the reconsideration of SSAP 15 'Accounting for deferred tax'. Internationally, the UK is virtually isolated in adopting the partial provision method whereby the provision for tax reflects the amount that will actually be paid taking account of deferrals that may be caused by future investment. Other countries require a full provision method, which ignores the impact of future tax deferrals and other factors affecting the future payment of tax. There is, however, a concern that deferred tax liabilities resulting from this method would be unrealistically high.

Given the difficulties associated with the subjectivity of the partial provision method and the excess liabilities recorded under the full provision method, the Board is discussing whether, under the full provision method, liabilities should be discounted to take account of the time value of money. The Board is also considering whether it is too complicated to attempt to assess future liabilities and whether instead the flow-through method should be used, whereby the only tax liability recorded is the tax due on the profit for the year. Under this method, potential future liabilities would be disclosed.

Financial instruments and provisions

Two further topics under consideration by the Board—financial instruments and provisions—are described below in the International Activities section since each has involved a significant degree of international consultation.

Statement of Principles

In July 1994 the Board issued the final draft chapter of its Statement of Principles, the document that is intended to enable it to ensure that its standards are derived from a consistent framework. As promised, the Board is now engaged in the task of reviewing all seven chapters with the intention of simplifying the Statement and bringing out clearly the underlying main principles.

The draft Statement, of which Chapters 1 and 2 were closely based on the International Accounting Standards Committee's 'Framework for Financial Reporting', has already had a remarkable impact on accounting in the UK.

Chapter 1 'The Objective of Financial Reporting', which suggested a more forward-looking approach to accounting than hitherto, was used as a driving force for the Operating and Financial Review and for FRS 3, the standard that revised the structure of the profit and loss account.

Also in October 1994 the Board launched a quarterly newsletter 'Inside Track', which was sent to finance directors of listed companies and given an extensive circulation. This initiative responds to the desire expressed by many members of the business community to have a simple and regular means of keeping abreast of the Board's work programme. Early reactions to the newsletter have been most encouraging.

Urgent Issues Task Force (UITF)

In February 1994 the Board published the Foreword to UITF Abstracts. The Foreword explains the authority, scope and application of the UITF Abstracts issued by the Board, which set out the consensus of the Task Force on particular issues. The composition and procedures of the Task Force are set out in an Appendix to the Foreword.

The Task Force issued in May 1994 three draft Abstracts, two of which were published by the Board in final form in September and one in December. The first, UITF 10 'Disclosure of directors' share options', was a response to growing public disquiet and pressure from the investing community for information about the use of share options as a form of remunerating company directors. Exceptionally the Abstract is non-mandatory as the legal advice received was that while the Companies Act required the value of emoluments to be shown, including the estimated money value of any benefits, if it proved impractical to value share options these were not required to be shown as part of disclosable emoluments; furthermore, somewhat to the Board's surprise, it was not possible to infer a requirement to provide sufficient disclosure to enable readers of the accounts to derive their own values. The Task Force took the view that the legal position was clearly unsatisfactory and wrote to the Department of Trade and Industry suggesting that the law should be amended. At the same time it wrote to the London Stock Exchange suggesting that similar disclosures should be considered for inclusion as requirements in the Listing Rules.

UITF 11 'Capital Instruments : issuer call options' dealt with a technical aspect of FRS 4—fulfilling the Task Force's role of removing ambiguities that emerge in the interpretation of standards.

The third Abstract, issued in December 1994, was UITF 12 'Lessee accounting for reverse premiums and similar incentives'. This was a response to a statement issued by the Review Panel earlier in the year noting that existing requirements in the law and accounting standards did not provide unequivocal guidance on the correct accounting treatment of reverse premiums.

International activities

The year again provided a heavy programme of international activities for Board members and staff. As well as the regular twice-yearly meetings of the EU Accounting Advisory Forum and attendance at three briefing sessions for UK representatives on the board of the IASC, one bilateral and three multilateral meetings were held with other national standard-setting bodies. In addition, the chairman, technical director and a project director joined standard-setters from a number of other countries in Edinburgh in June to discuss with the IASC its project on financial instruments.

The multilateral meetings were with two groups: Australia, Canada and the USA; and Australia and New Zealand. The latter group is expected to be extended to include South Africa. Representatives from the IASC attended all the meetings. At the bilateral meeting, with France, both standard-setters agreed in principle to hold formal meetings twice a year in addition to their occasional contacts at the EU Forum and elsewhere.

Financial investments

A prime topic discussed at all of these meetings was financial instruments. This priority was partly dictated by the need to respond to the IASC's exposure draft but also reflected the growing awareness in many countries that financial instruments, especially derivatives, have the ability to transform a company's balance sheet and expose it to risks that are often far from evident in present financial reporting. Standard-setters are likely to move first on disclosure requirements but all acknowledge the need to address the more difficult subjects of recognition and measurement (ie whether some or all financial instruments should be included in accounts at market value rather than historical cost and, if so, whether the resulting gain or loss should be recognised immediately in income) and hedge accounting (including the question whether it should be permissible to defer gains or losses on instruments that hedge future transactions such as future sales or remittances).

