

# Financial Reporting Brief.



The third quarter of 2013 has seen much comment by European supervisors on financial reporting; FRS 103 on Insurance Contracts has issued in draft; the Central Bank has published further consultation papers.

In Europe, the supervisory authorities have issued a number of reports indicating a certain lack of confidence in reporting due to misapplication of standards, highlighting a number of areas where there is scope for improvement and seeking stronger enforcement practices.

The International Accounting Standards Board (IASB) has responded to criticism of fair value accounting, and continues its work on revising the Conceptual Framework.

The UK Financial Reporting Council (FRC) has issued a draft standard on insurance contracts, FRS 103. It

has also issued an updated FRSSE, and the Financial Reporting Lab has issued additional guidance on the reporting of debt and cash flows.

The revised EU Accounting Directive has been published, with a two year deadline for transposition.

The Central Bank has issued further consultation papers on client assets and corporate governance.

This Brief comments on accounting and regulatory developments during the third quarter of 2013.

# International accounting and related developments

## Confidence in Financial Reporting

The Joint Committee of the European Supervisory Authorities (ESAs) has published a report indicating that there is a lack of confidence in the representation of the underlying economic financial position and financial performance of entities in financial reports fuelled by the belief that the existing IFRS accounting framework is frequently misapplied and that there are short comings and room for interpretation in the accounting framework.

Some of the main topics of concern are:

- Valuation of complex financial instruments, notably in illiquid markets
- Timely and sufficient recognition of impairment losses
- Valuation of goodwill and deferred tax assets in light of profitability prospects
- Overall transparency of financial information provided to the market.

## ESMA Enforcement Activities

The European Securities and Markets Authority (ESMA) has published a report providing an overview of the financial information supervision and enforcement activities carried out during 2012. With approximately 6,000 listed entities in Europe, over 1,000 interim and annual accounts were fully reviewed, with a further 1,200 partial reviews conducted during 2012.

Impairment of goodwill was a clear focus of attention in 2012, with concerns being expressed regarding the adequacy of impairment losses recognised given the difficult economic conditions.

Examples of other areas requiring additional effort to achieve improvement include:

- Application of the classification criteria for assets held for sale.
- Determination of discount rate for defined benefit obligations
- Classification and measurement of financial instruments
- Distinction between a change in an accounting policy and an accounting estimate
- Disclosures about risks and uncertainties, and judgements/estimates.

## ESMA Enforcement Guidelines

ESMA has launched a consultation on guidelines on the enforcement of financial information published by listed entities in the European Union. The proposed guidelines are the result of a review of existing standards published in 2003/04, to reflect experience gained by their use since 2005.

To protect investors, the scope of enforcement is extended to the whole financial reporting framework applicable in the EU, including IFRS, national GAAP and third country accounting standards which have been declared equivalent to IFRS. The objective of enforcement has been revised in order to reflect the importance of compliance with the relevant financial reporting standards and transparency of financial information.

## Long – Term Financing

The IASB has submitted a response to the European Commission's Green Paper 'Long Term Financing of the European Economy'. The IASB does not believe that fair value accounting principles have of themselves led to short termism in investment behaviour, and that

accounting should not be seen as or even tried to be used as an instrument to smooth out shorter term volatility. It concludes that it is important for all users to recognise the limitations of financial reporting.

## Conceptual Framework

The IASB has published a comprehensive Discussion Paper (DP) containing proposals for topical areas where it considers revision is necessary to the existing Conceptual Framework. These include (a) definitions of an asset and a liability, (b) to introduce guidance on de-recognition, (c) to clarify the objective and purpose of other comprehensive income, and (d) a framework for presentation and disclosure.

The European Financial Reporting Advisory Group (EFRAG), together with National standard-setters, continue to publish bulletins commenting on key aspects of the Framework.

## Discount Rate – Pension Schemes

After considerable discussion, the Interpretations Committee of the IASB has decided not to add to their agenda for deliberation the definition of high quality corporate bonds for the purposes of establishing the discount rate for pension obligations under IAS 19. The IC draws attention to the guidance in IAS 19 which states that the discount rate should:

- reflect the time value of money but not the actuarial or investment risk
- not reflect the entity-specific credit risk
- not reflect the risk that future experience may differ from actuarial assumptions, and
- reflect the currency and estimated timing of benefit payments

The IC also observed that the entity's policy for determining the discount rate should be applied consistently over time. IAS 19 requires an entity to disclose the significant actuarial assumptions used, and to discuss the judgements made in applying significant accounting policies.

## Non-Financial Materiality

*Accountability*, the global not for profit organisation promoting accountability, sustainable business practices and corporate responsibility, has released a new report 'Redefining Materiality II – Why it matters, Who is involved and What it means for Corporate Leaders and Boards. The report asserts that materiality is no longer restricted to purely financial indicators or single issues; rather it is necessary to apply it to all capitals - manufactured, financial, social and natural capital – if reports are to continue to be meaningful communications to investors.

