Response to FRC Consultation Document
Triennial review of UK and Ireland accounting standards: Approach to changes in IFRS

5 January 2017

CA House 21 Haymarket Yards Edinburgh EH12 5BH
enquiries@icas.com +44 (0)131 347 0100 icas.com

Direct: +44 (0)131 347 0252 Email: ahutchinson@icas.com

INTRODUCTION

ICAS welcomes the opportunity to comment on the FRC's Consultation Document – Triennial review of UK and Ireland accounting standards: approach to changes in IFRS.

Our CA qualification is internationally recognised and respected. We are a professional body for over 20,000 members who work in the UK and in more than 100 countries around the world. Our members represent different sizes of accountancy practice, financial services, industry, the investment community and the public sector. Almost two thirds of our working membership work in business, many leading some of the UK's and the world's great companies.

Our Charter requires its committees to act primarily in the public interest, and our responses to consultations are therefore intended to place the public interest first. Our Charter also requires us to represent our members' views and to protect their interests, but in the rare cases where these are at odds with the public interest, it is the public interest which must be paramount.

The ICAS Accounting Standards Committee has considered the consultation document and its comments are included below.

Any enquiries should be addressed to Amy Hutchinson, Assistant Director, Technical Policy and Secretary to the Accounting Standards Committee.

GENERAL COMMENTS

We support the overall objective of FRS 102 being an IFRS-based standard, and agree with the revised principles for developing succinct financial reporting standards for the UK and Republic of Ireland. To us, the key development since the first publication of FRS 102 has been the extension of its scope to include small entities. Therefore, in further developing FRS 102 via the triennial review mechanism, we believe that it is vital that the FRC prioritises the principles of stability and proportionality. Without this, there is a risk that small entity reporting will not be fit for purpose and therefore its value may be called into question. It is key that the high quality and relevance of financial reporting at the smaller end of the market in the UK and Ireland is maintained.

To this end, we believe the focus of the first triennial review should be on fixing practical problems in the current version of FRS 102 and in ensuring the standard is workable across the spectrum of entities applying it. We agree that it is important to also consider the potential implications of new and revised IFRSs, but we believe further work is required to demonstrate and justify the FRC's overall approach to changes in IFRS, and to explain how the principles for developing UK financial reporting are being applied in practice. We would encourage the FRC to develop more detailed proposals explaining how the key changes will be dealt with e.g. scaling down the requirements of new IFRSs to include the key principles only rather than the detailed requirements.

Finally, we note that as far as possible, it is important to plan for the potential impacts of Brexit on financial reporting – for example, the FRC will have more options in relation to small and micro-entities once the requirements of the EU Accounting Directive no longer need to be followed.

RESPONSES TO THE CONSULTATION QUESTIONS

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?

Response
We agree with the revised wording of the principles for developing succinct financial reporting standards for the UK and Republic of Ireland. Since the principles were originally drafted, the scope of FRS 102 has been extended to include small entities which previously reported under the FRSSE - we believe this has an impact on the considerations that should be taken into account in updating the

standard. Given that FRS 102 now all applies to all sizes of entity except those applying the micro-entities regime, it is more important that accounting solutions are proportionate, and that stability is considered, as smaller entities may have simpler reporting systems; fewer resources to deal with accounting changes than larger entities; and the users of their accounts may have less expertise in financial reporting matters than users of IFRS accounts.

We note that, as currently drafted, the reference to 'stability' in the revised principles (paragraph 1.11 (b)) could be read in different ways i.e. it could be taken as a reference to financial stability. It could be helpful to clarify that this refers to 'stability of the financial reporting framework.'

Overall, whilst we support the revised principles, we believe that the FRC could more fully articulate how these principles have been applied in developing the proposals in this consultation paper i.e. by providing a supporting analysis for each proposed change, in order for constituents to provide informed comment on the proposed direction of travel. Without such a focus on the application of the principles, there is a risk that FRS 102 might become too complex for application by smaller entities.

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.

