KPMG LLP
Audit
15 Canada Square
London E14 5GL
United Kingdom

Tel +44 (0) 20 7311 1000
Fax +44 (0) 20 7311 3311

Ms Jenny Carter
Financial Reporting Council
8th Floor
125 London Wall
London
EC2Y 5AS

Our ref pt/kl

By email to: ukfrs@frc.org.uk

20 December 2016

Dear Ms Carter

Triennial review of UK and Ireland accounting standards: ***approach to changes in IFRS***

We welcome the opportunity to comment on the above-named Consultation Document. The attached Appendix sets out our detailed responses and a number of suggestions. These include the following concerns:

- We do not believe that FRS 102 should be amended to reflect the IFRS 10 control model as part of this triennial review.
- We agree that in the longer term FRS 102 should be aligned with IFRS 15, IFRS 16 and IFRS 9 in a proportionate way. However, we are concerned that the timeline proposed does not take into account the inter-connected nature of IFRS 15 and IFRS 16, nor does it allow sufficient time to learn from practical and application issues identified as IFRS companies implement IFRS 16 and IFRS 9.

We look forward to considering the detail of proposed changes to FRS 102 as part of the Phase I FRED.

Please contact Pamela Taylor on 020 7694 1819 should you wish to discuss any of our comments further.

Yours sincerely

KPMG LLP

KPMG LLP

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 support the FRC in taking the opportunity of the triennial review to review the principles to be applied in developing standards. We largely agree with the proposed changes to the principles, but suggest an additional amendment.

We agree that there is a balance to be struck between making improvements and maintaining stability and a proportionate approach. Changes to existing standards should only be made if the benefits of improved financial reporting outweigh the potential costs and complexities of application.

However, in the revised principles, as drafted, it is not clear how principle (a) interacts with principle (b). Principle (a) could be interpreted as requiring changes to FRS 102 to reflect IFRS, even if the current standard is adequate for high-quality, relevant financial reporting. We believe that principle (b) should be applied to all potential changes to FRS 102, including those arising from changes to IFRS. The approach described in paragraph 3.3 of the Consultation Document indicates that this is also the intention of the FRC.

We believe that the Consultation Document does not consistently set out and analyse the relative benefits of making changes to align FRS 102 with IFRS against the potential costs of changes and reduced stability. That, together with the lack of clarity we perceive in the wording of the principles, lead us to propose that either principle (a) is amended to refer to the need for stability, or principle (b) is amended to make clear that this applies equally to changes arising from IFRS.

The need for clarity in the principles is underlined in our responses to this consultation. We do not believe that all of the proposals meet all of the principles or, in some cases, believe that there is insufficient information available at this time to make an assessment against each of the principles.

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.

IFRS 3 *Business Combinations (revised 2008)*

We provide below our comments on the specific possible changes to increase consistency of FRS 102 with IFRS 3 that are highlighted in paragraph 3.5 of the Consultation Document.

Reliable valuation of intangible assets

We agree with the proposal to not change FRS 102. Our experience, consistent with one body of opinion identified in the IASB's Post-Implementation Review findings and which we believe may be common in the UK, is that such assets are difficult to identify and their valuation is highly subjective.

Amortisation of goodwill

We agree with the proposal to not change FRS 102 for similar reasons as above.

Accounting for contingent consideration

Paragraph 3.5(c) of the Consultation Document refers to recognition of changes in fair value of contingent consideration in profit or loss. We consider a more critical first question to be measurement of contingent consideration at either fair value (as in IFRS 3) or best estimate (as currently required by FRS 102). We view measurement as an area to be considered for consistency with IFRS, as fair value measurement would better align with the rest of the purchase method of accounting for business combinations, which sets the fair value of the consideration against the fair value of assets acquired. We also note that FRS 101 has been amended for periods beginning on or after 1 January 2016, as a result of changes to the Companies Act, to permit measurement of contingent consideration at fair value through profit or loss, which indicates company law no longer constrains consistency with IFRS in this area.

