Financial Reporting Council

September 2016

Consultation Document

Triennial review of UK and Ireland accounting standards

Approach to changes in IFRS

The FRC is responsible for promoting high quality corporate governance and reporting to foster investment. We set the UK Corporate Governance and Stewardship Codes as well as UK standards for accounting, auditing and actuarial work. We represent UK interests in international standard-setting. We also monitor and take action to promote the quality of corporate reporting and auditing. We operate independent disciplinary arrangements for accountants and actuaries, and oversee the regulatory activities of the accountancy and actuarial professional bodies.

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Contents

Summary

(i) With effect from 1 January 2015, the Financial Reporting Council (FRC) revised financial reporting standards in the United Kingdom and Republic of Ireland. The revisions fundamentally reformed financial reporting, replacing the extant standards with five Financial Reporting Standards:

(a) FRS 100 *Application of Financial Reporting Requirements*;

(b) FRS 101 *Reduced Disclosure Framework*;

(c) FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*;

(d) FRS 103 *Insurance Contracts*; and

(e) FRS 104 *Interim Financial Reporting*.

The FRC has also issued FRS 105 *The Financial Reporting Standard applicable to the Micro-entities Regime* to support the implementation of the new micro-entities regime. It is effective from 1 January 2016 with early application permitted.

(ii) The FRC's overriding objective in setting accounting standards is to enable users of accounts to receive high-quality understandable financial reporting proportionate to the size and complexity of the entity and users' information needs.

Triennial review

(iii) When FRS 102 was issued in March 2013 the FRC indicated that it would be reviewed every three years.

(iv) The first triennial review is now in progress and the FRC is keen to hear stakeholders' views on possible improvements to FRS 102. There will be a number of opportunities for stakeholders to contribute to this debate.

(v) The triennial review process involves considering a wide range of potential sources of improvements and clarifications. This Consultation Document focuses on one of those potential sources. It considers whether and to what extent FRS 102 should be updated for recent changes to IFRS. Comments are requested by 31 December 2016.

(vi) Feedback to this Consultation Document will inform the FRC's work in developing proposals for detailed amendments to its standards. In 2017, the FRC will consult on those proposals through two separate Financial Reporting Exposure Drafts (FREDs); one will propose amendments to be effective in 2019 and the other will propose amendments to become effective over a longer period. Both are expected to include proposals arising from changes in IFRS.

Changes in IFRS

(vii) FRS 102 was developed from the IFRS for SMEs. The FRC's principles for developing succinct financial reporting standards for the UK and Republic of Ireland include implementing IFRS-based solutions unless an alternative clearly better meets the overriding objective (see paragraph (ii) above). Part of the triennial review therefore involves considering changes to IFRS and whether those changes should be reflected in FRS 102. When amendments to FRS 102 are proposed, they will be intended to be proportionate and practical solutions for the entities within the scope of FRS 102.

(viii) After considering recent changes to IFRS, this Consultation Document proposes that limited amendments be made to FRS 102 that will be effective from 1 January 2019. These amendments would:

(a) incorporate relevant improvements from the *2015 Amendments to the IFRS for SMEs*;

(b) incorporate the control model of IFRS 10 *Consolidated Financial Statements*;

(c) update definitions and the fair value hierarchy for greater consistency with IFRS 13 *Fair Value Measurement*; and

(d) improve the separation of contracts for the purposes of recognising and measuring revenue, so that it is similar in this regard to IFRS 15 *Revenue from Contracts with Customers*. The FRC will consider whether more extensive amendments should be made to FRS 102 to more closely reflect the model of revenue recognition in IFRS 15 as part of the next triennial review.

Subject to the responses to this Consultation Document, detailed proposals for these amendments will be included in the first FRED *Triennial review 2017 Phase 1 – Incremental improvements and clarifications* to be issued towards the end of the first quarter of 2017.

(ix) In addition, this Consultation Document proposes that more significant amendments be made to FRS 102 that will be effective from 1 January 2022. These amendments would:

(a) incorporate the expected loss model for impairment of financial assets, based on IFRS 9 *Financial Instruments*; and

(b) update lease accounting by lessees for consistency with IFRS 16 *Leases.*

Subject to the responses to this Consultation Document, the detailed proposals for these amendments will be set out in the second FRED *Triennial review 2017 Phase 2 – Expected loss model and leases* to be issued towards the end of the third quarter of 2017.

Other changes to FRS 102

(x) Although not the focus of this Consultation Document, the FRC continues to welcome and encourage feedback and suggestions for improvements from stakeholders arising from their experience of FRS 102 to date. Such feedback and suggestions should continue to be sent to ukfrsreview@frc.org.uk. These will be considered in developing proposals for incremental improvements in the Phase 1 FRED (proposed effective date of 1 January 2019).

(xi) In addition, the FRC may propose various other changes to FRS 102 to improve or clarify existing requirements.

Other standards

(xii) The triennial review is not restricted to FRS 102, but changes to other standards are expected to be limited and consequential in nature.