Response
Given that the scope of FRS 102 has been extended since it was originally drafted, to include small entities, we believe that the first triennial review should be focussed on identifying and rectifying problem areas in applying the standard in its current form. This approach would allow sufficient time to review the overall implementation of FRS 102, in particular to ensure that the standard in its current form is fit for purpose for smaller entities. It will also provide the opportunity to review the implementation of new IFRSs by listed companies.

We support the aim of FRS 102 being IFRS-based, and recognise that the incorporation into FRS 102 of the key principles of new IFRSs such as IFRS 9, 15 and 16, is likely to result in better-quality information for larger entities applying UK GAAP, and will be helpful in group situations where the parent prepares IFRS accounts. However, we do not believe that the same is necessarily true for small entities, as there is a risk that the accounting requirements are excessively complex and costly to apply. The FRC should present an analysis of how the proposed changes would be implemented in practice, and how these would be made proportionate for the various sizes of entity to which FRS 102 applies.

In relation to IFRS 15 – Revenue from Contracts with Customers, we are unsure if the piecemeal approach proposed, bringing one specific element of IFRS 15 into FRS 102 for 2019, is the most effective one. Undoubtedly alignment with IFRS will be useful for group situations, however an alternative option is that companies could simply use the option already in FRS 102 to refer to full IFRS in this respect. We note that implementation of IFRS 15 for listed companies is a significant undertaking, therefore we have concerns about the feasibility of planning the implementation of its principles for smaller entities, before the impact on listed companies is understood.

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 option (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)?

Response

We recognise that the expected loss model under IFRS 9 will produce better-quality information than the existing incurred loss model, and that for larger financial institutions using FRS 102, January 2022 appears to be a reasonable implementation date.

We would like to see evidence of how the model could be applied to smaller non-financial entities in a way that is proportionate, before determining the best way forward. We note that this consultation also discusses the possibility of reviewing the requirements of sections 11 and 12 of FRS 102, as well the definition of a financial institution – it is important that these various elements are considered as a whole.

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 Financial Instruments: Recognition and Measurement or IFRS 9 Financial Instruments (and elements of IAS 39 as amended by 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?

Response
We agree that the option to choose IAS 39 should be retained in FRS 102 until such time as the expected loss model from IFRS 9 is incorporated into FRS 102.

Question 5
Do you have any suggestions for how the requirements of IFRS 16 Leases 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?

Response
As stated in our response to Question 2, we have concerns about how the requirements of new IFRSs can be applied in a proportionate manner to all sizes of entity using FRS 102, particularly given that standards such as IFRS 16 are not yet effective for the listed sector. We support the 'right-of-use' model under IFRS 16 as an improvement on the existing lease accounting requirements, and agree that incorporation of this model in some form in FRS 102 may be a reasonable long-term aim. Further work is required by the FRC to demonstrate how this would work in practice.

Question 6
The FRC proposes to makes changes to FRS 102 to incorporate the control model of IFRS 10 Consolidated Financial Statements. Company law specifies when consolidated financial statements are prepared, and any changes would supplement these existing requirements by providing further guidance on what is meant by 'control'. 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?

Response
We note that aligning the definition of control may be helpful in a number of cases therefore we are content with this approach. We are not aware of any legal barriers to incorporating the IFRS 10 control model alongside the existing legal requirements.

Question 7
Do you have any comments on the cost-effectiveness of the requirements for share-based payments, currently set out in Section 26 Share-based Payment 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.

Response
We believe that the requirements for share-based payments are often not cost-effective for private companies – the resulting information is not sufficiently useful to justify the cost and effort of obtaining the information. In addition, with the introduction of section 1A, for small companies there is greater judgement around the provision of disclosures and therefore there could be decreased comparability in the accounts. We think there is merit in considering whether exemptions could be made from these requirements, either for unlisted shares or for small companies.

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?

Response
We agree with the proposed effective date from 1 January 2019 for incremental improvements. For more fundamental changes, we believe further analysis is required before the effective date is confirmed.

Question 9
Do you have any other comments on the approach to keeping FRS 102 up-to-date as part of the triennial review?

Response
We have no other comments.

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.

Response
We have no comments at this stage.