



Response to FRC FRED 67 – Draft amendments to FRS 102

15 June 2017

INTRODUCTION

ICAS welcomes the opportunity to comment on the FRC's Exposure Draft 67 – Draft amendments to FRS 102.

Our CA qualification is internationally recognised and respected. We are a professional body for over 20,000 members who work in the UK and in more than 100 countries around the world. Our members represent different sizes of accountancy practice, financial services, industry, the investment community and the public sector. Almost two thirds of our working membership work in business, many leading some of the UK's and the world's great companies.

Our Charter requires its committees to act primarily in the public interest, and our responses to consultations are therefore intended to place the public interest first. Our Charter also requires us to represent our members' views and to protect their interests, but in the rare cases where these are at odds with the public interest, it is the public interest which must be paramount.

The ICAS Corporate and Financial Reporting Panel has considered the consultation paper and I am pleased to forward their comments together with comments received from members of ICAS's Charities and Pensions Panels.

Any enquiries should be addressed to Carol Hislop, Head of Corporate and Financial Reporting and Secretary to the Corporate and Financial Reporting Panel.

GENERAL COMMENTS

We welcome FRED 67 which we see as pragmatic and responsive to views of practitioners.

We would however highlight that the following key areas must be considered:

(i) Application of Section 1A to entities which are not profit distributing companies

Paragraph 1A.4 of Section 1A of FRS 102 states that:

"This section applies to all small entities applying the small entities regime, whether or not they report under the Act. Small entities that do not report under the Act shall comply with the requirements of this section, and with the Small Companies Regulations (or, where applicable, the Small LLP Regulations) where referred to in this section, except to the extent that these requirements are not permitted by any statutory framework under which such entities report."

While we do not expect FRS 102 to provide an extensive list of all 'small entities' which are entitled to apply Section 1A, it would be helpful if the FRC required all SORP-making bodies, as a condition of approval, to make a statement within industry specific SORPs about the applicability or otherwise of Section 1A.

In addition, we believe that the FRC should publicly clarify whether charitable companies can apply Section 1A, we set out our concerns about the lack of clarity on this point below.

(ii) Charities

Accounting framework issues

Neither FRS 100 nor FRS 102, clearly addresses the complex relationship between company law, charity law and Section 1A of FRS 102.

Where a charity which is both a company and a 'small entity' is preparing its accounts under company law, strictly speaking, the FRC, and presumably other bodies within the UK, have no power to impose any additional requirements on it beyond Section 1A of FRS 102 because of the way the UK implemented Article 5 of the EU Accounting Directive.

However, for a charity's accounts to give a true and fair view, compliance with the Charities SORP (FRS 102) is either: a legal requirement for some companies under charity law, for example Scottish charitable companies; or considered necessary for others, for example standalone charitable companies solely registered with the Charity Commission for England and Wales.

The Department for Business, Innovation and Skills (BIS), now the Department for Business, Energy and Industrial Strategy (BEIS), and the FRC should have considered more fully the ability under, the EU Accounting Directive, to exclude non-profit distributing entities from the 'small entities regime' due to existing complexities with UK arrangements.

Having not addressed this issue, the FRC has remained silent and should now publicly clarify whether or not charitable companies can apply Section 1A of FRS 102. This would then enable clarification to be included within the Charities SORP (FRS 102).

ICAS takes the view that any charity preparing its accounts in accordance with FRS 102 cannot apply Section 1A if its accounts are to give a 'true and fair' view. However, we also take the view that compliance with full FRS 102 is over burdensome for most charities preparing 'true and fair' accounts. This creates further challenges for charities and the Charities SORP-making body (the Charity Commission for England and Wales and the Office of the Scottish Charity Regulator). We expect that the Charity SORP-making body may look to reduce the reporting burden on charities arising from FRS 102 and would welcome cooperation from the FRC in this regard.

(iii) Pensions

Section 1A

We would welcome clarification in the next update of the Pensions SORP that pension scheme accounts should not be prepared in accordance with Section 1A of FRS 102.

