

**Minutes of a meeting of the Corporate Reporting Council of the Financial Reporting Council held by conference call on 19 October 2016**

**Present:**

Roger Marshall	Chair
Michael-John Albert	Council Member
Richard Barker	Council Member (from minute 2.7)
Chris Buckley	Council Member
Michael Gallagher	Council Member
Sian Morgan	Council Member
Liz Murrall	Council Member
Veronica Poole	Council Member
Mark Smith	Council Member
Jeremy Townsend	Council Member

**Observers:**

Alison Ring	HMRC Observer
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**In attendance:**

Anthony Appleton	Director, Accounting & Reporting Policy
Jenny Carter	Director of UK Accounting Standards, Accounting & Reporting Policy Team
Annette Davis	Project Director, Accounting & Reporting Policy Team
Paul George	Executive Director, Corporate Governance & Reporting
Seema Jamil-O'Neill	Project Director, Accounting & Reporting Policy Team
Andrew Lennard	Director of Research
Susanne Minocha	Council Secretary

Rosalind Szentpéteri	Project Director, Accounting & Reporting Policy Team
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**Welcome and Apologies for absence**

Apologies were noted from Lee Piller (FCA Observer) and Michael Kavanagh (IAASA Observer).

The Chairman welcomed new Council members Sian Morgan and Michael-John Albert and new Council Secretary Susanne Minocha.

**1. Minutes of the previous meeting and rolling actions.**

- 1.1 The minutes of the Corporate Reporting Council meeting held on 21 July 2016 were approved for publication subject to some corrections which will be approved the Chair.
- 1.2 It was noted that all matters on the rolling action log were either to be discussed at the meeting, completed or could not yet be completed.

## 2. Director of Accounting and Reporting Report

2.1 AA referred to his report, drawing attention to the following.

### *EFRAG – Draft endorsement advice on classification and measurement of share-based payment transactions (the Draft Endorsement)*

2.2 A specific question was raised by EFRAG in its invitation to comment on the Draft Endorsement, on whether cost relief may be limited by the amendment, as it requires entities to separately account for any amount retained in excess of the statutory tax obligation as a cash settled plan. It was reported that this had been discussed at TEG where it was considered that this could have been made more simple and pragmatic.

2.3 After consideration Council approved the draft FRC response in the completed Invitation.

### *UK GAAP – Triennial Review*

2.4 AA reported that the triennial review consultation document had been issued; it focused on how FRS 102 might be updated for changes in IFRS. In addition stakeholders were providing feedback on areas for potential improvements. One issue that had been raised repeatedly so far was directors' interest-free loans particularly in the context of small companies, which need to be discounted at a market rate of interest. The executive had met with representatives from the ICAEW and its Small Practitioners' Committee to understand the small companies' perspective. This issue would need to be considered further once all feedback was received, with some stakeholders suggesting that the general principle that recognition and measurement should be the same for small and larger companies should be challenged in this area.

2.5 The market rate for loans to small companies by a person who is both a director and a shareholder, was questioned as the loans may only exist because of the related party relationship. This situation was difficult to provide for other than moving from a substance based approach to using the contractual terms of financial instruments. As the FRC has a commitment to try to respond to small private companies in their concerns a pragmatic solution may need to be considered.

2.6 The Council made the following observations or suggestions for further consideration:

- a. Whether there should be a policy option for loans from shareholders to be stated at cost.
- b. Consideration should be given to how small the entity should be to warrant an exemption. It was noted that there is already an exemption for micro-entities; however the extent to which any other small companies should be included was an issue for debate.
- c. The extent to which financial reporting is an obligation in the context of the advantages of incorporation should be considered.
- d. The quasi-equity nature of these financial instruments. It was noted that an owner may decide how much dividend to pay himself in the interests of a tax trade-off.
- e. Preparers' views of the financial reporting can be influenced by their understanding, correct or otherwise, of the impact on tax payable.

2.7 It was noted that the Council would discuss the matter further at a later stage.

### *FRS 103 Insurance Contracts*

2.8 FRS 103 had been revised early in the year to reflect a change in regulation. The changes were to referencing and definitions making it clear that there was no change in accounting

policies required. However the FRC had subsequently been made aware that company law had been amended to refer to the Solvency II directive when calculating long-term provisions. Specifically “due regard” was to be had to the “actuarial principles” laid down in the Directive. The meaning of “due regard” and “actuarial principles” needed clarification before determining whether or not a change in policy was needed. A round table of parties to discuss this is planned. It is possible that further changes to FRS 103 would be required.

