# Association of Accounting Technicians response to Financial Reporting Council FRED 67 Draft amendments to FRS 102

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## 1. Introduction

1.1. The Association of Accounting Technicians (AAT) is pleased to comment on FRED 67, Draft amendments to FRS 102, published on 23 March 2017.

1.2. AAT is the UK's leading qualification and membership body for accounting staff. AAT awards around 90% of all vocational accounting qualifications in the UK. Of AAT's 140,000+ members and students in the UK, two-thirds work in businesses or accountancy practices. As a result, thousands of accounting technicians are routinely involved in preparing accounts using FRS 102.

1.3. AAT is customer focused, we collaborate, we care about what we do and how we do it. AAT supports the FRC's objective to promote clear and concise corporate reporting that meets user needs. FRS 102 is an important part of the FRC's work to meet this objective and AAT is therefore happy to contribute to the Triennial review process.

1.4. AAT provides comment on the development of accounting standards where these are relevant to accounting technicians and their clients and employers. The comments therefore are based on the potential impact that the proposed changes would have on SMEs and micro-entities, many of which employ AAT members or would be served by AAT's 4,250 licensed accountants.

## 2. Executive summary

2.1. **AAT welcomes the decision not to incorporate major changes in IFRS into FRS 102 at this stage.** It is important that a robust process is set out for whether, and if so how, changes to IFRS will be incorporated in the future.

2.2. **In principle, AAT is always supportive of any move to improve, clarify and simplify accountancy and taxation, and most of the proposed amendments meet these criteria.** AAT supports the replacement of 'undue cost or effort' exemptions with clear and proportionate accounting policy choices.

2.3. **Certain proposed amendments might over-simplify the financial statements, including through the omission of important disclosures for some non-bank finance companies.** AAT considers that the definition of financial institutions should include firms that have FCA Part 4A permissions and provide credit, regardless of whether they accept deposits.

2.4. **Proposed amendments to Section 23, Revenue, could lead to substantial extra costs for preparers with limited, if any, benefits to users.** AAT considers that this "*interim step*" towards the implementation of IFRS 15 is incompatible with the FRC's decision not to incorporate major changes in IFRS into FRS 102 at this stage.

2.5. **The Business Impact Assessment is welcome but excludes some costs.** Additional costs should be included for the time that will be needed by non-accountant directors of companies reporting using FRS 102 to become familiar with the amendments and to assess the impacts on their businesses.

## 3. AAT response

3.1. The following paragraphs outline AAT's comments.

**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?**

3.2. AAT agrees with this approach and particularly welcomes the FRC's decision not to incorporate recent and forthcoming major changes in IFRS. As noted in AAT's response to the earlier consultation "*Triennial review of UK and Ireland accounting standards*", now is not the time for major changes to FRS 102 and it is too early to incorporate the core principals of IFRS 9, IFRS 15 and IFRS 16 into FRS 102.

**Question 2: FRED 67 proposes to amend the criteria for classifying a financial instrument as 'basic' or 'other'. 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?**

3.3. AAT agrees with the need to clarify the criteria for classifying a financial instrument. Unfortunately, new paragraph 11.9A appears to make much (or all) of the content of existing paragraph 11.9 redundant, and potentially confusing. This is illustrated by the examples, where the revised wording appears to suggest a need to test a debt instrument first against paragraph 11.9 and then against paragraph 11.9A. This approach appears to cause some significant problems, as illustrated by Example 5.

3.3.1. Example 5 describes a loan referenced to 2 times a bank's standard variable rate. This presumably refers to a bank's standard variable mortgage rate. This loan does not meet the 11.9 test as it is not linked to a single relevant observable index (a requirement set out in footnote 10 on page 79 of current FRS 102). That seems clear but it is not at all obvious that an interest rate for a loan to an SME that happens to be double the standard variable mortgage rate is not providing "*reasonable compensation*" to the lender. At current interest rates, such a loan would represent good value for most SME loans. It is also entirely normal for business loan rates to change by more than mortgage rates.

3.3.2. Other Examples appear to raise similar problems. AAT suggests it may prove more useful and practicable to include examples of how to apply 11.9A, rather than 11.9.

3.4. The heading of this section starting at 11.8 could more usefully read: 'Basic financial instruments (debt instruments)".

**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. Do you agree with this proposal? If not, why not?**

3.5. AAT agrees with this proposal as a straightforward simplification that should not reduce the usefulness of the financial statements and disclosures.