Provisions

A second major topic under active development with other standard-setters is provisions. The scarcity of existing requirements in this area allows considerable freedom to create provisions both at the time and of the amount desired. A particular concern is so-called 'big bath provisions', the practice of creating huge provisions—often said to relate to restructuring or future losses—that are reported as exceptional items and can provide a cushion for profits for many subsequent years. The subject is closely linked with that of impairment, which is also being studied internationally. In developing its own project on these subjects, the Board is glad to note that it shares much common ground with standard-setters from other countries.

Other issues

The EU Accounting Advisory Forum is currently discussing cash flow statements and environmental issues in financial reporting. It has also set in hand work to evaluate the relative influence of the prudence and matching principles and to consider to what extent, if at all, accounting requirements for individual companies and for groups might develop separately under the Directives. The Board is represented in all these projects. The last two topics are of especial interest, as they explore areas of financial reporting that are particularly constrained under the Directives. If EU companies are to reap the benefits of moves to international harmonisation, it will be essential to agree at the EU level ways of relaxing those parts of the Fourth and Seventh Directives that have grown obsolete with the passage of time and to assist standard-setting bodies in member states to co-ordinate their efforts to respond to global factors affecting financial reporting.

Statements of Recommended Practice (SORPs)

During the year the Board overhauled its arrangements for dealing with proposals for SORPs put forward by specialist bodies developing accounting practice for their sectors. The Board views the growing number of such bodies as welcome evidence of a widening desire to advance and maintain the standard of financial reporting, and is keen to play a constructive part in the promotion of good practice in specialist sectors by retaining a degree of oversight of proposed SORPs. Nevertheless the Board must focus its main effort on its own programme of work. To assist it in considering SORP proposals, therefore, the Board has established two specialist advisory committees comprising individuals with expertise in the relevant areas. The first committee, the Financial Sector and Other Special Industries Committee, is chaired by a Board member, Raymond Hinton, and began work straightaway on several proposals put to the Board. The second committee is based on the former Public Sector Liaison Committee but has been expanded, with a wider remit, as the Public Sector and Not-for-profit Committee, under the chairmanship of former Board member, Graham Stacy CBE. The committee's first task was to consider the Government's Green Paper on resource accounting and budgeting in central government; otherwise the committee's initial work programme is under consideration.

Big GAAP v Little GAAP

The Board has always been aware of the risk that accounting standards may be unduly and unnecessarily burdensome on smaller companies. Although it is concerned to raise the quality of financial reporting throughout the business community, the Board acknowledges that the deficiencies it is seeking to remedy are perhaps of most significance in the case of listed and other large companies. The Board's Statement of Aims includes in its guidelines an obligation to issue accounting standards only when the expected benefits exceed the perceived costs. The Board's concerns on this point were reflected in its very first standard, FRS 1, which specifically exempted small companies from its requirements.

To explore the question on a more systematic basis the Board in 1993 requested the Consultative Committee of Accountancy Bodies (CCAB) to consider and, on the basis of wide consultation, make recommendations on criteria for exempting certain types of enterprise from all or parts of accounting standards. The outcome of the exercise might be to distinguish different sets of generally accepted accounting principles (GAAP) of greater or lesser complexity for entities of different sizes (or with other features), hence 'Big GAAP v Little GAAP'. The working party set up by the CCAB to examine the issue published its consultative document in November 1994 and the Board looks forward to listening to the ensuing debate.

The length of documents

During the year some criticisms have been voiced about the length of the Board's documents, particularly FRSs. The Board would itself prefer to see shorter standards; the pressure for detail comes from outside the Board, from preparers of accounts and their auditors seeking greater certainty. The real question is the level of prescription and explanation necessary in a financial environment of burgeoning complexity in which auditors have felt themselves unable in the recent past to restrict abuses without invoking specific rules.

Much of the criticism has been directed at FRS 5 'Reporting the Substance of Transactions'. The application notes to this standard, which accounted for 67 of the 137 pages of the document, were included because the accounting firms with the closest knowledge of the subject insisted, both to the Board and its predecessor, that they could not apply the standard without them.

In order to facilitate the assimilation and accessibility of a standard, particularly for those who may need to refer to it only infrequently, each document is structured to assist rapid access to the relevant section. Apart from the statement of standard practice itself, a typical FRS usually includes:

- a preamble setting out the status of the key sections
- a list of contents, a conventional aid for readers
- a summary, so that readers do not have to read the complete document to find out whether it is likely to apply to their circumstances
- the objective, which sets out succinctly the overriding purpose—the spirit—of the standard
- an explanation of the standard, so that readers can better understand how it is intended to apply in practice and are not left entirely to their own devices
- a short appendix showing the relationship of the standard to International Accounting Standards, a matter that is likely to be of interest to preparers with international businesses

- a note of the relevant provisions in company legislation, with which standards usually interlock and to which readers may wish to refer
- finally, a section describing the origin of the standard and the deficiency it was designed to remedy, showing how the standard was developed and explaining how the Board responded to the comments received during the consultative stages. This is designed both as a historical record and as a guide to the arguments that the Board accepted and those it rejected. It is not compulsory reading, but is found helpful by those who wish to know why the standard is the way it is. (Similar material was published by the former ASC in the form of a typescript note.)

The comments that the Board receives do not suggest that any of these features of FRSs is an obvious candidate to be dropped in future. Indeed we know that many readers find them helpful. Experience also shows that commentators on exposure drafts are likely to call for more, rather than less, elaboration in both standard and explanation sections.