2.9 The Council made the following observations:

- a. As the old directive was fully repealed it would probably be difficult to reference, and therefore a change had been necessary;
- b. Under the provisions of IFRS, Solvency I principles could continue to be used, but under UK GAAP the provisions of Solvency II may apply. This may appear contrary to the general approach that UK GAAP aimed to be at least no more onerous than IFRS.

2.10 The executive was taking steps to resolve the situation as quickly as possible.

#### *Supplier payment policies*

2.11 It was drawn to Council’s attention that the Small Business and Employment Act allows the Secretary of State to set requirements to disclose supply and payment policies. Large businesses would be required to report on these. The Business Minister has now set out the likely detailed requirements, which it appears will be extensive, including filing a bi-annual report.

2.12 BIS had commissioned an external consultancy business to determine what costs of this are likely to be with some preparers suggesting these may be quite high.

2.13 FRC will seek to make contact with the relevant BEIS officials to discuss preparer concerns and consider next steps.

### **3. Director of Research Report**

#### *Recent meetings*

3.1 AL reported on the World Standard-Setters Conference and the International Forum of Accounting Standards Setters (IFASS) which were held in September. The FRC presented papers on a Framework for Corporate Reporting and cash flow statement research at IFASS which were well received.

#### *IASB Conceptual Framework*

3.2 AL noted that the IASB is expected to publish its revised *Conceptual Framework* in the first half of 2017. It is anticipated that the *Conceptual Framework* would include some acknowledgement of stewardship.

3.3 There was a discussion on asymmetry at a recent IASB meeting. Some IASB members raised reservations about including this topic in the *Conceptual Framework*. The Council agreed to wait for the IASB’s formal decisions from their meeting before writing to express any concerns. It was anticipated that by the next meeting of the Council an update and proposal paper would be available.

- 3.4 AL reported that the re-draft of key sections on measurement seemed to be satisfactory but it was likely that the examples included would be removed before (probably) being presented at the IASB's December meeting.

*Multinational Network Group*

- 3.5 There was a Multinational Network Group meeting fixed for the following week to consider a full agenda, including a discussion on the implications of Brexit.

*The Corporate Reporting Council's Academic Panel*

- 3.6 An Academic Panel meeting will be held on 30 November 2016, at which the Panel would be discussing a paper on the role of uncertainty in accounting. The Agenda for this meeting was distributed and Council members would be welcome to attend this meeting.

**4. Consultation Document – “the FRC’s Corporate Reporting Research Activities”**

- 4.1 The Council advice on the draft Consultation Document was sought.

- 4.2 The Council made the following main observations:

- At recent Codes and Standards there was a debate about research into accounting for accruing for pension liabilities, which it was suggested be added to the research agenda.
- It was questioned to what extent transactions for government, which had been highlighted, was relevant to the UK market compared with that overseas.
- Whilst accounting was poor in areas such as grants, this was arguably less important than the broad area of pensions.
- It was suggested that outcome of research into accounting for tax be reviewed, although the possibility of a thematic review looking at compliance with current requirements and possible improvements (though not seen as a priority) was noted.
- A number of small changes to wording in relation to intangible assets were agreed.

- 4.3 It was agreed that the FRC executive redraft and publish the document to include comments raised at the meeting.

**5. Definition of Business and accounting for previously held interests (proposed amendments to IFRS3 and IFRS11)**

- 5.1 It was reported that the main focus of the IASB's Exposure Draft was to try to amend the definition of a business to achieve more consistent application and reduce the level of judgement required. It also aims to clarify the accounting for previously held interests in two specific scenarios.

- 5.2 It was reported that:

- the comment period for the IASB issued exposure draft ED/2016/1 *Definition of a Business and Accounting for Previously Held Interests: Proposed amendments to IFRS 3 and IFRS 11* (ED) closes on 31 October 2016.
- EFRAG had agreed to extend the deadline for submission of our comment letter to them until after this CRC meeting.
- Several respondents to the post-implementation review of IFRS 3, including the FRC, raised concerns that the definition of a business was too wide, leading to diversity in practice and some acquisitions that were, in substance, asset acquisitions being

accounted for as business combinations. The IASB has therefore proposes to narrow the definition of a business.

