Financial Reporting Council

Minutes of a meeting of the Accounting Council held on Thursday 15 May 2014 in the Boardroom at Aldwych House, 71-91 Aldwych, London, WC2B 7HN

Present:

Roger Marshall	Chair
Richard Barker	Council Member
Chris Buckley	Council Member
Gunnar Miller	Council Member
Liz Murrall	Council Member
Veronica Poole	Council Member
Pauline Wallace	Council Member (Chair from minute 7.3-8.3)

Observers:

Matt Blake	HMRC Observer
Michael Kavanagh	IAASA Observer

In attendance:

Anthony Appleton	Director of Accounting and Reporting
Mei Ashelford	Project Director, Accounting & Reporting Policy Team
Jenny Carter	Director of UK Accounting Standards, Accounting & Reporting Policy Team
Francesca Chittenden	Council Secretary
Annette Davis	Project Director, Accounting & Reporting Policy Team
Andrew Lennard	Director of Research
Melanie McLaren	Executive Director
Seema Jamil-O'Neill	Project Director, Accounting & Reporting Policy Team
Susanne Pust Shah	Project Director, Accounting & Reporting Policy Team
Deepa Raval	Project Director, Accounting & Reporting Policy Team

Welcome and Apologies for absence

Apologies were noted from Mike Ashley (EFRAG observer) and Ross Campbell (HMT Observer).

1. Minutes of the previous meeting and rolling actions

1.1 The Council approved the minutes of the Accounting Council meeting held on 10 April as an accurate record of the meeting.

1.2 In relation to the rolling action log Anthony Appleton (AA) reported that the Codes & Standards Committee had approved the IMA SORP for authorised funds and, accordingly, the FRC statement endorsing the SORP had been issued.

1.3 The Council noted that all other actions on the rolling action log were either in hand or addressed on the agenda.

2. Director of Accounting Update

2.1 The Council noted a paper which provided an update on developments relating to UK and international accounting standards, matters of policy and an overview of staff activities since the last meeting. Particular attention was given to the following matters:

IASB

2.2 The Council noted that the IASB had established a group to support preparers in transitioning to the new revenue recognition standard. AA reported that the group would be formed of approximately 25 members who would reflect an appropriate mix of IASB and FASB stakeholders, and that the names of those members would be announced shortly.

2.3 The Council noted that the IFRS Interpretations Committee had published a tentative agenda decision not to address a clarification request in relation to 'IAS 1 Presentation of Financial Instruments: *Disclosure of material uncertainties about an entity's ability to continue as a going concern'.* The Council considered a draft letter prepared in response to the tentative agenda decision, which set out a range of concerns in relation to the implications of the decision and the assumptions that may be drawn from the reasons for the decision. The Council endorsed the letter but suggested that it be revised so it is clear that the FRC suggest the IFRIC reconsider its tentative agenda decision and that a recommendation as to what the FRC consider the IFRIC should do to address the issue be added.

Accounting Directive

2.4 It was noted that progress was being made in relation to the implementation of the Accounting Directive and that BIS were expected to issue a consultation document in the summer. AA reported that the FRC intends to issue a consultation alongside the BIS consultation and that an additional meeting of the Council, held by teleconference, would be scheduled to enable the Council to discuss the FRC consultation on 4 June. It was also noted that the FRC were liaising closely with colleagues at the Department of Jobs, Enterprise and Innovation in Ireland to ensure consistency in the approach to the implementation of the Directive.

UK Developments

2.5 The Council noted that the FRC had started a project entitled 'clear and concise reporting' and that the aim of the project is to bring together the various work streams across the FRC including the work of the Corporate Reporting Review Team, the Financial Reporting Lab and the Accounting and Reporting Policy team's work on cutting clutter.

Membership of CAPE

2.6 The Council approved the appointment of Alison Scott to the Committee on Accounting for Public-benefit Entities.

3. Director of Research Update

3.1 The Council noted a paper that provided an overview on current accounting research activities.

3.2 The Council noted that the FRC had continued to influence the discussions of the International Accounting Standards Board (IASB) in relation to leases and the addition of specific reference to prudence, stewardship and reliability in the Conceptual Framework. Andrew Lennard (AL) reported that EFRAG TEG had discussed a note on prudence, prepared by the FRC, on 7 May and that the note had been generally well supported and was to be used as a basis for further discussion.

4. Accounting Standards Advisory Forum (ASAF) Preparation

4.1 The Council noted the agenda for the ASAF meeting to be held on 2 and 3 June 2014. AL highlighted that there were two items on the agenda that were of particular relevance to the work of the Council, the Disclosure Initiative and the Conceptual Framework.