The size of its documents is a matter that the Board has constantly in mind. In essence the Board would like to publish short standards based on principle dealing with (say) 80 per cent of the issues. If many of the remaining, often peripheral and specialised, issues have to be dealt with it will disproportionately increase the length and complexity of our standards. How far the Board will be driven in that direction will depend on the willingness of the financial community to comply with the spirit of shorter standards and not to search for and exploit loopholes that will then have to be plugged by the issue of further rules.

While the Board is receptive to ideas for shortening standards, few constructive and specific suggestions have come forward. For its part the Board will continue to strive to keep the length of its pronouncements to the minimum to achieve its objectives and meet the reasonable needs of those who will implement and benefit from them. In return it asks those who comment on draft standards in future to spell out the respects, if any, in which they believe such documents are unnecessarily lengthy.

Conclusion

The last year has been a busy one for the Board. Just over a year ago some commentators had suggested that the Board had not produced a great deal in the then three years of its life. That certainly has not been a complaint I have heard in the last twelve months! It was probably unavoidable in starting with a complete new programme that many initial projects came to maturity at the same time.

The complications associated with the very difficult issues now facing the Board will undoubtedly slow down the programme. However, during the next twelve months I would expect to see Discussion Papers dealing with deferred tax, pension costs, provisions, and disclosure of financial instruments, together with further documents dealing with associates and joint ventures, goodwill and the valuation of fixed assets. In addition, as mentioned earlier, we expect to issue an exposure draft of the complete Statement of Principles and the revision to FRS 1. The only standard expected would be the development of FRED 8 'Related Party Disclosures'.

In conclusion, I should like to pay tribute and to extend my warm thanks to all those who assisted the Board during the year. The support of the Board members, the members of the Task Force, the staff and the Financial Reporting Council has of course been invaluable. I am also grateful to the many industrialists, accounting firms, user groups, accountancy bodies and individuals that have taken the trouble not only to respond to our documents but also to take part in discussions, conferences and field tests to help us to remove at least some of the problems of implementation and accounting inconsistencies that inevitably find their way into any proposed accounting standard.

DAVID TWEEDIE

THE FINANCIAL REPORTING
REVIEW PANEL

Chairman's Report

FINANCIAL REPORTING REVIEW PANEL

Report by the Chairman of the Panel

Since the last annual survey and up to the end of 1994 the accounts of some 46 companies were drawn to the Review Panel's attention. The references were, as in the past, from three broad sources—qualified audit reports or disclosed non-compliance with accounting standards or other requirements (6), cases referred by individuals or corporate bodies (21), and press comment (19).

There were eleven cases outstanding at the publication of the previous survey, making 57 in total considered during the period. Of those 57 cases 14 were not pursued beyond an initial examination, either because they did not fall within the jurisdiction of the Review Panel or because no point of substance arose. After consideration by the Review Panel and, where appropriate, discussion with the companies concerned, action was concluded on 29 of the remaining 43 cases. At the time of writing this report 14 were still under consideration. Public statements were issued in respect of six of the 29 concluded cases. Public statements are issued where it is accepted that some remedial action is called for.

Since the Review Panel came into being it has not proved necessary for the Panel to seek recourse to the court, though it has made clear its preparedness to do so should circumstances arise. All the six completed cases mentioned above about which public statements were made were concluded by agreement with the directors of the companies concerned.

As indicated in last year's Review, the Review Panel has endeavoured to specify more precisely in its public statements the circumstances that justified the Panel's intervention and the section of the Companies Act or the accounting standard at issue.

There was no clear pattern to the accounting issues raised in the six cases in which public statements were made, though one matter of concern to the Review Panel in two of the cases was the adequacy of the information provided in the accounts—in one case in respect of the accounting policies adopted and in the other in respect of the nature of the transaction itself. In these cases the intervention of the Review Panel led the companies in question to put the requisite information into the public domain at that point.

In one other case the intervention of the Review Panel resulted in the company in question publishing a full corrective Note. In all six cases appropriate corrective action was also taken in the companies' subsequent annual accounts.

In addition to the Review Panel's concerns about the adequacy of information provided in the accounts the other main issues addressed in the six cases referred to were:

- *The accounting treatment of reverse premiums.* The Review Panel noted that existing requirements did not provide unequivocal guidance and referred the matter to the Accounting Standards Board, which in turn referred it to the Urgent Issues Task Force. As a result the Board issued in December 1994 UITF Abstract 12 giving guidance on the issue.

- *The accounting treatment in respect of the disposal of a subsidiary* where, apart from the adequacy of the disclosures made, the issue was compliance with FRS 3 and Schedule 4 to the Companies Act 1985.

- *The treatment of exceptional items* where the issues were compliance with the provisions of FRS 3, as regards what should be treated as exceptional, and the requirement that exceptional items should be shown in the profit and loss account under the statutory format headings to which they relate.

- *The cash flow statement* where in three of the cases there was a failure to follow the provisions of FRS 1.

- *The balance sheet classification of a bank overdraft* when the issue was compliance with the provisions of Schedule 4 to the Companies Act 1985 as regards the period in which the bank overdraft fell due for repayment.

- *The accounting treatment of an investment in an associated company* where the issue was compliance with the provisions of SSAP 1 as regards the attribution of fair values to the intangible assets and the treatment of a revaluation reserve.

