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Dear Ms Sansom

The Future of UK GAAP

Introduction

Ernst & Young LLP welcomes the opportunity to comment on FRED 46 (draft FRS 100), FRED 47 (draft FRS 101) and FRED 48 (draft FRS 100) *The Future of Financial Reporting in the UK and Republic of Ireland* issued by the Accounting Standards Board ('the ASB'). This covering letter includes an overview of our comments on the proposals.

Overall comments

Overall, we support the proposed financial reporting framework outlined in draft FRS 100, and the extension of the reduced disclosure framework in draft FRS 101 and draft FRS 102 to all qualifying entities.

We also support the ASB's proposals for a mandatory implementation date of 1 January 2015, with early adoption not prior to periods beginning after the date of publication of the standards. However, we set out risk factors that could give rise to a need for delay in our response to Q8 in Appendix 1. Should there be a significant delay to finalisation of draft FRS 102, we believe that the ASB should proceed with issuing draft FRS 101. In our experience, many entities are interested in taking advantage of IFRS with reduced disclosures at the earliest opportunity, as this permits consistent recognition and measurement principles with IFRS used for group reporting purposes while reducing the burden of the disclosures required by full IFRS.

We support the ASB's objectives in issuing draft FRS 102, to improve financial reporting in the UK in a manner that will be proportionate to users' needs. We consider that FRS 102 will improve UK GAAP, most notably by introducing requirements on accounting for financial instruments, and that, over time, FRS 102 has the potential to reduce the burden of reporting for UK entities.

We recognise that the ASB has considered carefully and responded to the comments on the earlier FREDs 43 to 45 and has made a number of amendments to its proposals to reduce the reporting burden. In general, we support the amendments made by the ASB. However, we have a number of reservations and comments, mainly over the content of draft FRS 101 and draft FRS 102. In relation to the latter, these relate both to issues in the underlying text of the IFRS for SMEs and amendments made by the ASB. We have set out our concerns in some detail, and where appropriate, suggested ways of addressing the issues raised. We ask the ASB to consider these in finalising its proposals. It is important that the final standards are clear and workable for UK entities, many of whom do not have

experience with IFRS, and do not give rise to undue diversity of practice due to difficulties in interpretation.

As companies and their advisers start to look at the practical implications of implementing FRS 102, it is likely that more issues needing interpretation will be identified and need to be resolved. This is particularly likely because of the limited guidance in draft FRS 102 and lack of practical experience in applying the IFRS for SMEs, on which the proposed standard is based, as compared with IFRS. We anticipate that there will be an ongoing need for further formal interpretation of the requirements, and we ask the ASB to set out the process to achieve this.

Finally, FRS 102 will need to be reviewed in light of changes to IFRS and the IFRS for SMEs. We consider it important that UK entities understand the process for and likely timing of future updates to FRS 102. We support a stable platform for UK entities before implementing mandatory adoption of significant changes in IFRSs into FRS 102. However, we recognise that there may be a need for an Improvements process to address issues that may be identified with the final standards.

We set out below specific accounting areas where we have the greatest concerns. These and further significant issues identified are discussed in more detail in our response to Q1 in Appendix 1. There is a fuller list of issues identified in Appendices 2 to 5.

Significant comments on content of the proposals

Draft FRS 101

Formats

We believe it will be difficult for entities to comply with both IAS 1 and the company law formats for the balance sheet and income statement. These difficulties will be especially acute for companies reporting under Schedule 2 or Schedule 3 of The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 ('the Regulations') where there is no flexibility to adapt the formats. We therefore strongly recommend the ASB to require companies using FRS 101 to follow the company law requirements rather than additionally needing to comply with IAS 1. See our comments in Appendix 2.

Draft FRS 102

First time adoption

Draft FRS 102 states that an entity can only be a first time adopter of the standard once. Situations may arise where an entity would wish to reapply FRS 102, for instance where an entity had, say, moved to IFRS but later became part of a group whose members applied FRS 102 rather than IFRS in their financial statements. We believe that the ASB needs to clarify whether paragraph 35.2 requires an entity reapplying FRS 102 to 'grandfather' first time adoption accounting used when FRS 102 was applied for the first time, or requires full retrospective application of FRS 102. Since the IASB has amended IFRS 1 to clarify that an entity can be a first time adopter of that standard more than once, we ask the ASB to consider whether a similar amendment should be made to the FRS 102. This could ease the difficulties of restating transactions, particularly business combinations, under the requirements of FRS 102. We set out where we consider the ASB should clarify, amend or add additional transitional exemptions in our comments on section 35 in Appendix 5.