5.3 There was a broad agreement with the FRC's draft responses to the IASB and EFRAG, subject to the following:

- Our response should highlight the broader point that the IASB should aim to reduce or eliminate some of the unnecessary differences between the accounting for business combinations and asset acquisitions, such as those relating to the accounting for acquisition expenses, contingent consideration and deferred taxation.
- The extent to which the proposed amendments would reduce costs for preparers was questioned; while the level of judgement involved in the determination of whether a set is a business or an asset acquisition may be reduced, much of the time-consuming analysis underlying the assessment will still need to be performed.
- The screening test should not preclude assets of different classes being considered 'similar' if it is to achieve its intended purpose set out in the ED.
- A number of the illustrative examples should be redrafted. In some cases the examples in the FASB exposure draft are more clearly articulated.
- Some Council members had additional detailed drafting suggestions that they would provide to the staff after the meeting.

5.4 EFRAG had asked for feedback from constituents on two questions:

- a. Additional areas where the Council believes illustrative examples would be useful. The FRC's draft response to EFRAG highlights three areas where additional examples would be useful and several of the existing examples that we believe require clarification. In addition, our response should suggest that the examples provide more clarity on the application of the proposed screening test.
- b. Areas in which the Council believes differences in the wording of the proposals of the two boards may lead to divergence. The Council agreed that the structure of the IASB's proposed amendments is generally clearer, particularly the positioning of the screening test prior to the detailed requirements. However, the Council felt that the FASB's drafting was clearer in some areas (for example, the criteria for determining whether a process is substantive). The Council agreed with the position stated in the draft response, that the IASB and the FASB to reach converged conclusions on their proposed amendments wherever possible.

5.5 It was agreed that the draft responses to the IASB and EFRAG would be amended to reflect the above matters. PG and RM would then approve the final comment letters prior to submission.

## **6 FRED 66 Draft amendments to FRS 101 – 2016/17 cycle – initial discussion**

6.1 MA reported that the annual review of FRS 101 for the 2016/17 had been undertaken with only a couple of issues arising.

### *IFRS 16 Leases – Single lease disclosure note*

6.2 The Council agreed with the proposal to introduce an exemption from the requirement to provide a single disclosure note for leases.

#### *IFRS 16 Leases – Maturity analysis*

- 6.3 MA reported that an anomaly has arisen in respect of the maturity analyses disclosure requirements of IFRS 16 as a result of the drafting of IFRS 16, where the requirement for lessees contains a cross-reference to IFRS 7 *Financial Instruments* whereas the requirement for lessors does not. This would result in lessees being permitted to take an exemption by virtue of the cross-reference to IFRS 7 but lessors would not.
- 6.4 Feedback has been obtained from the UK GAAP TAG which noted that firstly lessees and lessors should both either be required to provide the respective disclosures or both permitted to take an exemption. There was also a concern noted that it might appear as incongruous to require maturity analysis of leases, but not of financial liabilities more generally where an exemption from IFRS 7 currently exists.
- 6.5 The Council acknowledged the concern, but also noted that the current reporting requirements are already incongruous as there are no exemptions from the equivalent, albeit slightly different, maturity analyses of IAS 17 *Lease*. The Council therefore advised that it should be proposed that both lessees and lessors should be required to provide the maturity analyses disclosures of IFRS 16 and that the existing exemption from IFRS 7 should remain.

#### *IAS 7 Statement of Cash Flows – Debt disclosures*

- 6.6 The Council advised that the new debt disclosures introduced into IAS 7 would not be useful without the supporting statement of cash flow, therefore the existing exemption from IAS 7 should remain which will have the effect of extending the exemption to these new disclosure requirements.
- 6.7 MA advised that a draft of FRED 66 would be presented to the Council at its next meeting, for it to approve its advice to the FRC Board.

### **7 FRS 102 – Triennial review 2017: Improvements – initial proposals**

- 7.1 MA reported that the consultation document on the approach to updating FRS 102 for IFRS had been issued. At the same time, the executive had continued working on some of issues that are intended to be addressed in the first FRED, expected to be issued in March 2017. The issues for this meeting were as follows:

#### *Undue cost or effort exemptions*

- 7.2 The Council had previously advised that FRS 102 should no longer have any undue cost or effort exemptions. As a result it was expected that the undue cost or effort exemptions would be removed from accounting for investments in associates, joint ventures and investment properties. As previously agreed, a policy choice for investment properties rented to other group entities would be proposed.

#### *Intangible assets acquired in business combination.*

- 7.3 The Council had previously agreed that under FRS 102 entities should be required to separate some but not all intangible assets from goodwill in a business combination.
- 7.4 Discussions centred around the use of reliable measurement for separate recognition of intangible assets, however, that reliable measurement was not considered a good filter for removing intangibles. The option recommended by the FRS executive was to separate

those intangibles which are separable (meaning its fair value is therefore more easily determinable) and arise from contractual or legal rights.