Invitation to comment

1 The FRC is requesting comments on this Consultation Document by 31 December 2016. The FRC is committed to developing standards based on evidence from consultation with users, preparers and others. Comments are invited in writing on all aspects of the Consultation Document. In particular, comments are sought in relation to the questions below.

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?

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.

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)?

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?

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?

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?

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.

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?

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.

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.

2 Information on how to submit comments and the FRC's policy in relation to responses is set out on page 24.

1 Overall approach

1.1 When FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* was issued in March 2013, the Financial Reporting Council (FRC) indicated its intention to review the standard every three years and make any necessary changes. Any changes arising from the first triennial review are not expected to be effective before 1 January 2019. Some changes may be effective from a later date.

UK and Ireland accounting standards

1.2 The main focus of the triennial review will be FRS 102, but it will potentially incorporate all the other UK and Ireland accounting standards:

(a) FRS 100 *Application of Financial Reporting Requirements*;

(b) FRS 101 *Reduced Disclosure Framework*;

(c) FRS 103 *Insurance Contracts*; and

(d) FRS 105 *The Financial Reporting Standard applicable to the Micro-entities Regime*.

1.3 However, it should be noted that:

(a) FRS 100 was updated in July 2015 to reflect changes in the financial reporting framework following the implementation of the EU Accounting Directive.

(b) FRS 101 is subject to an annual review to ensure that its disclosure exemptions are kept up-to-date as IFRS changes. These reviews also provide an opportunity to make any other necessary amendments and respond to issues raised by stakeholders. For example, in July 2016 FRED 65 *Draft amendments to FRS 101 – Notification of shareholders* was issued in response to feedback about the clarity and cost-effectiveness of FRS 101.

(c) FRS 103 was amended in May 2016 to reflect changes in the regulatory framework affecting insurers. It is expected that it will be reviewed again once the IASB has completed its project on insurance accounting.

(d) FRS 105 was issued in July 2015 to support the implementation of the new micro-entities regime. It was developed from FRS 102, but simplified significantly to reflect both the legal restrictions relating to the regime and further simplifications appropriate to micro-entities. Implementation experience may lead stakeholders to suggest possible amendments, and when changes are made to FRS 102 the FRC will consider whether consequential amendments are necessary to FRS 105.

As a result, at this stage, only limited amendments, if any, to standards other than FRS 102 are anticipated. Any amendments are likely to be consequential in nature.

1.4 FRS 104 *Interim Financial Reporting* sets out a framework that can be applied if interim financial reports are prepared by an entity that applies FRS 102 in its annual financial statements. Any changes in accounting arising from changes to FRS 102 will automatically feed through to interim financial reports. The FRC will consider whether any changes made to FRS 102 necessitate consequential changes to FRS 104, but this is considered unlikely.

Objective

1.5 When the FRC revised UK and Ireland accounting standards, issuing a suite of new standards that were effective for accounting periods beginning on or after 1 January 2015, it set out its objective in relation to those standards:

To enable users of accounts to receive high-quality understandable financial reporting proportionate to the size and complexity of the entity and users' information needs.

1.6 The FRC believes this objective remains appropriate, and it will continue to guide the development and maintenance of UK and Ireland accounting standards.

1.7 Following the UK referendum and the resulting vote to leave the European Union (EU), the framework for financial reporting in the UK has not changed. The FRC will continue to develop and maintain accounting standards within the framework set by UK and Ireland company law. This Consultation Document is framed within the context of the current legal requirements and does not attempt to pre-empt any possible future changes.

Principles supporting the objective

1.8 In meeting its objective the FRC has been applying five principles, which have assisted in developing succinct financial reporting standards that meet the overall objective. Developing and communicating the principles that have been applied enables consistent decisions to be made in developing the standards and also helps stakeholders to understand and assess the outcome.

1.9 As part of the triennial review the FRC has reviewed the principles and decided that, whilst they remain broadly appropriate, limited changes are necessary. The original principles were developed to support the introduction of a new suite of standards reflecting a significant revision to financial reporting. These standards are now effective and the triennial review represents an opportunity to incrementally develop and maintain them, which requires a degree of balance between making improvements and keeping stability.

1.10 The FRC continues to believe that standards that have broad consistency with international accounting standards are of benefit to UK and Republic of Ireland entities, their investors and other stakeholders. An IFRS-based framework allows better benchmarking and comparison between entities, and FRS 102 has already increased the transparency of reporting in certain areas, notably financial instruments.

1.11 The revised principles (inserted text is underlined) are to provide succinct financial reporting standards that:

(a) have consistency with international accounting standards through the application of an IFRS-based solution unless an alternative clearly better meets the overriding objective;

(b) balance improvement, through reflecting up-to-date thinking and developments in the way entities operate and the transactions they undertake, with stability;

(c) balance consistent principles for accounting by all UK and Republic of Ireland entities with proportionate and practical solutions, based on size, complexity, public interest and users' information needs;

(d) promote efficiency within groups; and

(e) are cost-effective to apply.

