Financial Reporting Council

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

Present:	
Roger Marshall	Chair
Richard Barker	Council Member
Chris Buckley	Council Member
Michael Gallagher	Council Member
Liz Murrall	Council Member
Veronica Poole	Council Member
Mark Smith	Council Member
Jeremy Townsend	Council Member
Pauline Wallace	Council Member
Observers:	
Mike Ashley	EFRAG Observer
Matt Blake	HMRC Observer
Michael Kavanagh	IAASA Observer
Lee Piller	FCA Observer
In attendance:	
Anthony Appleton	Director, Accounting & Reporting Policy
Patrina Buchanan	IASB Staff Member (minute 1 only)
Francesca Carter	Council Secretary
Jenny Carter	Director of UK Accounting Standards, Accounting & Reporting Policy Team
Annette Davis	Project Director, Accounting & Reporting Policy Team
Paul George	Executive Director, Conduct
Seema Jamil-O'Neill	Project Director, Accounting & Reporting Policy Team
Nick Land	Chair, Codes & Standards Committee and FRC Board Member
Andrew Lennard	Director of Research
Sue Lloyd	IASB Board Member (minute 1 only)
Melanie McLaren	Executive Director, Codes & Standards
Deepa Raval	Project Director, Accounting & Reporting Policy Team
Rosalind Szentpéteri	Project Manager, Accounting & Reporting Policy Team

Welcome and Apologies for absence

The Chair welcomed Nick Land, Ray King, Sue Lloyd and Patrina Buchanan to the meeting.

Apologies were noted from Gunnar Miller (Council Member).

1. Education Session – IFRS 16 *Leases*

1.1 The Council received a presentation from Sue Lloyd (SL) and Patrina Buchanan (PB) in respect of IFRS 16 Leases. The Council noted the Standard has been published earlier in the month and would be effective from 1 January 2019. In introducing the presentation Sue

Lloyd thanked the FRC for the contributions it had made to the development of the standard.

1.2 The Council noted the presentation which covered the following points:

- **The need for change.** PB reported that Leases are an important and flexible source of financing. A significant number of lease commitments do not appear on the balance sheet which makes it difficult for investors and others to get an accurate picture of a company's lease assets and liabilities, to compare companies that lease or buy lease assets and to estimate the amount of off balance sheet obligations.
- **An overview of what will change when the standard takes effect.** PB reported that for lessor accounting the IAS 17 accounting requirements will substantially be carried forward. For lessee accounting former operating leases would be capitalised and all leases, subject to practical expedients, will be accounted for similarly to today's finance leases. The new requirements will also affect key ratios used to analyse a company's financial leverage and performance.
- **The effective date and transition options**. PB reported that in implementing IFRS 16 there is no need to reassess whether existing contracts contain a lease. PB also reported that a wide number of transitional arrangements are available, and should, the cumulative catch-up transition method be elected companies would not be required to restate comparatives.
- **How the IASB responses to comments submitted by the FRC in response to the consultation process**. RB reported that the FRC's concerns in respect of the complexity of a dual model, the distinction between a lease v service, portfolio application and cost had been addressed. The lessor requirements of IAS 17 had also been substantially carried forward as recommended by the FRC.
- **The IFRS 16 Effects Analysis**. PB reported that the Effects Analysis has been issued as a separate document and will include quantitative information about the effects of the Standard and an assessment of the benefits and costs for investors, companies. The document will also include worked examples using real company information.

1.3 Through discussion it was noted that:

- IFRS 16 is intended to provide more transparent, accurate and comparable information which will be favourable to the market. Accordingly, it could be expected that the cost of capital will reduce.
- There will be significant implementation costs for the telecoms, retail and airline industries.
- The three year implementation period is intended to give companies time to prepare before the application date and the Effects document includes case studies that set out the steps a company will need to take to implement the Standard.
- It is expected that by the application date many firms who currently use frozen GAAP as the basis for covenants will have completed that cycle.
- The Standard is very clear on what criteria must be applied to determine what is a 'small lease' and what exemptions are permitted for 'small leases'.

1.4 Roger Marshall (RM) reported that, whilst the European Financial Reporting Advisory Group (EFRAG) had yet to receive a formal request for Endorsement Advice from the European Commission, EFRAG had begun work to assess the effect of the implementation of IFRS 16 in Europe. RM invited the Council to share any issues / concerns they may be aware of from a UK perspective.

