By email to: ukfrs@frc.org.uk
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Financial Reporting Council
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28 June 2017

Dear Madam

**FRED 67 – Draft amendments to FRS 102 – Triennial review 2017, Incremental improvements and clarifications**

We welcome the opportunity to comment, on behalf of PricewaterhouseCoopers LLP, on FRED 67, 'Draft amendments to FRS 102: Triennial review 2017'.

We broadly support the proposed amendments and do not have any significant concerns to raise.

Our responses to the specific questions asked by the FRC are given in the appendices to this letter. They include some editorial changes, suggestions to clarify the wording of some of the proposed amendments and areas that may require further guidance.

If you have any questions or would like to discuss any of the comments we have made in this letter, please contact Peter Hogarth on 0207 213 1654.

Yours faithfully

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP

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Appendix A

**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?**

We support the FRC's decision to focus on incremental improvements and clarifications, as well as editorial changes, at this stage. This will allow entities more time to learn from their implementation experience and grow used to FRS 102's principles and concepts before any more significant changes are considered.

As noted in our response to the consultation document that preceded FRED 67, now is not the time to begin working on incorporating IFRSs 9, 15 and 16 into UK GAAP. We believe that it is better to learn lessons from the IFRS adopters who will apply these standards in 2018 and 2019, before making decisions on incorporating them into UK GAAP.

**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?**

We agree with this approach given that it will allow for judgement to be applied where the circumstances warrant. A principles-based approach will allow for some instruments to be recognised as 'basic' which would otherwise be recognised as 'other' under the current rules, an outcome which has been one of the more challenging aspects of FRS 102's adoption, especially where the conclusion under IFRS or FRS 101 might have been more simple.

We agree the issue of 'two-way' break clauses should not be addressed in FRS 102 until the IASB has finalised their response to this issue, not least as we have significant concerns about the IASB's proposed solution. In our view, paragraph 11.9(c) of FRS 102 should be amended solely to recognise that compensation on early settlement of a debt instrument may be paid by either the issuer or the holder.

**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**

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**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 well as the FRC's recent short-term amendment to FRS 102 in order to ease the transition to section 1A for small companies.

We also agree with the scope of the proposed change. In particular we do not consider that this relief should be applied more broadly within FRS 102 (such as to larger companies or to intra-group loans) since we do not believe that this would result in better quality financial information. In addition we would question the need to expand the scope of this relief given that many entities have intra-group loans that are either repayable on demand or have no fixed repayment terms. We believe the establishment of a fixed term for an intra-group loan has meaning and that this should be reflected in the accounting for that loan.

**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?**

We agree with the revised definition and believe this will help to reduce interpretation difficulties on what is a financial institution.

We support the proposal for additional disclosure where the risks arising from financial instruments are particularly significant. We note that the wording of the proposed amendment to paragraph 11.42 takes the form of an encouragement for entities to provide more information rather than a requirement. We support that approach. But determining the extent of additional disclosure, if any, will require judgement and might, in practice, result in few additional disclosures being provided. It might, therefore, be helpful for an example to be provided of a set of circumstances in which the directors of a hypothetical entity did conclude that certain additional disclosures were required. That example should equally illustrate why certain disclosures were not required - it would be just as troubling if entities with financial instruments concluded that they must provide all of the disclosure in paragraphs 34.19 to 34.33 without challenging whether such disclosure was material.

**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?**

<u>Question 5(a):</u>

We agree with the proposal to allow an accounting policy choice for investment properties rented to other group companies, as a separate asset class, to be measured at either cost (less depreciation and impairment) or fair value.

We believe that all other investment properties (that is, those that are not rented to other group entities) should continue to be measured at fair value as this provides more relevant and decision-useful information, and would also be consistent with the requirements of 'old UK GAAP' in the form of SSAP 19. We believe that it would be a step backwards to permit investment properties, previously measured at market value under SSAP 19, to be measured at cost under FRS 102.

<u>Question 5(b):</u>

The proposed amendments to paragraph 18.8 of FRS 102 introduce probability into the recognition criteria for intangible assets acquired as part of a business combination. We accept this as a pragmatic means of dealing with intangible assets where an inflow of economic benefits is not probable, so that there is no need to fair value these separately.

