

22 December 2016

Jenny Carter
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By email to: ukfrs@frc.org.uk

Dear Ms Carter

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

Deloitte LLP welcomes the opportunity to comment on the Financial Reporting Council's Consultation Document: *Triennial review of UK and Ireland accounting standards – Approach to changes in IFRS* (the Consultation). We have set out our responses to the consultation questions in Appendix 1 and some further comments in Appendix 2.

We agree with the overall concept of keeping UK GAAP broadly aligned with IFRS but also would highlight the need to balance stability with improvement, as is set out in the proposed amendments to the principles for developing succinct financial reporting standards for the UK and Ireland. We believe it is important to be able to demonstrate how any proposed amendments to UK and Ireland financial reporting standards are in line with this principle. Bearing this in mind we believe the Phase I Financial Reporting Exposure Draft ("FRED") should focus on incremental improvements arising from the experience of stakeholders in applying FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*.

We agree that it is useful to consider and discuss the proposed more fundamental changes currently proposed to be effective from 1 January 2022. However we feel that publishing detailed proposals in 2017 would be premature when there is currently no practical experience of how UK listed companies have implemented the requirements of IFRS 9 *Financial Instruments* and IFRS 16 *Leases*.

We would be happy to discuss our letter and the draft proposals with you. If you have any questions, please contact Ken Rigelsford on 020 7007 0752 or krigelsford@deloitte.co.uk.

Yours sincerely

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Appendix 1

Responses to detailed questions

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 agree with the principles included in paragraph 1.11 for developing succinct financial reporting standards for the UK and Republic of Ireland. We also agree with the limited changes that have been made to these, particularly the introduction of the need to balance improvement with stability. This is an important consideration that we feel should be at the forefront of any decision to amend financial reporting standards. We would encourage the FRC to demonstrate how any proposed amendment to the standard satisfies these 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 a result of changes in IFRS as part of this triennial review? If not, please provide alternative suggestions.

We have provided comments on the proposals suggested for updating FRS 102 as a result of changes in IFRS as part of this triennial review in the table below. In our view it was not always clear how the conclusion reached by the FRC was in line with the revised principles.

Standard	Changes proposed?	Phase 1	Phase 2	Deloitte comments
IFRS 3 <i>Business Combinations</i> (2008)	No			We agree with the proposal not to change FRS 102 to increase consistency with IFRS 3 (2008) for the reasons set out in the Consultation.
IFRS 9 <i>Financial Instruments</i>	Yes – expected loss model		✓	See response to Question 3.
IFRS 10 <i>Consolidated Financial Statements</i>	Yes (limited) – control model	✓		See response to Question 6.
IFRS 11 <i>Joint Arrangements</i>	Yes (limited) – control model	✓		See response to Question 6.
IFRS 12 <i>Disclosure of Interests in Other Entities</i>	No			We agree with the proposal not to change FRS 102 to increase consistency with IFRS 12 for the reasons set out in the Consultation.
IFRS 13 <i>Fair Value Measurement</i>	Yes (limited) – definitions and process for determining fair value	✓		We do not agree with the proposal to change the definition of fair value or the process for estimating fair values in FRS 102 to increase consistency with IFRS 13 as part of the Phase 1 amendments. A consistent definition of fair value is a desirable aim but now is not the time to change it when people are only just getting used to the requirements of FRS 102. The hierarchy described in Section 11 is merely describing an order of preference for sources of valuations. Changing it to be

				consistent with the one in Section 34 is unlikely to have any practical effect but would make the standard more internally consistent and also consistent with IFRSs and therefore makes sense.
IFRS 15 <i>Revenue from Contracts with Customers</i>	Yes (limited) – separating contracts	√		<p>We agree with the proposal to provide additional guidance in FRS 102 to increase consistency with IFRS 15 as regards how revenue can be allocated to the component parts of a single transaction to reflect the substance of the transaction.</p> <p>We support the proposed approach of not making more significant changes to accounting for revenue as part of this triennial review given the current lack of experience of how IFRS 15 will be implemented in practice by UK listed companies.</p>
IFRS 16 <i>Leases</i>	Yes		√	See response to Question 5.

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 would favour requiring a subset of financial institutions (such as banks and building societies) to apply the impairment requirements of IFRS 9 and not making any other amendments to the impairment requirements at this stage, which is broadly in line with option (c). This approach promotes consistency for that subset of financial institutions where the benefits are greatest, whilst providing an opportunity to see how listed companies, particularly those that are not financial institutions, deal with the impairment requirements of IFRS 9 following its implementation. This will provide the practical information necessary for the FRC to develop simplified requirements and to assess the benefits and costs of introducing an expected loss model. It therefore seems premature to adopt approach (b) given the lack of experience in dealing with IFRS 9.

