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30 June 2017

Dear Mei

Subject: Consultation Document: *FRED 67 - Draft amendments to FRS 102: 'The Financial Reporting Standard applicable in the UK and Republic of Ireland' - Triennial review 2017 - Incremental improvements and clarifications (March 2017)*

The Accounting Committee of Chartered Accountants Ireland (AC) welcomes the opportunity to respond to this Consultation Document. AC's specific responses to the questions asked and its additional comments on various matters are set out in the attached Appendix.

If you would like to discuss this response further please contact me at barbara.mccormack@charteredaccountants.ie or at + 353 1 637 7236.

Yours sincerely

Barbara McCormack

Barbara McCormack

Secretary to the Accounting Committee of Chartered Accountants Ireland

Appendix

Question 1
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?

Overall, AC agrees with the approach of FRED 67. AC agrees that, at this point, it would be premature to amend FRS 102 for the changes in IFRS stemming from IFRS 10, IFRS 15 and IFRS 16 when those standards have not been widely applied in practice.

In relation to IFRS 10 and IFRS 15, as they are both based on the concept of a 'control model' AC suggests that the FRC should give due consideration to incorporating these two standards into FRS 102, if applicable, at the same time.

AC has identified some aspects of existing IFRS, including IFRS 9 and IFRS 13 that could be considered for incorporation into FRS 102 as part of the current process, in order to improve FRS 102, and which would comply with the FRC's principle of providing succinct financial reporting standards, while maintaining consistency with international accounting standards through the application of an IFRS-based solution where appropriate. These are the 'SPPI test' in IFRS 9 (see response to Question 2), IFRS guidance on new companies and group reorganisations, and the IFRS 13 definition of fair value (see below).

IFRS 13 definition of Fair Value
AC considers that FRS 102 could be improved by replacing the current definition of fair value with the definition from IFRS 13. AC is not convinced by the reasons identified for not amending the definition in paragraphs 58-61 of the Corporate Reporting Council's ('CRC') advice to the FRC.

The IFRS 13 definition of fair value has been applied extensively in practice and is widely understood and AC is aware of FRS 102 reporters that would welcome the introduction of the IFRS 13 definition of fair value into FRS 102. In AC's experience of applying the IFRS 13 definition of fair value it is the investment fund sector that were impacted most by the adoption of IFRS 13. AC suggests that this sector would benefit from use of the IFRS 13 definition of fair value in FRS 102 as it would eliminate a potential area of difference between IFRS and FRS 102 for users and preparers of the financial statements of investment funds.

AC also considers that aligning the definition of fair value with IFRS 13 would be consistent with allowing companies to apply the recognition and measurement principles of IAS 39 or IFRS 9 when accounting for financial instruments. However, as a minimum AC would welcome explicit clarification by the FRC that an entity which chooses to apply an accounting policy for financial instruments based on IAS 39 or IFRS 9 also applies the IFRS 13 definition of fair value.

New Companies and Group reorganisations
AC considers it would be helpful to include more guidance in FRS 102 on the accounting in situations where a newly incorporated company is added to the top of an existing group of companies as part of an equity-based group reorganisation. It would be helpful to indicate in FRS 102 that such

transactions do not always meet the definition of a business combination, and when they do, the new company is unlikely to be the accounting acquirer. In other words, the accounting should not reflect any goodwill or uplift in carrying values. This guidance is in IFRS 3 (Appendix B18) and was in FRS 6 (FRS 6.14).

Question 2

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?

AC welcomes the proposals in FRED 67 which are aimed at reducing the number of financial instruments that are classified as other than basic debt instruments and therefore required to be fair valued where amortised cost would appear a more appropriate approach. However, AC would support an alternative approach to that set out in FRED 67 in relation to determining whether a debt instrument qualifies as basic which either, ideally, incorporates the IFRS 9 'solely payments of principal and interest (SPPI) test' directly into FRS 102, but if this is not possible, incorporates the 'SPPI test' by cross reference to IFRS 9. AC considers the 'SPPI test' is more broadly defined and accommodates common commercial features found in debt contracts.

AC is unclear how the guidance in paragraph 11.9A will apply in practice and would welcome detailed illustrative examples outlining its application. AC would particularly welcome examples of those financial instruments that would be considered to be basic debt instruments under FRED 67 when compared to the current rules in paragraph 11.9.

AC also wondered whether an alternative structure of paragraph 11.9 and 11.9A which would see the principle based approach in paragraph 11.9A first, followed by the detailed criteria in 11.9, would be easier to apply in practice.

