Financial Reporting Council

Minutes of a meeting of the Accounting Council held on Thursday 11 December 2014 in the Boardroom at 8th Floor, 125 London Wall, London, EC2Y 5AS

Present:	
Pauline Wallace	Council Member (Alternate Chair)
Chris Buckley	Council Member
Michael Gallagher	Council Member
Gunnar Miller	Council Member
Liz Murrall	Council Member
Veronica Poole	Council Member
Mark Smith	Council Member
Observers:	
Matt Blake	HMRC Observer
Michael Kavanagh	IAASA Observer
Lee Piller	FCA Observer
In attendance:	
Anthony Appleton	Director of Accounting and Reporting Policy
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
Seema Jamil-O'Neill	Project Director, Accounting & Reporting Policy Team
Melanie McLaren	Executive Director, Codes & Standards
Deepa Raval	Project Director, Accounting & Reporting Policy Team

Welcome and Apologies for absence

Apologies were noted from Roger Marshall (Chair), Richard Barker, Jeremy Townsend (Council Members) and Mike Ashley (EFRAG Observer).

1. IFRS 9 Financial Instruments

1.1 The Council received an educational briefing on IFRS 9 – *Financial Instruments*. The purpose of the briefing was to provide Members with an overview of the new requirements in anticipation of future consideration of the EFRAG Endorsement Advice.

1.2 The Council noted:

- The minor changes introduced by IFRS 9 in relation to scope and recognition & de-recognition.
- The more significant changes introduced by IFRS 9 in respect of:

    - The classification of financial assets;
    - Impairment and measurement; and
    - Hedge accounting.
- The implications of the changes for various sectors; including banking and insurance.

In respect of hedge accounting it was noted that:

- The hedge accounting requirements under IFRS 9 are an improvement from IAS 39 as IFRS 9:
    - Is more flexible as it offers more eligible risk components and allows hedges of groups of items and net positions;
    - Removes the 80-125% effectiveness test; and
    - Provides for greater alignment with the risk management strategy.
- IFRS 9 does not address Macro hedging. IAS 39 which includes macro hedging and general hedging will run in parallel until the macro hedge accounting model is finalised; accordingly the issues of comparability remain.

2. Minutes of the previous meeting and rolling actions

2.1 The Council approved the minutes of the Accounting Council meeting held on 16 October 2014 for publication subject to two minor amendments.

2.2 The Council noted the status of the actions set out on the rolling action log.

3. Director of Accounting Report

3.1 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:

EFRAG

3.2 The Council congratulated Roger Marshall who had been appointed Acting President of EFRAG.

3.3 The Council noted that:

- The new EFRAG Board had met twice since the last meeting of the Council.
- At its December meeting the Board had discussed its work plan and its interaction / relationship with TEG and EFRAG Staff. The Board had tentatively decided that projects on its work plan would be classified as either significant or non-significant and that projects classified as significant would be discussed at Board meetings as opposed to non-significant projects which would be approved by written procedure.
- The Board had tentatively agreed with the views previously expressed by EFRAG in relation to the IASB's insurance contracts project and had deferred consideration of the IASB's leases project to a future meeting.
- The Board had appointed members of TEG from the NSS of Germany, Italy and the UK and that the appointment of a French member, a preparer and an insurance specialist would follow. The Council noted and congratulated Anthony Appleton on his appointment as the UK member of TEG.

- An update on the matters discussed at EFRAG TEG monthly meeting that had been held on 2-3 December.

3.4 The Council also noted that EFRAG had issued an Invitation to Comment on its draft endorsement advice and effects study report on IFRS 15 *Revenue from contracts with customers*. The Council discussed the draft response to the Invitation to Comment, and, subject to the addition of a covering letter to make specific reference to the establishment of the Joint Transition Resource Group for Revenue Recognition (TRG) which should help entities to implement IFRS 15, approved the Invitation to Comment for submission.

ARC

3.5 The Council noted that, at its meeting on 27 November, the Accounting Regulatory Committee (ARC) had discussed a letter requesting endorsement advice from EFRAG on IFRS 9 *Financial Instruments*. The Council noted that, unusually, the letter sets out a number of concerns identified by Member States for consideration by EFRAG and that there is uncertainty as to whether EFRAG will be able to address all of the concerns set out within the 6 month timescale.