During the year the Review Panel also drew to the attention of the Accounting Standards Board some other areas identified in cases on which no public statements were made where the Panel's enquiries revealed an area of ambiguity or uncertainty in the accounting treatment in question. Similarly, where appropriate the Review Panel has drawn to the attention of the Department of Trade and Industry any matters that fall within the Department's supervisory responsibility.

The Review Panel's revised procedures, adopted in September 1993, appear to be helping it to handle cases more informally in the early stages. The Review Panel remains concerned however about the length of time that some cases take to complete. There is a dilemma here; while the Review Panel is anxious to give directors of companies adequate time to respond fully to its enquiries it cannot, in the public interest, allow matters to drift. In the year ahead the Review Panel intends to tighten its internal workings and to insist on tighter timetables from companies under investigation wherever possible.

EDWIN GLASGOW

APPENDICES

MEMBERSHIP OF THE BODIES AT 31 DECEMBER 1994

The Financial Reporting Council

Chairman

*Sir Sydney Lipworth QC	Deputy Chairman, NatWest plc

Deputy Chairmen

*Roger Lawson	Chairman of the Consultative Committee of Accountancy Bodies. President of the Institute of Chartered Accountants in England & Wales. Director, 3i plc.
*John Kemp-Welch	Chairman, London Stock Exchange
*Sir Bryan Nicholson	President of the CBI. Chairman of BUPA and of Varity Holdings Ltd.

Members

Sir David Tweedie	Chairman of the Accounting Standards Board (ex officio)
Edwin Glasgow QC	Chairman of the Financial Reporting Review Panel (ex officio)
Brian Birkenhead	Group Finance Director, National Power plc
David Bishop	Partner, KPMG Peat Marwick
John Bourke	Chairman, Irish Permanent plc
Sir Alan Cox CBE	Chief Executive, ASW Holdings plc
Elwyn Eilledge	Senior Partner, Ernst & Young
*Brandon Gough	Director, S G Warburg Group and De La Rue plc
Hugh Jenkins	Chief Executive, Prudential Portfolio Managers Ltd
*Geoffrey Maitland Smith	Chairman, Sears Plc

Leif Mills	General Secretary, Banking, Insurance and Finance Union
Mrs Rowena Mills	Chairman, RMA Ltd
Bill Morrison CBE	Chairman, British Linen Bank Group Ltd
Tom O'Connor MBE	Chairman, Drumelis Ltd
John Parkes	Chief Executive, Humberside County Council
Sir Brian Pearse	Chairman, The Housing Corporation
Brian Hilton CB	Deputy Secretary, Department of Trade and Industry (Government nominee)
The Lord Rockley	Chairman, Kleinwort Benson Group Plc
Ian Salter	Deputy Chairman, London Stock Exchange
Jack Shaw CBE	Deputy Governor, Bank of Scotland
*Mark Sheldon	Consultant, Linklaters & Paines
Christopher Swinson	Partner, BDO Stoy Hayward
Stephen Walls	Chairman, The Albert Fisher Group Plc

Observers

Sir John Bourn KCB	Comptroller & Auditor General, National Audit Office
Professor Andrew Likierman	Chief Accountancy Adviser to the Treasury and Head of the Government Accountancy Service
Michael Smith	Head of Business Finance Division, Bank of England (Bank of England nominee)

Informal Observer

Peter Baldwin — Department of Enterprise and Employment (Republic of Ireland)

Secretary

Sydney Treadgold

In the period since November 1993 the following ceased to be members of the Council:

Sir Ron Dearing CB (formerly chairman)
Michael Chamberlain (formerly deputy chairman)
Sir Andrew Hugh Smith (formerly deputy chairman)
Robert Priddle CB

NOTE: The Council's Appointments Committee comprises the members indicated by *.

The Accounting Standards Board

Chairman (full-time)
Sir David Tweedie

Technical Director (full-time)
Allan Cook

Members (part-time)

David Allvey	Group Finance Director, BAT Industries Plc
Ian Brindle	Senior Partner, Price Waterhouse
Michael Garner	Formerly Director, TI Group Plc
Raymond Hinton	Chairman UK Professional Standards, Arthur Andersen
Huw Jones	Director, Prudential Portfolio Managers Ltd
Donald Main *(retired 31 December 1994)*	Executive Director, Forte plc
Professor Geoffrey Whittington	Professor of Financial Accounting, University of Cambridge
Ken Wild	Accounting Technical Partner, Touche Ross

Observers

Professor Andrew Likierman	Chief Accountancy Adviser to the Treasury and Head of the Government Accountancy Service
Sarah Brown	Head of Companies Division, Department of Trade and Industry
Professor Robert Jack CBE	Formerly Senior Partner, McGrigor Donald

In the period since November 1993 the following ceased to be members or observers of the Board:

