By email to: ukfrs@frc.org.uk
Jenny Carter
Financial Reporting Council
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15 December 2016

Dear Madam

Consultation document – Triennial review of UK and Ireland accounting standards

We welcome the opportunity to comment, on behalf of PricewaterhouseCoopers LLP, on the consultation document on FRS 102's triennial review, including the approach to changes in IFRS.

In principle we support an approach that keeps FRS 102 broadly aligned with IFRS. We would support changes where it would preserve comparability to IFRS with little or no practical impact or where changes are clearly an improvement when compared to existing requirements.

We acknowledge that there is a balance to be struck between stability and improvements to standards. With this in mind, the FRC should ensure that any changes are proportionate to those entities applying FRS 102. It should also be remembered that most entities applying FRS 102 are not familiar with IFRS and this should be taken into consideration when weighing up improvements with stability. We also prefer to leave time to see how significant changes to IFRS work in practice before introducing them for UK GAAP reporters.

We believe that significant changes, such as the introduction of IFRSs 9, 15 and 16, should be dealt with outside the triennial review. In particular there should be a separate due process for such changes. This is to ensure that there is appropriate consideration of the proposed changes and their impact and that changes are appropriately signalled to parties affected by them. In our view the triennial review should only deal with incremental changes and clarifications.

Our responses to the questions asked by the FRC are given in the appendix to this letter.

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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

Appendix

Question 1

The FRC has reviewed its principles for developing succinct financial reporting standards for the UK and Republic of Ireland. As a result, limited changes have been made to the principles, to emphasise the need to balance improvement with stability and the need for proportionate solutions (see paragraph 1.11). Do you agree with the principles? If not, why not?

We agree with the revised principles.

The IFRS framework is directed towards different users from those typically applying FRS 102. The revised principles have placed more weight on stability, which we agree is generally important for entities that apply FRS 102, rather than an environment of frequent change to which IFRS reporters are subject.

We are supportive in principle of changes being made to FRS 102, where this would preserve comparability to IFRS with little or no practical impact. We would also support an approach of not continually changing FRS 102 where such changes would not be proportionate to the size and nature of FRS 102 reporters, such as aligning the definition of fair value to IFRS 13.

Where changes to FRS 102 are proposed, we recommend that these are referenced to the FRC's principles, for example IFRS 16 is proposed to be adopted to reflect up-to-date thinking. It would be helpful if this referencing to the principles explained why change was preferred to stability and, where the change is significant, that this is explored in a subject-specific discussion paper (see further our response to question 2).

Question 2

Significant changes in IFRS have been considered against the FRC's principles for developing succinct financial reporting standards for the UK and Republic of Ireland; see Section 3 Changes in IFRS – Detailed analysis. Do you agree with the proposals for updating FRS 102 as result of changes in IFRS as part of this triennial review? If not, please provide alternative suggestions.

We believe that there should be a separate process for significant changes, which we consider to include IFRSs 9, 15 and 16, outside the triennial review to ensure appropriate due process is followed and changes are appropriately signalled to parties affected by them.

We believe that the triennial review should only address incremental improvements and clarifications, which may include elements of existing IFRS standards. We provide further comments below on the proposed adoption of new and existing IFRS standards.

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IFRS 3:

We agree that FRS 102 should not be amended to increase consistency with IFRS 3 (2008).

It would not be possible to fully implement IFRS 3 (2008) within FRS 102 as a result of legal constraints - under IFRS 3 (2008), goodwill is not amortised, while this is required by company law. In addition, with regard to step acquisitions, IFRS 3 (2008) requires previously-held interests to be remeasured to fair value. Such remeasurements would not be realised profits under company law and therefore may not be recognised in profit or loss under FRS 102.

We note that IFRS 3 (2008) is still subject to post-implementation review and so would recommend deferring any proposed implementation in FRS 102, subject to compliance with company law, until after that review.

The information provided by separating identifiable intangible assets may be of questionable value in the context of many private company business combinations. We believe that 'organically replaced' intangibles – which are replenished on an on-going basis through marketing and promotion – should not be separately recognised and that they should instead be subsumed within goodwill in FRS 102.

IFRS 9:

See our response to question 3 below concerning incorporating IFRS 9's expected loss model into FRS 102.