The focus of this consultation – updating FRS 102 for changes in IFRS

1.12 The triennial review is an opportunity to make improvements to FRS 102. These might be identified through a variety of different sources including implementation experience and wider developments in financial reporting. Some amendments might be viewed as incremental, others as more fundamental. All amendments will be subject to public consultation through a Financial Reporting Exposure Draft (FRED). However, the FRC is seeking stakeholders' views in advance of developing detailed proposals.

1.13 As FRS 102 has been developed to have consistency with international standards, one of the potential sources for amendments to FRS 102 is a review of recent changes to IFRS. This Consultation Document focuses on how the FRC should respond to changes in IFRS in updating FRS 102.

1.14 Section 2 *Changes in IFRS – Overview* provides an overview of the proposed approach to changes in IFRS and how they might impact on the development of FRS 102. Section 3 *Changes in IFRS – Detailed analysis* provides more details on a number of significant changes in IFRS.

1.15 Various other issues will be considered as part of the triennial review, including issues that stakeholders have already brought to the FRC's attention, and those submitted in response to the FRC's request for stakeholders' views on the implementation of FRS 102, issued via a Press Notice[1] published in March 2016. Section 4 *Other issues* discusses certain other issues that might be considered as part of the triennial review, although it is not a comprehensive guide to all the issues that might be considered.

Subsequent consultations

1.16 Subsequently, we expect two FREDs to be developed, taking into account all the feedback received, as follows:

(a) FRED *Triennial review 2017 Phase 1 – Incremental improvements and clarifications* to be issued towards the end of the first quarter of 2017; and

(b) FRED *Triennial review 2017 Phase 2 – Expected loss model and leases* to be issued towards the end of the third quarter of 2017.

1.17 The majority of the proposed amendments arising from the triennial review are expected to be included in the Phase 1 FRED. Areas where the proposed changes are more fundamental and entities need longer to prepare for implementation will be included in the Phase 2 FRED.

Effective date

1.18 The two phases to this triennial review have different effective dates.

1.19 The incremental improvements and clarifications to FRS 102, to be set out in the Phase 1 FRED, are expected to be effective for accounting periods beginning on or after 1 January 2019. The following items may give rise to these amendments to FRS 102:

(a) feedback received from stakeholders on areas where FRS 102 can be improved;

(b) minor, or narrow scope, amendments to IFRS and new interpretations (IFRICs);

(c) *2015 Amendments to the IFRS for SMEs*; and

(d) any minor improvements to FRS 102 arising from significant changes in IFRS.

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[1] Press Notice 15/16 *FRC invites feedback on FRS 102 to inform is future development* (22 March 2016).

1.20 When more significant changes to FRS 102 are proposed, the amendments are expected to be effective for accounting periods beginning on or after 1 January 2022. This is in order to give entities more time to prepare for transition and to be able to learn from the experience of listed groups already applying the IFRS standards on which the amendments are based. These will be set out in the Phase 2 FRED.

1.21 In all cases, it is expected that early application will be permitted.

Next triennial review

1.22 Some of the amendments arising from this triennial review will not be effective until 1 January 2022, which is expected to coincide with the effective date of the amendments arising from the next triennial review. Current expectations are that Phase 2 of this triennial review will not replace the second triennial review, which will still commence in 2019, with a view to making any further necessary improvements that will also be effective from 1 January 2022.

Timetable

1.23 The timetable for consultation on the triennial review and the expected effective dates of the resulting amendments to FRS 102 is set out in the Appendix: *Timetable*.

2 Changes in IFRS – Overview

2.1 FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* was developed from the IFRS for SMEs (issued in July 2009). However, as part of that development process many amendments were made, for example to permit additional accounting policy choices, reflect the wider scope of application of FRS 102, provide additional clarification and address certain issues that had previously been covered in UK and Ireland accounting standards. Some of these amendments incorporated requirements from IFRS.

2.2 One of the principles for developing UK and Ireland financial reporting standards continues to be “consistency with international accounting standards through the application of an IFRS-based solution unless an alternative clearly better meets the overriding objective”. Therefore, as IFRS changes, or the IFRS for SMEs is revised, it is necessary to consider whether similar changes should be made to FRS 102.

2.3 We have identified three groups of changes to IFRS to consider:

(a) new standards issued and significant changes to existing standards;

(b) minor, or narrow scope, amendments to existing standards and new interpretations (IFRICs); and

(c) amendments to the IFRS for SMEs.

2.4 Although originally based on the IFRS for SMEs as issued in July 2009, FRS 102 already reflects some subsequent developments in IFRS, such as the hedge accounting requirements of IFRS 9 *Financial Instruments*. Nevertheless, there have been a significant number of changes to IFRS that have not been reflected in FRS 102. Conversely, there are some requirements of IFRS that have been considered but are not reflected in FRS 102 because a better alternative is available for the entities within the scope of FRS 102. We do not propose to revisit these areas unless there is evidence that the current requirements of FRS 102 can be improved. One example of an IFRS requirement that is not reflected in FRS 102, and which we do not intend to revisit, is IFRIC 14 *IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction*.