Members
Robert Bradfield
Sir Bryan Carsberg
Graham Stacy CBE

Observer
Arthur Russell CB

The Urgent Issues Task Force

Chairman

Sir David Tweedie (non-voting)	Chairman, Accounting Standards Board

Members

Dr Patricia Barker	Senior Lecturer, Dublin City University Business School
Martin Broughton	Group Chief Executive & Deputy Chairman, BAT Industries Plc
Bill Comyn	Partner, Touche Ross
David Davis	Partner in charge of auditing services, Clark Whitehill
Richard Hall	Partner, Binder Hamlyn
Keith Hamill	Group Finance Director, Forte plc
Peter Holgate	Accounting Technical Partner, Coopers & Lybrand
Michael Hughes	Chairman of the Accounting Committee, KPMG Peat Marwick
James Joll	Finance Director, Pearson Plc
Mary Keegan	Partner, Price Waterhouse
Will Lifford	Partner, Grant Thornton
Christopher Nunn	Technical Partner, Arthur Andersen
Ron Paterson	Technical Partner, Ernst & Young
Andrew Robb	Finance Director, Pilkington Plc
Jack Shaw CBE	Deputy Governor, Bank of Scotland

In the period since November 1993 the following ceased to be members of the Task Force:

Richard Brandt
Henry Gold
Raymond Hinton
Matthew Patient CBE
Ken Wild

Financial Sector and Other Specialised Industries Committee

Chairman	
Raymond Hinton	Member, ASB and Chairman, UK Professional Standards, Arthur Andersen
Members	
Nicholas Brittain	Chief Accountant, Barclays Bank plc
Bill Callaghan	Head of Economic and Social Affairs Department, Trades Union Congress
Clive Gilchrist	Managing Director, BES Trustees plc
John Hitchins	Audit Partner, Price Waterhouse
Jim Jack	Controller, Group Accounting, Prudential Corporation
Professor Richard Macve	Department of Accounting and Finance, University of Wales, Aberystwyth
Arthur Russell CB	Former Head of Companies and Insurance Divisions, Department of Trade and Industry
Bill Smith	Deputy Chief Executive, Equities Division, Barclays de Zoete Wedd Securities Limited
Richard Stocks	Adviser Member Assessment, IMRO Limited
Observer	
Sarah Brown	Head of Companies Division, Department of Trade and Industry

Public Sector and Not-for-profit Committee

Chairman	
Graham Stacy CBE	Formerly ASB Member and Consultant, Price Waterhouse
Members	
Michael Dallas	Partner, Public Service Audit, Coopers & Lybrand
Martin Evans	Head of Technical and Research Division, Chartered Institute of Public Finance and Accountancy
Michael Hathorn	Partner, Scott-Moncrieff
Professsor Irvine Lapsley	Professor of Accounting and Business Method, University of Edinburgh
Martin Pfleger	Assistant Auditor General, National Audit Office
Tony Sheppeck	Board Member for Finance, London Regional Transport
Professor John Sizer CBE	Chief Executive, Scottish Higher Education Funding Council
David Taylor	Deputy Director and Director of Finance & Services, World Wide Fund for Nature
Ken Wild	Member, ASB and Accounting Technical Partner, Touche Ross
Harry Wilkinson	Director, Accounting Practice, The Audit Commission
Observer	
Ken Bradley	Accountancy Advice Division, HM Treasury

The Financial Reporting Review Panel

Chairman
Edwin Glasgow QC

Deputy Chairman
Michael Renshall CBE

Members

David Allen CBE	Chairman, SFM Limited
John Baden	Director, Girobank
Sir John Bourn KCB	Comptroller & Auditor General, National Audit Office
Roger Buttery	Managing Director, Hartshead Pension Management Ltd
Susan Ellen	Managing Director, BUPA Health Services
Kit Farrow	Director General, London Investment Banking Association
Richard Gillingwater	Joint Head of UK Corporate Finance, Barclays de Zoete Wedd Limited
Peter Goldsmith QC	Chairman, The General Council of the Bar
Roger Looker	Director, Rea Brothers Ltd
Nigel Macdonald	Partner, Ernst & Young
Richard McGregor	Finance Director, J Bibby & Sons
David Mallett	Chief Group Inspector, Standard Chartered Bank
Anthony Mallinson	Solicitor, formerly with Slaughter and May
John Marples	Chartered Surveyor, Consultant, Conrad Ritblat & Co
David Mitchell	Company Secretary, Allied Domecq
Ron Scott	Chartered Surveyor, formerly Director, Storey Sons & Parker
Nigel Stapleton	Chief Financial Officer, Reed Elsevier plc
Christopher Swinson	Partner, BDO Stoy Hayward

Appendix 2

THE FINANCIAL REPORTING COUNCIL
THE ACCOUNTING STANDARDS BOARD
THE FINANCIAL REPORTING REVIEW PANEL

CONSTITUTIONS AND REMIT

Introduction

The Financial Reporting Council and its companion bodies the Accounting Standards Board and the Financial Reporting Review Panel were established following the report in 1988 of the Review Committee on the making of accounting standards chaired by Sir Ron Dearing CB. The Review Committee had been established by the Consultative Committee of Accountancy Bodies, under whose auspices the former Accounting Standards Committee operated, and they accepted its findings, recognising that changes were needed if good financial reporting was to be maintained and improved.

At the time the three bodies were coming into being the Government introduced important changes to company law through the Companies Act 1989. A significant change affecting annual accounts was provision for voluntary revision of defective accounts and for compulsory revision where the court is satisfied that the original accounts do not show a true and fair view or do not otherwise comply with the requirements of the Companies Act 1985. The Review Panel is authorised to apply to the court for this purpose. In such circumstances the court may order that revised accounts should be circulated to all those who received the original accounts, and it may also order that the costs of the court application and of the accounts revision should be borne personally by the directors who were party to the approval of the defective accounts.