We do not agree with the proposal that an entity should be permitted to recognise more intangible assets than would meet the criteria in paragraph 18.8. We do understand that there might be circumstances in which recognition of additional intangibles might provide useful information (such as in the acquisition of a business with non-transferable licences, which would therefore not be both contractual *and* separable), although we believe that such circumstances will be rare.

If the FRC proceeds with permitting wider recognition, we consider that this should be restricted to assets that meet the criteria in either paragraph 18(b) <u>*or*</u> 18(c) (as well as meeting condition (a)) to avoid recognising more intangible assets under FRS 102 than would be recognised under IFRS (that is, IFRS 3 para B31).

**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.**

Please see Appendix B.

**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.**

While we do not object, we question the need for and relevance of the optional transition exemption for investment properties rented to other group entities in paragraph 1.19(a). FRS 102 has been used for only a short time so entities will almost certainly have the necessary information to apply the accounting policy choice retrospectively.

We agree with the mandatory transition relief for retrospective application of the new guidance on intangible assets acquired in a business combination in paragraph 1.19(b). If the new requirements were to be applied retrospectively, it might result in the derecognition of intangibles that were previously recognised, which would not result in better quality or more useful information.

**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.**

We have no additional comments on the costs and benefits likely to arise from the proposals.

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**Appendix B - Comments in response to Question 6:**

Below are our comments in response to Question 6.

**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.**

| **Paragraph reference** | **Response** |
|---|---|
| **Incremental improvements and clarifications:** | |
| 1A.17A | The reference to 3.16A should have been replaced with a reference to 3.16B, rather than supplemented by adding 3.16B. We note that para 3.16B says a disclosure is not required if it is not material, whereas para 3.16A says that material information should not be obscured by immaterial items and that material items that have different nature/function should not be aggregated. |
| 1A.20 | Para 1A.5 requires a true and fair view. The proposed wording, and use of the word 'encouraged', suggests that an entity could elect not to give the disclosures even if the financial statements would not give a true and fair view without them. We propose for the original text to be kept. |
| 1.4, 1.5, 10.6 | Given that we do not know whether UK companies applying IFRS (or FRS 101) will still be using IFRS as adopted by the EU, we believe that for consistency the references in FRS 102 should remain as EU-adopted IFRS, until such time as the law is changed or we have greater clarity of how the law might look in 2019. |
| 4.12(a)(iv) | We agree that company law already requires separate disclosure of the number of shares allotted, but there is no requirement to disclose other movements in the number of shares. We note that there is a requirement to reconcile components of equity by value, but these disclosures wouldn't inform a reader as to how many shares were bought back. There could also be consolidation or sub-division of shares (e.g. 10p shares converted to £1 shares or vice versa) at some point during the year. Without a reconciliation in number of the shares, this wouldn't be evident. We also believe that the requirement to provide a reconciliation doesn't seem particularly onerous and thus would propose to leave the disclosure requirement. |
| 7.22 | The definition of net debt includes borrowings together with any related derivatives. Para 7.22 requires that the net debt reconciliation shows changes resulting from market value and exchange rate |

| Paragraph reference | Response |
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| | movements in a single line item. We believe that movements relating to changes in market value (for example derivatives measured at fair value) should be shown separately from exchange rate retranslation differences (for example foreign currency debt measured at amortised cost) as the changes are different in nature. |
| 9.13(d)(i) | Para 9.13 - the word 'identifiable' has been added to "... share in the net identifiable assets ...". We consider that the word ' 'identifiable' could be omitted here, given that it is included in the wording that follows in the brackets and we think that 'share of net assets' reads better. |
| 11.9 (c) | This new wording may call into question whether financial instruments containing non-contingent contractual repayment provisions would still be considered a basic financial instrument. We believe that such provisions would not fail the principle but we believe the old wording is clearer.<br><br>We suggest that the guidance in IFRS 9 para B4.1.10 may be useful as a reference for considering how best to draft this paragraph as it is more balanced in its wording. The IFRS 9 guidance specifies that the contractual cash flows that could arise over the life of the instrument due to prepayment provisions should be solely the payment of principal and interest on the principal amount outstanding, and that an entity may also need to assess the nature of any contingent event (ie the trigger) that would change the timing or amount of the contractual cash flows. |
| 11.9A – Example 6 | The proposed amendment says 'the negative variable rate is also inconsistent with the description in 11.9A......' We suggest referring to '*the combination of a positive fixed rate less a variable interest rate*' rather than *'the negative variable rate'*. This is to avoid any confusion that negative variable interest rates cannot be consistent with the description in 11.9A because para 47 of the Corporate Reporting Council's Advice to the FRC to issue FRED 67 clarifies that negative variable interest rates can be consistent. This says that ".... *it is entirely feasible that prevailing nominal interest rates for particular financial instruments become negative, for example sub-zero LIBOR rates for a LIBOR linked loan. In such cases, the negative interest rates represent reasonable compensation for the risks of a basic debt instrument issued.*"<br><br>With an inverse floater it is the fact that the variable rate is deducted from the positive fixed rate that results in the combined rate being |