2.5 The intended approach to updating FRS 102, as part of this triennial review, for changes in IFRS is as follows:

Type of changes	**Approach**	**Consultation**
New standards and significant changes to existing standards	Each standard (or set of standards) is considered against the principles to determine whether changes are appropriate or not. This is set out by standard in Section 3.	Approach consulted on in this document. Detailed proposals to follow either in Phase 1 FRED or Phase 2 FRED.
Minor, or narrow scope, amendments to existing standards and new IFRICs	Considered on a case-by-case basis to determine whether FRS 102 has the same underlying requirements and whether it would be improved by making similar amendments.	Detailed proposals to be included in Phase 1 FRED.

Type of changes	Approach	Consultation
2015 Amendments to the IFRS for SMEs	A number of the changes reflect requirements already included in FRS 102. Considered on a case-by-case basis to determine whether FRS 102 would be improved by making similar amendments.	Detailed proposals to be included in Phase 1 FRED.

2.6 The new standards and significant changes to existing standards that are not currently reflected in FRS 102 and have been considered as part of this triennial review are:

(a) IFRS 3 *Business Combinations* (as revised in 2008);

(b) IFRS 9 *Financial Instruments*;

(c) IFRS 10 *Consolidated Financial Statements*;

(d) IFRS 11 *Joint Arrangements*;

(e) IFRS 12 *Disclosure of Interests in Other Entities*;

(f) IFRS 13 *Fair Value Measurement*;

(g) IFRS 15 *Revenue from Contracts with Customers*; and

(h) IFRS 16 *Leases*.

2.7 Section 3 *Changes in IFRS – Detailed analysis* demonstrates how the principles in paragraph 1.11 have been applied in determining whether or not changes to FRS 102 should be proposed for each of the above standards. Broadly speaking, there are four approaches proposed:

(a) Do not amend FRS 102 – there may be company law restrictions and/or it is not clear that any changes would improve financial reporting by entities within the scope of FRS 102.

(b) Make limited amendments to FRS 102 to improve consistency and clarity and either:

(i) review the standard again at a subsequent triennial review once more implementation experience is available; or

(ii) do not review the standard again.

(c) Make significant amendments to FRS 102 to improve financial reporting by entities within the scope of FRS 102.

2.8 In summary, the FRC proposes to make the following changes:

Standard	Changes proposed?	Phase 1	Phase 2
IFRS 3 *Business Combinations* (2008)	No		
IFRS 9 *Financial Instruments*	Yes – expected loss model		✓
IFRS 10 *Consolidated Financial Statements*	Yes (limited) – control model	✓	
IFRS 11 *Joint Arrangements*	Yes (limited) – control model	✓	
IFRS 12 *Disclosure of Interests in Other Entities*	No		

Standard	Changes proposed?	Phase 1	Phase 2
IFRS 13 *Fair Value Measurement*	Yes (limited) – definitions and process for determining fair value Note: No changes are proposed to reflect the extended disclosures in IFRS 13.	✓	
IFRS 15 *Revenue from Contracts with Customers*	Yes (limited) – separating contracts	✓	
IFRS 16 *Leases*	Yes		✓

3 Changes in IFRS – Detailed analysis

3.1 Each significant change in IFRS has been assessed against the principles in paragraph 1.11 to determine whether changes to FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* should be proposed as part of this triennial review.

3.2 Any changes to FRS 102, including those for consistency with IFRS, will be developed in a proportionate and practical way bearing in mind the entities that are within the scope of FRS 102.

3.3 In each case, the FRC has considered whether changes to FRS 102 for consistency with IFRS will improve financial reporting in the UK and Republic of Ireland, and intends to make changes to FRS 102 when this is the case. In particular, the FRC has had regard to the reasons for the IASB undertaking some of these projects, especially when they were addressing concerns that arose during the financial crisis and there was global support for the improvements.

IFRS 3 *Business Combinations* (revised 2008)

3.4 IFRS 3 *Business Combinations* was substantially revised in 2008 but the IFRS for SMEs and FRS 102 are generally based on the original IFRS 3 from 2004. IFRS 3 (as revised in 2008) was effective for accounting periods beginning on or after 1 July 2009.

3.5 Company law includes requirements relating to the accounting for business combinations, and any resulting goodwill. It would not be possible to fully implement IFRS 3 within FRS 102 whilst complying with company law. For example, company law requires goodwill to be amortised over its useful life, whereas IFRS 3 (2008) does not permit amortisation and instead requires an annual impairment test. Other significant changes to FRS 102 that would be required for consistency with IFRS 3 (2008) include:

(a) adding an assertion that a reliable valuation can always be obtained for identifiable intangible assets, potentially increasingly the number to be separately recognised and measured;

(b) requiring acquisition-related costs to be recognised as an expense in the periods in which the costs are incurred or the services are received; and

(c) recognising any changes in the fair value of contingent consideration in profit or loss.