Among other legislative changes, accounting standards were given legal definition, and large companies are required to disclose whether or not they have complied with them.

Although the Financial Reporting Council and its companion bodies have the strong support of Government they are not government-controlled, but rather part of the private sector process of self-regulation and this is reflected in their constitutions, membership and financing. The Department of Trade and Industry, together with the Northern Ireland Department of Economic Development and the National Audit Office, provides around one-third of the Council's finances, around one-third coming from the Consultative Committee of Accountancy Bodies, and the balance from the London Stock Exchange and the banking and investment communities.

The three bodies together have a current annual budget of around £2 million for operational expenditure and the Review Panel's legal costs fund (see below) is being maintained at a level of £2 million.

The Financial Reporting Council

The Financial Reporting Council Limited (the FRC) is constituted as a company limited by guarantee. The FRC acts as the management vehicle to which funds from its financial supporters are channelled. In turn the FRC provides funds and staff to The Accounting Standards Board Ltd (the ASB) and The Financial Reporting Review Panel Ltd (the FRRP) to enable those companies and their committees to carry out their functions.

The FRC's constitution provides for a **Council** whose function is to determine the general policy of the company.

The chairman and the three deputy chairmen of the Council (who also act in the same capacity as directors of the company) are appointed by the Secretary of State for Trade and Industry and the Governor of the Bank of England acting jointly.

Normally, under the company's constitution, the board of directors can be expected to include a representative from the Consultative Committee of Accountancy Bodies or accountancy generally, a representative from the London Stock Exchange Council or the City generally, and a representative from the governing body of the Confederation of British Industry or industry and commerce generally. The present chairman is Sir Sydney Lipworth QC. The deputy chairmen are John Kemp-Welch, Roger Lawson and Sir Bryan Nicholson.

The chairman of the Accounting Standards Board and the chairman of the Review Panel are members of the Council ex officio, and the Government and the Bank of England each have the right to nominate one member. The remaining members and observers are appointed by the chairman and deputy chairmen. The membership is designed to include wide and balanced representation at the most senior level of preparers, auditors and users of accounts and of others interested in them. The full membership of the Council is given in Appendix 1.

The remit of the Council is to provide support to the operational bodies—the Accounting Standards Board and the Review Panel—and to encourage good financial reporting generally. At its first meeting, in May 1990, the Council codified this role as being

- (i) to promote good financial reporting, and in that context from time to time make public reports on reporting standards. In that role it would from time to time make representations to Government on the current working of legislation and on any desirable development of it
- (ii) to provide guidance to the Accounting Standards Board on work programmes and on broad policy issues
- (iii) to verify that the new arrangements are conducted with efficiency and economy and that they are adequately funded.

The Council normally meets twice a year.

The Accounting Standards Board

Like the FRC, the ASB is a company limited by guarantee, and is formally a subsidiary of the FRC, which acts as its sole director. The company contains an **Accounting Standards Board** whose role is to make, amend and withdraw accounting standards. The Board took over this role from the former Accounting Standards Committee on 1 August 1990. By statutory instrument the Secretary of State for Trade and Industry has prescribed the Board for the purposes of section 256(1) of the Companies Act 1985 with the effect that statements of standard accounting practice issued by the Board are "accounting standards" for the purposes of the accounting requirements of the Act. The Board is autonomous; it needs neither outside approval for its actions, nor approval from the company's director. It is however the practice of the Board to consult widely on all its proposals, and to present its forward programme to the Council.

The maximum membership of the Board is ten, of whom two are full-time and the remainder part-time. Appointments to the Board are made by the FRC Appointments Committee which comprises the FRC chairman and deputy chairmen together with three members of the Council. The Board's full-time chairman is Sir David Tweedie, and Allan Cook is its full-time technical director.

The Board's membership is given in Appendix 1.

A majority of seven Board members (six if there are fewer than ten Board members) is required under its constitution for any decision to adopt, revise or withdraw an accounting standard.

At its inception the Board adopted the 22 then extant Statements of Standard Accounting Practice (SSAPs) issued by the former Accounting Standards Committee or its predecessor. Adoption by the Board gave the SSAPs the status of "accounting standards" within the terms of Part VII of the Companies Act 1985. The Board is reviewing these SSAPs individually as appropriate opportunities arise during the course of its work.

The Board's policy towards the development of Statements of Recommended Practice (SORPs) is that in respect of SORPs developed in accordance with Board guidelines by bodies recognised by the Board for that purpose, the Board will give a negative assurance statement confirming, as appropriate, that the SORP does not contain any provision that is inconsistent with the Board's principles and policy. It has formed two committees to assist in considering SORPs—the Financial Sector and Other Special Industries Committee and the Public Sector and Not-for-profit Committee. The membership of these Committees is given in Appendix 1.

The Board has published its Foreword to Accounting Standards which explains the authority, scope and application of accounting standards. It also sets out the procedures whereby the Board issues accounting standards and their relationship to International Accounting Standards. Included as an appendix to the Foreword is an Opinion given in April 1993 by Miss Mary Arden QC (now the Honourable Mrs Justice Arden DBE) on the relationship between the true and fair requirement in the Companies Act 1985 and accounting standards. The Opinion expresses the view that changes brought about by the Companies Act 1989 and changes in the standard-setting process have enhanced the status of accounting standards in legal proceedings.