AC notes that Example 8 illustrates one scenario of paragraph 11.9A being applied in practice and suggests that it would be useful for the Example to clarify the prepayment terms of the loan from Bank A to Entity S.

Question 3
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?

AC agrees with this proposal.

However, AC recommends that the wording in paragraph 11.13A is reviewed to ensure that it is clear whether the word "person" in the phrase "close member of the family of that person", refers to the lender, director or shareholder.

Question 4
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?

AC has reservations about the proposed amendments to the definition of a financial institution.

AC would welcome more detail in the advice from the CRC about the practical difficulties that have arisen in applying the existing FRS 102 definition.

AC suggests that the proposed amended definition would create more debate and judgement in identifying entities that meet the definition of a financial institution and are not convinced that the revised definition would reduce interpretation difficulties.

For example, the 'Accounting Council's Advice to the FRC' in the current version of FRS 102 identifies that a subsidiary engaged solely in treasury activities for the group as a whole is likely to meet the definition of a financial institution. Would such an entity meet the FRED 67 definition? One interpretation might be that such an entity is similar to a bank. A second interpretation might be that the principal activity of such an entity is not similar to that of a bank, as it is not regulated as a bank and not subject to capital maintenance rules and does not engage with the public. We would welcome clarification in this regard. Other examples of entities that AC suggests should be captured by the definition include SPVs and finance lessors and it is not readily apparent to us how such entities are clearly captured by the proposed definition.

Question 5
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?

(a) AC agrees with the proposals to remove the three instances of the 'undue cost or effort exemption' and to introduce an accounting policy choice for investment property rented to another group entity so that they may be measured at cost (less depreciation and impairment).

(b) AC agrees with the proposals to recognise fewer intangible assets acquired in a business combination separately from goodwill, but would welcome some additional information in the CRC's advice to explain the rationale for, and objective of, this amendment, for example is this aimed at aligning with FRS 10.

AC also suggests that more guidance is needed in relation to this proposal. For example, it would be helpful to include illustrative examples of the types of intangible asset that would now be required to be recognised in a business combination. Furthermore, additional guidance on determining the useful life of goodwill which includes intangible assets (with varying useful lives) which might previously have been separated from goodwill and have now been subsumed into goodwill would be helpful. (AC suggests the guidance should not require the entity to calculate the individual components of goodwill in this regard and that the sections in FRS 10 on 'determining useful economic lives' might be relevant.)

In addition, AC would welcome clarification in relation to the determination of a 'class' of intangible assets for the purpose of applying the alternative policy of recognising certain intangible assets.

For the avoidance of doubt AC suggests the language in paragraph 18.8 should clarify that all of the conditions at (a), (b) and (c) have to be satisfied for an intangible asset to be required to be separately recognised. To that end AC suggests "all of the following" is included in paragraph 18.8 before (a).

Question 6
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.

AC has set out comments on Question 6 in the following categories;

- Comments on other parts of FRED 67
- Comments on other parts of existing FRS 102

Comments on other parts of FRED 67:

6.1 Amendment to paragraph 1.18
The amendment proposes that a small entity is encouraged to disclose the fact that a small entity early adopts the 2017 triennial review amendments. AC suggests clarifying whether this reference to 'small entity' only applies to a small entity applying Section 1A of FRS 102.

6.2 Deletion of paragraph 5.11
AC is unclear why paragraph 5.11 of FRS 102 has been deleted and suggests that this be covered by the CRC's advice.

6.3 Example showing presentation of discontinued operations
AC is not clear why this example has been amended. AC suggests that the basis for this change be explained in the CRC's advice on the amendments. AC would also welcome guidance from the FRC on a situation where there is a sale of an operation which doesn't meet the definition of a discontinued operation and whether any such gain or loss is presented in operating profit.

6.4 Amendment of paragraph 11.8(d)
It is proposed in FRED 67 that paragraph 11.8(d) be amended to state that "an investment in a non-derivative instrument that is equity of the issuer" is a basic financial instrument. AC suggests that this paragraph should be clarified in order to explain what equity of the issuer means for this purpose and suggests that 'equity' in paragraph 11.8(d) is linked to the definition of equity in the glossary.

Paragraph 43 to 44 of the CRC's advice, notes that the amendment is aimed at addressing an anomaly in the current accounting for an investment in preference shares. However, AC is not clear that all anomalies associated with such an investment have been addressed, as it is not clear how these shares would qualify as basic debt instruments, i.e. would meet the condition in paragraph 11.9(b) of FRS 102.