3.6 After IFRS 3 was revised, the IASB carried out a Post-Implementation Review, issuing its findings in June 2015. This identified a number of implementation challenges and also that investors have mixed views about a number of the requirements, including the absence of amortisation of goodwill and the identification of so many intangibles separately from goodwill.

3.7 In applying the principles, the FRC initially notes that company law constrains the achievement of consistency with IFRS, that the concerns raised by users in relation to IFRS 3 (2008) suggest greater consistency with IFRS may not reflect an improvement in FRS 102 and that the cost involved in obtaining valuations for some intangible assets may not be cost-effective. Therefore, the FRC proposes not to change FRS 102 to increase consistency with IFRS 3 (2008).

IFRS 9 *Financial Instruments*

3.8 IFRS 9 *Financial Instruments* was completed in stages and replaces IAS 39 *Financial Instruments: Recognition and Measurement*. It includes requirements for classification and measurement of financial instruments (including impairment), and hedge accounting.

It was completed in 2014 and is effective for accounting periods beginning on or after 1 January 2018. It has not yet been endorsed for use in the EU.

3.9 When the classification requirements of FRS 102 were revised in July 2014, the amendments took into account the IASB's work on IFRS 9, but were drafted as a set of conditions (set out in paragraph 11.9 of FRS 102) to determine classification. As part of this triennial review the FRC will consider feedback from implementation experience and whether these conditions can be further improved, but does not propose to change the overall classification framework. As already announced, the review of the classification conditions will include consideration of the classification of loans with 'two-way' compensation clauses.

3.10 In July 2014 amendments were made to FRS 102 to incorporate hedge accounting requirements based on IFRS 9.

3.11 The most recent significant change to IFRS 9 was the finalisation of the requirements for the impairment of financial assets, ie the move from an incurred to an expected credit loss model. The expected loss model of IFRS 9 is widely regarded as an improvement on IAS 39, on which FRS 102 is based, and was developed in response to the financial crisis. It is this part of IFRS 9 that the FRC considers could be reflected in revisions to FRS 102. Financial institutions are expected to be impacted the most by the introduction of IFRS 9 and some financial institutions are within the scope of FRS 102.

3.12 In applying the principles, the FRC initially notes that consistency with IFRS 9 would represent an improvement in financial reporting and promote consistency between financial institutions applying IFRS and those applying FRS 102, and would anticipate that any costs of implementation should be outweighed by the benefits of improved reporting. Therefore, the FRC proposes to amend FRS 102 to incorporate an expected loss model for the impairment of financial assets. IFRS 9 includes a simplified approach for trade receivables and therefore the impact of amending FRS 102 is likely to be less significant for entities that are not financial institutions.

3.13 Detailed proposals for amendments to FRS 102 will be developed in due course, but a number of approaches are available, including:

(a) incorporating similar, detailed, requirements to those in IFRS 9 – this approach would be similar to the way in which the hedge accounting requirements of IFRS 9 were reflected in FRS 102;

(b) requiring financial institutions (as defined in FRS 102[2]), or a sub-set of financial institutions (such as banks and building societies), to apply the impairment requirements of IFRS 9, whilst replacing the existing impairment requirements of FRS 102 for all other entities with new requirements based on the simplified approach in IFRS 9; or

(c) requiring financial institutions (as defined in FRS 102), or a sub-set of financial institutions (such as banks and building societies), to apply the impairment requirements of IFRS 9 and not making any other amendments to FRS 102 unless there was evidence that the current impairment requirements of FRS 102 were not operating effectively.

3.14 At present the FRC favours option (b) because this will mean all financial institutions (or a sub-set such as banks and building societies) are calculating impairment losses for financial assets on the same basis, which was revised in response to the financial crisis. It

[2] As part of the triennial review, in response to feedback from stakeholders, the FRC intends to review the definition of a financial institution to ensure that it includes appropriate entities.

will also mean that for other entities, the approach is derived from the same principles, but is proportionate and practical.

3.15 When IFRS 9 was finalised in 2014, with an effective date of 1 January 2018, the entities that will be applying it were given over three years to prepare for implementation. Entities applying FRS 102 will similarly want a significant amount of time to prepare for the implementation of an expected loss model within FRS 102, and to be able to learn from the experiences of those applying IFRS 9. Therefore the FRC proposes to delay the effective date for the expected loss model until 1 January 2022. These more significant amendments will be included in the Phase 2 FRED.

FRS 102 accounting policy choice to apply IAS 39

3.16 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 or IFRS 9 (and elements of IAS 39 as amended by IFRS 9). The reference to IAS 39 clarifies that it should be 'as adopted for use in the EU'.

3.17 Assuming IFRS 9 is endorsed for use in the EU, once it is effective IAS 39 will no longer be available as part of EU-adopted IFRS. However, this option within FRS 102 will continue to be available until FRS 102 is amended to remove it. The FRC has considered when it might be appropriate to remove the option.