| Paragraph reference | Response |
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| | inconsistent with the description in 11.9A |
| 11.13 | We propose the following editorial changes are made to improve the wording in para 11.13:<br><br>'An arrangement constitutes a financing transaction if payment is deferred beyond normal business terms <u>and is financed at a rate of interest that is not a market rate</u>, for example, providing interest-free credit to a buyer for the sale of goods <u>or</u>~~, or is financed at a rate of interest that is not a market rate, for example,~~ an interest-free or below market interest rate loan made to an employee.' |
| 11.14(a) | We do not believe that the proposed amendment works given that '*non-interest bearing debt instruments that are payable or receivable within one year*' would be financing transactions and thus excluded from being recognised at the undiscounted amount. We would suggest to refer to 'beyond normal business terms' rather than 'one year'. |
| 12.17B | IAS 39 (para 74) and IFRS 9 (para 6.2.4) permit an entity to separate the interest element and spot price of forward contracts and the intrinsic value and time value of options. Hedging foreign currency transactions for spot exchange risk using forward contracts is a common strategy for UK entities. It would be helpful if FRS 102 explicitly provided a similar exemption since the current wording included in paras 12.17A and 12.17B suggest that hedging using 'specific risk elements (e.g. spot price risk, intrinsic value) of derivatives would not be acceptable, which may result in entities having to record significant ineffectiveness.<br><br>We would propose adding at 12.17A (c) 'for *the spot risk element of a foreign currency contract excluding the forward element, or for the intrinsic value of an option excluding the time value*'.<br><br>Also consider including guidance as to whether it is permissible to separate other risk elements from the derivative such as cross currency basis spread. |
| 16.4A and 16.4B | We propose that "individual financial statements' should be removed as it is feasible to have a sub group that prepares consolidated financial statements where this policy choice would be relevant. |
| 16.9A and 16.9B | The amendment for transfers to and from investment property is based on paras 60 and 61 of IAS 40. The amendment does not cover transfers to and from inventory (and we note that this has been removed from |

| Paragraph reference | Response |
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| | the IAS 40 wording in the proposed change to FRS 102). In our view, similar accounting applies for transfers to inventory (that is, use 'deemed cost' at the date of change in use) but there is a company law issue as stocks have been removed from the alternative accounting rules on which this treatment relies. As a result, the treatment will require an override of company law, assuming that the inventory does not qualify for FVTPL in FRS 102. We suggest it would be helpful to refer to this in the legal appendix. |
| 17.31A | We suggest that the disclosures clarify that all disclosures required by section 17 of FRS 102, except those relating to fair value measurement, should equally apply to investment properties held at cost and accounted for under this section. |
| 18.8 | The words "fair value," which were bold in 18.8 and now deleted, should be bold the next time they appear, which is in para 18.11. |
| 18.12 | Para 18.12 is proposed to be amended to refer to the cost of an intangible asset acquired by way of a grant being its fair value at the date of receipt in accordance with Section 34 on Specialised Activities, where applicable. However, under section 34, the intangible is not strictly granted - it is exchanged for the delivery of construction services measured at the value of those services provided. This will be cost plus margin, but may not necessarily be the standalone fair value because the revenue under the service concession is allocated between construction and operation services based on their *relative* fair values. |
| 22.8 | Para A4.24 makes it clear that the Act's section 615 relief continues to be available under the cost model for investments in subsidiaries (ie, the carrying amount of the investment can exclude the 'premium' element for which relief has been given under section 611). Where sections 611 and 615 relief apply on the transfer of other non-monetary assets (eg intangible assets) there is diversity in practice around how this should be interpreted. Some take the view, influenced by the requirements of section 26 regarding share-based payments, that the non-monetary assets should be measured at fair value. However, in our view the section 615 relief can also be used for the carrying amounts of those assets under the cost model, but it would be useful to clarify this in the legal appendix. |
| Appendix to Section 22 | Our understanding is that the 'written option' example has been inserted to confirm that written puts over own shares are treated as derivatives and measured at fair value through profit and loss and not |