2. Minutes of the previous meeting and rolling actions

2.1 The minutes of the meeting held on 17 December 2015 were approved for publication.

2.2 The rolling action log was noted.

3. Director of Accounting Report

3.1 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:

IASB

3.2 Anthony Appleton (AA) reported that the Economic and Monetary Affairs (ECON) Committee of the European Parliament had an exchange of views with Hans Hoogevoorst and Michael Prada in early January relating to the governance of the IFRS Foundation and, in particular the operation of the Monitoring Board and its geopolitical context. AA reported that Michael Prada highlighted that it was difficult for him to comment on the operation of the Monitoring Board as the Trustees were accountable to it, not the other way round. At a subsequent meeting with the FRC and he had expressed some surprise at the FRC response to the Structure and Effectiveness review, as he felt the Trustees already provided the oversight we were calling for. It was noted that this might not be clear from the Minutes of the Trustees meetings and they will consider providing more detail in these.

EFRAG

3.3 AA reported on a number of changes to the EFRAG Board membership. It was noted that the EFRAG Board had appointed Andrew Watchmen as EFRAG TEG Chairman and CEO and Nicklas Grip as the EFRAG TEG Vice-Chair. It was also noted that Michael Ashley and Andrea Toscelli would retire on 31 March.

UK Matters

3.4 AA reported that the FRC's statement on Update Bulletin 1 to the Charities SORP (FRS 102) had been approved by the Codes & Standards Committee at its January meeting and was due to be considered by the FRC Board on 27 January.

Other matters

3.5 The Council discussed a concern raised by a member of the Council relating to the IASB / FASB Joint Transition Resource Group for Revenue Recognition (the 'TRG'). The Council noted that the IASB had withdrawn UK members from the TRG and that moving forward the TRG would only be attended and observed by IASB staff, as opposed to Board, members. The large audit networks were concerned with these developments as there may still be significant issues for IFRS preparers that had not yet been raised with the TRG or resolved. The Council supported the concerns raised and suggested the executive explore the issue further.

4. Director of Research Report

4.1 The Council noted a brief verbal update from Andrew Lennard (AL) in respect of the projects he is working on whilst on secondment to the IASB.

4.2 The Council also noted that the FRC's Academic Panel would be meeting on 4 March and that the agenda would include sessions on:

- Non-financial information
- Prudence
- The Corporate Financial Information Environment
- How to do an effects analysis
- Consideration of the endorsement criteria.

AL reported that the meeting would be followed by a reception for Geoff Whittington who has been working with the FRC for 25 years.

5. Review of annual reports from SORP-making bodies

5.1 Jenny Carter (JC) introduced a paper setting out the remaining two annual reviews completing the 2015 Annual review of SORPs by the SORP-making bodies, the Further and Higher Education (FEHE) SORP and the Housing SORP. JC reminded the Council that SORP-making bodies are required by the FRC *Policy and Code of Practice on SORPs* (the 'Policy') to consider annually whether there:

- are any implications for the SORP in respect of new or proposed accounting standards;
- is any evidence of widespread or significant failure to follow the SORP in the relevant industry / sector;
- are any developments in the sector which suggest further guidance is desirable; and
- is a continuing need for the SORP.

5.2 JC reported that a summary report pulling together feedback from all seven reviews would be presented to the Codes & Standards Committee in February. The report would be used to inform a discussion of the review process and to enable the Committee to consider whether there are any overall lessons that can be learnt from the process. The Council agreed that the reviews completed by the SORP-making bodies had been of good quality and that the SORP-making bodies had considered relevant issues.

Further and Higher Education (FEHE) SORP

5.3 The Council supported a request from the FEHE SORP making body to insert an editorial amendment without consultation to draw users of the SORPs attention to SORP guidance notes which are to be published on the SORP website.

5.4 The Council noted that the current FEHE SORP requires application of FRS 102 which permits the application of the small entities regime and that this is a widening of scope that was not permitted in the previous SORP in order to ensure consistency of reporting by all institutions. Following a short discussion the Council concluded it appropriate for the scope to be widened to permit access to the small entities regime on the basis that:

- the majority of higher education institutions would exceed the small entity thresholds;
- any disclosures required by the SORP will be required for compliance with the SORP;
- representatives from relevant regulators on the SORP Board have not expressed concern in respect of the widening of scope and potential for inconsistent reporting.

5.5 The Council supported the recommendation that the SORP-making body keep the impact of the availability of the regime under review.

Housing SORP

5.6 The Council noted that the SORP working party had issued guidance notes in respect of potential impairment of housing property and the Government's changes to rent policy in which it is clear that they do not form part of the SORP and have not been formally reviewed by the FRC.

5.7 The Council noted that, as with the FEHE SORP, the previous Housing SORP did not permit application of the FRSSE and that with the revisions to FRS 102 the scope had been widened and the small entities regime could be applied by housing associations meeting the small entities regime thresholds. As with the FEHE SORP the Council concluded that it would be appropriate for the small entities regime to be applied if the criteria were met but that the SORP-making body be asked to keep the impact of the availability of the regime under review.

