FRS 102 FACTSHEET 2
TRIENNIAL REVIEW 2017 — TRANSITION

Triennial Review 2017 — Transition

The first triennial review of FRS 102 was conducted over a two year period and included both informal and formal consultations and two exposure drafts. The review concluded with the publication of the final amendments in December 2017, and a revised edition of FRS 102 was published in March 2018, alongside revised editions of the other UK accounting standards. The Triennial Review 2017 Amendments are generally effective for accounting periods beginning on or after 1 January 2019 and two transitional exceptions to retrospective application have been introduced. The date of transition is the beginning of the earliest period for which an entity presents full comparative information.

This factsheet illustrates how some transactions may be dealt with on transition to the *Triennial Review 2017 Amendments*. A separate factsheet UK GAAP Factsheet 1 *Triennial Review 2017 Amendments* has been prepared which highlights some of the more notable changes to FRS 102 to assist preparers and their advisors in getting ready for implementation.

Principal changes to FRS 102

The majority of the amendments made by the *Triennial Review 2017 Amendments* are editorial in nature and/or are intended to merely clarify rather than change accounting treatment. The principal amendments that might have an impact on financial statements are:

- The **removal of undue cost or effort exemptions** which, in some cases, are replaced by accounting policy options. In particular, an accounting policy choice is introduced for entities that rent **investment property** to another group entity, whereby they can choose to measure the investment property either at cost or at fair value. A transitional exemption was introduced in relation to these types of investment property.
- The introduction of a **description of a basic financial instrument** to support the detailed conditions for classification as basic. This should result in a relatively small number of financial instruments, which breach the detailed conditions for classification as basic, now being considered to be basic and measured at amortised cost.
- For small entities, a more proportionate accounting solution for a **loan from a person within a director's group of close family members** that includes at least one shareholder in the entity, which will permit the loan to be initially measured at transaction price rather than present value.
- Entities will be required to recognise fewer **intangible assets acquired in a business combination** separately from goodwill. This will reduce the cost of compliance, whilst still providing users with useful information about the business combination. Entities may choose to separately recognise additional intangible assets acquired in a business combination if this provides useful information to the entity and the users of its financial statements. A transitional exemption was introduced in relation to intangible assets and goodwill arising from existing business combinations.
- The principle included in the **financial institution definition** has been amended to remove references to 'generate wealth' and 'manage risk', and stockbrokers and retirement benefit plans have been removed. These changes should reduce the number of entities that meet the definition.

This factsheet considers how entities with these transactions may account for them on transition.

Entities will need to update their accounting policies note as required to reflect the new requirements of FRS 102 and any accounting policy choices that have been made.

Removal of undue cost or effort exemptions

Amendments to Section 14 *Investments in Associates* and Section 15 *Investment in Joint Ventures*

Previously, entities that are not parents could choose to measure investments in associates and joint ventures either at (a) cost, (b) at fair value with changes in fair value recognised in other comprehensive income (the fair value model) or (c) at fair value with changes in fair value recognised in profit or loss. Under the fair value model (option (b)), FRS 102 previously allowed an undue cost or effort exemption whereby when it is impracticable to measure fair value, cost could be used instead. This has exemption has been removed.

On transition

If an entity has previously used the undue cost or effort exemption in relation to investments in associates or joint ventures measured under the fair value model, it can simply change its accounting policy and opt to use the cost model going forward.

Amendments to Section 16 *Investment Property*

Investment property rented to a third party

Previously, entities were required to measure all investment property at fair value unless the fair value cannot be determined without undue cost or effort, in which case it is measured at cost less depreciation and impairment, until such time that a reliable measure of fair value can be determined.

This undue cost or effort exemption has been removed and all investment properties rented to a third party will need to be measured at fair value.

On transition

An entity that has investment property rented to a third party measured at cost will need to determine a fair value for these properties using the guidance set out in the Appendix to Section 2 *Fair Value Measurement*. The Appendix to Section 2 does allow for situations when a reliable fair value cannot be determined, however, we would expect these situations to be extremely rare.

Investment property rented to another group entity

To address a significant implementation issue, Section 16 was amended to introduce an accounting policy option in respect of investment property rented to another group entity whereby entities may elect to transfer these properties to property, plant and equipment and measure them at cost (less depreciation and impairment) under Section 17 *Property, Plant and Equipment*.

On transition

A transitional provision has been introduced in paragraph 1.19(a). An entity that chooses to measure investment properties rented to another group entity under the cost model going forward has a choice of accounting treatment on transition:

1) apply the transitional provision which allows an entity to take the fair value at the date of transition (ie not the current carrying amount) and use that as the property's deemed cost going forward; or
2) use the historical cost of the property, and depreciate/impair the asset as if it had always been carried at cost.

An entity has a free choice but the availability of information and the work required to determine the carrying value at the transition date, prior year end and current year end may lead an entity to take the transitional exemption for ease.

When an entity chooses to take the fair value at the date of transition as deemed cost going forward, the investment property is not carried on a cost basis and is instead measured under the alternative accounting rules. Therefore any fair value uplift existing on transition must be recognised in a revaluation reserve and additional disclosures required by paragraph 34 of Schedule 1 to the Regulations must be given.