4.2 The Council discussed a draft paper that had been prepared to contribute to ASAFs debate on performance reporting and its relation to measurement. The Council noted that the paper was built on views expressed by the Accounting Standards Board for Japan (ASBJ) and FASB member Tom Linsmeier in relation to the selection of a measurement basis and the reporting of income and expenses in two performance statements. The Council noted that the objective of the paper was to set out an alternative rationale that would demonstrate the significance of the business model and of prudence in determining the selection of a measurement basis and the reporting of income, and to reinforce the view that the Conceptual Framework should specifically acknowledge or refer to the concepts.

4.3 The Council welcomed the draft paper but suggested that its impact could be improved by including a section that set out recommendations for the IASB to consider. The Council suggested that the recommendations include an acknowledgement that recognition asymmetry is the norm and, in highlighting the role of the business model, a description of two categories of businesses, ‘value added’ and ‘price change’ businesses, clearly stating the distinction between the two categories. The Council also suggested that the body of the paper be reviewed so that the application of the proposals to financial institutions is clearer.

5. Draft CCAB SORP for LLPs

5.1 Susanne Pust Shah (SPS) introduced the final draft of the CCAB SORP for LLPs. SPS provided a summary of the consultation process and confirmed that the CCAB had complied with due process throughout the consultation and analysis process.

5.2 The Council noted a number of minor issues that had been identified by the UK GAAP Technical Advisory Group (UK GAAP TAG) and were content with the action taken to resolve the issues identified.

5.3 The Council discussed the examples set out in the SORP that demonstrate the application of the measurement requirements for post-retirement benefit obligations. Through discussion a potential conflict between the requirements of FRS 102 (and thereby the SORP) and the Companies Act in relation to the use of fair value was highlighted, which may arise in a relatively narrow set of circumstances. The Companies Act places certain restrictions on when a financial liability may be measured at Fair Value Through Profit and Loss (FVTPL). Those restrictions may prevent a company or LLP to measure financial liabilities on that basis, even though under FRS 102 that financial liability may need to be classified as non-basic. AA undertook to clarify whether in fact there is an inconsistency as a matter of urgency.

5.4 Subject to the findings of the issue raised at minute 5.3 the Council agreed to advise the Codes & Standards Committee that the FRC Statement on the LLP SORP is issued.

6. Application of IFRIC 14 principles in UK GAAP

6.1 AA introduced a paper that had been drafted to inform consideration as to whether or not the FRC should apply IFRIC 14 principles in respect of pension minimum funding requirements within UK GAAP.

6.2 Through discussion the following observations were made:

- The Council noted that the UK GAAP Technical Advisory Group (TAG) had considered the issue and concluded that there is significant diversity in practice stemming from differences in opinion as to whether or not the IFRIC principles must be applied under FRS 102 and the varying views of preparers and auditors who have IFRS experience. The Council also noted that there is diversity in the FRS 102 manuals that have been issued by PwC and Deloitte.
- The Council noted that the nature and structure of UK pension schemes are different to the schemes IFRIC 14 was developed to cover. In the UK the schedule of defined benefit contributions is designed to meet only the present obligation, whereas IFRIC 14 was developed for schemes where the funding contributions are designed to meet more than the present obligation.
- The costs of compliance with the IFRIC principles are not consistent with the objectives agreed in developing FRS 102
- The asset ceiling hurdle set out in FRS 102 is less onerous than the requirements of existing UK accounting standards. Therefore, it is likely that there will only be a minority of schemes that would have to recognise an additional liability under IFRIC 14, but all schemes with a schedule of contributions would have to incur the costs of assessing if a liability is required.
- Whilst the issue is only relevant to a small number of schemes, the number of schemes affected may increase.
- The impact of applying IFRIC 14 principles to UK GAAP accounting may have significant cost implications due to the complexity of the requirements; it is questionable as to whether that cost can be justified.
- The impact of the application of IFRIC 14 principles on the balance sheet would also be very significant.
- The Council discussed the risks associated with not taking any action to address the issue, and concluded that the issue is too significant to not address.

Accordingly, the Council concluded that IFRIC 14 principles are inconsistent with the principles for the development of UK GAAP and therefore should not be applied under UK GAAP.

6.3 Following a detailed discussion of the various options available; and consideration of the FRCs principles for issuing or amending Codes, Standards and Guidance; the Council concluded that an amendment to FRS 102 to remove the asset ceiling requirement would be the most appropriate and simplest way to address the issue. The Council noted that the FRC would be required to undertake a full three month consultation on the proposed amendment and suggested that this consultation should take place as soon as possible to provide a steer to those affected as to what accounting treatment should be followed. However, in acknowledging the call from various stakeholders not to issue guidance and make changes to Standards on a piece meal basis the Council suggested that the FRC hold off making the amendments until the amendments in response to the implementation of the EU Accounting Directive are made.