6.5 Amendment of paragraph 11.9(c)
The proposed wording of paragraph 11.9(c) includes the following "The inclusion of contractual terms that, as a result of the early termination, require the issuer to compensate the holder for the early termination do not, in themselves, constitute a breach of the conditions of paragraph 11.9". For the avoidance of doubt AC suggests that this paragraph refers to "**reasonably** compensate the holder for the early termination". This would achieve consistency with IFRS 9, para B4.1.12 and paragraph 47 of the CRC's advice on FRED 67.

<u>6.6 Examples of debt instruments</u>

Example 4A

In the example of "A loan with a condition that the interest rate is reset to a higher rate if a set number of payments are missed", AC suggests that the example should clarify that the higher rate satisfies the condition in (a) of paragraph 11.9.

Example of written option that fails fixed-for-fixed criteria

AC suggests that the FRC consider the consistency of the accounting in this Example with the accounting in paragraphs 9.19C to 9.19D of FRS 102 'Acquisition – Increasing a controlling interest in a subsidiary', which requires the transaction to be accounted for as a transaction between equity holders, with the requirement that any difference between the amount of NCI and fair value of the consideration paid should be recognised directly in equity. AC notes that paragraph 22.2 of FRS 102 scopes out "contracts for contingent consideration in a business combination" but not options to acquire a non-controlling interest.

Separately, AC notes that part (b)(ii) of paragraph 22.3's definition of a financial liability excludes a contract that will or may be settled by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. Therefore, for example, a written option that allows the holder of equity shares in an entity to demand their repurchase by the entity for a fixed amount of cash qualifies as an equity instrument for the issuer. AC notes that the same conclusion arises under IFRS (IAS 32.22). However, IFRS differs from FRS 102 because IAS 32.23 also requires the recording of a financial liability for the redemption amount. It says '..a contract that contains an obligation for an entity to purchase its own equity instruments for cash or another financial asset gives rise to a financial liability for the present value of the redemption amount (for example, for the present value of the forward repurchase price, option exercise price or other redemption amount).' Under IFRS the corresponding debit entry is recorded in equity. IAS 32.23 also notes that this is the required accounting even if the obligation to repurchase is conditional on the counterparty exercising a right to redeem, with IAS 32's Illustrative Example 6 (paragraph IE30) setting out the journals arising. At present, FRS 102 does not require the recording of this liability amount. AC is unclear as to the rationale for this difference between FRS 102 and IFRS and have a concern that this results in liabilities arising being omitted under FRS 102. AC would welcome the inclusion of the requirement of IAS 32.23 into FRS 102 to eliminate this area of difference.

6.7 Paragraphs 23.33 to 23.34
AC suggests the proposed paragraphs 23.33 to 23.34 are not consistent with IAS 11 and should be revised as follows (as have been done in the revised 'FRS 102 - Staff draft'):
"The gross amount due ~~to~~ **from** customers for contract work is the net amount of:
(a) costs ~~recognised as contract expenses~~ **incurred** plus recognised profits; less
(b) the sum of recognised losses and progress billings
for all contracts in progress for which costs incurred plus recognised profits (less recognised losses) exceeds progress billings."

"The gross amount due ~~from~~ **to** customers for contract work is the net amount of:
(a) costs ~~recognised as contract expenses~~ **incurred** plus recognised profits; less
(b) the sum of recognised losses and progress billings,
for all contracts in progress for which progress billings exceed costs incurred plus recognised profits (less recognised losses)."

6.8 Definition of 'net debt' in the glossary
AC notes that the definition of 'net debt' refers to 'borrowings' and 'related derivatives' and considers that further guidance would be helpful here on what is meant by 'borrowings', for example would the FRC expect preference shares that are accounted for as financial liabilities to be included in net debt? AC would also welcome guidance on what is meant by 'related derivatives', for example is this only intended to refer to derivatives that are accounted for as hedges of borrowings?

6.9 Definition of 'held as part of an investment portfolio' in the glossary and scope of consolidation
AC welcomes the clarification in FRED 67 that a single investment may be considered an investment portfolio; however, AC considers that clarification regarding a parent who holds its investment portfolio through an intermediate holding company would be helpful. In particular, does the intermediate parent company form part of the investment portfolio that is accounted for at fair value through profit or loss? The same issue applies to consolidation considerations for master-feeder arrangements in the investment fund sector. AC considers the appropriate accounting is to 'look-through' the intermediate holding company in such situations and would welcome clarification of this from the FRC.