FRC Board

3.6 Melanie McLaren (MM) provided a summary of matters that had been discussed by the FRC Board the previous day (10 December), including acknowledging the Council's contribution to completion of new UK GAAP and its support for the proposed development of standards to enable the Accounting Directive implementation within the necessary legal timeframe. The Council noted that the FRC Plan and Budget for 2015/16 had been discussed in detail and that would be issued for consultation the following week.

4. Director of Research Report

4.1 Andrew Lennard (AL) introduced a paper that provided an overview on current accounting research activities. It was noted that:

- The IASB has finished its deliberations in respect of the Conceptual Framework and that Accounting Standards Advisory Forum (ASAF) is due to receive a fatal flaw draft of the Exposure Draft in the near future. AL reported that whilst the FRC had successfully influenced the thinking of the IASB in some areas, concern in respect of the proposals for re-measurement and recycling from 'Other Comprehensive Income' remain.

- AL is working closely with the IASB on its Statement of Cash Flows project and would be presenting a second, narrow scope paper to the IASB at its meeting on 15-17 December. The Council discussed the draft paper and was content with the views expressed and conclusions reached, noting that those views are similar to the requirements of UK standard FRS 1. In response to a query, it was confirmed that issues in relation to cash flows statements for financial institutions would be addressed in a future paper.

- Given the narrow scope of the issue, a staff response will be submitted to the EFRAG paper 'Presentation of the reversal of acquisition "steps ups"'. It was suggested that the response query whether the intention is that the effect of an acquisition step up is identified in financial reports and if so, how far preparers will be expected to go, noting that the effect of an acquisition step up on Plant, Property and Equipment could last 10-15 years. AL undertook to circulate the response to the Council before submission.

4.2 AL reported that the next meeting of the Accounting Council's Academic Panel would be on 3 March 2015 and invited Council Members to attend.

5. Insurance Contracts

5.1 Seema Jamil-O'Neill (SJON) introduced a paper that summarised the IASBs re-deliberations in relation to accounting for participating contracts and the concerns that had been raised both in the UK and Internationally in respect of the IASB's possible solution.

5.2 The Council were provided with an update on recent developments in relation to participating contract accounting, it was noted that:

- At an IASB education session in November representatives of the CFO forum presented the industry's alternative approach to accounting for participating contracts. From the education session it was clear that:
  - Opening the contractual service margins for insurer's share of the returns on the underlying assets for all participating contracts is the most important component of the industry alternative.
  - A number of aspects of the industry alternative, including unit of account and the treatment of options & guarantees require further deliberations in respect of the detail.
- There is no indication of when the IASB intend to complete their deliberations; however, the final insurance standard is expected to be issued in late 2015 and to be effective from 1 January 2019.
- At a meeting with the ABI on 26 November the importance of giving consideration to how the approach might apply in the context of the UK and Continental Europe was highlighted. The December meeting of the EFRAG Insurance Accounting Working Group was used as a forum to discuss the issues that had been raised and to identify where there is agreement between the European industry and the IASB. SJON reported that the meeting had been successful and that further meetings, to which members of the industry would be invited, were to be planned.

5.3 The Council welcomed the developments and agreed that, in light of those developments and the series of meetings that are to be scheduled, it is no longer appropriate for the FRC to write to the IASB. However, the Council expressed some concern that discussion at the EFRAG Working Group could result in certain requirements, which are particularly relevant to the UK, being overlooked. Accordingly, the Council highlighted the importance of ensuring that a UK agreed example is presented to, and considered by, the EFRAG Working Group. The Council suggested that the FRC consider how it could support the industry in developing an example.

6. Responses to the Consultation Document: Accounting Standards for small entities – Implementation of the EU Accounting Directive.

6.1 Jenny Carter (JC) introduced a paper setting out an analysis of the responses to the Consultation Document. The Council noted that 31 responses to the consultation had been received and that respondents were generally very supportive of the proposals. The Council was reminded that, as set out in the consultation document, Financial Reporting Exposure Drafts (FREDs) setting out the detailed proposals would be developed and issued in Q1 of 2015.

