Financial Reporting Council

Minutes of a meeting of the Corporate Reporting Council held on Thursday 21 April 2016 in the Boardroom at 8th Floor, 125 London Wall, London, EC2Y 5AS

Present:	
Roger Marshall	Chair (to minute 6)
Pauline Wallace	Council Member (Acting Chair from minute 6)
Richard Barker	Council Member (from minute 5)
Chris Buckley	Council Member
Michael Gallagher	Council Member
Gunnar Miller	Council Member (to minute 6)
Liz Murrall	Council Member
Veronica Poole	Council Member
Mark Smith	Council Member
Observers:	
Trevor Rushe	IAASA Observer (in place of Michael Kavanagh)
Nicolas Bernier-Abad	European Commission
In attendance:	
Anthony Appleton	Director, Accounting & Reporting Policy
Mei Ashelford	Project Manager, Accounting & Reporting Policy Team
Francesca Carter	Council Secretary
Jenny Carter	Director of UK Accounting Standards, Accounting & Reporting Policy Team
Annette Davis	Project Director, Accounting & Reporting Policy Team
Seema Jamil-O'Neill	Project Director, Accounting & Reporting Policy Team
Andrew Lennard	Director of Research
Deepa Raval	Project Director, Accounting & Reporting Policy Team

Welcome and Apologies for absence

Apologies were noted from Jeremy Townsend (Council Member), Paul George (Executive Director, Corporate Governance & Reporting), Matt Blake (HMRC Observer) and Lee Piller (FCA Observer).

1. Minutes of the previous meeting and rolling actions.

1.1 The minutes of the meeting held on 24 March 2016 were approved for publication subject to a correction to the attendee list.

1.2 The rolling action log was noted.

2. Director of Accounting and Reporting Report

2.1 The Council noted a paper that 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:

IFASS

2.2 AA and Andrew Lennard (AL) had recently attended a meeting of the International Forum of Accounting Standard Setters in Toronto. AL had presented an update to the Forum on the research project on cash flow statements being carried out in conjunction with the IASB; the proposals had been well received. AA had followed the presentation to highlight the need for greater disclosures of the restrictions on movements of cash and had highlighted the Lab's work in the area.

EFRAG

2.3 The Council agreed FRC responses to EFRAG Invitations to Comment on: *Recognition of Deferred Tax Assets for Unrealised Losses (Amendments to IAS 12)* and *Disclosure Initiative (Amendments to IAS 7*).

UK Matters

2.4 The Council noted that, as discussed at the previous meeting, the FRC expects to be withdrawing the Memorandum of Understanding relating to FRS 27 Life Assurance and that the FRC has begun the process of writing to all signatories notifying of the intention to withdraw. Formal approval would be sought from the Codes & Standards Committee on 3 May.

Non-Financial Reporting

2.5 The Council noted that the Task Force on Climate-Related Financial Disclosures' (TCFD) has published its Phase 1 Report which has a one month consultation on the scope and objectives of voluntary disclosures on climate change. AA reported that the TCFD was set up in response to a request from the G20 for the Financial Stability Board to consider how the financial sector can better incorporate climate related issues into decision making and that the initiative is gathering a great deal of interest.

Other matters

2.6 The Council discussed the importance of ensuring any issues or concerns identified in respect of accounting standards are discussed publicly and highlighted the important role the IASB / FASB Joint Transition Group fills in providing a mechanism through which matters can be interpreted and a consensus view can be reached.

3. Director of Research Report

3.1 AL reported on an IASB meeting held on 20 April. The Council noted that the Board had considered a series of staff papers on the Conceptual Framework (CF) and had, acknowledging the need to stick to the timetable, broadly reaffirmed the position as set out in the Exposure Draft. AL reported that the Board had not considered chapters of the CF relating to Stewardship, Prudence and Cash Flow and that those topics would be considered at the June meeting.

3.2 The Council noted that AL would be developing the paper on Cash Flow, it was suggested that the paper might discuss the treatment of reverse factoring and whether imputed cash flows should be reported.

4. Applying IFRS 9 with IFRS 4 (Amend to IFRS 4) ED/2015/11 - Update

4.1 Seema Jamil-O'Neill (SJON) introduced a paper that provided an update on the IASBs deliberations in respect of its November 2015 Exposure Draft (ED) *Applying IFRS 9*

Financial Instruments with IFRS 4 Insurance Contracts (Proposed amendments to IFRS 4) and provided a verbal update on decisions taken by the IASB at its meeting on 18 April.