As has been indicated earlier, the Board's policy is to consult widely on all its proposals, which are issued in a variety of forms. For some the proposal is first issued informally in Discussion Draft or Discussion Paper form. For all new proposals there is a formal Exposure Draft, the comments received on which are normally placed on the public record.

The Urgent Issues Task Force

The Urgent Issues Task Force is a committee of the Accounting Standards Board. Its main role is to assist the Board in areas where an accounting standard or Companies Act provision exists, but where unsatisfactory or conflicting interpretations have developed or seem likely to develop. In addition the Board may from time to time seek the Task Force's view on significant developments in accounting and financial reporting in areas where no legal provision or accounting standard at present exists. The Task Force operates in a broadly similar way to its counterparts in Canada and the USA by seeking to reach a consensus on the issue under consideration. There are fifteen voting members, of whom eleven constitute a quorum. The requirement for the achievement of a consensus is that not more than two of the voting members or their alternates present at the meeting dissent. Unless the consensus thus established conflicts with the law, accounting standards, or the Board's policy or plans, the Board would expect it to be regarded as accepted practice in the area in question, and the intention is that it should be considered to be part of the corpus of practices forming the basis for what determines a true and fair view. Thus the expectation is that companies will conform to it, if necessary by changing previously adopted accounting policies.

The urgent nature of the matters tackled by the Task Force necessarily means that it is not possible for it to follow an extended consultation and due process procedure. The Board has therefore taken special measures to publicise the matters on the Task Force's agenda, and UITF Information Sheets are now circulated to some 4,000 people, including the finance directors of all listed companies.

The results of the Task Force's deliberations on a subject, when a consensus is reached, are promulgated by means of UITF Abstracts.

The non-voting chairman of the Task Force is Sir David Tweedie, the chairman of the Board. Its full membership is listed in Appendix 1.

The Financial Reporting Review Panel

Like the ASB, the FRRP is constituted as a company limited by guarantee and is formally a subsidiary of the FRC, which acts as its sole director. The company contains a **Review Panel** which is autonomous in carrying out its functions; it needs neither outside approval for its actions nor approval from the company's director.

The role of the Review Panel is to examine departures from the accounting requirements of the Companies Act 1985 including applicable accounting standards and if necessary to seek an order from the court to remedy them. Its authority stems from Statutory Instrument 1991/13 made by the Secretary of State for Trade and Industry which, from 1 February 1991, authorised the Review Panel for the purposes of section 245B of the Companies Act 1985 (which was inserted into that Act by the Companies Act 1989). By agreement with the Department of Trade and Industry the normal ambit of the Review Panel is public and large private companies, the Department dealing with all other cases. The companies within the Review Panel's ambit are thus

- public limited companies (PLCs) (except PLCs that are subsidiaries in a small or medium-sized group)
- companies within a group headed by a PLC
- any company not qualifying as small or medium-sized as defined by section 247 of the Companies Act 1985
- any company within a group that does not qualify as small or medium-sized as defined by section 249 of the Act.

For these categories the Review Panel is concerned with accounts for financial years beginning on or after 23 December 1989.

The Review Panel does not scrutinise on a routine basis all company accounts falling within its ambit. Instead it acts on matters drawn to its attention, either directly or indirectly.

The Review Panel operates under formal procedures that have been considered by the Secretary of State, and were last revised in September 1993.

In considering an individual case the Review Panel normally operates by means of a group constituted to deal with it and consisting of five or more members drawn from the Panel's overall membership. The group is then responsible for carrying out the functions of the Review Panel for that case; there is no collective involvement by the other Panel members.

Groups normally aim to discharge their tasks by seeking voluntary agreement with the directors of a company on any necessary revisions to the accounts in question. (The Companies Act 1989 made possible the voluntary revision of accounts as well as their revision by court order.) But if that approach fails and the Review Panel believes that revisions to the accounts are necessary it will seek a declaration from the court (see Introduction).

As part of the financing arrangements for the FRC and its companion bodies the Review Panel has available to it a legal costs fund of £2 million maintained on a rolling basis to cover the cost of litigation.

Appointments to the Review Panel are made by the FRC Appointments Committee. There is no upper limit to membership. The chairman of the Review Panel is Edwin Glasgow QC, who practises at the commercial bar. The deputy chairman is Michael Renshall CBE, formerly a partner in the London practice of KPMG Peat Marwick.

The Review Panel's membership is listed in Appendix 1.

Northern Ireland

Legislative provisions similar to those outlined above relating to the Accounting Standards Board and the Review Panel have also been made for, and apply in, Northern Ireland.

The Republic of Ireland

The accounting standards made by the former Accounting Standards Committee were promulgated in the Republic of Ireland by the Institute of Chartered Accountants in Ireland (ICAI), which is one of the constituent members of the Consultative Committee of Accountancy Bodies. These promulgation arrangements continue for accounting standards made by the Accounting Standards Board, which from time to time will include modifications to take account of the different legislative background in the Republic.

The Board maintains close liaison with the ICAI, and the Republic of Ireland Department of Enterprise and Employment sends an observer to the meetings of the Financial Reporting Council. The Review Panel does not operate within the Republic.