**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. Do you agree with this proposal? If not, why not?**

3.6. AAT is concerned that the proposal retains an existing area of uncertainty over whether a finance company that provides credit but does not accept deposits as a financial institution.

3.7. The existing definition could be interpreted as including non-deposit taking lenders, as they generate wealth for their owners by lending money. The new “similar to” wording appears to exclude non-deposit taking lenders.

3.8. Many lenders to small businesses are non-bank finance houses and many of the disclosures for financial institutions in Chapter 34 appear as relevant to them as they are to a deposit taker.

3.9. It may be useful to review the use of the term ‘credit institution’ in this definition. The FCA Handbook refers to the EU Capital Requirements Directive (CRD) definition, being a firm that accepts deposits (or equivalent) and grants credit. AAT suggests the definition for this purpose should include any firms that have FCA Part 4A permissions and provide credit, regardless of whether they accept deposits and are therefore ‘credit institutions’ for CRD purposes.

**Question 5: FRED 67 proposes to remove the three instances of the ‘undue cost or effort’ exemption 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. Do you agree with these proposals? If not, why not?**

3.10. AAT supports the removal of these exemptions when replaced with a clear and proportionate accounting policy choice. The ‘undue cost or effort’ test is difficult to apply and leads to inconsistencies between firms.

**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.**

3.11. AAT is concerned that the proposed changes to Section 23, Revenue. The new 23.3A requirement and the removal of “*where necessary*” in 23.8 mean that a split is required whenever there are separately identifiable goods and services, even in cases where such a split will not better reflect the substance of the transaction.

3.12. AAT considers this change could create significant extra work for some firms without delivering benefits to users of their accounts. It is unclear why the Corporate Reporting Council considers it necessary, other than as an “*interim step*” towards implementation of IFRS 15. If this is the principle rationale, it appears incompatible with the FRC’s statement that it has decided not to incorporate changes to IFRS into FRS 102 at this stage. As an absolute minimum, this amendment should be reconsidered for FRS 105 (please also see comments below on Business Impact Target assessment).

**Question 7: FRED 67 includes transitional provisions. 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.**

3.13. AAT has no comments on 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.**

3.14. AAT welcomes the inclusion of a Business Impact Target assessment, but has various comments and concerns over the provisional assessment as follows:

3.15. It is important to clarify whether the Assessment is being made only for changes to FRS 102 or also for changes to other Standards including FRS 105. The title suggests the former, but the number of entities affected at 4.0 million suggests the latter.

3.16. AAT considers that if any changes to FRS 105 are substantive then a separate Assessment should be made, given the importance of FRS 105 to millions of smaller companies. As described above, AAT considers that the proposed amendments to Section 23, Revenue, are of such major significance as to need further analysis of the costs and benefits to all companies, and particularly to smaller companies applying FRS 105.

3.17. The costs appear to have been understated as they do not include the time spent by the company directors. It seems reasonable to allow some time (e.g. 0.5 hours per company) for directors of all the affected companies to become familiar with the changes to their accounts, for example by being briefed by their accountants.

**Other observations**

3.18. AAT notes the proposal to add the Corporate Reporting Council's Advice to the FRC into FRS 102. Although the Advice provides useful background, it seems unnecessary to make it an integral part of the Standard. This would make the Standard longer and more complicated to apply. Instead, AAT recommends it is kept available for reference on the FRC's website.

3.19. Having delayed consideration of how recent and forthcoming major changes in IFRS should be incorporated into FRS 102, it is important that the FRC has a clear process for how it will do this in the future. AAT considers that any significant changes should only be considered following a post-implementation review of use of the new IFRS by public interest entities. Proposals for changes should then be included in the next Triennial review, including full cost-benefit analysis.

## 4. About AAT

4.1. AAT is a professional accountancy body with approximately 50,000 full and fellow members and over 90,000 student and affiliate members worldwide. Of the full and fellow members, there are over 4,250 licensed accountants who provide accountancy and taxation services to individuals, not-for-profit organisations and the full range of business types.

4.2. AAT is a registered charity whose objectives are to advance public education and promote the study of the practice, theory and techniques of accountancy and the prevention of crime and promotion of the sound administration of the law.

## 5. Further information

If you have any questions or would like to discuss any of the points in more detail then please contact Aleem Islan, AAT Technical Consultation Manager, at:

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