4.2 The Council noted that the IASB had:

Overlay approach

Considered and tentatively agreed to:

- Require that for financial assets to which overlay approach is applied: the presentation in the P&L should reflect the application of IFRS 9 with a single, separate line item for the overlay adjustment; and OCI should reflect the overlay adjustment separate from other components of OCI consistently with IAS 1.
- Widen the scope of IFRS 4 to permit surplus financial assets held for regulatory, or internal capital requirement purposes to be designated as relating to contracts, and therefore, qualify for the overlay approach.
- Require entities to explain the basis for designating financial assets held by one legal entity as relating to contracts within the scope of IFRS 4, if issued by a different legal entity within the same group.

Temporary exemption from IFRS 9 – Qualifying criteria

Scope

- Considered and tentatively agreed to extend the scope of the temporary exemption to include entities whose activities comprise issuing contracts within the scope of IFRS 4 and investment contracts measured at FVTPL applying IAS 39.

Predominance Ratio

- Considered and tentatively agreed to include 'other' liabilities that are connected to insurance activities in the definition of the numerator and the denominator of the predominance ratio.
- Considered and tentatively agreed that the entity's activities are deemed to be predominantly related to insurance only if:
  (i) the predominance ratio is greater than 90%; or
  (ii) the predominance ratio is greater than 80% but less than or equal to 90% and the entity can provide evidence that it does not have a significant activity that is unrelated to insurance.

Date of Assessment

- Tentatively agreed that an entity should be required to compute the predominance ratio using the carrying amounts of liabilities reported on the entity's balance sheet at the annual reporting date between 1 April 2015 and 31 March 2016.

Disclosures

- Agreed to require additional disclosures on how the entity concluded that it is eligible for the temporary exemption by requiring it to disclose:
  (i) any liabilities included in the numerator of the predominance ratio, other than those within the scope of IFSR 4; and
  (ii) the information used to determine the entity's activities are predominantly related to insurance if the predominance ratio is between 80% and 90%.

4.3 SJON highlighted that, the tentative decisions taken by the IASB address a majority of the concerns raised in the FRC's response and appear, through early outreach discussions, to be workable in the UK. It was noted however, that concerns raised by some bank-assurers, based in other European countries, had not been addressed. The Council acknowledged that the IASB's tentative decisions address a majority of the concerns raised by the Council and commended the IASB in the progress it had made on a contentious issue in a short time period.

4.4 The Council noted that the IASB would discuss the remaining issues at its May 2016 meeting and that a final vote on permission to ballot would be taken in June 2016. SJON undertook to provide a further update on the proposals in due course.

5. UK GAAP Triennial review – strategy and content

5.1 AA introduced a paper that set out an updated strategy for the triennial review of FRS 102 and a number of recommendations relating to the content of the standard. AA highlighted that, as previously advised by the Council, the principles underpinning the strategy had been updated to achieve a balance between stability, consistent with the FRC's commitment to focus on embedding and improving current practice, and a need to reflect up-to-date thinking and improve quality. The Council noted that text would be inserted in to the Council's Advice to reflect the overriding requirement of compliance with Company Law.

5.2 The Council considered an analysis of the application of the principles to changes in IFRS that are not currently reflected in FRS 102. Through discussion the following observations were made and advice was given:

IFRS 3 Business combinations (revised 2008)

5.3 The Council concluded that it would be premature to update FRS 102 for IFRS 3 (revised 2008) as part of the forthcoming triennial review on the basis that:

- A move to the full IFRS 3 (2008) model would not be consistent with UK law.
- There are mixed views as to whether the costs of implementing IFRS 3 (2008) outweigh the benefits of implementation.
- A number of concerns were raised during the IASB's post implementation review (PIR) and amendments to the Standard are expected.