3.18 The FRC proposes that the option to choose the recognition and measurement requirements of IAS 39 should remain until the requirements for the impairment of financial assets have been amended in FRS 102 (ie for accounting periods beginning before 1 January 2022). At this time, the proposed updating of the financial instruments requirements of FRS 102 in response to the publication of IFRS 9 will be complete, and the option to apply IAS 39 should be removed. The FRC proposes to retain the option to apply the recognition and measurement requirements of IFRS 9.

IFRS 10 *Consolidated Financial Statements* and IFRS 11 *Joint Arrangements*

3.19 IFRS 10 *Consolidated Financial Statements* and IFRS 11 *Joint Arrangements* were issued in 2011 and are effective for accounting periods beginning on or after 1 January 2013. They revised the definition of control, which is used to determine how investments are incorporated into consolidated financial statements. IFRS 10 also includes an investment entity exemption, which requires an investment entity to account for its subsidiaries at fair value, rather than through consolidation.

3.20 FRS 102 already includes a variant of the investment entity exemption, although it focuses on the investee rather than the investor and was developed within the requirements of company law.

3.21 The changes to the definition of control will not have a practical effect on the accounting for many subsidiaries or joint arrangements, and entities may be able to quickly establish when this is the case. However, the improvements in the definition of control were made to address concerns about the boundary of the reporting entity and, when relevant, these improvements should also apply to entities applying FRS 102.

3.22 In applying the principles, the FRC initially notes that consistency with the control model of IFRS 10 (and consequently joint control in IFRS 11) would represent an improvement in financial reporting (given the reasons for the changes in IFRS) and the FRC anticipates that many entities will be able to cost-effectively determine that any changes in FRS 102 do not impact on their accounting (for example because they clearly meet the company law criteria for preparing group accounts), limiting the costs of implementation. A more significant impact may be noticed in relation to special purpose entities.

3.23 The FRC proposes to make limited amendments to FRS 102, as part of the Phase 1 FRED, to update the control model, principally by revising the definition of control and providing guidance on its application. This will be in addition to any specific circumstances in which company law requires group accounts to be prepared.

IFRS 12 *Disclosure of Interests in Other Entities*

3.24 IFRS 12 *Disclosure of Interests in Other Entities* was issued in 2011 and was effective for accounting periods beginning on or after 1 January 2013. It requires disclosure about subsidiaries, joint arrangements and associates.

3.25 FRS 102 requires fewer disclosures than IFRS, and already includes disclosure requirements relating to interests in other entities. To date there is no evidence that the users of financial statements prepared in accordance with FRS 102 require additional disclosure about interests in other entities.

3.26 In applying the principles, the FRC initially notes that consistency of disclosure between IFRS and FRS 102 is not necessary given the differences in the users of the financial statements of listed groups and entities applying FRS 102. There is no current evidence that the FRS 102 disclosure requirements for interests in other entities require improvement. Therefore, stability is important and it would not be cost-effective to require additional disclosure. As a result, the FRC proposes not to amend FRS 102 following the issue of IFRS 12.

IFRS 13 *Fair Value Measurement*

3.27 IFRS 13 *Fair Value Measurement* was issued in 2011 and was effective for accounting periods beginning on or after 1 January 2013. It provides a framework for determining fair value, when other standards require or permit fair value measurement, and requires disclosure about fair value.

3.28 FRS 102 was amended in March 2016 to require financial institutions to provide information in accordance with a hierarchy based on IFRS 13.

3.29 As part of the March 2016 amendments to FRS 102 the FRC has already indicated that paragraph 11.27 of FRS 102 (which sets out a process for estimating fair values) would be reviewed for greater consistency with IFRS 13. The FRC will also consider the consistency of key definitions. These minor amendments will be included in the Phase 1 FRED.

3.30 In applying the principles, the FRC initially notes that this consistency of definitions will aid preparers and users in obtaining and understanding fair value information, when it is required. However, as FRS 102 generally requires fewer disclosures than IFRS but already requires financial institutions to provide certain disclosures that are consistent with IFRS 13, the FRC proposes not to amend FRS 102 to incorporate any further disclosure requirements of IFRS 13.

IFRS 15 *Revenue from Contracts with Customers*

3.31 IFRS 15 *Revenue from Contracts with Customers* was issued in 2014 and is effective for accounting periods beginning on or after 1 January 2018. It provides a five-step process for recognising and measuring revenue. It has not yet been endorsed for use in the EU.

3.32 Revenue is usually a key piece of performance information for the users of financial statements and therefore users of financial statements are likely to value consistency of approach to the recognition and measurement of revenue. This makes it easier to understand financial statements and make comparisons between entities that report under different accounting standards. Therefore the FRC proposes that, in the longer term, the revenue requirements of FRS 102 should be aligned with IFRS 15.