| Paragraph reference | Response |
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| | at the present value of the redemption amount as under IFRS. We can accept this treatment in consolidated accounts for a put option written by a parent entity to a minority shareholder of one of its subsidiaries.<br><br>However we question the appropriateness of derivative treatment in single entity accounts where the company issues a written put to its own shareholders over its own shares. Should the put be exercised the company would be buying back its own shares at the agreed put price and whether that price is above or below the market value of the Company's shares we are unclear what the value ascribed to the derivative would actually represent for the Company. It would seem to make the shares themselves puttable and the guidance in paras 22.4-5 would require a gross liability to be recognised unless the criteria to treat as equity are met.<br><br>Also the example says that only written puts over own shares that fail the fixed for fixed criteria are accounted for as derivatives. Is it the intention that where the put option is over a fixed number of shares for a fixed amount of cash that as this would not meet the definition of a derivative financial liability and hence any premium would be recognised directly in equity with no remeasurement and that no obligation to repurchase own shares on exercise of the put would be recognised despite the company not being able to avoid the obligation to buy its own shares should the shareholder exercise the put? |
| 23.3A | Consistent with our response on the triennial review discussion paper submitted on 15 December 2016, we do not support the need to introduce the concept of 'relative standalone selling price' into FRS 102 at the current time. |
| 23.33 to 23.35 | We have the following comment on the proposed changes to this section of the standard. The drafting in paragraphs 23.33 and 23.34 in FRED 67 seems to be the wrong way round. Amounts due <u>to</u> a customer are deferred income and so the billing will be higher than the work performed. Conversely, amounts due <u>from</u> the customer are accrued income and so the work performed will be higher than the billing. So, we consider that:<br><br>• Paragraph 23.33 should say "The gross amount due from customers ...".<br>• Paragraph 23.34 should say "The gross amount due to customers ...".<br><br>We note that the wording in these paragraphs in the redline version of |

| Paragraph reference | Response |
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| | FRS 102 is correct. |
| 23A.37 to 23A.40 | In relation to the inclusion of the principal agent guidance as an example in section 23, example 27 simply repeats the words that are already in the glossary to the standard. We don't think it does any harm to repeat it in the standard, but given that the examples have less authority than the glossary (generally, examples are not part of the mandatory guidance but a defined term would be), we are not sure what it achieves. |
| 26.1 | The reference to counterparty settlement choice has been removed. However, this is within the scope of section 26 (para 26.15B) and thus it is unclear as to why this reference was deleted. |
| 30.21 | We agree with the change here, which comes from IAS 21, but the proposed text in 30.21(b) is problematic when an entity first adopts FRS 102, because the comparative amounts will be reported under a different GAAP and so cannot simply be left alone. We note that this is also a problem under IFRS (and FRS 101) where IAS 21 and IFRS 1 between them are silent on what happens in the first year of adoption when the comparative amounts were previously reported under a different GAAP. |
| 31.8(bA) and 31.9 | The proposed amendments require any revaluation surplus that arose in previous periods to be eliminated. However, where property, plant and equipment and intangibles are carried at a valuation, this would be under the alternative accounting rules of the Companies Regulations, in which case, disclosure of the cumulative net revaluation reserve would be required. We suggest to clarify the position in the legal appendix. |
| 33.7A | It is not clear whether key management compensation should be disclosed for both directors and key management when they are not the same (which the wording would suggest), or only the key management who are not directors. The legal disclosure requirements under schedule 5 of Companies Regulations are restricted on defined benefit plans i.e. only the number of directors in defined benefit plans has to be disclosed and thus no value is attached to the employee benefit as it would be in FRS 102 key management compensation disclosures.<br><br>It would be odd to have a different type of disclosure for key management, including defined benefit plan and share-based payment, compared with directors where the regulatory disclosures are restricted to only the number of directors in a defined benefit plan and the |

