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Ms Mei Ashelford
Financial Reporting Council
8th Floor
125 London Wall
London
EC2Y 5AS

National Office

Grant Thornton UK LLP
Grant Thornton House
Melton Street
London NW1 2EP.

T +44 (0)20 7383 5100
F +44 (0)20 7383 4715
DX 2100 EUSTON
www.grant-thornton.co.uk

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Dear Ms Ashelford

FRED 67: Draft amendments to FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* – Triennial review 2017 ("the exposure draft")

Grant Thornton UK LLP (Grant Thornton) welcomes the opportunity to comment on the exposure draft.

Our general observations

We fully support the approach taken by the FRC in this first triennial review, which limits amendments to incremental improvements and clarifications. Further, we welcome steps taken by the FRC to simplify FRS 102 in respect of the accounting for investment properties and business combinations.

We also believe that the outcome of this triennial review will result in a version of FRS 102 that users will find more understandable and easier to apply in practice, leading to a reduced cost of compliance for many entities.

Contact details

We have sought to answer each question as fully as possible, and we hope that our observations are of use during this first triennial review process.

If you have any questions regarding this response, please contact either me, or Neil Parsons (t: 0121 232 5385; E: Neil.B.Parsons@uk.gt.com).

Yours sincerely

Jake Green
Technical Partner
(t: 0207 728 2793; E: jake.green@uk.gt.com)

For Grant Thornton UK LLP

Appendix
Detailed Response to Questions
RESPONSES TO SPECIFIC QUESTIONS

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 agree with the approach taken by the FRC to limit amendments in this first triennial review only to incremental improvements and clarifications. Unless we state otherwise in our response we agree with the amendments contained in the exposure draft.

In particular, we welcome:

- A new paragraph highlighting that unwarranted disclosure of immaterial information can obscure the more material information. Also that it is important that material information, which has a different nature or function, should be disaggregated (paragraph 3.16A)
- The re-introduction of the requirement to disclose an analysis of net debt (paragraph 7.22)
- Enhanced disclosure requirements regarding the nature and extent of interests in unconsolidated special purpose entities (paragraph 9.23(f))
- The removal of unnecessary disclosure requirements such as a share reconciliation (paragraph 4.12(a)(iv) and the total cost of inventories expensed (paragraph 13.22(d))

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?

The current approach in section 11 of FRS 102 of classifying financial instruments as 'basic' or 'non-basic' is not principles based. Instead, classification depends on applying specific rules driven by the identification of certain features that a financial instrument might or might not have.

Applying this approach in practice to the classification of debt instruments has caused a considerable level of difficulty, as well as resulting in the inappropriate classification of some debt instruments as 'non-basic'. FRS 102 requires the accounting of some debt instruments at fair value, whereas IFRS would permit accounting for the same instrument at amortised cost.

We are therefore pleased that the FRC has sought to address this matter by inserting paragraph 11.9A into Section 11. This will provide an important guiding principle to aide both preparers and auditors.

On another matter; for loans with two-way compensation clauses we note that paragraph 49 of the exposure draft, states that the FRC believes that paragraph 11.9A should help in the classification of such instruments as 'basic' or 'non-basic'. We do not believe that paragraph 11.9A will provide a conclusive solution in isolation. The IASB is currently completing its project in this area, and if the result of that project is not pragmatic for the UK, then the FRC should consider a different solution.

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?

Since the demise of the FRSSE, we have always been of the view that FRS 102 should maintain consistency for the recognition and measurement principles applied by small and non-small entities. The amendment that is the subject of this has now been fast-tracked by the FRC, and is effective.

We understand that is as a one-off case arising from the extreme difficulty that certain small entities are experiencing in identifying an appropriate market rate of interest for such loans.

We recommend that the FRC extend the amendment to the treatment of loans provided by members of a small LLP who are natural persons, but then seek to limit any other divergences on the accounting treatments for small entities to special cases going forward. We recommend that the FRC identify principles for when divergence might be appropriate.

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 amendment to the definition of a financial institution but also believe that the FRC should provide additional qualitative guidance to supplement this amended definition. Clarification would be most welcome in respect of whether entities providing group treasury functions and entities such as stockbrokers and insurance brokers are no longer financial institutions.