## Convergence Still "Amber"

The Financial Stability Board (FSB) has released several reports about progress in connection with the fundamental reforms of the global financial system initiated by the G20 in 2008. Among the developments that are not yet completed, the FSB chairman cites convergence of global accounting standards. The FSB highlights loan loss impairment and insurance contracts as areas where convergence is threatening to come to a standstill. The IASB and the FASB have been called on to complete their convergence projects by the end of 2013.

# Financial Reporting Council and Related Bodies - Developments

## Insurance Contracts

The FRC has issued a draft new UK/Irish accounting standard (FRS 103) Insurance Contracts. The proposals rationalise existing UK/Irish accounting provisions for insurance rather than establishing new requirements. The FRC will only consider international developments and their potential adoption in UK GAAP when there is much more certainty about the outcome of the IASB's work.

Draft FRS 103 follows on from the 2012 Discussion paper 'Insurance Accounting – Mind the UK GAAP'. The draft Implementation Guidance is drawn from the existing FRS 27 Life Assurance and the Statement of Recommended Practice (SORP) published by the Association of British Insurers. The FRC expects little change in accounting by entities within their scope. Mandatory implementation is intended for 1 January 2015.

## Residential Management Companies

The FRC has issued FRED 50 containing draft residential management companies' financial statements which sets out the treatment of residential management transactions in the financial statements of residential management companies (RMCs). FRED 50 applies to residential management companies preparing financial statements under FRS 102.

## Smaller Entities

The FRC has issued an updated version of the Financial Reporting Standard for Smaller Entities (FRSSE) following the issuance of FRS 100 'Application of Financial Reporting Requirements' which contained a number of amendments to the FRSSE. The updated FRSSE contains no new amendments to those previously issued. The updated FRSSE will be effective for 2015.

In light of recent revision of the EU Accounting Directive, the FRC will be revisiting the FRSSE in due course.

The UK Department for Business, Innovation and Skills (BIS) has published their proposals for the implementation of the EU Directive on micro-entities in the UK, which will result in a substantially reduced level of disclosure for UK businesses meeting certain criteria.

## Debt and Cash Flows

The FRC's Financial Reporting Lab has published additional guidance for directors on what can be done to answer investors' basic questions about debt and cash flows, following three reports previously issued by it on the topic. The reporting practices proposed are intended to help companies that have significant levels of debt, or that plan to approach the market for funding in the future, to communicate certain key information effectively. This would include information on net debt reconciliations, debt terms and maturity tables, and operating cash flows.

## SORPs

The FRC has published a document that sets out its Policy and Code of Practice on SORPs with effect from 1 August 2013, replacing an earlier version published in July 2000.

As a result of the issue of FRS 102, seven out of the eight existing SORP-making bodies are currently updating their relevant SORP, with some having already issued drafts for consultation. The insurance SORP is expected to be withdrawn once the new accounting standard, FRS 103 Insurance Contracts, is issued by the FRC.

## Strategic Report

For UK companies, the FRC has issued for consultation 'Guidance on the Strategic Report' applying the requirements in the recently issued UK Companies Act 2006 (Strategic Report & Director's Report) Regulations 2013. The guidance builds on the changes made to the UK Corporate Governance Code in October 2012 requiring annual reports to be fair, balanced and understandable. The guidance is aimed at 'cutting clutter' and improving relevance of corporate reporting to investors.

The FRC encourages companies to experiment and be innovative in the drafting of their annual reports, presenting narrative information in a way that allows them to 'tell their story' to investors concisely, linking related information.

## Directors Remuneration

On 1 October 2013, the Directors' Remuneration Reporting Regulations and Narrative Reporting Regulations will be implemented for companies incorporated in the UK.

The FRC has published a paper setting out proposed changes to the Listing Rules in response to the new regulations.



# Legal and regulatory developments

## Contacts

### Accounting Directive

The EU has published the new Accounting Directive which aims to simplify the accounting requirements for small companies and to improve the clarity and comparability of companies' financial statements within the Union. EU Member States have to incorporate the rules of the Directive into their national law by 20 July 2015. The Directive will require transposition into Irish law at a time when the Companies Bill 2012 is going through the comment and approval process.

### Central Bank

The Central Bank has published two Consultation Papers.

- Client Asset Regulations and Guidance – seeking to streamline the client asset regime and make it easier to understand, and
- Corporate Governance Code for Credit Institutions and Insurance Undertakings – proposed revisions to the Corporate Governance Code for these organisations, which became effective on 1 January 2011. The Consultation Paper sets out a series of proposed amendments in such areas as the composition of the risk committee and the board sub-committees more generally, together with the requirements of the Chairman and Chief Executive.

Our firm's website, [www.iasplus.com](http://www.iasplus.com), provides a world-leading continuously updated information source on international financial reporting developments and includes a link to our freely accessible IFRS eLearning programme, and now includes a focused subsite, UK Accounting Plus ●

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