7. FRED 54 Draft amendments to FRS 102: Basic Financial Instruments. Initial analysis of responses and key issues

7.1 Seema Jamil-O'Neill (SJON) introduced a paper that provided an analysis of the consultation responses, a summary of the key issues raised and recommendations in respect of the issues raised. SJON reported that 29 responses had been received and that the responses were generally supportive.

7.2 The Council discussed the key issues raised and the recommendations in respect of the issues raised, through discussion the following observations were made and advice was given:

- No change is required to the FRED 54 proposals in relation to accounting for social housing loans.
- No significant changes are required to clarify the grey area of what might constitute an observable index of general price inflation, however, the following text 'provided that the link is not leveraged' should be added to the end of paragraph 11.9(b), and 'leverage' should be added to the glossary.
- A sub-clause should be added to paragraph 11.9(c) to specify that changes in levies applied by a central bank, or arising from changes in tax legislation is permitted and would not preclude the instrument from being classified as basic; this change should also be reflected in paragraph 11.9(e).
- No change is required to the FRED 54 proposals to deal with negative interest rates however, it might be useful to develop examples to assist users. The Council also suggested that it would be useful to clarify in the Accounting Council's advice statement that if the instrument is classified as basic at the outset there is no requirement to continually reassess whether the instrument continues to be classified as basic.
- No changes are required to the FRED 54 proposals to deal with non-recourse and limited recourse loans; however, the language should be reviewed to ensure the treatment is consistent throughout the document.
- A sentence should be added to the Council's Advice in relation to transition to clarify that all changes arising from the amendment proposed in FRED 54 apply fully retrospectively.

7.3 The Council noted that one respondent had identified that the treatment of investment shares, that are also debt instruments, are not addressed in FRED 54 and in the absence of specific guidance the approach set out in FRED 54 would result in all preference share investments being measured at FVTPL. The Council discussed the solution proposed by the respondent but did not consider it to be suitable. The Council discussed a range of alternative solutions but were unable to reach a conclusion. SJON undertook to consider the issue in more detail and bring back a practical recommendation.

7.4 The Council noted a range of issues that had been identified in the consultation responses that had been received that were out of the scope of the consultation. The Council agreed that a comment be included in the Council's feedback statement to set out that as part of the FRCs three year review of FRS consideration would be given to:

a) Whether a principle based approach can be adopted for classification of financial instruments; and
b) How the inconsistency between FRS 102 and IFRS Fair Value Hierarchy can be addressed.

The Council also agreed that a comment on the treatment of intercompany loan balances should be included in the Accounting Council's feedback statement to clarify the change from current UK GAAP and to encourage greater consistency in the accounting treatment followed.

7.5 The Council highlighted that the issue identified during the discussion of the LLP SORP (minute 5.3) and the potential inconsistency with the Companies Act in relation to fair value accounting would, should the inconsistency be confirmed, be an issue in respect of FRED 54 and requested this be investigated further.

8. FRED 51 Hedge Accounting

8.1 SPS introduced the latest draft hedge accounting requirements that have been revised in response to the comment letters received, discussions of the Council and input from the TAG. SPS also introduced the draft Accounting Council Advice to the FRC on the amendments to hedge accounting.

8.2 The Council reflected on its discussion with BSA representatives at its April meeting. It was noted that a worked numerical example of a portfolio hedge requested from the BSA may have helped to inform its deliberations at this meeting. Through discussion of the various issues identified by the BSA the following observations were made and advice was given:

- The Council does not consider it appropriate to incorporate the macro-hedging model of IAS 39 in FRS 102 based on the evidence it has seen.
- No exemptions or practical expedients should be provided in FRS 102 in respect of the application of the effective interest rate method when determining the amortised cost of a financial instrument. The Council considered that whether an expedient method to determine amortised cost is appropriate in the context of the requirements in FRS 102 is a matter for the building societies and their auditors to consider.
- In respect of loan loss provisions, the Council considered that the requirements of FRS 102 in relation to loan loss provision are consistent with the equivalent

requirements of the BBA SORP. The Council noted that building societies apply the BBA SORP under current UK GAAP, even though it had been withdrawn.

- The Council noted that if the adoption of FRS 102 by building societies were to result in releases of loan loss provisions, the FRC may be criticised for introducing accounting rules that appear less prudent than current requirements. However, the Council carefully considered the rationale for its position and noted that this should be clearly expressed in the Council's Advice to the Board.