On the assumption that contingent consideration is measured at fair value under FRS 102, we would expect any remeasurement to be charged to profit and loss because contingent consideration is a financial liability.

Acquisition related costs

In our view, it would be an acceptable amendment to FRS 102 to have acquisition-related costs recognised as an expense as this would improve consistency with IFRS.

IFRS 9 *Financial Instruments*

We have provided our comments on the FRC proposals in our responses to Questions 3 and 4.

Our comments on the classification framework were included in the paper titled "The FRS 102 triennial review - observations of the large six accounting firms in the UK on financial instruments accounting", submitted to the FRC in October 2016.

IFRS 10 *Consolidated Financial Statements* and IFRS 11 *Joint Arrangements* and IFRS 12 *Disclosure of Interests in Other Entities*

We do not believe that changing the control model and guidance would be a 'limited' change, as described in paragraph 3.23 of the Consultation Document. The IFRS 10 control model is very different in principle and should not be approached without good reasons or anticipated benefits for FRS 102 users.

There has been some difficulty in practice in the application of the IFRS 10 control model, in particular for those entities with special purpose vehicles. Therefore, we do not believe that it is sufficiently clear at this stage that it would be cost-effective, proportionate or practical for FRS 102 reporting entities to apply that model, or that such a change would result in better financial reporting. We note that IFRS 10, 11, and 12 will be assessed by the IASB in an upcoming Post-Implementation Review (PIR). The review will assess the effect of the requirements of these standards, including the control model, on investors, preparers and auditors. The results of that PIR will be valuable in informing any proposed amendments to FRS 102. As such, currently we do not support making any amendments to FRS 102 for consistency with IFRS 10, 11, or 12 and instead, suggest that the FRC await the results of the PIR that is likely to identify and address issues with those standards.

We also do not believe that changing FRS 102 to incorporate the IFRS 10 control model meets principle (b) in paragraph 1.11 of the Consultation Document: The model does not clearly represent an improvement, we do not see that this represents most up-to-date thinking and incorporating such a model now will not provide stability, particularly if there are future changes to IFRS 10.

For the avoidance of doubt, we interpret the Consultation Document to propose a change only to the control model and to make no proposal to change the rules on whether controlled entities are consolidated. As such, we have not considered the investment entity consolidation exemption in our response.

IFRS 13 *Fair Value Measurement*

We agree in principle with the FRC's proposal to review paragraph 11.27 of FRS 102 for greater consistency with IFRS 13. However, we believe that any proposed changes should be in line with the overarching principle that the fair value guidance in FRS 102 should be straightforward to use and capable of operating on a stand-alone basis, i.e. without the need for users to refer back to IFRS 13. Further, we do not believe that the own credit requirements of IFRS 13 should be brought into FRS 102.

We also agree with the suggestion not to incorporate any further IFRS 13 disclosure requirements into FRS 102.

IFRS 15 *Revenue from Contracts with Customers*

We agree that in the longer term the requirements of FRS 102 should be aligned with IFRS 15. We also support consideration of IFRS 15 as part of the next triennial review whilst making no significant changes to revenue recognition before then, for the reasons outlined in paragraph 3.33 of the Consultation Document. We agree with the proposal to include additional guidance in the meantime to encourage better disaggregation of revenue into components and with the recommendation that stand-alone values are used as a basis of allocation. We will consider the detailed proposals when they are outlined in the Phase 1 FRED.

IFRS 16 *Leases*

We largely agree with the proposal to incorporate the requirements of IFRS 16 into FRS 102, effective 1 January 2022. However, we do not agree with the proposed timing of developing the detailed proposals for incorporating IFRS 16 into FRS 102. IFRS 16 is recognised as part of a suite of recently issued standards in inter-connecting areas. As a result the IASB will only allow IFRS 16 to be adopted if the relevant company has adopted IFRS 15 already. We note that the FRC has proposed that, apart from providing guidance on allocating revenue to component parts of a single transaction, it will revisit the application of IFRS 15 at the next triennial review from 2019. We believe that it is appropriate to consider the adoption of IFRS 16 at that point as well. This would allow consistent adoption or amendment of these two standards to occur and the overall approach to their adoption would reflect the approach taken by the IASB.