- 7.5 The Council made the following observations:
- a. If an intangible asset has been recognised in the past, the new requirements should not require it to be changed.
  - b. The executive had identified an anomaly in a situation where a transaction can never be repeated, eg the acquisition of a company with non-transferable broadcasting rights. In this situation the broadcasting rights would not be separately recognised from goodwill even though a reliable fair value may be determinable.
- 7.6 The Council acknowledged that wherever the line is drawn between what should be recognised separately and what should be subsumed into goodwill will always be arbitrary, and advised that the requirement should be more permissive to allow entities the ability to recognise more intangibles separately if they are able to determine a reliable fair value.

*Incorporation of control model from IFRS 10 and 11 into FRS 102*

- 7.7 It was reported that Council had previously expressed the view that the control model from IFRS 10 and 11 should be incorporated into FRS 102 as part of the triennial review to provide consistency in the scope of consolidation within IFRS and UK GAAP. Some preliminary feedback from the UK GAAP TAG suggested there were the following concerns about this approach:
- a. There was a fear that this would be seen as change for changes sake, and that all FRS 102 reporters would be required to incur costs where for the vast majority of them there will be no change in accounting (although it is not clear to what extent this is true).
  - b. There could be a conflicts with company law.
- 7.8 The feedback from the consultation document is not yet known but will provide useful information in due course. The Council asked the executive to provide a more in depth paper at its next meeting for it to consider, with a focus on identifying the types of entities / SPEs where the accounting may be impacted through the introduction of the control model.

*Revenue – separation of components of a single transaction*

- 7.9 The executive proposed that paragraph 23.3 of FRS 102 in relation to measurement of revenue be re-drafted to include a paragraph 23.3A in order to make it more likely that a single accounting policy for revenue could meet the requirements of both IFRS 15 and FRS 102.
- 7.10 It was noted that this could involve a large amount of work, and the cost to an average company was questioned. Council considered the new wording was better but questioned what would be changed as a result of introducing them.
- 7.11 After consideration Council was supportive of the general principle.

*Incorporation of company law disclosures*

- 7.12 Earlier feedback showed general agreement that company law disclosures should be put into FRS 102 or alternatively into an appendix. The executive suggested it would not be practical to integrate the disclosures throughout FRS 102 without losing the succinctness of FRS 102 and therefore suggested putting these disclosures into an appendix or making no changes to FRS 102 in this regard.

- 7.13 Council made the following observations:
- a. Adding company law disclosures would make FRS 102 more cumbersome to no effect as there was enough information in the public domain already.
  - b. However some FRS 102 users might not be aware of the extent of company law disclosures.
  - c. There were numerous commercial checklists which could be cross-referenced for ease of updating.
  - d. There is a cost in maintenance. A stand-alone appendix of requirements could be more easily updated.
  - e. An appendix may give the message that the requirements are all included.
  - f. There are also banking company and insurance company requirements to consider.

7.14 In view of the above Council advised that no action should be taken.

#### *Definition of a Financial Institution*

7.15 It was reported that this definition was developed by the FRC as an addition to FRS 102, when compared to the IFRS for SMEs. The definition specifies types of entity and is followed by a “catch all” clause for similar entities. The main purpose of the definition is to define the entities required to provide extra disclosure about financial instruments.

7.16 Initial outreach identified the definition as an area of considerable discussion and questions in implementing FRS 102. Some queried whether the overall FRS 102 principle was about accountability of entities or fiduciary duties. Examples of some of the more detailed queries related to the definitions of “principal activity” and “similar activities”.

7.17 Possible solutions identified by constituents included: removing specific types of companies from the list, amendments to the principle to remove references to risk management and wealth generation, or the removal of the definition of financial institutions altogether, leaving disclosures to be made by companies for whom financial instruments were material.

7.18 A number of options for addressing anomalies were highlighted and Council members’ views were sought.

7.19 The Council raised the following issues:

- a. Driving disclosures by nature of financial institution. Some Members considered that disclosures should be made if the holdings of financial instruments are material.
- b. It was noted that there is not a clearly articulated publicly available list of regulated entities in order to devise a definition based on the regulated nature of entities. It was also noted that there are different definitions of regulated entities depending on whether regulated by PRA or FCA, for example the FCA definition includes IFAs.
- c. Exempting wholly-owned subsidiaries from the definition may lead to unintended consequences e.g. by exempting subsidiaries that act as quasi-financial institutions.

