HW Fisher
& Company

CHARTERED
ACCOUNTANTS

20 December 2016

Financial Reporting Council
by email to ukfrs@frc.org.uk

Our Ref: NNS/MPC

Dear Sirs

COMMENTS ON TRIENNIAL REVIEW OF FRS 102

We write to offer our comments in response to the September 2016 Consultation Document "Triennial review of UK and Ireland accounting standards".

We agree with most of the proposals made by the FRC (including in some areas to defer consideration of particular points to Phase 2 of the review). Our detailed responses to the 10 points raised for discussion are set out in an Appendix to this letter.

The main point that we believe should be considered in Phase 1 of this consultation concerns the treatment of long term interest free, or below market rate, loans between related parties. We continue to believe that in this area (as with the point discussed under Question 7 in the Appendix) FRS 102's requirements give a result which is both confusing and misleading. As suggested in point (x) of the Summary of the Consultation Document, we wrote in more detail on this point on 31 October 2016.

The changes which the FRC has been required to make as a result of the EU Accounting Directive have caused problems. The FRC's view at that time was that the interaction of the exemptions in Section 1A with the continuing requirement to give a true and fair view would lead to an increased burden for companies (in particular where an audit is completed) in deciding which additional disclosures are necessary in each case. In practice, based on discussions with other firms as well as observations within our own practice, the prevailing view appears to be that it would be relatively unusual for disclosures which are not formally required under Section 1A to be made in order to give a true and fair view. In some cases this may have reduced the usefulness of published small company accounts. However, this was not an issue of the FRC's making, and we believe that the changes made to FRS 102 to cater for the Directive were a reasonable compromise in the circumstances.

Notwithstanding our proposals for change in some areas, and the difficulties arising from the EU Accounting Directive, we continue to be supportive of FRS 102 and believe that it has made an overall improvement to accounting.

Yours sincerely

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APPENDIX

RESPONSES TO SPECIFIC POINTS RAISED 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 set out in paragraph 1.11 and with the amendments that have been made to them.

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 broadly agree with the conclusions reached in Section 3 for the updating of FRS 102 to reflect changes in IFRS,

In addition to the more specific points raised in Question 3 below, we would note in particular:

a) The suggestion in 3.5 a) is that an assertion "that a reliable valuation can always be obtained for identifiable intangible assets" would increase consistency with IFRS 3, and might increase the number of assets separately recognised and measured. Such an assertion would clearly not be true. Instead the ability to reliably measure such assets should be a precondition for separate recognition and measurement so that the rational application of this principle would <u>reduce</u> the number of assets separated out. We therefore support the conclusion at 3.7.
b) We agree with the general conclusion on the implementation of the limited changes deriving from IFRS 10 and IFRS 11 regarding the definition of control. The suggestion at 3.22 is that entities "will be able to cost-effectively determine that any changes in FRS 102 do not impact on their accounting". Guidance on the FRC's understanding of the circumstances in which the new requirements <u>are</u> likely to produce a different result would be useful.
c) We agree with the proposal to defer detailed consideration of IFRS 15 until Phase 2 of this review. We also agree that it would be useful to allow some concessions to allow groups whose consolidated accounts are prepared in IFRS scope to apply a consistent approach in component accounts prepared under FRS 102. However, there will be tension between these objectives. In our view the first objective should override the second. That is to say that the minor changes which it is proposed to include in the Phase 1 FRED should not prejudge the issues which will be considered in Phase 2.

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?

We agree that option b) promises to give the best balance between applying these requirements where they are useful (i.e. to financial institutions which are often party to a greater number of complex financial instruments) while avoiding the need for other entities to make disclosures which have no real content.

While we understand why current trading balances are included in the general classification of financial instruments, the standard should, as far as possible, treat such balances in a straightforward manner and make clear those particular circumstances which may require a more complex approach.

We also agree that this is an area which should be left to Phase 2 of the project.

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 think that anything more than a simple judgement as to the recoverability of such assets is required.

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?*

We agree that the option to follow the requirements of IAS 39 should be removed in due course, and that the proposed timing gives a reasonable transition period.

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?

We believe that the traditional view that operating leases and finance leases are different types of contract has merit. The difficulties in deciding which side of the divide some leases fall does not justify the IFRS 16 view that (put simply) all leases are finance leases.

In the absence of particular UK legal or commercial considerations, which might justify a long-term departure from IFRS 16, it may be difficult for the FRC to argue that a different approach clearly better meets the overriding objective, but we believe the FRC should consider carefully whether the short-term lease and low value exemptions really go far enough to allow for accounting that makes sense to a sufficiently wide group of users to the accounts. Leases which would previously have been regarded as clearly being operating leases should not need detailed consideration.

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?*

We have no comment to make on this point, but are not aware of any particular legal barriers.

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?

We have no comments on the point raised, other than the comment made in part b) of our response to Question 2.

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 have previously commented on the application of the requirements concerning share-based payment transactions in private companies where share prices may not be reliably obtained, and are disappointed that this question is phrased in terms of the "cost effectiveness" (and in 4.4 the "difficulties of obtaining reliable fair value measures" for such transactions).

It is questionable whether the requirements of IFRS 2, FRS 20, or FRS 102 Section 26 are consistent with the Statement of Principles. Equity settled share-based payments are transactions with owners or potential owners which do not create a liability in the company and yet are regarded as creating an expense. Even in cases where share-based payments are used to settle an existing liability (for services provided that would otherwise have been paid for in cash), while the expense should be recognised, the use of the share-based payment would be better regarded as converting the liability to an amount in equity.

The argument in favour of the current treatment is that if a company whose shares are traded, and hence readily convertible to cash, enters into a share-based payment arrangement the outcome is in some ways similar to making a payment in cash. In such a company regular payments in shares could readily be converted to cash with little or no effect on the ownership of the company. It is such companies which are the primary focus of the IFRS standards.

For a private company whose shares are not traded, this analogy simply doesn't apply. In such cases share-based payments are exercised more rarely, and then the outcome is more appropriately reflected as a change in ownership of the company. Any charge reflected in the accounts in respect of such arrangement is simply misleading.

We would suggest that if the entity's shares are not traded, equity settled share-based payment arrangements should only be reflected in the accounts on exercise. The existence of such arrangements should be disclosed by way of note until that point. This difference from the IFRS requirements can be justified as such companies are not the primary focus of those standards.

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?

Yes, we agree with these proposals.

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 further points to raise at the moment.

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.

The simplifications we have suggested regarding long-term loans and equity settled share-based payments would reduce costs, as well as producing more comprehensible accounts, but we have not quantified the savings.