

## FRED 67 Draft amendments to FRS 102

A public consultation issued by the Financial Reporting Council

Comments from ACCA to the Financial Reporting Council

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## SUMMARY

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ACCA welcomes the opportunity to provide views in response to the FRC's FRED 67 draft amendments to FRS 102. This has been done with the assistance of members of ACCA's Global Forum for Corporate Reporting, ACCA's Financial Services and Practitioners Panels, ACCA Members' Advisory service and other ACCA members in UK and Ireland. If further information is needed, please get back to us.

We are pleased to see that FRED 67 responds effectively to a number of implementation issues, notably clarifying section 11 on basic financial instruments. However, we do not agree with the removal of the 'undue cost or effort' exemption: provided that undue cost or effort is clearly defined, we believe the exemption serves a genuine purpose in ensuring that the reporting burden on entities is proportionate to the informational benefit to users of the financial statements.

We would also urge the FRC to address the issues we raised in our post-implementation review submission about distributable and non-distributable profits. The accounting of financial instruments and the measurement of investment properties at fair value under FRS 102 have raised questions about distributable and non-distributable reserves, with differences in practice emerging. Some companies record separate reserves on balance sheet and others tracking it through file notes. We would recommend that the FRC alerts the preparers to the importance of tracking the amount of non-distributable reserves from year on year.

## AREAS FOR SPECIFIC COMMENT:

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**Q1. Overall do you agree with the approach of FRED 67 being to focus, at this stage, on incremental improvements and clarifications to FRS 102? If not, why not?**

ACCA supports FRED 67's focus on incremental improvements.

Feedback that we have received from our members and engagement with other stakeholders indicate that both practitioners and software developers are still coming to grips with FRS 102, both in terms of accounting and wider systems and processes. On this basis, incremental improvements and clarifications would seem to be the right approach. In particular, we welcome the steps which the FRC have taken to address commonly-expressed concerns, including the clarified definition of financial instruments and directors' loans.

One possible disadvantage of incremental improvements is the risk of greater disparity between new UK GAAP and international standards. While the adoption of FRS 102 has not been problematic for larger entities, the gap between FRS 102 and EU-endorsed IFRS under the FRS 101 reduced disclosure framework remains a source of uncertainty for medium entities. It would be helpful for the FRC to provide expected timescales for the incorporation of new IFRSs in FRS 102. At the same time, the incremental improvements could result in greater disparity between FRS 102 and IFRS

for SMEs, and we would encourage the FRC to consider the impact of incremental changes on the alignment between the two standards.

**Q2. Do you agree that this is a proportionate and practical solution to the implementation issues surrounding the classification of financial instruments, which will allow more financial instruments to be measured at amortised cost, whilst maintaining the overall approach that the more relevant information about complex financial instruments is fair value? If not, why not?**

We welcome the amendments to section 11 on basic financial instruments. It will help in alleviating the accounting burden for entities, and we support the more principle-based approach to the identification of basic financial instruments.

As a minor point, the inserted footnote to paragraph 11.2(b), intended to clarify the version of IAS 39 that should be applied, may cause some confusion. In particular, the inclusion of an external web-link and reference to the IASB's SME web pages is not user-friendly and may be subject to change. The FRC may wish to explore other ways of referencing IAS 39, without relying on an external website.

**Q3. FRED 67 proposes that a basic financial liability of a small entity that is a loan from a director who is a natural person and a shareholder in the small entity (or a close member of the family of that person) can be accounted for at transaction price, rather than present value (see paragraph 11.13A). This practical solution will provide relief to small entities that receive non-interest-bearing loans from directors, by no longer requiring an estimate to be made of a market rate of interest in order to discount the loan to present value. Do you agree with this proposal? If not, why not?**

We welcome the exemption from discounting for non-interest bearing directors' loans. This is a practical solution, ensuring that the costs of reporting for small entities are proportionate to the benefits.