IFRS 10 & 11:

We do not support implementing the IFRS 10 control model.

It may be that, for most entities, few differences would exist in practice since the IFRS 10 model does not provide bright lines but rather is principle-driven. But based on our experience of implementing IFRS 10, entities would have to carry out procedures to determine that there was no change, for little benefit in most cases. So, given the differences in the users of the financial statements of listed groups and entities applying FRS 102, we consider that stability is better served by not changing the control definition at this stage.

See our response to question 6 below concerning implementation considerations regarding the IFRS 10 control model if the FRC does decide to proceed with this.

IFRS 12:

We agree that it is not necessary to incorporate all of the disclosure requirements of IFRS 12, given the differences in the users of the financial statements of listed groups and entities applying FRS 102.

However, reflecting our comments about IFRS 10 above, we believe that proportionate disclosure about unconsolidated structured entities may be useful and we would support such disclosure requirements from IFRS 12 being incorporated into FRS 102.

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IFRS 13

We do not consider it appropriate to incorporate IFRS 13's definition of fair value into FRS 102. This would require own credit risk to be incorporated into the fair value measurement of liabilities, which would be difficult in practice for many companies because typically there is no observable credit information readily available and many of the valuation models used do not make adjustment for this risk. It is also arguable whether this basis of measurement produces more relevant and reliable information for users.

In addition, FRS 102's classification and measurement model would require these fair value movements to be reported in the income statement, whereas, IFRS 9's model is more sophisticated and requires changes in fair value related to own credit risk to be presented separately in other comprehensive income unless held for trading. This approach was developed in response to widespread feedback that gains and losses due to own credit risk distort the income statement.

The existing definition in FRS 102, which is based on IAS 39's definition of fair value, allows for a choice in approach in determining the fair value of liabilities. The fair value can either be determined based on a presumption that an entity has the practical ability to settle the liability in a way that enables it to realise gains and losses from changes in its own credit risk, or based on a presumption that the 'close-out amount' that would be paid to the counterparty to settle the liability would not incorporate changes in the entity's credit risk since inception of the contract. This allows preparers not to be bound to an approach that is too difficult to apply in practice. The accounting policy selected should be disclosed and applied consistently.

As a result, we do not consider it desirable for the definition of fair value to be amended to align it with IFRS 13.

Similarly we do not believe paragraph 11.27 of FRS 102, which sets out a hierarchy for estimating fair value, should be amended for greater consistency with IFRS 13. We acknowledge that the hierarchy of three categories may potentially be confusing for preparers given the categories for disclosure are not based on the same hierarchy. However, we believe this potential confusion may be alleviated not by referring to this as a hierarchy but as factors to consider in the process of estimating fair value. We also note that in practice we have not seen the guidance in paragraph 11.27 of FRS 102 leading to different estimations of fair value as compared to IFRS 13.

We agree with the FRC's proposal not to amend FRS 102 to incorporate any further disclosure requirements of IFRS 13.

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IFRS 15:

We understand the proposed changes to be: including more guidance on identifying performance obligations, in line with IFRS 15; replacing the guidance on 'separately identifiable components'; and a requirement to allocate transaction price using the relative stand-alone selling price (SSP) methodology.

In practice, significant differences are also likely to arise from:

i) Inclusion of variable consideration in the transaction price;
ii) 'Point in time' versus 'over time' recognition;
iii) Licensing guidance; and
iv) Potentially from other areas of guidance (modifications, cash payments to customers, put options etc.), dependent on the specific business model.

As such, we are not convinced that amending for only some aspects of IFRS 15 would achieve convergence in industries where major change is expected.

In many cases, the judgements taken using an IFRS 15 methodology for identifying performance obligations and allocating transaction price would be acceptable under FRS 102, but would not be the only acceptable application of FRS 102. For example, allocation using SSP would be an acceptable application of FRS 102, but an entity could also use other methods such as the residual method.

As such, we believe that an FRS 102 reporter might in many cases be able to align with the group's accounting policy, without any changes being made to the standard. Such a change in accounting policy would need to result in more reliable and more relevant information (as per para 10.8(b) of FRS 102), although given that it would be coming into line with the latest standard in this area we believe that would likely be reasonably easy to justify. Similarly, we believe that in many cases the performance obligations identified using an IFRS 15 methodology could be the same as those identified under FRS 102, even though this might not be the only answer.