5.4 The Council suggested that the rationale supporting the decision should be clearly articulated.

IFRS 10 *Consolidated Financial Statements*, IFRS 11 *Joint Arrangements* and IFRS 12 *Disclosure of Interest in Other Entities*

5.5 It was noted that:

- FRS 102 applies a risk and rewards approach to determining whether an SPE should be included in consolidated accounts in contrast to IFRS 10 which applies a control-based test.
- UK legislation would limit the extent to which a full IFRS 10 / 11 model could be introduced on the basis that:
    - FRS 102 identifies subsidiaries partly on the basis of the legal definitions - IFRS 10 uses a three-part test to define control.
    - FRS 102 identifies joint arrangements purely on legal form - IFRS 11 introduces an alternative approach to determining joint arrangements.
    - The FRS 102 investment entity exemption is based on exemptions in UK Company law.
- If FRS 102 were aligned more closely with IFRSs 10 and 11, within the population applying FRS 102 there would be little difference to the entities to be consolidated except at the margins in respect of SPEs.
- IFRS 10 has been subject to a number of amendments and it is not yet clear whether it is settled – regard must be given to the principle of stability. Furthermore, the IFRS for SMEs has not been updated in response to the introduction of IFRS 10 and 11.

- It is unclear what the cost would be, for some entities groups will already have systems in place to report under IFRS 10, accordingly, amendments to FRS 102 to align with IFRS 10 might be welcomed.
- IFRS 10 introduces new thinking in respect of control being a predominance criteria which could be of benefit to the quality of reporting.

5.6 The Council noted that a number of number of options are available to improve FRS 102 by reflecting some of the thinking around control and that FRS 102 can be updated to align with IFRS 10 by making it more principles based in relation to the accounting for joint arrangements The Council suggested that the executive develop a proposed approach to bring back to the Council in due course.

5.7 The Council highlighted a potential risk to the FRC should the FRC chose not to update FRS 102 to reflect the requirements introduced by IFRS 10 in response to the financial crisis.

IFRS 13 *Fair Value Measurement*

5.8 It was noted that FRS 102 had not previously been updated for the main requirements of IFRS 13, and whilst recent amendments to align some of the disclosure requirements for financial institutions and retirement benefit plans have been made there remain some inconsistencies relating to fair value measurement. The Council supported the proposal to introduce limited amendments to address those inconsistencies and supported the suggestion that a separate Section on fair value measurement be introduced.

IFRS 9 *Financial Instruments*

5.9 It was noted that:

- IFRS 9 is a complex standard which, amongst other matters, includes classification and measurement requirements.
- FRS 102 has a simplified approach which has already been revised in response to feedback from stakeholders. Changes have also already been made to FRS 102 to more closely align the hedging model with IFRS 9.
- IFRS 9 has an incurred loss impairment model which is generally considered to be an improvement on the expected loss model in FRS 102. The Council's Advice to FRS 102 recommended consideration of the impairment requirements of IFRS 9 once available.
- Practical implications of updating the impairment model of FRS 102 are likely to be most significant for financial institutions.
- IFRS for SMEs was not updated for IFRS 9; however, the scope of FRS 102 is different in that it includes financial institutions.
- IFRS 9 will be effective for accounting periods beginning on or after 1 January 2018.

5.10 The Council discussed the possibility of limiting introduction of the expected loss model to financial institutions but advised that this would not be appropriate and that all entities within the scope of FRS 102 should be subject to the requirement. The Council suggested FRS 102 should be as closely aligned with the requirements of IFRS 9 as possible in respect of the expected loss model. In noting that the expected loss model is more complex and there would be likely to be significant practical implications the Council supported the proposal to provide a longer transition period for the move to an expected loss model. The Council highlighted the importance of ensuring that early adoption should be permitted in any instance.

IFRS 15 *Revenue from Contracts with Customers*

5.11 It was noted:

- IFRS 15 sets out a prescriptive five step process for identifying distinct performance obligations within contracts.
- Adopting an IFRS 15 style model for all entities within the scope of FRS 102 would require significant investment.
- IFRS 15 uses control as a defining feature in analysing transactions rather than a mixed model where in some situations risks and rewards are used. This has required the IASB to introduce detailed guidance to aid application and has resulted in a number of implementation questions being raised at TRG.
- Whilst in most situations the risk and reward approach set out in FRS 102 will produce the same conclusion as the control approach there is some inconsistency in approach relating to the substance of multiple element transactions.

5.12 On the basis that IFRS 15 is a very complex standard and has not yet been fully implemented and embedded by IFRS reporters the Council advised that consideration of whether or not to amend FRS 102 to reflect IFRS 15 should be deferred to the next triennial review at which point conclusions could be drawn as to cost benefit. The Council supported the proposal to update FRS 102 to introduce modest guidance on separating contracts, consistent with the risk and reward model, to guide preparers and encourage consistency in application both amongst preparers and between FRS 102 and IFRS 15 in the interim.