3.33 However, the FRC acknowledges that IFRS 15 is not yet effective, and has recently been subject to amendment as entities prepare for its introduction. For some entities the introduction of IFRS 15 will be a significant change in approach and entities applying FRS 102 will want to take advantage of the experience of others in preparing for a smooth transition. Therefore the FRC is not proposing to make significant changes to accounting for revenue as part of this triennial review, but will revisit IFRS 15 at the next triennial review from 2019. It is too early to determine the outcome of that review, from which any amendments would be expected to be effective from 1 January 2022 or a later date.

3.34 However, some entities applying FRS 102 might be members of a group that applies IFRS in its consolidated financial statements. Minimising consolidation adjustments will lead to a more cost-effective accounts production process for these entities and groups, and is consistent with the principle of promoting efficiency within groups. Therefore the FRC has considered whether the requirements of FRS 102 could be strengthened to make it more likely that a single accounting policy for revenue could meet the requirements of both IFRS 15 and FRS 102. In order to achieve this, the FRC proposes to provide additional guidance in FRS 102 on how revenue can be allocated to the component parts of a single transaction to reflect the substance of the transaction. This guidance would be likely to highlight the need to consider all goods and services that have been transferred and recommend the use of relative stand-alone values as a basis for allocation. These minor amendments will be included in the Phase 1 FRED.

IFRS 16 *Leases*

3.35 IFRS 16 *Leases* was issued in 2016 and is effective for accounting periods beginning on or after 1 January 2019. It has a single model for lessee accounting and requires more leases to be recognised as an asset and a liability than previously. It has not yet been endorsed for use in the EU.

3.36 The FRC notes that IFRS 16 is intended to provide enhanced information for users of financial statements by giving more accurate information about the financial position of an entity and will allow better comparisons between companies that borrow to finance assets and those that use leases.

3.37 Leasing is common amongst entities applying FRS 102 and the improvements in information for users that are expected for entities applying IFRS 16 should be equally relevant to entities applying FRS 102. Indeed, it is possible that once IFRS 16 has been implemented, some users, for example lenders, will be expecting similar information from any entity whether or not it is reported in the financial statements.

3.38 In applying the principles, the FRC initially notes that consistency with IFRS 16 would improve the information available to the users of financial statements regarding leases. It may also be more cost-effective than providing additional information to users when it is not included in the financial statements. Therefore the FRC proposes to amend FRS 102 to incorporate the requirements of IFRS 16.

3.39 The FRC notes that IFRS 16 includes a practical expedient for short life and low value leases. The FRC will be giving particular consideration to how the low value expedient might operate for FRS 102.

3.40 However, entities applying FRS 102 will want time to prepare for implementation and assess the impact on current, and proposed, leases and similar contracts, particularly if other financial arrangements require amendment (such as loan covenants). Therefore the FRC proposes to delay the effective date for leases until 1 January 2022. These more significant amendments will be included in the Phase 2 FRED.

3.41 In the meantime, the FRC will give consideration to whether the lease disclosures of FRS 102 can be enhanced in order to improve the information available to users. If any changes are considered to be appropriate, these minor changes will be included in the Phase 1 FRED.

4 Other issues

4.1 The FRC has also considered other issues that might be a driver for changes to FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*.

Financial instruments

4.2 Some stakeholders have suggested aspects of the financial instruments requirements of FRS 102 that could be reviewed as part of this triennial review. This includes the definition of a financial institution and the classification of financial instruments. In addition to any amendments to implement further aspects of IFRS 9 *Financial Instruments*, the FRC intends to consider these issues, amongst others. The FRC may also reconsider the layout of Sections 11 and 12 of FRS 102, and whether it can be improved.

Share-based payment transactions

4.3 FRS 102 is broadly consistent with IFRS 2 *Share-based Payment* and FRS 20 (IFRS 2) *Share-based Payment*, which applied in the UK and Republic of Ireland before FRS 102 became effective. It does, however, include some simplifications that were intended to make it easier to value share-based payment transactions.

4.4 The FRC has not, to date, received significant feedback suggesting that Section 26 *Share-based Payment* of FRS 102 is in need of substantial revision. However, in the past some commentators have noted the difficulties of obtaining reliable fair value measurements for share-based payment transactions in private companies, when share prices may not be easily obtainable.

4.5 The requirements of Section 26 have broadly been operating since 1 January 2006 and this converged solution is well embedded and results in the recognition of an expense when goods or services are received in a share-based payment transaction. However, the FRC would be keen to understand any views about its practical implementation and cost-effectiveness, and whether any alternatives could provide useful information to users.

Government grants

4.6 FRS 102 includes advice to the FRC from the Accounting Council that permitting the accrual model for government grants, as well as the performance model, should be considered an interim solution given that there was inconsistency in practice at the time, and pending a research project on the topic.

4.7 The FRC notes that inconsistency in practice has continued. There is also potentially an inconsistency in accounting for grants depending on the source of the grant, as grants that are not from government sources are accounted for in accordance with Section 34 *Specialised Activities*, which requires the application of the performance model.