ACCOUNTING STANDARDS BOARD DOCUMENTS CURRENT AT 31 DECEMBER 1994

Accounting standards

(a) *Statements of Standard Accounting Practice (SSAPs) developed by the former Accounting Standards Committee or its predecessor and adopted by the Accounting Standards Board*

SSAP 1	Accounting for associated companies
SSAP 2	Disclosure of accounting policies
SSAP 3	Earnings per share
SSAP 4	Accounting for government grants
SSAP 5	Accounting for value added tax
SSAP 8	The treatment of taxation under the imputation system in the accounts of companies
SSAP 9	Stocks and long-term contracts
SSAP 12	Accounting for depreciation
SSAP 13	Accounting for research and development
SSAP 15	Accounting for deferred tax
SSAP 17	Accounting for post balance sheet events
SSAP 18	Accounting for contingencies
SSAP 19	Accounting for investment properties
SSAP 20	Foreign currency translation
SSAP 21	Accounting for leases and hire purchase contracts *(NB non-mandatory Guidance Notes on SSAP 21 are also extant)*
SSAP 22	Accounting for goodwill
SSAP 23	Accounting for acquisitions and mergers[1]
SSAP 24	Accounting for pension costs
SSAP 25	Segmental reporting

(b) *Interim Statement and Financial Reporting Standards (FRSs) issued by the Accounting Standards Board*

Interim Statement	Consolidated accounts[2]
FRS 1	Cash Flow Statements
FRS 2	Accounting for Subsidiary Undertakings
FRS 3	Reporting Financial Performance
FRS 4	Capital Instruments
FRS 5	Reporting the Substance of Transactions
FRS 6	Acquisitions and Mergers
FRS 7	Fair Values in Acquisition Accounting

[1] Being superseded by FRS 6
[2] Partly superseded by FRS 2

(c) *Amendments to accounting standards*

Amendment to SSAP 15 'Accounting for deferred tax' - December 1992
Amendment to SSAP 19 'Accounting for investment properties' - July 1994
Amendment to FRS 5 'Reporting the Substance of Transactions':
Insurance Broking Transactions and Financial Reinsurance - December 1994

Urgent Issues Task Force (UITF) pronouncements

UITF Abstract 3	Treatment of goodwill on disposal of a business
UITF Abstract 4	Presentation of long-term debtors in current assets
UITF Abstract 5	Transfers from current assets to fixed assets
UITF Abstract 6	Accounting for post-retirement benefits other than pensions
UITF Abstract 7	True and fair view override disclosures
UITF Abstract 9	Accounting for operations in hyper-inflationary economies
UITF Abstract 10	Disclosure of directors' share options
UITF Abstract 11	Capital instruments: issuer call options
UITF Abstract 12	Lessee accounting for reverse premiums and similar incentives

Other definitive statements

ASB Statement of Aims
Foreword to Accounting Standards
Foreword to UITF Abstracts
The application of UITF abstracts (PN 26)
Operating and Financial Review
Policy for the Development of SORPs (PN 47)

Financial Reporting Exposure Drafts (FREDs)

FRED 8	Related Party Disclosures

Draft Statement of Principles

Chapter 1	The objective of financial statements
Chapter 2	The qualitative characteristics of financial information
Chapter 3	The elements of financial statements
Chapter 4	The recognition of items in financial statements
Chapter 5	Measurement in financial statements
Chapter 6	Presentation of financial information
Chapter 7	The reporting entity

Discussion Papers

The Role of Valuation in Financial Reporting
Goodwill and Intangible Assets
Associates and Joint Ventures

Research study *(produced jointly with other standard-setting bodies)*

Future Events: A Conceptual Study of their Significance for Recognition and Measurement

Miscellaneous publications

Announcements are made in press notices. Apart from the press, these are also available to other interested readers who receive the Bulletin, which additionally includes news of the Financial Reporting Council and the Financial Reporting Review Panel.

The ASB also publishes a quarterly newsletter 'Inside Track', which briefly summarises progress on ASB projects and contains other news.

Details of all these publications, and how to obtain them, are available on request.

THE FRC'S FOURTH ANNUAL REVIEW OF FINANCIAL REPORTING

Reader Survey

1 **How useful did you find the Review?**

	VERY USEFUL	QUITE USEFUL	NOT VERY USEFUL
Overview			
FRC Chairman's Report			
ASB Chairman's Report			
FRRP Chairman's Report			
Appendix 1			
Appendix 2			
Appendix 3			
Your overall assessment			

2 **What about its length?**

	ABOUT RIGHT	TOO LONG	TOO SHORT
Overview			
FRC Chairman's Report			
ASB Chairman's Report			
FRRP Chairman's Report			
Appendix 1			
Appendix 2			
Appendix 3			
Your overall assessment			

3 **What *additional* information (if any) would have been helpful?**

4 **What (if anything) should be *omitted?***

5 **Any other comments?**

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6 **How did this Survey reach you?**

As listed company finance director ☐

From the FRC's or ASB's mailing list ☐

Requested from the FRC ☐

Passed on by a colleague ☐

Other (please specify)

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7 **It would help if we could have brief details of the person filling in the questionnaire**

Name

Organisation

Position in organisation

PLEASE PHOTOCOPY THIS QUESTIONNAIRE IF MORE THAN ONE PERSON WISHES TO COMMENT. WHEN COMPLETED PLEASE RETURN IT TO:-

Jill Bartholomew
Financial Reporting Council
Holborn Hall
100 Gray's Inn Road
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many thanks

FRC

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