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Jenny Carter
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Dear Sir

Consultation: Triennial review of UK and Ireland accounting standards – Approach to changes in IFRS

Kreston Reeves LLP appreciates the opportunity to respond to the consultation document issued by the Financial Reporting Council in September 2016 on the Triennial review of UK and Ireland accounting standards.

Kreston Reeves LLP is a firm of Chartered Accountants that is amongst the top 25 largest firms in the United Kingdom. Based in London and the South East, we have a wide range of clients, including AIM listed companies, but predominantly we operate in the SME market providing audit and other accountancy services. We are a member firm of Kreston International, a global network of independent accounting firms.

Q1. 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?

Overall we agree with the principles. Any changes to IFRS should be incorporated into UK GAAP where considered appropriate. However, some of the IFRSs are extremely complex and the majority of entities reporting under IFRS are larger and more complex businesses than those reporting under UK GAAP. Therefore we feel that, when considering how to incorporate changes in IFRS into UK GAAP, the FRC should ensure that any changes are proportionate to the entities applying the standard. As an example, the proposal to introduce the control model in IFRS 10 does not appear to result in a level of benefits that would justify the costs associated with making the change.

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Q2. 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 a result of changes in IFRS as part of this triennial review? If not, please provide alternative suggestions.

We are of the opinion that the first triennial review should focus on making incremental improvements and clarifications to FRS 102 rather than looking forward to some of the substantial changes to IFRS that are on the horizon and how they will be incorporated into UK GAAP. We believe that it is too early to incorporate the core principles of IFRS 9, IFRS 15 and IFRS 16 into FRS 102. None of these IFRSs are as yet effective or have yet been endorsed for use in the EU. Therefore, their practical impact is yet to be determined and will not be for some time yet. Implementation should be deferred until the next triennial review commencing in 2019. It would seem logical to take the opportunity to learn lessons from the IFRS adopters who will apply these standards with effect from 1 January 2018 and 2019 before committing to an amended version for use by UK GAAP adopters.

Q3. 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 do not believe that an expected loss model should be incorporated into FRS 102 at this time. We would favour an approach that simply refers banks and building societies to the relevant sections of IFRS 9 by way of cross reference. All other entities would continue to adopt the incurred loss model currently set out in FRS 102. Our preferred option is the approach set out in paragraph 3.13 (c).

Q4. 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?

We agree with the proposed approach. The option to apply IAS 39 should be retained until FRS 102 has been updated to reflect the requirements in IFRS 9.

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Q5. 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?

As noted above, we do not feel that it is the right time to introduce the "right to use" asset model into FRS 102 for the reasons set out above, even if the effective date is delayed until 1 January 2022.

We would anticipate that any version that is eventually incorporated into FRS 102 would incorporate the short-term lease exemption and the exemption for leases where the value of the underlying asset is low.

Q6. 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?

The proposed changes would have no effect on the vast majority of entities and so the costs of the changes would appear to outweigh the benefits. This is not consistent with the principle to balance improvement with stability. However, we are not aware of any legal barriers to doing so.

Q7. 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.

In our experience, it is particularly hard for small companies to apply the recognition and measurement requirements of Section 26. Share option accounting relies on the use of complex mathematical and valuation models that tend to have little relevance to small companies and can be potentially misleading, ineffective and costly.

We appreciate that under the recent EU Accounting Directive it is not legally permissible to mandate additional disclosures. However, we would propose reverting to a disclosure-only model for small entities when the UK leaves the EU.

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Q8. Do you agree with the proposed effective dates 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 agree with the effective date of 1 January 2019 for incremental improvements and clarifications. We also agree that it would appear reasonable for the more fundamental changes to be effective from 1 January 2022 but that there might need to be more flexibility in implementing some of the changes in terms of timescales than once every three years.

Q9. Do you have any other comments on the approach to the triennial review?

We have no further comments at this time.

Q10. 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 believe that the costs of implementing the proposed changes to reflect the incremental improvements and clarifications, in particular the control model in IFRS 10, will outweigh the benefits.

Yours faithfully

Joe Timms
Director of Financial Reporting
For and on behalf of Kreston Reeves LLP