Taxation

We believe that the new section 29 that proposes a 'timing differences plus' approach which aims to give in most cases the same answer as IFRS, is based on a flawed conceptual approach. There is a conflict between its competing objectives of a 'timing differences plus' approach and its requirement that deferred tax represents the future tax consequences of transactions and events recognised in the financial statements of the current and previous periods. There are also a number of internal inconsistencies. The combination of no sound conceptual foundation and inconsistent guidance means that there will be uncertainty over accounting for many situations where there is clarity or consensus under UK GAAP and IFRS. In our view, the ASB needs to reconsider the approach and redraft this section to make it workable. See our comments on section 29 in Appendix 5.

Treatment of ESOPs/EBTs

We believe that draft FRS 102 disturbs the established consensus for the treatment of ESOPs (and EBTs) under UK GAAP and now includes various internal inconsistencies between the requirements of sections 2, 9 and 28. Most significantly, it includes an apparent requirement for ESOPs to be consolidated where an investor is a parent, whether or not consolidated financial statements are prepared, but for ESOPs to be treated as an extension of the reporting entity where an investor is not a parent. It is not clear whether this is intentional and we do not understand the conceptual basis for this distinction. We strongly recommend that the ASB review these inconsistencies and reconsider the model for ESOPs. Since IFRS does not specify whether ESOPs are to be consolidated or treated as an extension of the sponsoring entity, we recommend that the ASB does not alter the position under UK GAAP and that FRS 102 should continue to treat ESOPs as an extension of the sponsoring entity. We highlight various further drafting issues in the discussion of paragraphs 9.10 and 9.25 in Appendix 5.

Derecognition of financial assets

The financial asset derecognition rules in paragraph 11.33(c) differ from those contained in EU adopted IFRS (in particular, paragraph 20 of IAS 39). The derecognition rules in draft FRS 102 derive from those included in the IFRS for SMEs, that were based on an exposure draft of new control-based derecognition rules which were never adopted into IFRS. They appear to require derecognition even where the transferor retains some significant risks and rewards of ownership of a financial asset, provided the transferee has the practical and unilateral ability to sell the asset in its entirety to an unrelated third party. The practical impact of this is that financial assets subject to most sale and repurchase ('repo') and stock lending transactions would be derecognised under draft FRS 102 but not under EU adopted IFRS, IFRS 9 or current UK GAAP. In our view, this would be inappropriate and we recommend that draft FRS 102 be amended to align the financial asset derecognition rules with those of EU adopted IFRS. This issue is discussed in more detail in the section of Appendix 5 dealing with section 11.

Share-based payments

Section 26 (unlike FRS 20/IFRS 2), as drafted, scopes out group share-based payment plans not involving equity instruments of, or a liability based on the value of equity instruments of the reporting entity, and, therefore, it appears that there is no requirement to account for these. However, where the reporting entity has a liability based on the value of equity instruments of another group entity, say its parent, this could inadvertently be within the scope of section 12 (financial instruments) because it is not a share-based payment, as defined in section 26 and the Glossary (see paragraph 12.3(i)). We presume that it is the intention that section 26 scopes out group share-based payment plans involving

equity instruments of another group entity (to provide simpler requirements than FRS 20/IFRS 2). However, we recommend that the ASB amends the scope of section 12 to exclude schemes where the reporting entity has a liability based on the value of equity instruments of another group entity and includes requirements for such schemes to be accounted for as cash-settled share based payment schemes under section 26.

Also, section 26 has much less guidance than FRS 20/IFRS 2 in a number of areas. In particular, it does not address cancellations and settlements of share-based payment plans, which is a significant omission. We consider that section 26 should be redrafted to add guidance to address cancellations and settlements, and certain other areas (see our comments on section 26 in Appendix 5).