8.3 The Council discussed the key issues raised by other respondents in respect of FRED 51. Through discussion of the recommendations, the following observations were made and advice was given:

- The Council considered the additional feedback requested from the ICAEW in relation to net position hedging. The Council concluded that net position hedging should not be permitted within FRS 102, because the additional complexity that net position hedging would introduce is not justified by the benefit it would yield.
- All five of the hedge accounting conditions proposed in FRED 51 should be retained. The Council advised that the condition concerning the entity's risk management strategy is important as it imposes some discipline on entities when hedge accounting may be applied. The condition to determine hedge ineffectiveness requires entities to analyse what may cause ineffectiveness in a hedging relationship, to ensure that ineffectiveness can be properly captured in profit or loss.
- It should be clarified that for a group of items to be eligible to be hedged, the items in the group must both be subject to the same risk, being the hedged risk.
- The Council acknowledged concerns noted by UK GAAP TAG that the proposed transitional rules may allow entities to apply undue hindsight. The Council considered these concerns, but concluded that entities should be allowed the greatest possible flexibility during the transition period to put the required hedge documentation in place. Flexibility should not be sacrificed in the interest of anti-abuse.

8.4 The Council noted and endorsed its draft Advice to the Board, subject to the amendments discussed. The Council noted that the final amendments and a revised Advice to the FRC would be brought to the Council for approval in June.

9. FRED 53: Amendments to FRS 101

9.1 Mei Ashelford (MA) introduced the final proposed amendments to FRS 101 that had been developed as a result of FRED 53 *Amendments to FRS 101: Reduced Disclosure Framework*. MA reminded the Council that the objective of the consultation was to ensure FRS 101 maintains consistency with EU-adopted IFRS, and, that it retains its effectiveness.

9.2 The Council noted that respondents had welcomed the timing of the review and largely agreed with the principles behind the proposed amendments. MA summarised the two key issues identified in the paper, and reported on additional comments that had been received since the paper had been circulated. The Council noted that some respondents consider FRS 101 to be too company centric, specifically, paragraphs 4A and 6. Accordingly, the Council agreed the recommendation from the Executive that the text at paragraph 4A is redrafted to incorporate the fact that entities that are not companies are permitted to apply FRS 101, and secondly that paragraph 6 is deleted and replaced by the inclusion of guidance within the appendix which would explain the legal requirements for companies of paragraph 36(4) of Schedule 1 to the Regulations.

9.3 The Council discussed whether an amendment was required to Application Guidance in relation to investment entities where IFRS 10 and IAS 27 require investments in subsidiaries to be measured at fair value through profit or loss in the separate financial statements of the investment entity. The Council concluded this amendment was not necessary and that additional explanatory guidance in the legal appendix would be sufficient.

9.4 The Council noted that a further final draft, incorporating the advice given at the meeting, would be brought to the Council for approval in June. The Council noted it would also be asked to approve its Advice statement, its feedback statement and the impact assessment.

9.5 The Council agreed that a review of the IFRS 1 *First-time adoption of International Reporting Standards* requirement to provide a third statement of financial position is rolled into the next annual review of FRS 101.

10. IFRS 3 – Post-implementation review response

10.1 AA introduced a paper that set out proposed issues and recommendations for inclusion in the FRC's response to the IFRS 3 Request for Information. AA reported that the points identified for inclusion in the response had been informed by discussions with the FRC's AQR and CRR teams and views expressed at a joint ICAEW & FRC outreach event.

10.2 The Council noted the range of views that had been commonly expressed throughout the outreach process and were invited to consider whether in the Council's view, any other issues should be reported to the IFRS. Through discussion the following suggestions were made:

- In relation to stewardship the Council suggested that it might be useful to require entities to provide the rationale underpinning acquisitions and to provide detail on how the acquisition is progressing.
- Consideration should be given to the treatment of goodwill.
- Consideration should be given to the complexities of IFRS 3 and the potential for simplification.
- Consideration should be given as to whether a holistic approach to disclosures could be developed.
- Consideration should be given to the treatment of remuneration and the links to intellectual property.
- Consideration should be given to providing disclosures to more easily permit comparison of acquisitive companies and those that have grown organically.

10.3 The Council suggested that the letter, which would accompany the response, should reiterate that the FRC suggest the IASB undertake a comprehensive review of IFRS 3 in light of the feedback received. The Council also suggested that this view should be raised at the September meeting of ASAF.

10.4 The Council recommended that the FRC response should be presented as a representation of the practical issues UK constituents had expressed but that the response should also capture the FRC's viewpoint from an enforcement perspective.

11. Bulletins

11.1 AL introduced two draft Bulletins, 'Cash Flow' and 'Unit of Account' for the Council to consider. AL reported that EFRAG TEG who had welcomed the direction of the Bulletins and requested they be brought back to the TEG for review when they were at a more developed stage had considered the Bulletins. The Council echoed the views expressed by TEG.

11.2 The Council noted that some of the material developed by AL in relation to financial Institutions would no longer be included in the 'Cash Flow' Bulletin; the Council highlighted the importance of ensuring that material is not lost.

12. Any other business

12.1 The Council noted that the FRC would be moving office on 13 June, accordingly, the next meeting would be held at the new office, 8th floor, 125 London Wall.

12.2 There was no other business.