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Mei Ashelford
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Dear Sir

Invitation to comment: Triennial review 2017 – Proposed incremental improvements and clarifications to FRS 102

Kreston Reeves LLP appreciates the opportunity to comment on Financial Reporting Exposure Draft (FRED) 67, Draft amendments to FRS 102, published on 23 March 2017.

Kreston Reeves LLP is a firm of Chartered Accountants that is amongst the top 25 largest firms in the United Kingdom. Based in London and the South East, we have a wide range of clients, including AIM listed companies, but predominantly we operate in the SME market providing audit and other accountancy services. We are a member firm of Kreston International, a global network of independent accounting firms.

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?

We agree with this approach and we are of the opinion that the first triennial review should focus on making incremental improvements and clarifications to FRS 102 rather than looking forward to some of the substantial changes to IFRS that are on the horizon and how they will be incorporated into UK GAAP. However, we would advocate that the accounting principles of the new IFRS standards are incorporated into UK GAAP much earlier than is currently planned, to enable consistency between standards, particularly where there are groups with a mixture of IFRS and UK GAAP reporting.

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?

We advocate clarification guidance on classification of financial instruments.

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It is likely that, by including a description of a basic financial instrument at paragraph 11.9A, a very small number of financial instruments that previously breached the detailed conditions in paragraph 11.9, will qualify for treatment as basic.

We agree with the need to clarify the criteria for classifying a financial instrument as basic. However, paragraph 11.9A has the potential to confuse the preparer of financial statements as it effectively requires the preparer to test a debt instrument first against paragraph 11.9 and then against paragraph 11.9A.

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 agree with this proposal as a welcome simplification that should take nothing away from the true and fair view of the state of affairs of a company as set out in the financial statements. We note that the FRC has subsequently issued an optional interim relief for small entities on 8 May 2017 by inserting a temporary paragraph 1.15A into FRS 102. However, we believe that this accounting treatment should be extended to all similar interest-free loans including loans from non-shareholder directors and loans from shareholders who are not directors. This will promote a consistency of approach for loan arrangements that are fundamentally the same.

We would also like to see the proposal extended to loans to directors, not just loans from them as these arrangements also have the same practical issues in relation to estimating a market rate of interest and a repayment period of the loan where no formal terms are in place.

In addition, we believe that this accounting treatment should be extended to all companies and not just small companies in order to ensure that there are common accounting practices for entities of all sizes. It is not uncommon for medium-sized and large companies to receive non-interest bearing loans from their directors with no fixed repayment terms. These companies will have the same practical issues as small companies when it comes to accounting for the loan at present value.

There is also a strong argument that loans from other group companies should be accounted for at transaction price. It is common practice for group companies to borrow money within the group due to an inability to source external financing. This makes it extremely difficult for a company to estimate a market rate of interest. This practical issue, combined with the general lack of formality surrounding group loan repayment terms makes it extremely difficult for management to calculate the present value of a loan.

Finally, we would recommend that the same exemption is extended to loans from members in a LLP, on the basis that this is an almost identical scenario to loans from director shareholders.

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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?

The removal of references to 'generate wealth' and 'manage risk' should mean that fewer entities will meet the definition of a financial institution and should also allow for fewer interpretational difficulties.

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?

We agree with the removal of these exemptions provided that they are replaced with a clear accounting policy choice. The 'undue cost or effort' test is difficult to apply and leads to inconsistencies between reporting entities. We further support the removal of the exemption as it can lead to inappropriate use of the exemption resulting in conflict between management and the auditors.

The treatment of investment properties has proved particularly challenging and confusing for some groups and therefore, new paragraphs 16.4A and 16.4B which deal with investment property rented to another group entity, are particularly welcomed. It is likely that the accounting policy choice to apply the cost model will be the most popular amongst preparers of financial statements.

The requirement to separately identify intangible assets from the goodwill in a business combination can be a costly exercise as it generally requires the involvement of an external valuer. Providing an entity with the option, on an asset-by-asset basis, to separately recognise additional intangible assets acquired in a business combination if doing so provides useful information to the entity is a more pragmatic approach.

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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.

The inclusion of a net debt reconciliation within an entity's cash flow statement in accordance with paragraph 7.22 is a welcome addition and will provide users of accounts with better information in relation to the entity's borrowings, in a format that they are familiar with from FRS 1.

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.

We have no comments to make on 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.

The completion of a Business Impact Target assessment would seem sensible to ensure that any anticipated reduction in the costs of regulatory compliance and benefits to the preparers of financial statements outweighs the costs of implementing the proposed changes to reflect incremental improvements and clarifications. However, the assessment of transitional costs must be very subjective and judgemental and we would imagine very difficult to quantify.

Removing the need to separately recognise intangibles on a business combination will be of considerable benefit, especially to SMEs, and will save both time and costs in valuing them (which may require the involvement of external valuers) and in auditing them. Additionally, the change to investment property held in a group, provides a potential cost saving to businesses by adopting the cost model.

Yours faithfully

Joe Timms
Director of Financial Reporting
For and on behalf of Kreston Reeves LLP