However, we are concerned that restricting the exemption to loans from small entity directors and their close family members would give rise to a disparity in accounting treatment for legal structures that serve the similar commercial purposes. We would recommend the FRC to consider broadening the scope of paragraph 11.13A to reflect:

- Directors' loans in a small group context (for example, where a loan is provided by a director of an entity to another entity within the same small group), and
- Loans from shareholders in a small entity who are not directors.

Further, we would recommend the FRC to define more precisely a close family member in the glossary to FRS 102. The glossary currently identifies the persons included within the definition, but a specific list, as is provided in the Charities SORP, would be beneficial.

**Q4. FRED 67 proposes to amend the definition of a financial institution (see the draft amendments to Appendix I: Glossary), which impacts on the disclosures about financial instruments made by such entities. As a result, fewer entities will**

**be classified as financial institutions. However, all entities, including those no longer classified as financial institutions, are encouraged to consider whether additional disclosure is required when the risks arising from financial instruments are particularly significant to the business (see paragraph 11.42). Do you agree with this proposal? If not, why not?**

ACCA agrees with the amended definition of a financial institution. We also welcome the additional disclosures under paragraphs 34.19 to 34.33 where the risks arising from financial instruments are particularly significant.

**Q5. FRED 67 proposes to remove the three instances of the ‘undue cost or effort exemption’ (see paragraphs 14.10, 15.15 and 16.4) that are currently within FRS 102, but, when relevant, to replace this with an accounting policy choice. The FRC does not intend to introduce any new undue cost or effort exemptions in the future, but will consider introducing either simpler accounting requirements or accounting policy choices if considered necessary to address cost and benefit considerations.**

**As a result, FRED 67 proposes:**

- a) an accounting policy choice for investment property rented to another group entity, so that they may be measured at cost (less depreciation and impairment) whilst all other investment property are measured at fair value (see paragraphs 16.4A and 16.4B); and**
- b) revised requirements for separating intangible assets from the goodwill acquired in a business combination, which will require fewer intangible assets to be recognised separately. However, entities will have the option to separate more intangible assets if it is relevant to reporting the performance of their business (see paragraph 18.8 and disclosure requirements in paragraph 19.25B).**

**Do you agree with these proposals? If not, why not?**

*Undue cost or effort exemption*

ACCA does not agree with the removal of the ‘undue cost or effort exemption.’ The exemption was brought into IFRS for SMEs to address a real issue faced by smaller entities, balancing the usefulness of financial information in decision-making with the cost or effort required to provide the information. We believe that the issue is pertinent today and is likely to remain as financial reporting standards develop in the future.

In addition, the removal of the exemption is an instance of growing divergence between FRS 102 and IFRS for SMEs. We would encourage the FRC to avoid such divergence unless there is specific need to do so.

*Investment property rented to another group entity*

ACCA does not agree with the introduction of paragraph 16.4B.

Our engagement with members have highlighted that the accounting issues arise most often with regards mixed-use properties. As properties are renovated, the component of

the property occupied by a group entity is liable to change. In such situations, paragraph 16.4B would require entities to separate out the specific component rented to the group entity in order to apply the accounting choice allowed. The cost or effort required to separate out the property, plant and equipment component from investment property could be disproportionate to the benefit it provides to users of the financial statements.

As we argued above, the undue cost or effort exemption serves a purpose, and it is relevant for the accounting treatment of mixed-use properties. We would urge the FRC to reconsider the replacement of the exemption with a specific accounting choice in this case.

#### *Intangible assets other than goodwill in a business combination*

While we recognise that the flexibility in separate recognition, as introduced in paragraphs 18.8 and 19.25B, is intended to improve the decision-relevance of the financial statements, we are concerned that this may introduce too much disparity in practice. It would be helpful for the FRC to publish a staff education note providing more illustrative guidance about the characteristics of intangible assets which should be recognised separately from goodwill.

As goodwill and intangible assets are both amortised under FRS 102, one characteristic of intangible assets which would benefit from separate recognition may be useful lives which are significantly different from the period over which goodwill is amortised.

We would also encourage the FRC to make reference to software costs as intangible assets in FRS 102. We understand that many preparers are applying IAS 38 (paragraph 4) in determining whether software should be capitalised as an intangible asset or as property, plant and equipment. However, given the potentially significant tax impact that this can have, more direct clarification would be beneficial.