5.8 The Council noted that, as part of the annual review, SORP-making bodies are required to submit details of membership of the SORP-making body and / or working party. JC reported that the memberships of the FEHE and Housing SORP making bodies are considered to be suitably representative.

5.9 The Council also noted an update on progress that had been made in respect of the advice given by the Council at its December meeting in relation to the annual reviews considered at that meeting.

5.10 The Chairman suggested that it would be useful to undertake an analysis later in the year to assess the impact the introduction of new UK GAAP has had on the accounts. It was suggested it would be useful to involve colleagues from the Audit Division in the analysis. AA undertook to consider the suggestion in more detail.

6. Non-Financial Reporting Directive – initial views on the consultation

6.1 Deepa Raval (DR) introduced a paper seeking input form the Council on the lines to take in response to the upcoming Department of Business, Innovation and Skills (BIS) consultation on the implementation of the Directive on non-financial and diversity information (2014/95/EU) (the 'non-financial reporting Directive'). DR reported that it is expected that BIS will issue the consultation shortly and that, as a result of the delays in issuing the consultation, it is likely that the consultation period will span a period of 8 weeks. DR also reported that, in light of the Governments deregulatory agenda, it is likely that the consultation will be used as an opportunity to seek input on whether there are existing narrative reporting regulations that can be repealed.

6.2 DR invited the Council to consider proposed lines to take in respect of a number of issues. Through discussion the following observations were made and advice was given:

Scope

- The Council noted that the scope of the Directive, which applies to large Public Interest Entities (being those with more than more than 500 employees) is narrower than the scope of the Strategic Report requirements and that, should the requirements of the Directive be taken forward, half of those who are currently required to report under the Strategic Report requirements would not have to.
- Through discussion the Council highlighted the:
    - Importance of transparency and the concerns investors would raise should transparency be reduced.

    - Importance of having a simple narrative reporting framework.
    - Arbitrary nature of the criteria for 'large' being set at 500 employees.
- On the basis of the discussion the Council supported the proposal that the FRC should encourage BIS to retain the existing scope in the UK and extend the scope to include any unquoted credit institutions and insurance undertakings.

Placement of information

- The Council noted that the Directive provides Member States with the option of providing flexibility for companies to include information that is required by the Directive in a separate document outside the annual report on the basis that the report is published together with the management report, or made available on a company's website within six months after the balance sheet date. DR reported that, whilst this would be beneficial for many companies, the principles in the FRC's Guidance on the Strategic Report set out that where information is relevant it should be included in the Strategic Report.
- Through discussion the Council highlighted the importance of ensuring that where non-financial information is relevant it should be included in the annual report and supported the proposal that the FRC should encourage BIS to either take up the Member State option to permit the issue of a separate document and allow companies to decide where this information is reported or encourage BIS to introduce a requirement to provide non-financial information outside the annual report with an option to promote information relevant to investors to the Strategic Report.
- The Council also noted that, in contrast to the FRC Guidance, the Directive requires the reporting of information on policies and due diligence processes and does not provide an option for information in the non-financial statement to be split.
- The Council highlighted that the response should encourage BIS to promote the use of electronic reporting where ever possible.

Assurance

- The Council noted that the Directive also provides a Member State option in respect of the provision of assurance over non-financial information and supported the proposal that the response should not support a requirement for such assurance. The Council agreed that any need for assurance should be driven by the market.

De-regulation

- The Council supported the proposal that BIS should be encouraged to explore removing the following disclosure requirements from the director's report:
    - Post balance sheet events
    - Indication of likely future developments in the business
    - Detailed employee disclosures such as the policy on the employment of disabled persons
    - Greenhouse gas emissions.
- The Council also suggested BIS be encouraged to consider removing the requirements for providing disclosures in respect of political donations and reducing the requirements in respect of directors' remuneration.

Improvements to disclosures

- The Council suggested the response to the consultation should reiterate the concerns regarding the requirement for Companies to disclose the name and registered office of each subsidiary in the annual report.
- The Council supported the proposal that BIS be encouraged to amend the legal requirement for companies to include a breakdown of the number of employees by gender

split between directors, senior managers and other employees on the basis that the requirement includes directors of subsidiaries whom may not be of strategic significance to the group.

Electronic reporting

- The Council agreed the response should encourage BIS to explore the broader use of electronic reporting.
- The Council supported the suggestions that BIS be encouraged:
  - To review the requirement for Companies to provide the annual report as a printed document.
  - To revisit the idea of the Annual Directors Statement as a 'repository for reporting requirements which are required disclosures irrespective of materiality or impact on the business as a whole'.

6.3 DR reported that a draft response would be developed, reflecting the views expressed by the Council, once the consultation had been issued. DR also reported that the FRC intends to hold outreach events during the consultation period to seek input, particularly from investors, to inform the FRC response.