In terms of suggestions for how the simplified approach in IFRS 9 to impairment losses for trade receivables, contract assets and lease receivables might be developed into a suitable model for FRS 102, we again believe it would be most beneficial to await implementation of IFRS 9 to gain some exposure as to how listed entities are applying these requirements in practice. The requirement to incorporate forward looking information and consider multiple scenarios may mean that a lot of work will be needed to apply even the simplified IFRS 9 impairment model, which ultimately may not have a significant impact on the level of impairments recognised by most corporate entities (i.e. other than banks and building societies). We believe that, in line with the principles included in paragraph 1.11, the FRC should seek to ensure that any change proposed to the impairment model for such corporate entities is proportionate and practical.

We are in favour of requiring only a subset of financial institutions to apply the impairment requirements of IFRS 9. A possible approach, which we would support, is to restrict it to banks and building societies as defined in paragraphs (a) and (b) of the existing definition of a financial institution in FRS 102. An alternative might be to use the EU definition of a credit institution which is “an undertaking the business of which is to

take deposits or other repayable funds from the public and to grant credits for its own account" although this is likely to have the same practical effect in the UK.

This approach involves a simple cross reference to the relevant requirements of IFRS 9 for those within scope. It could therefore be implemented through the Phase 1 amendments but with a 2022 effective date. This would have the advantage of making the requirements available for early adoption by any banks and building societies that wanted to do so at the same time as IFRS reporters. Extension of the requirements to other entities in some form could then be considered at a later date.

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 option to choose to apply the recognition and measurement requirements of IAS 39 until the requirements for the impairment of financial assets have been amended in FRS 102.

However we believe it is important to amend the reference to IAS 39 in paragraph 11.2 of FRS 102 following the introduction of IFRS 9 given the fact that IFRS 9 will replace IAS 39. This is in order to ensure minimal disruption to entities currently applying IAS 39. A means of doing this would be to amend the description in paragraph 11.2(b) to read "the recognition and measurement provisions of IAS 39 *Financial Instruments: Recognition and Measurement* (as previously adopted for use in the EU at 1 January 2016)..." This would prevent any confusion around the ongoing ability to apply IAS 39 following its replacement by IFRS 9 for periods beginning on or after 1 January 2018. It is necessary to retain reference to adoption by the EU to permit the continued availability of the "carve out" for any entities currently making use of it.

We agree with the proposal that, once the amended requirements to FRS 102 for the impairment of financial assets are mandatorily effective, that the option to apply the recognition and measurement requirements of IAS 39 would be removed.

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 it is appropriate to converge FRS 102 with IFRS 16 *Leases* to address long-standing concerns about the transparency around off-balance sheet liabilities. We support the proposal to introduce such requirements in 2022 but to give advance notice of that intention now. However, we believe that in the short term it would be more reasonable and practical to let UK listed companies gain the experience of applying IFRS 16 first before completing (or even starting) the drafting of any amendments to FRS 102.

We suggest that the FRC publishes a discussion paper once there is experience of applying IFRS 16 in order to inform the development of an exposure draft of FRS 102 incorporating the principles of IFRS 16. We do not, at this time, have any specific comments on application of either of the exemptions in IFRS 16 given the current lack of experience of applying these exemptions under IFRS itself.

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?

There is an existing tension between the requirements of FRS 102 and the legal definition of a subsidiary undertaking which will not be resolved by these proposed changes to FRS 102. We understand that it is the FRC's intention that all entities meeting the legal definition of a subsidiary undertaking should be included in the consolidation except when specific exceptions apply. In comparatively rare cases, some additional entities meeting the wider definition of "subsidiary" in FRS 102 may also need to be consolidated. We do not believe that this conflicts with the law. However, irrespective of any changes to converge with the control model in IFRS 10, it would be helpful to amend Section 9 to state, for the avoidance of doubt, that the definition of a subsidiary includes any entity that is a subsidiary undertaking for legal purposes.

We do not agree with the incorporation of the control model of IFRS 10 into FRS 102 at this time although we agree that it should be a longer term aim. A consistent control model is a desirable aim but now is not the time to change it when people are only just getting used to the requirements of FRS 102. It may also be appropriate to await the outcome of the post-implementation review of IFRS 10 before incorporating its principles into FRS 102.

Following the adoption of IFRS 10, very few listed companies had to make any changes to their previous accounting, one exception being the introduction of the concept of de facto control which affected a limited number. De facto control is very unlikely to be relevant to companies applying FRS 102. It would therefore be beneficial if the FRC could provide some further information as to whether they have in mind any specific type of entity that they believe should be being consolidated that currently is not under FRS 102. This would allow some insight as to the reasons behind these proposed amendments and how they fit with the principles in paragraph 1.11, particularly the need to balance improvement with stability and the need for cost-effectiveness. More targeted amendments, or improved disclosures, to address specific concerns would be a better solution in the short term.