The above suggestion would, we believe, fit into the suggested adoption date of 1 January 2022 although early adoption of the FRS 102 version of IFRS 16 should be allowed provided the adopted FRS 102 IFRS 15 guidance is applied at the same time as well.

We will consider any proposed disclosure changes when these are included in the Phase 1 FRED.

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)?

We agree that the IFRS 9 expected loss model is an improvement on the IAS 39 incurred loss model. For that reason we believe that all entities reporting under FRS 102 should probably move to an expected loss model in due course.

However, while we believe that it is appropriate for certain financial institutions (such as banks and building societies) to apply either the impairment requirements of IFRS 9 or a simplified version thereof at some point (depending on their ability to adopt the full version), we do not believe it is appropriate to commit to replacing the existing FRS 102 requirements for all other entities with new requirements based on the simplified approach until the practical consequences of adopting IFRS 9 are identified.

Timeline

We do not believe that the proposal to develop an FRS 102 expected credit loss model as part of this triennial review (in the Phase 2 FRED) allows the necessary time for learning from implementation of IFRS 9. We believe that the FRC could use this triennial review period to express a clear intention as to the scope of companies that would be covered by a detailed expected loss model, set expectations for the form of that detailed model and to get input on timetable and readiness of relevant companies.

For entities that are not banks and building societies, no decisions should be made on the impairment model until the next triennial review. Developing detailed proposals for the FRS 102 impairment model as part of the next triennial review would allow time for analysis of implementation issues in practice for IFRS 9 preparers, consistent with the approach proposed for IFRS 15 in paragraph 3.33 of the Consultation Document.

We also do not believe that the FRC needs to remain committed to the 2022 effective date for the expected loss model for banks and building societies if practical considerations mean that application by some of those entities make a later date appropriate. There is precedent for changes to FRS 102 becoming effective outside of triennial review dates. Early adoption of the expected loss model should be permitted.

Scope of detailed expected loss impairment model

We do not believe that the detailed impairment model in IFRS 9 would be appropriate for all FRS 102 entities.

We also do not believe that the cost of implementing the full IFRS 9 impairment rules is justified for all entities that currently meet the definition of "financial institution". For example there are not proportionate benefits for entities that have mostly inter-company loan assets (e.g. group treasury companies). The current definition of "financial institution" is broadly drawn and there are challenges in determining its scope. We understand that the current definition may be revised as part of the triennial review of FRS 102, but even in that case, the scope of the detailed impairment loss requirements is likely to need further consultation and consideration given the costs involved.

Without understanding the proposed details of the impairment model for different entities it will not be possible for feedback on the Phase 1 FRED revised definition of a financial institution to be relied upon when making decisions as to whether that revised definition is appropriate for the detailed expected loss model. The scope of the detailed impairment model should be consulted on along with the detailed proposals.

In determining an appropriate sub-set of financial institutions, one possibility would be to require compliance with the IFRS 9 provisions only for financial institutions that have significant third party loan books, such as banks and building societies. However, before this is mandated consideration needs to be given as to whether the full IFRS 9 model could in practice be applied by some of the smaller banks or building societies and, therefore, whether a simplified version of the impairment model under IFRS 9 would be more in line with the FRS 102 principles.

Other comments on developing the FRS 102 expected loss model

Consideration needs to be given as to whether there are any complications of applying the IFRS 9 impairment model without applying the classification and measurement aspects of IFRS 9. Additionally, whatever model is developed for FRS 102 users, it is important that it can operate on a stand-alone basis and be followed without the need to refer to any of the extensive guidance and interpretation in IFRS 9.