In many cases, allocation using SSP will be more costly and complex than other allocation methods, because it requires entities to collect data enabling them to estimate SSPs if none are observable and because SSP is a more complex methodology requiring two steps of calculation (calculating the SSPs then making the allocation).

If the FRC wishes to drive consistency in revenue reporting between FRS 102 and IFRS, we do not believe that this will be achieved by the changes suggested and are concerned that this might cause more confusion if the stated aim is convergence, but differences remain.

If an IFRS reporting group wishes to minimise consolidation adjustments, the subsidiaries are able to adopt FRS 101. So, even if an entity concludes that an 'IFRS 15 answer' is not an acceptable application of FRS 102, we note that such groups have an option for uniform accounting policies already by adopting FRS 101. In addition, we note that, as described above, some aspects of IFRS 15 might be more costly to implement than FRS 102 and so the cost-benefit analysis should take into account all FRS 102 reporters, not just those that are subsidiaries of IFRS reporting groups.

In conclusion, we suggest that no change is made at this stage.

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IFRS 16:

In principle we support the direction in which the FRC is heading regarding the adoption of IFRS 16 from 1 January 2022. However, we are concerned that significant amendments may be incorporated without sufficient due process. As noted earlier, we suggest that significant amendments are addressed in separate subject-specific consultations.

We appreciate that IFRS 16 will result in more transparent information for users, but also acknowledge that adoption may entail a degree of complexity for many entities. We recommend that the implementation of IFRS 16 should be deferred until IFRS reporters have had sufficient experience of adopting the standard so that practical difficulties can be appropriately and proportionately addressed in FRS 102.

Question 3:

In relation to the impairment of financial assets, the FRC proposes to amend FRS 102 in order to incorporate an expected loss model. Paragraph 3.13 sets out three options for how this may be achieved, with the FRC favouring options (b). Which option would you prefer, and why?

Do you have any suggestions for how the simplified approach to impairment losses for trade receivables, contract assets and lease receivables in IFRS 9 might be developed into a suitable model for entities applying FRS 102 (other than financial institutions, or a sub-set such as banks and building societies)?

We do not agree with the proposal to incorporate IFRS 9's expected loss model for impairment of financial assets into FRS 102 at the present time for two key reasons. Firstly, it is too early to make this decision given the lack of implementation experience to date, and secondly, the model may be a challenge for smaller banks reporting under IFRS. Therefore we should proceed with caution before requiring FRS 102 reporters to apply it.

IFRS 9's model was developed in response to the financial crisis and the issues encountered by the larger banks and building societies recognising 'too little too late'. It is too early to say whether IFRS 9's model is necessarily 'fit for purpose' for the population of companies applying FRS 102 as it was not designed with these companies in mind. Is recognition of expected rather than incurred losses helpful and relevant information for FRS 102 reporters?

Larger corporates reporting under IFRS are yet to fully assess the impact of applying the simplified approach which requires upfront recognition of expected losses – for example is recognising a day 1 loss on long term intercompany lending helpful and relevant information?

We understand that the small subset of banks and building societies reporting under FRS 102 are taking the IAS 39 option in section 11/12 of FRS 102 so that they are able to apply macro-hedging. Therefore, amending FRS 102 to incorporate an expected loss model is likely to be of little consequence for this subset. Question 4 is more relevant.

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We would suggest waiting to see how IFRS 9's expected loss model is implemented in practice before committing to incorporating it into FRS 102. We also expect the IASB to undertake a post-implementation review as they have done for other standards, although we acknowledge that the results of this review may not be available for some time yet as any such review is unlikely to start before 2020.

We believe the FRC should be guided by the implementation experience of the smaller banks and corporates reporting under IFRS. As a consequence, at this stage we consider it is too early to commit to a particular approach.

Therefore, we do not favour any of the options presented in the consultation and believe this should be considered further at the next triennial review once we have a clearer view on implementation experience in practice.