6.2 Through discussion of the analysis and the issues arising from the consultation, the following observations and advice were given:

Micro-entities

- The Council advised that the work to develop a separate accounting standard for micro-entities choosing to apply the micro-entities regime should proceed as proposed.
- The Council noted that the title of the standard would be FRS 105 *The Financial Reporting Standard applicable to the Micro-Entities Regime* as some respondents had suggested the acronym "the FRSME" was potentially confusing as the same acronym had been used for FRED 44.
- The Council discussed in detail whether the recognition and measurement simplifications set out in the consultation document should be taken forward:
  - Some respondents commented that accounting for deferred tax should be required due to the potential implications for distributions if it is no longer required. The Council noted that, as with FRS 102, a cross-reference to the ICAEW and ICAS guidance on distributable profits was proposed to be included in the legal appendix of draft FRS 105 and advised that no further guidance be given on distributable profits, and that draft FRS 105 should reflect the proposal not to require accounting for deferred tax.
  - The Council noted that concern had been raised in respect of the accounting for financing transactions at non-market rates for micro-entities. The Council noted that this was an area where FRS 102 had introduced a change in accounting and it considered the implications separately for both micro-entities and small entities. Through detailed discussion the Council agreed the principle that small entities (that are not micro-entities) should apply the recognition and measurement requirements of FRS 102 without amendment, but simplifications should be available to micro-entities. In relation to lending/borrowing at non-market rates, the Council advised that a simplification should be available to micro-entities and therefore be reflected in draft FRS 105.
- It was noted that the comments made in respect of charities that are the size of micro-entities would be passed on to the Charity Commission.
- The Council highlighted the risk of a gap in the knowledge that directors of micro-entities and small entities hold in respect of accounting requirements.

Small entities

- The Council advised that the new Small Entities section of FRS 102 should apply to all entities (not just companies) meeting the criteria.
- The Council advised that the FRSSE should be withdrawn and that small entities should bought within the scope of FRS 102.

- The Council noted that a small minority of respondents raised suggestions for a small number of recognition and measurement simplifications that in their view should be made available to small entities. Whilst the Council agreed there is insufficient evidence to support simplifications that would result in inconsistency in the recognition and measurement requirements with FRS 102, the Council suggested a question be included in the FRED on the matter (both in respect of micro-entities and small entities) and that the FRED should clearly set out the principles adopted by the FRC in determining simplifications or otherwise.
- The Council advised that all company law disclosure requirements for larger companies need not be included in FRS 102, but that, as suggested by some respondents, consideration should be given to preparing an appendix to FRS 102 containing these disclosure requirements as part of the three year review update.
- The Council advised that IAS 1 presentation should be permitted in FRS 101, if permissible under the law and suggested that it should also be available to entities applying FRS 102.

Resident's management companies

- The Council noted that there was significant disagreement from respondents to the proposal to include a new subsection in Section 34 *Specialised Activities* of FRS 102 in relation to residents' management companies with only some 32% of respondents agreeing with the proposal. Those disagreeing with the proposal noted that the issue was too narrow for inclusion in FRS 102 and that interpretation of the law and accounting standards should be addressed through an alternative route.
- Therefore the Council advised that FRS 102 should not be amended as proposed, but instead text setting out the legal position (ie that RMCs act as principals and not agents) should be included in the Accounting Council's Advice.
- The Council considered that whilst this approach may not completely remove diversity in practice, it would clearly state that RMCs should not prepare dormant accounts (unless they have genuinely not engaged in any transactions during the period) and would encourage RMCs to apply judgement in selecting the most appropriate accounting treatment applicable to their circumstances.