IFRS 16 *Leases*

5.13 It was noted:

- IFRS 16 affects accounting by lessees and removes the distinction between operating and finances leases.
- The recognition of more assets and liabilities will improve users' understanding of the resources controlled and obligations incurred by an entity and is likely to be welcomed by users.
- IFRS 16 is effective for accounting periods beginning on or after 1 January 2019. It has not yet been endorsed in Europe and little progress towards implementation has been made by IFRS preparers.

5.14 Whilst it was noted that IFRS 16 represents an improvement for users and is a relatively simple standard, on the basis that there is a desire to maintain stability the Council supported the proposal to update FRS 102 with a delayed implementation date. The Council suggested that early adoption should be available to those who choose it.

5.15 The Council highlighted the role of the regulator in responding to changes in accounting standards and suggested the conclusions reached should be set out in a paper for discussion with the FRC Board in due course.

Other factors

5.16 The Council noted that there are other factors that may also be drivers for change to FRS 102 and noted an analysis of topics that might be considered. It was suggested that the Council be given the opportunity discuss whether amendments to FRS 102 in respect share-based payments are necessary at a future meeting.

5.17 The Council commended the executive on updating the principles underpinning the strategy and for the detailed analysis presented to inform the Council discussion.

6. Responses to FRED 63 - Amendments to FRS 101 (15/16 cycle)

6.1 JC introduced a paper summarising responses received to FRED 63 *Draft amendments to FRS 101 – 2015/16 cycle* and a number of recommended actions to be taken in response to issues raised. JC reminded the Council that FRED 63 proposed limited amendments to FRS 101 *Reduced Disclosure Framework* that would give disclosure exemptions in relation to IFRS 15 *Revenue from Contracts with Customers* and highlight a legal requirement about the order of the notes to the financial statements.

6.2 The Council noted that 14 comment letters had been received. Whilst respondents were broadly supportive of the proposed changes, a small number of issues had been raised. The Council considered the issues identified by respondents and proposed solutions; through discussion the following points were noted and advice was given:

Principles for determining disclosure exemptions

6.3 The Council noted that whilst the majority of respondents agreed with the suggestion that there are limited external users of the financial statements and that those users focus will be on information supporting the statement of financial position, some respondents suggested that this would not be the case for banks and insurers, who will have a wider range of external users, and that the interests of providers of credit will likely be focused on liquidity and solvency. The Council highlighted that user needs vary significantly and that decisions as to whether disclosure exemptions should be applied should be undertaken on a case by case basis, accordingly, the Council advised that text be inserted to set out that in determining whether new exemptions should be taken an entity should have regard to the need to ensure the information provided would enable the user to make an informed analysis as to the financial position of the entity. It was suggested the executive refer to the FRC’s Disclosure Initiative publication for suitable wording.

Notification of shareholders

6.4 The Council noted that a number of respondents had raised concerns in respect of the requirement for an entity to notify its shareholders that it intends to take advantage of reduced disclosures. Respondents had highlighted that there is insufficient guidance as to how the application should be applied, which has resulted in diversity in practice; and had questioned whether the requirement is cost-effective, particularly in relation to ultimate parents and wholly-owned subsidiaries. JC reported that the Council had considered the requirement in detail three years previously and in recognition of the importance of protecting minority shareholders had taken the decision to retain the requirement. To respond to the concerns raised the Council suggested a consultation should be issued proposing removal of the requirement, noting that it will now be clear from the prior year’s financial statements that an entity is adopting the reduced disclosure framework. The Council noted this would provide users and investors with the opportunity to raise any concerns.

6.5 JC reported that a further, more detailed paper would be brought to a future meeting.

7. Amendments to FRS 103 – Solvency II (FRED 64)

7.1 It was agreed that, due to time constraints, a conference call be scheduled for the week commencing 25 April to discuss *Amendments to FRS 103 – Solvency II* (FRED 64).

8. Presentation from the European Commission on Non-Financial Reporting Capital Markets Union and Country by Country reporting

8.1 The Council received a presentation from Nicolas Bernier-Abad (NBA) on the European Commission's work in respect of Non-Financial Reporting and Country by Country reporting.

9. Any Other Business

9.1 There was no other business.

10. Date of next meeting

10.1 It was noted that the next formal meeting of the Council would be held on 18 May 2016 by conference call.