**Q6. Please provide details of any other comments on the proposed amendments, including the editorial amendments to FRS 102 and consequential amendments to the other FRSs.**

#### *Revenue*

We welcome the changes proposed to section 23 on revenue, as they represent a positive step towards alignment with IFRS 15. However, to ensure more consistency in the application of the approach set out in inserted paragraph 23.3A, we would encourage the FRC to go further in adopting the five steps with regards to recognition under IFRS 15.

Further, we would recommend that 'significant acts', as referred to in paragraph 23.15, is defined, in order to address differences in the timing of revenue recognition among preparers.

#### *Share-based payments*

Section 26 requires equity-settled share-based payment transactions with employees to be measured at the fair value of the equity instruments at the grant date, while the measurement date for transactions with parties other than employees is the date when the entity obtains the goods or the counterparty renders service (paragraph 26.8). The definition of employees may need to be broadened to reflect common small company structures: for example, the accounting treatment of share-based payment transactions with directors in an owner-managed business needs to be clarified.

#### *Statement of cash flows*

We welcome the insertion of paragraph 7.22, requiring an analysis of changes in net debt to be disclosed.

#### *Consequential amendments to FRS 105*

The amendments to FRS 105 reflect the additional micro-entity disclosure requirements brought in by Statutory Instrument 2015/980. Paragraph 1.5 states that the amendments are applicable from accounting periods beginning on or after 1 January 2019. However, Statutory Instrument 2015/980 states that the disclosure requirements apply for financial years beginning on or after 1 January 2016. We would request the FRC to amend paragraph 1.5 accordingly.

A clear definition of what constitutes an employee would be beneficial for micro-entity disclosure purposes (under inserted paragraph 6.2). Given the growing range of employment status today, more clarity would also benefit financial reporting as a whole.

**Q7. FRED 67 includes transitional provisions (see paragraph 1.19). Do you agree with these proposed transitional provisions? If not, why not?**

**Have you identified any additional transitional provisions that you consider would be necessary or beneficial? Please provide details and the reasons why.**

On the basis that FRED 67 contains incremental improvements, it would be beneficial for entities to apply the amendments as soon as practicable. We would encourage the FRC to consider the feasibility of bringing forward the date of application to 1 January 2018. Doing so may also mean that the next triennial review would need to be brought forward by one year: this would be beneficial in any case, given the timing of the UK's exit from the European Union.

The practicability of bringing forward the application date is crucially dependent on ability of software providers to make necessary software changes. It would be helpful for the FRC to engage as early as possible with software providers regarding FRED 67 changes.

We agree with the specific transitional provisions for investment property rented to another group entity and intangible assets.

Further guidance would be helpful regarding transitional arrangements where a small entity that has accounted for directors' loans at transaction price, no longer qualifies as

small. A simple approach may be to allow the same accounting treatment to continue for loans which have been recognised in previous periods.

**Q8. The overall impact of the proposals is expected to be a reduction in the costs of compliance. In relation to the Consultation stage impact assessment, do you have any comments on the costs or benefits identified? Please provide evidence to support your views of the quantifiable costs or benefits of these proposals.**

ACCA is fully supportive of incremental improvements to FRS 102: in our view, the benefits of FRED 67 clearly outweigh any short-term savings that may be gained from doing nothing.

While we recognise that it is difficult to monetise the benefits, we believe more effort could be put into estimating the benefits of FRED 67 beyond those outlined on page 130 of the document. If it is not currently possible to monetise the benefits at this stage, a commitment should at least be made to do so at an appropriate date in the future. Clearer articulation of the benefits would help to drive continued support for high quality financial reporting. Further, this would also inform future changes to FRS 102.

Beyond the changes which have been subject to this consultation, some FRED 67 amendments are more than editorial in nature: for example, the changes to the statement of cash flows, revenue, and inventory disclosures. More stakeholder outreach may help to identify whether these may give rise to any unintended consequences. As mentioned above, the software implications of these changes need to be considered carefully in conjunction with software providers and preparers.