7.20 The Council reviewed the list of potential entities, noting that pension schemes did not need to be on it as there was a separate section for pensions, and also considered whether only items considered material should be captured.

7.21 It was agreed to bring this matter back to Council with additional consideration of issues and potential solutions.

#### *Definition of Fair value (IFRS 13).*

- 7.21 It was proposed in response to FRED 62 *Draft amendments to FRS 102 - Fair value hierarchy disclosures* that FRS 102 be brought into line with aspects of IFRS 13 *Fair Value Measurement*. It was noted that the current FRS 102 definition of fair value is based on the IFRS for SMEs. Some respondents to the ED highlighted a potential need to amend the definitions and guidance.
- 7.22 Proposals considered were to:
- a. Align the definition of fair value and relevant guidance sections in FRS 102 to those in IFRS 13. The advantage of this would be to bring FRS 102 as close as possible to IFRS 13 and ensure consistency in the application of fair value requirements between entities within the scope of FRS 102 and IFRS reporters; or
  - b. Align the definition of fair value only to that of IFRS 13. There would be no significant change to the relevant guidance so that companies within FRS 102 would use the definition without significant further guidance; or
  - c. Maintain the status quo.
- 7.23 Initial feedback suggested maintaining the status quo, particularly as any changes would be so soon after the implementation of the standard.
- 7.24 The Council considered the above and made the following comments:
- a. The disclosure hierarchy had been changed for consistency with IFRS 13, but the hierarchy and measurement guidance are entirely separate, and there may not be a need to align them both.
  - b. The IFRS 13 definition of fair value would lead to changes in measurement in practice, but it was not clear the costs of such a change were justified for FRS 102 reporters.
- 7.25 The Council advised maintaining the status quo at the present time.

## **8. EFRAG Consultation on the endorsement of IFRS 16 Leases**

- 8.1 The Council was asked for its views on EFRAG's Preliminary Consultation Document regarding the endorsement of IFRS 16 *Leases*.
- 8.2 AD noted that the reason EFRAG had issued a Preliminary Consultation Document was departing from its usual endorsement advice process was due to the fact that EFRAG had not reached preliminary conclusions on certain topics, e.g. whether the benefits of implementing IFRS 16 exceeds the costs. EFRAG's Document was published on the day the Council papers were uploaded and, consequently, no analysis was included in the agenda papers; however an initial discussion to assist with the development of views at the Council's November meeting was considered useful. The document contained a series of questions aimed at gathering evidence. It was noted that EFRAG had commissioned economic consultants to undertake an impact analysis which would include looking at the potential impact of IFRS 16 on the leasing industry and SMEs.
- 8.3 The Council's views and comments on the preliminary consultation were as follows:
- a. A change in the behaviour of some companies was already being seen, with some opting to buy rather than lease. It was noted that this would have a neutral effect on the economy because companies would still be investing but might affect leasing companies.
  - b. The extent to which the FRC has spoken to leasing companies was queried. It was confirmed that both the UK leasing association FLA and Lease Europe have been heavily involved with commenting on the development of the standard.

- c. It was queried whether banks would reduce or stop lending to SMEs after the implementation of IFRS 16 as the balance sheet would show a higher level of debt with the recognition of all lease liabilities.
- d. The tax treatment is not independent of the accounting however, HMRC are consulting on whether or not to change the tax law in this area.

8.4 Some Council members noted that they had been heavily involved in commenting on the development of the standard over the course of the two Exposure Drafts and preceding Discussion Paper. Now that IFRS 16 has been issued the focus is on implementation and solving any potential issues that arise. A concern was expressed that some retailers may start to use leases that meet the short-term lease exception (12 months or less) and this could understate the operational risk of using these types of leases. It was noted that for these type of leases lessors may increase price because of the risk of finding another tenant.

8.5 It was noted that some companies had scoped the impact of this and were quite advanced already, and could be able to quantify issues in order to create cost estimates. RM – we need to do focused discussion perhaps with retailers about the costs, and ask some other pertinent questions at the same time.

8.6 It was noted that some companies had quantified the impact of IFRS 16 and would be able to estimate the cost of implementation. It was recommended that staff endeavour to obtain feedback from preparers and users and, in particular, endeavour to obtain evidence relating to one-off and ongoing costs for preparers.

## **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 17 November 2016.