We agree with the amendment that more entities that are not financial institutions should consider whether additional disclosure is required when the risks arising from financial instruments are significant. The question states additional disclosure is required where risks are particularly significant. We believe that the appropriate threshold for additional disclosure is where the risks are significant.

However, we believe that this requirement should not extend to qualifying entities that are applying reduced disclosures. On this basis, we recommend that the FRC amend paragraph 11.42 so that only an entity (other than a qualifying entity) must consider whether additional disclosures are required. Further, we believe that it will not be necessary for such entities to consider capital requirements in paragraphs 34.31 and 34.32 as this will create clutter in the financial statements of entities that are not financial institutions.

Our suggested rewording of paragraph 11.42 is as follows:

An entity shall disclose information that enables users of its financial statements to evaluate the significance of financial instruments for its financial position and performance. For example, for long-term debt such information would normally include the terms and conditions of the debt instrument (such as interest rate, maturity, repayment schedule, and restrictions that the debt instrument imposes on the entity). When the risks arising from financial instruments are ~~particularly~~ significant to the business, additional disclosure may be required. Paragraphs 34.19 to 34.33, which set out disclosure requirements for financial institutions, may provide examples of disclosures relevant in such cases. A **qualifying entity** is not required to provide such additional disclosure.

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?

Undue cost or effort

We agree with the removal of the concept of the 'undue cost or effort exemption'. In the absence of robust guidance, this concept has been highly subjective and difficult to apply consistently in practice. Although we have no direct evidence, we believe that this concept has been potentially open to abuse.

We are concerned that the FRC's approach of replacing this concept with an accounting policy choice may not suffice in all circumstances. Other alternatives remain possible, such as allowing easier treatments, where accounting requirements might be 'impracticable'.

Investment property rented to another group entity

The FRC's proposal to allow entities to measure investment property rented out to another group entity at cost (less depreciation and impairment) in accordance with Section 17 *Property, plant and equipment* is a welcome and pragmatic solution, which our clients and this firm fully support.

Separating intangible assets from the goodwill acquired in a business combination

We do not agree with the FRC proposal to allow an accounting policy choice to separate intangible assets from goodwill on a business combination on a relevant class basis.

We are concerned that, by allowing this choice, more inconsistency will arise in practice and could lead to 'cherry picking' of the class or classes of intangible asset separated. A tendency could arise not to separate classes of intangible assets that are more susceptible to impairment if accounted for separately.

We believe an entity should have an accounting policy election to either separate all intangible assets that are capable of reliable measurement from goodwill in a consistent manner to IFRS 3 *Business Combinations* (issued in 2004), or instead keep such intangible assets subsumed within goodwill.

Were such an approach to be allowed, entities which keep intangible assets subsumed within goodwill should be required to disclose the types of intangible asset that have remained subsumed within goodwill.

Although our proposed approach will lead to the possibility of taking the FRS 102 accounting for goodwill and intangible assets on a business combination back to similar requirements in old UK GAAP and FRS 10, we believe that this pragmatic solution will suffice while the FRC considers a better overall alternative for the next triennial review.

Finally, we recommend that the FRC consider issuing a discussion paper on identifying a complete single model for the accounting of intangible assets arising from business combinations. For example, might it be possible for the FRC to consider previous research regarding 'wasting' and 'organically replaced' intangible assets? Is it possible for the FRC to re-engage with users of private equity financial statements regarding their particular views on the merits of separating intangible assets?

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.

We set out our observations in the table below, in their order of appearance in FRS 102.