7. Response to IASB ED – Applying IFRS 9 with IFRS 4 Insurance

7.1 Seema Jamil-O'Neill (SJON) introduced a draft response to the IASB Exposure Draft (ED) Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts (Proposed Amendments to IFRS 4).

7.2 SJON reported that the draft FRC response to the ED incuded two solutions. The solution recommended by the Council at its December meeting proposing that the deferral approach is applied to all regulated insurance entities, whether at reporting entity level or below. And an alternative solution proposing that the exemption is applied to an entity at the level at which it meets the predominance criteria set out in the ED. The Council noted that the draft is broadly aligned with the EFRAG draft response to the IASB ED.

7.3 The Council discussed a summary of the key points raised by attendees at an FRC constituent roundtable held on 15 January. It was noted that:

- Insurance preparers would like the deferral to be applied at group reporting level and would support the application of a holistic approach that would enable as many firms as possible to be eligible to apply the deferral.
- Some investors are against the deferral approach as they want better financial reporting from insurance companies. Other investors support the deferral approach as they do not want to see two sets of changes in relation to accounting for financial assets within three years of each other.
- Accounting firm representatives noted that in the UK, whilst there was a lot of support for the deferral approach, accounting firms are undecided on whether the deferral should be applied on a regulated entity basis or predominance criteria basis.
- Some accounting firms have expressed concern that if deferral of IFRS9 is applied below the reporting entity level some groups may need to apply more than one account standard to their financial assets.
- In respect of the sunset clause:
  - Insurance companies were of the view that the sunset clause could be revisited should more time be required to take stock of the requirements in IFRS 4 Phase II.

- Accounting firms expressed concern that insurance contract liabilities accounting is already substandard and that, if the deferral was applied for longer than three years, this would be perpetuated.
- Investors agreed that prompt finalisation and endorsement of IFRS 4 Phase II should be the most important goal in relation to insurance companies.

7.4 The Council discussed the proposed draft response, having regard to the points raised at the roundtable. The following observations and suggestions were made:

- It was noted that an inherent difficulty in reaching a solution that would be acceptable to all stakeholders is that the structure of insurance companies varies significantly.
- The Council highlighted the importance of identifying a pragmatic and simple solution that would capture all of those who need deferral of IFRS 9.
- It was suggested that the regulated entity approach may be 'too blunt' to achieve the objective. On reflection, the Council preferred to further develop the predominance criteria and its application.
- Members highlighted that consideration should be given to identifying a set of characteristics, linked to the business model, for companies to consider in order to make a judgement as to their eligibility to apply the deferral and to require companies to make a statement in respect of that judgement.
- Whilst it was noted that a permissive, short-term approach would be to link the criteria to the assets of an entity it was suggested this approach would be difficult to develop.
- The importance of ensuring that any deferral is time limited, for a period of three years, was highlighted.
- Members suggested that investor view on acceptable time horizons for the sunset clause should be further clearly indicated in the response.
- It was suggested that the FRC response would have more impact if it set out only one solution and if that solution built upon the solution put forward by the IASB.

7.5 In conclusion the Council advised that the response should be redrafted to:

- Agree with the principle that the predominance criteria focus on insurance and investment contract liabilities in making the assessment regarding eligibility for deferral from applying IFRS 9.
- Propose that a rebuttable presumption based on consideration of other characteristics relating the business model be included for those companies on the margin.
- Propose that a 'waterfall' approach be applied to allow the deferral to be applied below the reporting level.
- Ensure that a water-tight sunset clause is included to ensure the deferral is time limited.

7.6 SJON undertook to revise the draft to reflect the advice of the Council and to circulate the revised draft by email for comment. It was agreed that a conference call be scheduled to discuss the response prior to submission.

8. Any other business

8.1 The Council considered the following two items of AOB.

IASB, FSB and EDTF statements about encumbered assets

8.2 The Council discussed a concern that the EDTF statement in respect of the presentation of encumbered assets is being portrayed as a core financial requirement that is inconsistent with IFRS 7 and could result in the publication of misleading information. The council noted that the FRC had flagged its concern with the PRA and that MM would be meeting with Paul Ebling to discuss the issue the following week. MM undertook to report to the Council in due course.

Call for views from the EFRAG Board and General Assembly on the EFRAG Board Performance and Effectiveness in the first year post-reform.

8.3 Through discussion it was suggested that EFRAG should be encouraged to undertake activities in order to raise its profile within Europe. It was suggested there is a lack of awareness and clarity in respect of the role EFRAG undertakes post the issue of a standard and that it is important that EFRAG promote this aspect of its work.

9. Date of next meeting

9.1 It was noted that the next formal meeting of the Council would be held on 25 February 2016.