Fair value hierarchy

We acknowledge and support the amendments made to the fair value hierarchy disclosure requirements, published in March 2016. However, in our response to FRED 62, dated 29 January 2016, we stated that:

"It is disappointing that the FRC introduced differences between the fair value hierarchy in FRS 102 and that of IFRS. The proposed amendments will only go some way to align the fair value hierarchy with IFRS as no changes are being proposed to the fair value determination or to the fair value disclosures for entities which are not financial institutions or retirement benefit plans (pension schemes)."

Our position remains unchanged and as a matter of principle we believe that it would make sense to align the fair value hierarchy in FRS 102 with that of IFRS as we can see no valid reason for the initial departure.

Financial institution

The formal removal of retirement benefit plans from the definition of a 'financial institution', while not being a major change in substance, is nevertheless a welcome clarification.

Investment risk disclosures

We believe that the credit risk disclosures do provide some value to the users of pension scheme accounts. However, we believe their value is diminished by the extent and the questionable relevance to stewardship accounts of the other investment risk disclosures i.e. those dealing with economic risk.

We recommend that as part of its next triennial review, the FRC reviews its position on the application of the investment risk disclosure requirements which deal with economic risk to pension scheme accounts with a view to both reducing the volume of the disclosures and making the investment risk disclosures more meaningful.

We welcome the pragmatic approach taken by the FRC to the proposed changes to FRS 102 set out in FRED 67 and believe that such an approach should be extended, in future, to reviewing risk disclosures requirements placed on pension schemes.

The Fund Account

Paragraph 34.37 of FRS 102 specifies the presentation of the Fund Account, including the requirement to present 'transfers to and from other plans'. This is inconsistent with the presentation of transfers recommended in the current and previous versions of the Pensions SORP. The Pensions SORP (FRS 102) (paragraph 3.7.2) separates the presentation of 'transfers in' and 'payments to and on account of leavers'. We would prefer to see the presentation of transfers in the Fund Account treated consistently within FRS 102 and the Pensions SORP (FRS 102). While we have no strong preference for either option, we would be happy to support the view of the Pensions SORP Working Party which is to amend FRS 102.

RESPONSES TO THE CONSULTATION QUESTIONS

Q1. 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?

Response:

We agree with the approach being proposed by the FRC. Small entities are, in general, just completing the first full year of reporting under FRS 102. The view of ICAS's Corporate and Financial Reporting Panel members is that there may be insufficient time for some entities to amend their systems to account for major changes to recognition and measurement criteria and applying an incremental approach is therefore a practical way to proceed.

Q2. FRED 67 proposes to amend the criteria for classifying a financial instrument as 'basic' or 'other'. This will mean that if a financial instrument does not meet the specific criteria in paragraph 11.9, it might still be classified as basic if it is consistent with the description in paragraph 11.9A

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?

Response:

We agree with this approach which will bring more debt instruments into the basic classification category. Members have indicated that it would be useful to have additional examples of "reasonable compensation for the time value of money, credit risks and other basic lending risks." Reasonableness will vary between entities, reducing comparability. It would be useful if the standard specified that when the principle-based paragraph is adopted, this is explained within the financial statements as a significant area of judgement when the debt instrument is material to the financial statements.

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?

Response:

We agree with the proposal but believe it should be extended to include all related party loans from shareholders, small entities which are not part of a group and individuals with an association to the company. The view has been expressed by members that the definition of a "close family member" is narrow and would result in transactions between extended family members having to be disclosed at fair value. For these small entities, members have suggested that the FRC considers removing the requirement for these entities to estimate a market rate of interest.

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?

Response:

We believe that the wording of paragraph 11.42 could be strengthened by including a reminder that the financial statements are required to present a true and fair view.

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 is 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).

Response:

We agree with the removal of the three instances of “undue cost or effort exemption” and with the proposal of replacing these, where relevant with an accounting policy choice. In relation to (b), ICAS members have suggested that there is a need to explain the nature of assets which remain included within goodwill to ensure that users of financial statements receive all required information.

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

Response:

We recognise that the FRC has taken the opportunity to perform editorial amendments to FRS 102 and consequential amendments to other FRSs. This will be helpful to ICAS members and will lead to more consistent approaches.

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

Response:

We agree with the transitional provisions.

Q8. Following a change in legislation the FRC is now required to complete a Business Impact Target assessment. A provisional assessment for these proposals is set out in the Consultation stage impact assessment within this FRED.

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.

Response:

We have no comments to add to this.