FRS 102 reference	Observation	Recommendation
1.2	Paragraph 1.2 is amended to clarify that all paragraphs with a prefix 'PBE' shall be applied. This clarification may have the unintended consequence of creating a potential conflict if a SORP required an alternative treatment to a specific 'PBE' paragraph.	We recommend that this paragraph is reworded as follows: "Public benefit entities shall apply all paragraphs prefixed with 'PBE', provided that the accounting requirements are not prohibited by the relevant SORP."
3.1B	This new proposed paragraph states that a small entity is not required to comply with paragraph 13.17(d) – the requirement to present a statement of cash flows - regardless of which regime it applies in the preparation of financial statements. There might be confusion in practice as to what the term 'regime' means. For example certain not for profit entities might interpret the regime to include the SORP, or other relevant legislation.	We recommend that this paragraph is reworded to state the following: "Unless a small entity is required by a SORP or other legislation to prepare a statement of cash flows then a small entity is not required to comply with paragraph 13.17(d)."
3.14	This paragraph requires the presentation of comparative information, unless FRS 102 permits or requires otherwise. SORPs often require additional disclosures over and above the requirements of FRS 102. Currently, we read FRS 102 as requiring comparatives for these SORP disclosures.	We recommend that an additional paragraph is inserted into section 34 for PBEs stating that: "Where a SORP introduces an additional disclosure not required by this FRS, it is for the SORP to determine whether comparative information is required."

11.9 Examples	Some examples conclude that an entity must measure an instrument at fair value in accordance with Section 12, other examples conclude by referring to meeting a specified condition in paragraph 11.9.	We recommend that the solutions to examples 1, 2, 3 and 4 state explicitly that those instruments qualify as a basic instrument under Section 11.
16.4	Regarding mixed-use property, following the deletion of the undue cost or effort exemption it is not clear how an entity should approach the accounting going forward where it is not possible to allocate such a property between its investment property and PPE components on a reliable basis. We understand that preparers, in particular, PBEs would still require a pragmatic accounting solution.	We would recommend that this paragraph should also state: "Where it is impracticable to separate investment property and property, plant and equipment the entire property should be accounted for as property, plant and equipment in accordance with Section 17."
22.8B	This new paragraph states that an entity is not required to apply 22.8 and measure equity instruments at fair value in the situation where the creditor is acting in the capacity of an existing shareholder, or where the substance of the transaction is an equity distribution or contribution.	Our interpretation of the wording in this paragraph suggests that an entity has an accounting policy choice over such transactions. Our view is that it is not appropriate to recognise a gain or loss in such circumstances. We are of the view that paragraph 22.8B should be reworded so that it shall not allow the application of paragraph 22.8A in those circumstances.
23.3A	This new paragraph requires allocation of consideration to separately identifiable goods and services when practicable. Practicable is not a defined term.	We recommend that the paragraph is amended to state that: "Unless impracticable, total revenue is allocated…" Impracticable is already a defined term in FRS 102.

23.3A	With regard to the allocation of revenue from a single transaction, this new paragraph requires allocation between all of the separately identifiable goods and services. This paragraph appears to follow the requirements of IFRS 15. Our letter in December regarding the triennial review stated that FRS 102 already provided proportionate requirements for separating contracts and therefore we saw no merit in adding requirements to FRS 102 that reflected the requirements of IFRS 15. Further, we believe that an entity can already achieve such separation by applying the existing principles in Section 23.	We recommend that the FRC does not insert paragraph 23.3A into Section 23 of FRS 102.
33.7A	We agree with the insertion of this paragraph. Disclosure of key management personnel remuneration should not be required where legislation requires the disclosure the directors (or their equivalent) and these persons are the same. Where the directors (or their equivalent) and key management personnel are different persons the requirement to disclose remuneration under both legislation and FRS 102 will remain. This is often a source of confusion for shareholders and users, who do not understand that FRS 102 requires additional disclosure of items such as share based payments and national insurance contributions, but legislation does not require disclosure of these amounts.	Therefore, in addition to paragraph 33.7A, we recommend that Section 33 should include an additional disclosure to reconcile the total of key management personnel remuneration to the total of directors' remuneration (or equivalent).

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.

We would welcome additional guidance in the scenario where a small entity had applied paragraph 11.13A to record a loan from a shareholder who was a director at transaction price, but that entity no longer qualifies as small.

Such guidance should address whether this results in a change in accounting policy, a prospective change or whether there would be no requirement to revisit the accounting for the loan.

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.

Although we have no direct evidence to support this, we believe that the impact of these proposals is likely to lead to a reduction in the cost of compliance of reporting under FRS 102 for those entities affected by these proposals.