Developing a simplified approach for trade receivables etc.

With regards to suggestions for how the simplified approach to impairment losses in IFRS 9 might be developed into a suitable model for entities applying FRS 102 (other than the sub-set of financial institutions applying the full IFRS 9 impairment model), we believe that it is too early to make these decisions. Until IFRS 9 is applied by non-financial institutions we do not have an appreciation of the consequences of applying the impairment model of IFRS 9 in order to determine where simplifications need to be made. Until we have this insight we believe that the FRC should not commit to any detailed course of action. That said, one possible option is to use a 'lifetime credit loss' model for all financial assets to avoid entities having to make the additional judgements involved with the dual approach, for example determining whether there has been a significant increase in credit risk.

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 (i.e. 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 proposal to retain the IAS 39 option until 1 January 2022 and to withdraw it once the FRS 102 amendments for the impairment of financial assets become effective.

We note that the mandatory effective date for IFRS 9 is 1 January 2018. As of that date, IAS 39 will therefore be superseded, other than the hedge accounting requirements, which remain available pending finalisation of the IASB's dynamic risk management project.

We therefore suggest that, for the avoidance of any doubt, the revised FRS 102 clarifies explicitly that the latest version of IAS 39 immediately prior to the effective date of IFRS 9 remains available for use under the FRS 102 accounting policy choice.

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?

On the assumption that the decision is taken to apply IFRS 16, then we would expect FRS 102 guidance on the practical expedients for short life and low value leases to be consistent with IFRS 16 except where it can be demonstrated that an improvement is justified to meet the FRS 102 objective.

Consideration of any changes to IFRS 16 guidance would be part of the wider consideration of IFRS 16 and IFRS 15 and should take into account practical lessons learned from IFRS 16 transition projects.

Question 6
The FRC proposes to make 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?

Please see our comments on IFRS 10 under Question 2.

We are not aware of any legal barriers to incorporating the control model of IFRS 10 alongside the existing legal requirements.

Based on our experience in practice, entities with special purpose vehicles (SPVs) are most significantly affected by the adoption of the IFRS 10 control model, since increased analysis is required to determine whether control per IFRS 10 exists and that analysis is a qualitative, manual process for each SPV. We do not have the information to comment on how significant this will be for FRS 102 reporting entities, but note that financial institutions have a large number of SPVs and hence are likely to be most affected.

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.

We do not have any comments on the cost-effectiveness of the requirements of FRS 102 Section 26 *Share-based Payment* or what alternative requirements, if any, may be more cost-effective.

With regards to practical implementation of the requirements, whilst we acknowledge that in the past some commentators have noted difficulties in measuring the fair value of awards granted, we believe there is now a good understanding of the approach. We also note that, in our experience, valuation experts are able to reasonably estimate of the fair value of awards even for private companies. The alternative measurement approach currently in IFRS 2.24 (intrinsic value) is used in extremely rare circumstances and considered burdensome because of remeasurement at each reporting date and hence, is not an alternative that we believe to be more cost-effective.

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 largely agree with the proposed effective dates except where noted in our responses above.

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

Please note that there is no need to repeat comments about potential areas for improvements to FRS 102 that have already been submitted to ukfrsreview@frc.org.uk as these comments have already been noted and will be considered. Detailed comments about potential improvements should continue to be submitted to ukfrsrevew@frc.org.uk. Those comments received by 31 October 2016 will be taken into account in developing formal proposals for changes. Comments received after this date will be taken into account in the later stages of the review, if they cannot be considered sooner.

We have no other comments at this point. We previously provided comments in an October 2016 submission to the FRC.

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 do not have any further comments on the costs and benefits likely to arise from the outline proposals in this Consultation Document, other than to emphasise that:

- for IFRS 16 and IFRS 9 it is difficult to adequately assess the costs and benefits in advance of adoption of those IFRSs; and

- we believe that the disadvantages of adopting the IFRS 10 control model at this time will outweigh the benefits.