Our views on the options presented are as follows:

Option a). Absent an understanding at this stage of what a proportionate approach for smaller banks reporting under IFRS is considered to be, we do not yet know how feasible it will be to incorporate IFRS 9's guidance in a more simplified manner (similar to the way the hedging guidance was incorporated). Before concluding on the appropriateness of this option we would want some comfort that the simplified guidance would not result in diversity in how the model is applied in practice.

Option b). We do not consider it appropriate to require all financial institutions (as defined in FRS 102) to apply IFRS 9's expected loss model as it is too complex for many of the entities captured by the financial institutions definition. It could be mandated for the subset of banks and building societies applying FRS 102, but as noted above many of these entities are likely to be applying the IAS 39 option in section 11/12 of FRS 102 anyway. Consequently for this subset of entities, question 4 is more relevant.

In addition, before mandating IFRS 9's expected loss model for this subset, we would want to understand further what has become practice for the smaller banks reporting under IFRS and whether such an approach is appropriate for this subset. If the FRC proceed with this option we would need more clarity as to which financial institutions would be affected.

For other entities it is too early to assess whether IFRS 9's simplified approach (upfront recognition of expected losses) produces better and more relevant and reliable information than the incurred loss model currently in FRS 102. It was generally the larger banks and building societies that were criticised for recognising 'too little too late' not the population of companies applying FRS 102.

Option c). See comments under option b) for whether IFRS 9's expected loss model should be mandated for financial institutions or a subset of them. For other entities, we agree that at the present time no other amendments should be made to FRS 102 unless evidence comes to light that the current impairment requirements are not operating effectively.

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Question 4:

Presently, in paragraph 11.2 (and paragraph 12.2), FRS 102 permits an accounting policy choice in relation to financial instruments, allowing an entity to choose the recognition and measurement requirements of FRS 102, IAS 39 or IFRS 9. The FRC proposes to retain the option to choose IAS 39 until the requirements for the impairment of financial assets have been amended in FRS 102 (ie for all accounting periods beginning before 1 January 2022). From 1 January 2022 the FRC proposes that the available options will be the requirements of FRS 102 or IFRS 9. Do you agree? If not, why not?

We agree with the FRC's objective that the option to choose IAS 39 should not be retained indefinitely in FRS 102 once IAS 39 is replaced by IFRS 9.

However, as noted above, we have concerns about amending the impairment requirements in FRS 102 to an IFRS 9 model absent any implementation experience on which to base this decision.
We consider it too early at this stage to set a deadline for the removal of the IAS 39 option. We would suggest the FRC signal their intention to ultimately remove the option but state that this will not be before 2022 and acknowledge that it may be later depending on the implementation experience of IFRS 9.

We note that many banks and building societies reporting under FRS 102 have taken the IAS 39 option so that they are able to apply macro-hedging. Once this option is removed we expect them to take the IFRS 9 option in FRS 102 instead so that they can continue to apply macro-hedging as this form of hedging is not available in section 12 of FRS 102. This would effectively force these banks and building societies to apply IFRS 9's expected loss model. Consequently we believe the IAS 39 option should not be removed until we understand further what has become practice for the smaller banks reporting under IFRS and whether such practice in applying the expected loss model is appropriate for banks and building societies reporting under FRS 102.

We note that the accounting policy option in paragraph 11.2 of FRS 102 allows IAS 39 'as adopted in the EU' to be applied. Once IAS 39 is replaced by IFRS 9 it will no longer exist in its current form as an 'adopted in the EU' accounting standard. We suggest that the accounting policy option could be amended to allow FRS 26 to be applied instead. FRS 26 is currently the same as IAS 39 and prior to the introduction of new UK GAAP was applied by some UK entities. Therefore, FRS 26 could be reinstated as a short term solution.

Question 5:

Do you have any suggestions for how the requirements of IFRS 16 might be developed into a suitable model for entities applying FRS 102? In particular, do you have any suggestions relating to the application of the short-term lease exemption or the exemption for leases when the value of the underlying asset is low?

Consistent with our response to question 2, we recommend that the FRC issues a separate discussion paper on possible changes to FRS 102 to incorporate IFRS 16 requirements. We have no specific comments at this time given that IFRS 16 is still at the early adoption stage.

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Question 6:

The FRC proposes to make changes to FRS 102 to incorporate the control model of IFRS 10. Are you aware of any legal barriers to incorporating the control model of IFRS 10 alongside the existing legal requirements?