We also believe that it would be difficult to abbreviate the requirements of IFRS 10 significantly if the objective is to achieve consistency of interpretation between IFRS 10 and FRS 102. Taking de facto control as an example, users who are unfamiliar with IFRS 10 would be unlikely to reach the same conclusion from just the high level principles without reference to the Application Guidance. The requirements might therefore need to be disproportionately lengthy to achieve any change of practice. These issues can be addressed in slower time and need not be part of the Phase 1 amendments.

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 believe that the accounting for share-based payment transactions under FRS 102 should not provide any new challenges, except in the case of small companies transitioning from the FRSSE to Section 1A of FRS 102, given the consistency with old UK GAAP.

We understand that there appears to be some continuing concern about the cost/benefit of applying these requirements to companies that do not have a quoted share price. However, we believe that if companies offer such benefits to employees they should be able to determine the value of these in an overall cost-effective manner.

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 agree with the proposed effective date of 1 January 2019 for the introduction of incremental improvements and clarifications.

In principle, we agree with working toward a proposed date of 1 January 2022 for the introduction of more fundamental changes relating to IFRS 9 *Financial Instruments* and IFRS 16 *Leases*. We also believe that it is beneficial to consider these issues now and to gather views on any potential changes given the possible uncertainty amongst non-IFRS reporters in the UK. However we feel it is essential that some flexibility is retained given the lack of experience of the practical issues of applying both these standards amongst IFRS preparers. It would therefore be more beneficial to delay the drafting of more fundamental changes to closer to the time to allow experience of applying IFRS 9 and IFRS 16 to be obtained. This could be kept under review and then fall within the scope of the second triennial review scheduled to commence in 2019.

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 already made the FRC aware of certain issues by the 31 October 2016 deadline.

In terms of the approach to keeping FRS 102 up to date we support the overall idea of the triennial reviews but would suggest that some flexibility be incorporated in order to be able to make changes on a more piecemeal basis if necessary. This could be achieved by the issuance of a simple clarification statement as and when required and would ensure that any minor changes could be made, for example to fix errors, significant areas of inconsistency or unintended results, rather than delaying these for potentially three years until the next triennial review.

We also believe that it is important to ensure that there is sufficient public awareness and outreach of any discussions relating to keeping FRS 102 up to date and of any potential amendments. We are aware that some commentators are calling for the minutes of the UK GAAP TAG meetings to be made publicly available but appreciate that there are difficulties with this given the advisory status of the group. Any amendments to standards or definitive interpretations must go through appropriate due process. However, there may be circumstances when it is helpful to acknowledge publicly that issues are under discussion and that views on interpretation may differ pending any formal amendment to FRS 102. This happened in the case of the social housing loans with two-way compensation clauses. Conversely, it might be possible to indicate, for example through Staff Education Notes, that there is a wide consensus that FRS 102 should be interpreted in a particular way. A quarterly newsletter might be another approach to informing stakeholders of issues currently being considered.

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 believe that at this point it is hard to comment on the costs and benefits likely to arise. However, as detailed elsewhere, we do not believe that some of the proposed amendments meet the principle of balancing improvement with stability and consequently the cost is likely to outweigh the benefit for these at this point.

Appendix 2

Other comments

Financial instruments

We have already submitted our comments on the proposal to review the definition of a financial institution as part of this triennial review. In terms of reconsidering the layout of Sections 11 and 12 of FRS 102 we do not believe this is a major priority and, although acknowledging the potential benefits of having only one section of the Standard that deals with financial instruments, we realise that reporters will now have become accustomed to the current layout.

Share-based payments

Again, we have already submitted comments on the need to revise Section 26 *Share-based Payment* of FRS 102. Although we acknowledge that no fundamental changes need to be made to converge FRS 102 with IFRS 2 *Share-Based Payment* we do believe that some minor drafting improvements could be made to FRS 102 to improve consistency in some areas. For example some of the definitions provided in IFRS 2 are currently missing from or inconsistent with the contents of FRS 102 when there is no good reason for such inconsistency. While consistency with the requirements of IFRSs has to be weighed against stability, in the case of share-based payment accounting, the requirements of FRS 20 were already converged with IFRS 2. Therefore this is also about ensuring consistency with the requirements of FRS 20 with which most users are already familiar.

Government grants

We agree with the proposal not to undertake any significant change to Section 34 *Specialised Activities* of FRS 102 in relation to the accounting for government grants given the present international inconsistency in this area which needs to be resolved.

Disclosure

We do not believe that this triennial review is the right time to review the disclosure requirements of FRS 102 for larger entities with a view to seeking greater alignment with company law requirements. Given the UK vote in June 2016 to leave the European Union, the future shape of UK company law, particularly after any EU exit, is uncertain. It would therefore be preferable to wait until this uncertainty is at least partly resolved before undertaking any attempts to greater align FRS 102 disclosure requirements with those of UK company law.