6.3 JC provided an update on the proposed timetable. It was noted that:

- The timetable is very tight. The FRC intends to consult on the detailed proposals in a number of FREDs in order to deliver the final standards and amendments by July 2015 to be in line with the implementation deadline of the Accounting Directive.
- Taking account of respondents' feedback and the advice given by the UK GAAP TAG, the consultation period for the FREDs will be extended from 2 months to 10-11 weeks.
- Based on an effective date of accounting periods beginning on or after 1 January 2016, the transition date of 1 January 2015 will have passed a number of months before the standards and amendments are issued, therefore consideration will have to be given to transitional arrangements for small entities.
- Should early adoption of the new legal requirements be permitted for accounting periods ending on or after 31 December 2015, this will be reflected in the accounting standards.
- It is proposed that the new section of FRS 102 for small entities is drafted to clarify the interaction of the requirement to prepare financial statements giving a true and

fair view and the limited mandatory disclosures set out in law. If BIS permits small companies to prepare abbreviated accounts for shareholders, consideration will be given to encouraging the disaggregation of certain balance sheet items where necessary for giving a true and fair view.

7. FRED 58 – Draft FRS 105 The Financial Reporting Standard applicable to the Micro-Entities Regime

7.1 Mei Ashelford (MA) introduced FRED 58 Draft FRS 105 *The Financial Reporting Standard applicable to the Micro-Entities Regime* for the Council to approve its advice to the FRC Board. The Council noted that respondents to the Consultation Document had expressed overwhelming support for the development of a standard for micro-entities. The Council noted that the draft standard has been developed with significant input from the UK GAAP Technical Advisory Group.

7.2 The Council noted that paragraphs 19 to 31 of the Council's advice set out the amendments to FRS 102 that are required to align draft FRS 105 with the legal restrictions of the micro-entities regime and cover: scope, prohibitions in relation to the alternative accounting and fair value accounting rules, formats of financial statements and disclosure restrictions.

7.3 The Council also noted the principles that have been used to inform the assessment of whether simplification should be introduced, are set out in the Council's advice. In particular the Council agreed with the principle that no accounting policy choices should be included in draft FRS 105 as it adds complexity for preparers and may cause confusion to users due to the lack of detail in the formats of the financial statements and lack of supporting disclosures to explain the policy choice taken.

7.4 MA summarised the notable comments that had been made in response to the Consultation Document in respect of micro-entities and highlighted that the two significant comments, deferred tax and the treatment of financial instruments at non-market rates had been discussed under the previous agenda item. MA also summarised the additional simplifications introduced to draft FRS 105 (on top of those set out in the Consultation Document) which are summarised in the draft Accounting Council's Advice and consistent with the principles set out. For example:

- The option to capitalise development costs has been removed from Section 18 *Intangible Assets other than Goodwill*.
- The requirements of FRS 102 in respect of liabilities and equity have been retained on the advice of the UK GAAP TAG.
- The policy choice for Governance grants has been removed but a specific question on whether the mandatory treatment should be to apply the accruals method (in line with the FRSSE) will be asked in the FRED.
- The drafting in respect of cash-generating units (CGUs) has been amended so that it refers to the impairment of assets only, and when a micro-entity has a CGU, it is required to refer to FRS 102.
- The treatment of Residential Management Companies as set out at minute 6.2.

The Council was content with the simplifications and amendments set out in FRED 58, subject to the revisions discussed in respect of distributable profits and the treatment of financial instruments as set out at minute 6.2.

7.5 The Council requested that the summary in FRED 58 be revised to remind users that accounts prepared in accordance with FRS 105 will be very basic and to encourage those who wish to prepare fuller, more detailed accounts to look at FRS 102. The Council requested that the FRED 58 be updated and presented to the Council for final advice at its January 2015 meeting.

8. Responses to FRED 55: Draft Amendments to FRS 102 – Pension Obligations

8.1 JC introduced a paper setting out an analysis of the 20 responses that had been received in respect of FRED 55. The Council noted that FRED 55 had been issued in response to two narrow scope implementation issues that had arisen in relation to FRS 102, in particular, whether or not an entity applying FRS 102 should consider the requirements of IFRIC 14 *IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction* in determining whether to recognise a liability for a schedule of contributions, and, whether any irrecoverable surplus in a defined benefit pension plan should be recognised in profit or loss or other comprehensive income.