| Paragraph reference | Response |
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| | number of shares received under a long term incentive plan.<br><br>In smaller private companies, the directors and key management will usually be the same. In larger companies, it might be sensible to require fuller key management compensation disclosure i.e. all key management including directors. We believe that it would appear odd for small non-corporates to have more onerous key management compensation disclosure requirements than a corporate of the same size. We suggest that the requirement should be to make disclosures for key management equivalent to the legal required disclosures made in respect of directors. |
| A4.40C | The proposed amendment may suggest that fair value movements on investment properties that are rented to other group companies should be recognised in a revaluation reserve upon transition. Given that investment properties are measured in accordance with the fair value rules and not alternative rules of the Companies Regulations, we believe that such guidance would not be relevant for the transition rules per para 1.19(a). As a result, we suggest that the reference to 'investment property rented to another group entity' be removed from para A4.40C as this paragraph would only be relevant to first-time adopters of this FRS and not the transition rules applicable on the first application of the 2017 triennial review amendments per para 1.19(a). |
| | |
| **Consequential amendments to FRS 101:** | |
| Para 7A | Paragraph 7A of FRS 101 says that a first-time adopter of FRS 101 applies IFRS 1, but this does not apply if an entity is moving from IFRS (as per the more detailed transition rules set out in paragraph 12 of FRS 100). It would be helpful to include a reference in paragraph 7A of FRS 101 to paragraph 12 of FRS 100 to avoid misinterpretation. |
| Footnote 4 to para 8(d) and (e) | Footnote 4 to paragraph 8(d) and (e) says "*It should be noted that companies which are subject to the requirements of the Act and Regulations are legally required to provide disclosures related to financial instruments, including those measured at fair value. Further guidance in relation to financial instruments measured at fair value is provided in Appendix II Note on legal requirements*".<br><br>For paragraph 8(e), which is referring to the exemption from IFRS 13, the footnote should also refer to non-financial assets measured at fair value (eg investment property) as company law disclosure is also |

| Paragraph reference | Response |
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| | required for these. |
| Definition of qualifying entity (also FRS 100) | The definition of a qualifying entity for FRS 101 presently excludes charities. We suggest removing this exclusion because 'exempt' charities - for example, registered social landlords (RSLs) - which are not required to apply the Charities SORP, are currently prevented from applying the standard. The Housing SORP admits the possibility of an RSL preparing its accounts in accordance with EU-IFRS, yet the group entities would not be not permitted to apply FRS 101 in their individual accounts.<br><br>Company law prevents charitable companies from preparing IAS individual (and group) accounts, but this does not prevent them from using FRS 101. We consider that the ability of a charity to apply FRS 101 should be determined by their applicable SORP, rather than by the standard itself. |
| A2.10A | A separate line for 'non-current assets held for sale' (and for related liabilities) as per IFRS 5 is not consistent with company law formats. We suggest that an explanation of the nature of the potential conflict between IFRS 5 and the law and state clearly how this should be dealt with. For example, if there are any held for sale items, they should be dealt with by memorandum disclosure on the face of the balance sheet (or a separate line within fixed assets if it relates to an asset rather than a disposal group) if material. |
| Legal appendix or Advice to the FRC | We suggest that the legal appendix or the 'Advice to the FRC' in FRS 101 mentions that there have been amendments to FRS 102 for unrealised gains to be recognised in OCI, rather than profit and loss (for example, unrealised foreign currency gains on monetary items), and that these are not reflected as amendments in FRS 101, because of para AG1(k) (which refers to gains being recognised in profit or loss unless prohibited by the Act). |
| | |
| **Consequential amendments to FRS 105:** | |
| 3.13A | Public companies are excluded from the micro-entities regime and thus it appears odd to include a requirement for entities to state whether they are a public or a private company, although that is what the law requires. We suggest to include a footnote to clarify the position. |

| Paragraph reference | Response |
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| 6.2 | The wording of paragraph 6.2 implies that the positioning of the disclosures listed in 6.2(a) to (d) is mandated by law. In fact, only the positioning of items 6.2 (c) and (d) is so mandated. We suggest paragraph 6.2 is reworded as follows:<br><br>"6.2 The notes to the financial statements of a micro-entity shall include the following information:<br><br>(a)...<br><br>(b)...<br><br>(c)...<br><br>(d)<br><br>In accordance with section 472(1A) of the Act, the information required by (c) and (d) above shall be presented at the foot of the statement of financial position." |