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Dear Jenny

Consultation Document: Triennial Review of UK and Ireland Accounting Standards

We are pleased to have the opportunity to comment on Consultation Document: Triennial Review of UK and Ireland Accounting Standards (the Consultation Document).

Whilst we agree with the FRC's intentions in trying to finalise the more fundamental changes well in advance of their proposed effective date, the knock on effect is that the Consultation Document is seeking views on the proposed changes before the IFRSs that are driving them have themselves become effective. As a consequence we are concerned that there is an insufficient body of practical implementation evidence on which to base a robust debate about whether and how the principles embodied in these, often complex and lengthy, new IFRSs should be brought into FRS 102. In our view, where changes to FRS 102 are being proposed with a view to maintaining general consistency with IFRSs, these changes should only be made prior to the first post implementation review of the relevant IFRS standard where there is compelling evidence that they will constitute an improvement to the extant requirements. This is consistent with the approach already adopted by the FRC in respect of IFRS 3(R) and IFRS 15 but appears to be inconsistent with the proposals in respect of other major standards such as IFRS 9 and IFRS 16.

We also have a more general point to make about the FRC's approach to conflicts with company law in FRS 101 and FRS 102. As an example, paragraph 3.5 of the Consultation Document highlights that it would not be possible to adopt the IFRS 3(R) requirement not to amortise goodwill as it would be in conflict with the requirements of company law. However, in FRS 101, the FRC has allowed this conflict to exist (through the use of a true and fair override). Conversely, however, both FRS 101 and FRS 102 amend the requirements that apply to negative goodwill under IFRS 3 in order for them to comply with company law. In our view, the FRC should consider adopting a consistent approach to company law throughout UK GAAP or make the reasons for the inconsistency clearer in the standards.

Our responses to the specific questions asked in the Consultation Document are set out in an appendix to this letter.

If you wish to discuss any of the points further, please do not hesitate in contacting me directly.

Yours sincerely,

[redacted]

Nicole Kissun
Partner
For and on behalf of BDO LLP

Appendix: Responses to the questions asked in the Consultation Document

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?

Yes, we agree with the principles as redrafted.

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 set out our views on the proposals and questions related to IFRS 9, IFRS 10 and IFRS 16 in our responses to questions 3, 5 and 6 below.

IFRS 3 Business combinations (revised 2008)

We agree with the proposal not to change FRS 102 to introduce a greater consistency with IFRS 3(R). Furthermore, in response to the acknowledgement in paragraph 3.6 of the Consultation Document that investors had expressed mixed views about, among other things, the identification of so many separate intangibles, we would add that preparers often consider the requirement unduly onerous and expensive to apply. In consequence, we would recommend that the FRC considers whether the triennial review is an opportunity to relax the requirement to recognise intangibles in a business combination accounting.

The above point notwithstanding, we would also make the following observations:

- In paragraph 3.5(a), you state that adding an assertion that a reliable fair value can always be obtained for intangibles would potentially increase the number of separate intangibles recognised under FRS 102. In practice we have generally seen that even with the current wording of FRS 102, the same number of intangibles would be recognised under both frameworks. This has largely been driven by the expert valuers who are, of course, used to IFRS and the assumption that a reliable valuation can always be obtained. It is then difficult to argue that you cannot arrive at a valuation simply because you are operating under a different accounting framework.
- In terms of introducing an IFRS 3(R)-consistent requirement to expense acquisition related costs or fair value contingent consideration through profit or loss, in our view, such changes should only be made if they can be shown to represent a clear and cost effective improvement to FRS 102. We do not consider that to be the case and, therefore, support the FRC's conclusions in this instance.

IFRS 12 Disclosure of Interests in other entities

We agree with the proposal not to update the disclosure requirements of FRS 102 in the light of the introduction IFRS 12.

IFRS 13 Fair value measurement

We agree with the proposal not to update the valuation requirements of FRS 102 in the light of the introduction IFRS 13. We note that it is common practice under UK GAAP to exclude "own credit risk" adjustments from fair value measurements of financial liabilities whereas, under IFRS 13, "own credit risk" adjustments must be taken into account. In consequence, we consider that harmonising the language used would lead to the introduction of a potentially complex and onerous valuation consideration into UK GAAP, which we would not support.

In our response to FRED 62 *Draft amendments to FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland - Fair value hierarchy disclosures*, we expressed the view that it was unhelpful to introduce a disclosure requirement that was inconsistent with the measurement requirements in FRS 102. Instead, we recommended that the FRC allowed an entity a choice between providing disclosures that are consistent with the hierarchy set out in IFRS 13 or consistent with the hierarchy as set out in FRS 102. We remain of this view.

IFRS 15 Revenue from contracts with customers

We agree with the proposal to update the revenue recognition requirements of FRS 102 in order to ensure that an IFRS 15-complaint accounting policy is also acceptable under FRS 102. We also agree with the proposal to bring this change in the Phase 1 FRED.

We also agree with the proposal not to consider further harmonisation with the requirements of IFRS 15, which we can be an extremely complex standard to apply, until the 2019 triennial review. In our view, it is important to consider what, if any, requirements of new IFRSs should be brought into UK GAAP once their practical implications have become apparent through use.

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)?

It is not possible to answer this question decisively without seeing the nature of the "...similar, detailed, requirements..." proposed under option (a) and the "...requirements based on the simplified approach in IFRS 9..." proposed under option (b) and being able to assess whether and to what extent those requirements might differ from those included in IFRS 9.