8.2 JC summarised the key issues identified through the consultation; it was noted that:

- The majority of respondents agreed that the issue is of sufficient importance to require urgent clarification and amendment to FRS 102 prior to its effective date.
- The majority of respondents agreed with the proposed solution to amend FRS 102 so that a schedule of contributions is not required to be recognised as a liability where an entity has accounted for its pension obligations in accordance with paragraphs 28.15 and 28.18, is practical and proportionate and better meets the overriding objective in relation to entities applying FRS 102.
- Two respondents disagreed with the proposal and would prefer that employers accounted for defined benefit pension arrangements by recognising the current contributions to the plan and any commitment to make additional contributions to address a deficit, but given that this is not the approach taken in FRS 102, and that this proposal is for a narrow scope amendment to the existing approach, there is little that can be done in response to these comments at this time.
- That, in response to comments received, the Executive felt it necessary to expand paragraph 28.41(a) to clarify the disclosure requirement in relation to the funding policy, to confirm that the implications of a schedule of contributions and the expected cash flows arising from it should be considered; disclosure may be important for assessing matters such as going concern.

8.3 The Council agreed its advice that the Executive should proceed with the proposed amendments to FRS 102 as set out, subject to the addition of text to make it explicitly clear that disclosure of the cash flow implications arising from the schedule of contributions is a requirement.

8.4 The Council noted that the final draft amendments would be presented to the Council at its January meeting and, subject to the advice of the Council, submitted to the Codes & Standards Committee and FRC Board for approval. JC confirmed that the tentative decision would be published on the FRC website to assist preparers in the intervening period.

9. Reporting the financial effects of rate regulation

9.1 Annette Davis (AD) introduced a paper setting out the key issues identified in respect of the IASB's Discussion Paper (DP) *Reporting the financial effects of rate regulation.* The Council noted that:

- The deadline for response to the DP is 15 January and that the views of the Council were sought to inform the development of the FRC response.
- The FRC has previously responded to the IASB on the topic and in that response set out that the FRC does not consider rate-regulated activities result in the creation of assets and liabilities, accordingly, it is proposed that the response to this DP sets out the same view.
- The Council has previously responded to the IASB to suggest that it should not continue with the project but, given that times have moved on, the Executive now consider that the IASB should continue with the project to determine the fate of IFRS 14.
- The wording set out in the DP is very specific and refers to 'cost base schemes' and 'incentive schemes'. AD reported that in the UK the most common regulatory scheme adopted is the 'incentive scheme', and that 'cost based' schemes are generally only used in North America.

9.2 AD drew the Council's attention to the three issues that should be addressed in the FRC response as follows:

- Focus - Whether the IASB should focus on a defined type of rate regulation in order to provide a common starting point for a more focussed discussion about whether rate regulation creates a combination of rights and obligations for which specific accounting guidance or requirements might need to be developed.
- Description - Whether the description of defined rate regulation captures an appropriate population of rate regulatory schemes in its scope, and whether modifications need to be made to the description.
- Approach – what approach would best portray the financial effects of defined rate regulation in IFRS financial statements?

9.3 The Council considered the DP and issues to be addressed and advised that the response should suggest the focus should be on the features of rate regulation, rather than defining the regime. The Council also suggested that the IASB be encouraged to explore what features make a difference to the ability to identify assets and liabilities, suggesting that, once the features are identified and agreed upon, the implications considered in the current DP could be addressed. The Council suggested that a discussion with The 100 Group to help identify those features would be useful.

9.4 The Council noted EFRAG TEG's draft response to the DP, which broadly expresses support for the project. The Council advised that the FRC should write to EFRAG TEG and highlight the views expressed at minute 9.3.

10. Non-Financial Reporting Directive

10.1 AA introduced a paper that provided an overview of the European Union (EU) Directive 2014/95/EU 'Disclosure of Non-Financial and Diversity Information'. The Council noted that the Directive introduces new disclosure requirements relating to environmental, social, employee, human rights, anti-corruption and bribery matters and that BIS intend to consult on how the new requirements will interact with existing non-financial disclosure requirements in the Strategic Report in early 2015. AA reported that the FRC will also need to consult on a narrow scope amendment to the 'Guidance on the Strategic Report' to ensure that the guidelines reflect changes to legal requirements and that a paper would follow in due course.

11. Any other business

11.1 There was no other business.