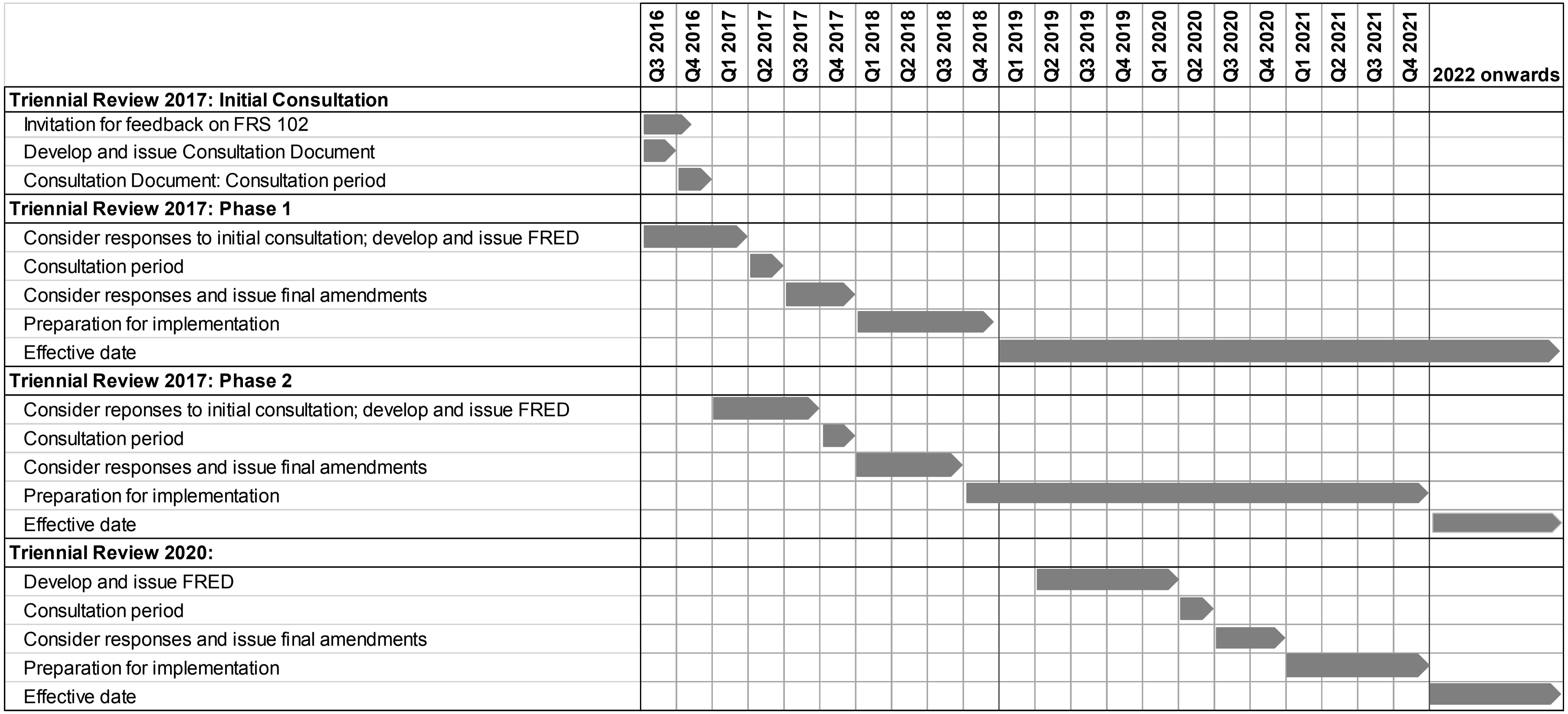
4.8 This remains a situation which is not ideal. It should also be noted that entitles have the option to apply EU-adopted IFRS instead of UK and Republic of Ireland accounting standards, including IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*, and so without an internationally accepted solution inconsistency in this area is likely to continue. Therefore although the FRC would like to improve consistency of accounting in this area, the time is not right for significant change. The FRC will participate in any international efforts to move this debate forward, and although this project is not currently on the IASB's active or research agendas, the FRC will consider adding the issue to its own research agenda.

Disclosure

4.9 When changes were made to FRS 102 to incorporate Section 1A *Small Entities*, the FRC received some feedback about similarly aligning the disclosure requirements for larger entities with company law requirements.

4.10 As part of this triennial review the FRC intends to review the disclosure requirements of FRS 102 with a view to seeking greater alignment with company law requirements, when possible, and to consider whether, in the light of experience, any requirements should be amended.

Appendix: Timetable



This Consultation Document is issued by the Financial Reporting Council for comment. It should be noted that the proposals may be modified in the light of comments received before an Exposure Draft is issued.

For ease of handling, we prefer comments to be sent by e-mail to:

ukfrs@frc.org.uk

Comments may also be sent in hard copy to:

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

Comments should be despatched so as to be received no later than 31 December 2016.

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