In most situations, any changes to the definition of control in FRS 102 will have no impact in practice. However, in other cases entities may be consolidated for the first time or cease to be consolidated. Do you have any information about how significant the practical impact may be and the circumstances in which it might occur?

As noted in our response to question 2, we do not support implementing the IFRS 10 control model at this time. However, if the FRC decides to proceed with this, its implementation will require some careful consideration.

> i) The control guidance in IFRS 10 is principle-driven with supplemental guidance and examples included in the appendix. Either the guidance and examples would also need to be incorporated into FRS 102 (to promote consistent application) - either within the standard itself or within an appendix; or, more in line with the simplified nature of FRS 102, the guidance and examples are not included, which could mean different interpretations are possible.
>
> ii) The Companies Act 2006 requires a parent to consolidate subsidiary undertakings. Undertakings are defined in the Act and are considered to be akin to entities as referred to in FRS 102. IFRS 10 refers to investors and investees in its definition of control, rather than entities. Investors and investees are not defined and may be interpreted more broadly than subsidiary undertakings as defined in the Act.
>
> We would suggest to replace investors and investees, as used in the IFRS 10 control definition, with *entities* which would be more consistent with Companies Act terminology. However, we acknowledge that this could result in differences from IFRS 10, such as in respect of a ring-fenced portion of a larger entity (sometimes referred to as a 'silo') and also referred to as a deemed separate entity.

We are aware of two examples that often occur in practice:

1) Asset managers: Under FRS 102, an asset manager would generally only consolidate its investment when it has a shareholding of more than 50% (i.e. power of the investee). Under IFRS 10, an asset manager is likely to consolidate at less than 50% if it is subject to variable returns proportionate to its decision making capabilities.
2) General partners: General partners are generally limited companies and have decision making powers established by law. Therefore, under FRS 102, a general partner would need to consolidate an investee because it has power over it, but general partners often take a true and fair override to avoid consolidation. Under IFRS 10, the investee would not be consolidated if the investor does not have exposure to variable returns.

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Question 7:

Do you have any comments on the cost-effectiveness of the requirements for share-based payments, currently set out in Section 26 of FRS 102? If you consider that alternative requirements would be more cost-effective, please provide details of how you would adapt the current requirements whilst still providing useful information to users.

We consider that the present accounting requirements for share-based payments (SBPs) in the standard are appropriate. Whilst it may be more difficult for private companies to obtain fair values for SBPs than for entities with listed equity instruments, we do not consider that this is sufficient reason to alter the accounting requirements.

Furthermore, private companies may be private-equity backed, and the use of SBPs in such cases is ubiquitous to incentivise management to improve performance in anticipation of an exit event. It would therefore be a retrograde step, in our view, to remove any requirement to account for SBP awards merely because a company is private. In any event, where an SBP is expected to result in the entity settling in cash, then some form of accounting is required - and the requirements for cash-settled awards in the standard are similar to those for other employee incentive schemes (section 28 - Employee Benefits).

We would, however, not object to a simplification for small entities, now that they are accommodated within the standard. Previously under the FRSSE, small entities did not need to account for equity-settled SBP awards. We would not oppose a similar relief for small entities under FRS 102, although we do not have a strong view on whether this should be available only to small entities applying section 1A of the standard, or to all small entities (i.e. in a similar manner to the cash flow statement exemption).

Question 8:

Do you agree with the proposed effective dates for the amendments arising from the triennial review, with incremental improvements and clarifications effective from 1 January 2019 and more fundamental changes effective from 1 January 2022?

We support the effective dates for the amendments arising from the triennial review, with incremental improvements and clarifications effective from 1 January 2019.

We believe that the fundamental changes proposed to be effective from 1 January 2022 should not form part of the triennial review, but rather form part of separate consultation.

Question 9:

Do you have any other comments on the approach to keeping FRS 102 up-to-date as part of the triennial review?

We have no additional comments.

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Question 10:

The FRC will be preparing consultation stage impact assessments to accompany the FREDs arising from the triennial review. At this stage do you have any comments on the costs and benefits likely to arise from the outline proposals in this Consultation Document that will help inform those impact assessments? Please provide evidence to support your views of any quantifiable costs or benefits.

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