In addition, we have not yet got a body of experience-based evidence on which to base an assessment of: (i) whether the proposals in IFRS 9 result in a tangible improvement in reporting and (ii) whether the requirements of IFRS 9 are practical and proportionate for the generally smaller and less sophisticated entities that apply FRS 102. We are already experiencing considerable implementation challenges in applying IFRS 9 to intra-group balances. In consequence, consistent with our response to the proposals in respect of introducing aspects of IFRS 15 into FRS 102, we would advocate waiting until the practical implications of IFRS 9 have become apparent through use of the standard before seeking to introduce them into FRS 102. This is particularly the case if, as alluded to in paragraph 3.13(c) there is a suggestion that the FRC is unable to show that the current requirements are "...not operating effectively...".

The above points notwithstanding, however, we are sympathetic to options (b) or (c) for the reasons stated in the consultation. Given the ongoing implementation issues associated with the definition of a "financial institution", we would strongly favour the requirement to look to IFRS 9 to be limited to an unambiguous and small subset of companies that fall within that definition. We would not support the imposition of IFRS 9 on, for example, group treasury companies.

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?

It is counterintuitive that an FRS 102 adopter could elect to use IAS 39 once it has been removed from IFRSs. However, we accept that without this approach, companies that currently apply IAS 39 and who do not wish to transition to IFRS 9, may be forced to move back to the extant version of FRS 102.11/12 for their accounting period beginning on or after 1 January 2018 and before adopting any changes that may arise as a result of the Phase 1 FRED for their accounting period beginning on or after 1 January 2019 and further changes to the impairment model under the Phase 2 FRED. In consequence, we agree that the option to use IAS 39 should remain in place beyond periods beginning on or after 1 January 2018 for those companies that have previously used that option.

However, as the "incurred loss" impairment model in IAS 39 is consistent with that included in the extant version of FRS 102.11/12, we do not consider impairment to be a matter that should be relevant in an entity's decision regarding whether it adopts FRS 102 chapters 11/12 or IFRS 9. In consequence, on the basis that the FRC does not intend to make any further significant changes to FRS 102's classification framework after the Phase 1 FRED, we do not consider it necessary to extend the option to use IAS 39 beyond the effective date of those changes (ie 1 January 2019, unless early adoption is applied).

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?

Whilst we support the general principle of attempting to retain broad consistency with IFRSs, and understand that the introduction of IFRS 16 into IFRSs will introduce significant inconsistencies with the existing requirements of FRS 102, we regard it as premature to be considering how to introduce it into FRS 102 for the following reasons:

- EFRAG has not yet concluded on its endorsement advice in respect of IFRS 16. As part of its work, it has indicated that it will be performing additional research on the effect of IFRS 16 on SMEs. EFRAG's findings in this respect will have direct relevance on the appropriateness of its introduction into FRS 102.
- Many IFRS preparers have only just started considering the practicalities of the introduction of IFRS 16, meaning the body of evidence on which any decision made will be limited; and
- The Consultation Document, in using phrases such as "...it is possible that lenders will be expecting similar information in FRS 102..." and "...may be cost effective...", implies uncertainty over whether users of financial statements will benefit from its introduction.

In consequence, it is our view that the FRC should wait to see what practical implementation problems exist, seek the views of lenders and investors and have regard to the EFRAG findings, before deciding on whether and how to bring IFRS 16's requirements into FRS 102. This conclusion would be consistent with the one the FRC has reached in respect of IFRS 15. We would also highlight that, if preparers of financial statements consider consistency with IFRSs of paramount importance, the option to adopt FRS 101 exists.

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?

Like many of the new IFRSs, IFRS 10 is a detailed and lengthy standard which will be inherently difficult to simplify sufficiently to introduce into FRS 102 without introducing application ambiguities and inconsistencies. In consequence, on the basis that the FRC has concluded that "...in most situations, any changes to the definition of control in FRS 102 will have no impact in practice...", we question the need to incorporate IFRS 10's control model into FRS 102, irrespective of any consideration of company law barriers.

If the FRC is able to make a case for the importance of the introduction of the IFRS 10 control model on the basis of entities that may be consolidated for the first time or cease to be consolidated, then that may also be a case for using a true and fair override to overcome any company law issues that might be identified.

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.

The use of any "generally accepted valuation methodology for valuing equity instruments" as allowed under FRS 102.26.10(c) will be a judgemental exercise for private companies and one might question the usefulness of the value determined when it is subject to such a high degree of estimation uncertainty, particularly when considered in the context of the potential costs involved in seeking expert valuation advice. We note that the FRSSE dealt with equity-settled share-based payment transactions on a disclosure-only basis and consider that there may be some merit in introducing this exemption for private companies under FRS 102.

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?

Whilst we sympathise with the FRC's intentions in trying to finalise the more fundamental changes well in advance of their proposed effective date, the knock on effect is that the Consultation Document is seeking views on the proposed changes before the IFRSs that are driving them have themselves become effective. In our view there is an insufficient body of practical implementation evidence on which to base a robust debate about whether and how the principles embodied in these new IFRSs should be brought into FRS 102. In our view, unless there is compelling evidence that the extant requirements of FRS 102 are not operating effectively, any changes to FRS 102 in the name of maintain consistency with IFRSs should be delayed until after the first post implementation review of the relevant IFRS standard.

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 on the approach to keeping FRS 102 up-to-date as part of the triennial review.

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 further comments on the costs and benefits likely to arise from the outline proposals in this Consultation Document that will help inform the impact assessments.