A related aspect of FRS 102 which AC suggests the FRC should consider is the scope of consolidation in section 9. The wording of paragraph 9.1 has been clarified by the editorial amendments. AC would welcome clarification about the application of paragraph 9.3(g) when taken together with paragraph 9.1. Paragraph 9.3(g) states that a parent is exempt from the requirement to prepare consolidated financial statements when it is a parent not reporting under the Companies Act and its statutory framework does not require the preparation of consolidated financial statements. If, for example, an entity not subject to the Companies Act is a parent and its statutory framework or constitution requires it to prepare financial statements that give a true and fair view, but does not explicitly state that where it is a parent it is required to prepare consolidated financial statements, is it entitled to take advantage of the exemption in paragraph 9.3(g)? AC considers that the approach taken in FRS 102 is in contrast to the position that prevailed in FRS 2, as that earlier standard required entities that are not in scope of company law to apply the provisions of FRS 2 on an equivalent basis.

AC notes there is an investment fund-related Statement of Recommend Practice (SORP) in issue entitled *Financial Statements of UK Authorised Funds* published by the Investment Management Association – May 2014 which includes guidance on the topic of consolidation. This SORP's scope is 'authorised funds' which are defined in section 1.17 to include various unit trusts, open-ended investment companies established under the OEIC Regulations and certain other contractual schemes, all being entities that fall outside of the scope of regular company law. It also includes in section 1.31 a definition of a master-feeder arrangement being one where a feeder fund invests 85% of its assets in a single master scheme. As regards the guidance on consolidation, the SORP includes the following two pieces of guidance:

(a) *'Authorised funds do not report under the Companies Act and therefore are exempted from the requirement to prepare consolidated financial statements by paragraph 9.3(g) of FRS 102. However, authorised funds that hold investment property through intermediate holding vehicles (IHVs) should prepare consolidated financial statements that include the authorised fund and the IHVs it controls. The consolidation should be prepared in accordance with the procedures set out in section 9 of FRS 102.' (*SORP*, s*ection 2.79)

*(b) 'A feeder in a master-feeder arrangement should not consolidate the master but should instead carry the master at fair value.' (*SORP, section 2.20*)*

In relation to (a) above, it appears the SORP requires the parent authorised fund to consolidate the intermediate holding vehicle in order to ensure the parent's financial statements reflect the underlying assets within the intermediate holding vehicle. As noted above, AC considers that clarification would be useful that the exemption in FRS 102.9.3(g) is available and is not subject to separate consideration of whether consolidation is necessary in order to give a true and fair view. In addition, the SORP may need to be brought into line with FRS 102.9.3(g).

In relation to (b) above, it appears that in this case it is the feeder parent that has limited operations, with the investing largely being conducted via its subsidiary (master). Here, the SORP indicates that there is no option to consolidate and thus reflect the master's assets on the statement of financial position of the feeder. This is despite, arguably, that the master is not necessarily that dissimilar to an intermediate holding vehicle in (a) above.

While the equivalent Irish funds do not fall in scope of the SORP, AC considers that the SORP guidance raises some concerns as to the appropriate approach for entities applying FRS 102 that do not fall in scope of UK/Irish company law. AC therefore would welcome clarification of these points by the FRC.

Comments on other parts of FRS 102

6.10 Paragraph 19.30 of FRS 102

Paragraph 19.30 of FRS 102 explains the application of the merger accounting method and requires the results and cash flows of all the combining entities to be brought into the financial statements of the combined entity from the beginning of the financial year and the comparatives to be restated. However, in practice, AC considers that this will not always be feasible, for example where the merger does not take place between two legal entities. This might arise where two trades are 'hived out' of legal entities into a newly formed legal entity and sufficiently detailed financial information about either of the trades as individual reporting entities does not exist in relation to earlier periods. Another example is where there is a later change of control of an entity which takes part in a group reconstruction and the new parent does not have access to the sufficient predecessor financial information of its acquired entity.

6.11 Paragraph 26.16 of FRS 102

AC suggests that paragraph 26.16 of FRS 102 is clarified to explain that the reasonable allocation of a group share-based payment expense is only appropriate where that expense has been determined in accordance with IFRS or FRS 102.

6.12 Merger Accounting

AC notes the conditions for using merger accounting in company law differ from those for a group reconstruction in FRS 102, because they apply where overall control, rather than the rights of all shareholders, remains the same. AC therefore recommends that the conditions for use of merger accounting in company law and FRS 102 are aligned.

Question 7

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.

AC agrees with the transitional provisions.

Question 8
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.

AC has no comments on the costs or benefits identified.