Introduction of a principle for the classification of financial instruments

Amendments to Section 11 *Basic Financial Instruments*

Previously, the classification of financial instruments as 'basic' or 'other' was dependent on a list of prescriptive conditions set out in paragraph 11.9. Paragraph 11.9A has been inserted to add a principles-based description of a 'basic' financial instrument. This paragraph need only be considered for debt instruments that do not meet the detailed conditions. We expect that this amendment will result in a relatively small number of financial instruments, which breach the detailed conditions, now being considered as basic and measured at amortised cost.

On transition

An entity with financial instruments classified as 'other' should consider whether any of them might meet the principle-based description, and now be measured at amortised cost. However, this will not be necessary for all 'other' financial instruments, derivatives for example are not usually 'basic'.

For an entity that has debt instruments that previously would have been measured at fair value but which are now classified as basic and measured at amortised cost, this change in classification will represent a change in accounting policy as a result of a change in the requirements of FRS 102. Insofar as it is practicable, comparative information needs to be presented as if the new policy has always been applied. The requirements for retrospective application are set out in paragraph 10.12 and an entity will need to provide the disclosures required by paragraph 10.13.

Simplified treatment for directors' loans

Amendment to Section 11 *Basic Financial Instruments*

Previously, off-market directors' loans (ie loans from a director to a company in which he/she is also a shareholder) were required to be measured at the present value of the future payments discounted at a market rate of interest for a similar debt instrument. A new relief has been introduced in paragraph 11.13A(a) for loans to small entities from a directors' group of close family members (which includes the director), when that group also includes a shareholder. The relief allows these loans to be measured initially at transaction price. This relief also applies to small LLPs and loans from its members.

On transition

A small entity that wishes to take advantage of this relief should account for this retrospectively as a voluntary change in accounting policy, and insofar as it is practicable, comparative information needs to be presented as if the new policy has always been applied. The requirements of retrospective application are set out in paragraph 10.12. Small entities will also need to provide the disclosures required by paragraph 10.14.

Changes in eligibility

If an entity has taken advantage of the exemption but subsequently ceases to be a small entity, as per paragraph 11.13B, it may determine the present value of the liability:

a) on the basis of the facts and circumstances existing at that time; or

b) at the date the financing arrangement was entered into.

In order to make the accounting more straight-forward and to reflect the fact that it is a change in circumstance that has triggered the change in accounting (rather than an accounting policy choice) the change should be accounted for prospectively. As a result, comparatives will not be restated.

An entity only makes an assessment of whether it is eligible for the small entities regime at the reporting date, therefore, at that date, the liability would be remeasured to present value with the associated adjustment to equity. The income statement effect will be recognised from the following reporting period. For example, if an entity was no longer eligible for the small entities regime for the year ending 31 December 2019, it would adjust the carrying value of the loan as at 31 December 2019. The financial statements for 2020 would, for the first time, include any associated interest expense.

Simplified treatment for intangible assets acquired in business combinations

Amendments to Section 18 *Intangible Assets other than Goodwill*

The accounting treatment for intangible assets acquired in business combinations has been simplified to address implementation issues. An entity is now only required to separately recognise intangible assets from goodwill if the intangible assets meet the recognition criteria, are separable *and* arise from contractual or other legal rights. An entity may choose to recognise other intangible assets separately if they meet the recognition criteria and are either separable *or* arise from contractual or other legal rights.

The Basis for Conclusions (paragraph B18.10) sets out some examples of intangible assets that would, and those that would not, normally satisfy the criteria for separate recognition. Intangible assets that would normally satisfy the criteria include licences, copyrights, trademarks, internet domain names, patented technology and legal protected trade secrets. Those that would not normally satisfy the criteria include customer lists, customer relationships and unprotected trade secrets. The items listed are only examples and entities are expected to apply judgement in determining whether separate recognition is required or not.

On transition

A mandatory transitional provision has been introduced in paragraph 1.19(b). The amendment outlined above constitutes a change in accounting policy as a result of a change in FRS 102. However, contrary to paragraph 10.12, this change in policy shall be applied prospectively (not retrospectively) and therefore an entity shall not subsume intangible assets that previously have been separately recognised within goodwill. If an entity makes further acquisitions after the implementation of these amendments it will need to ensure it provides suitable disclosure of its approach to recognising intangible assets.

Definition of a financial institution

Amendments to Section 34 *Specialised Activities*

An entity that meets the definition of a financial institution is required to provide additional disclosures set out in paragraphs 34.17 to 34.33. The definition includes a list of specific types of entity and a principle. To reduce the interpretational difficulties associated with the principle, it was amended to remove references to ‘generate wealth’ and ‘manage risk’. This should reduce the number of entities meeting the definition. Additionally, retirement benefit plans and stockbrokers were also removed.

On transition

An entity that no longer meets the definition of a financial institution is not required to provide the disclosures in Section 34, however, in the transitional year it would be useful for the notes to the financial statements to include a brief explanation as to why this is the case.

Additionally, when the risks arising from financial instruments are particularly significant to an entity that is not a financial institution, paragraph 11.42 has been amended to encourage such an entity to provide additional disclosures to enable users of its financial statements to evaluate the significance of financial instruments for its financial position and performance. The financial institutions disclosures in paragraphs 34.19 to 34.30 include examples of disclosures around risks arising from financial instruments that may be relevant in such cases.