In addition, given that all UK entities, except those applying the FRSSE, are already applying FRS 20/IFRS 2, we recommend that there should be a choice of policy for entities as to whether to apply FRS 20/IFRS 2 or the simplified provisions in section 26. It would add additional burden for such entities to be required to evaluate whether the treatment remains appropriate under section 26, or to amend the treatment of existing schemes where there are differences e.g. in respect of accounting for schemes where the reporting entity has a choice of settlement in equity or cash. This principle of opting into IFRS in certain areas has already been established in relation to financial instruments.

Surplus on defined benefit plans

According to draft FRS 102 paragraph 28.22, an entity shall recognise a plan surplus as a defined benefit plan asset only to the extent that it is able to recover a surplus either through reduced contributions in the future or through refunds from the plan. No further guidance is provided. Given that there are significant differences in surplus recognition between FRS 17 and IFRIC 14, the lack of any guidance on how to measure a surplus through reduced contributions or through refunds from the plan, is likely to result in significant diversity in practice.

We recommend that the ASB include guidance on surplus recognition based on either FRS 17 or IFRIC 14. More generally, we consider it critical that the ASB clarify whether or not IFRIC 14 is intended to apply more widely, as this can lead to recognition of an additional liability in certain circumstances, which would not be the case under UK GAAP. See our comments on section 28 in Appendix 5.

Application of the hierarchy under draft FRS 102

In significant areas, there is much less detailed guidance in draft FRS 102 compared to existing UK GAAP (and equivalent IFRSs). There is lack of clarity over the requirements - both in terms of material that was previously in the draft FRSME and in respect of the amendments made by the ASB. This is likely to lead to implementation difficulties and diversity of practice until a consensus or body of experience develops.

In the absence of specific guidance, the GAAP hierarchy in paragraphs 10.4 to 10.6 of draft FRS 102 must be followed. This hierarchy refers first to requirements and guidance in FRS 102 dealing with similar and related issues; second, the requirements and guidance of any relevant SORP dealing with similar and related issues; and finally, the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses in section 2. In making judgements over the accounting policies to be applied, management *may* consider the requirements and guidance in EU adopted IFRS (our emphasis).

We have some concerns that the **requirement** for management to refer to and consider the applicability of guidance in FRS 102 dealing with similar and related issues may have an unintentional consequence of extending the scope of certain requirements in FRS 102. We consider that this is likely to be more of an issue than under the equivalent requirement of paragraph 11 of IAS 8, as draft FRS 102 has been designed to simplify the requirements of IFRS and, therefore, it may be less appropriate to apply by analogy to related areas. Also, IFRS includes more detailed guidance and application of the hierarchy is less common than is likely to be the case under FRS 102.

Where IFRS provides relevant guidance which is not included in FRS 102, we believe that the ASB should consider whether to adapt the first step of the hierarchy to explicitly permit entities a choice, on a case by case basis, of *either* applying the relevant IFRS guidance *or* considering similar and related issues in FRS 102. There may be a need for further riders, for example, the requirements of IFRS on a particular accounting area must be similar to the requirements of the relevant section in FRS 102 and consistent with 10.5(b) and (c) of the hierarchy.

Compliance with company law

We highlighted in our response letter to the consultation on FREDs 43 to 45 that the benefits of the proposed framework in reducing regulatory burden are unlikely to be fully realised without changes to the Companies Act 2006 ('the Act') and the EU's 4th and 7th Company Law Directives ('EU Accounting Directives'). There is complexity due to the need to comply with the Act and The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 ('the Regulations') made under the Act. We continue to urge the ASB to work together with BIS to seek to address this matter.

We recognise that there are unlikely to be significant changes to company law resolving this complexity in the timescale for implementation of the ASB's proposals. The proposed changes to EU Accounting Directives may resolve some but not all conflicts with existing company law, e.g. by removing the concept of extraordinary items and prohibiting reversals of goodwill impairment. As highlighted by the ASB, these proposed changes may also remove the disclosure exemption for intra-group transactions involving wholly owned subsidiaries. If the proposed changes proceed (and the related changes are made to UK company law), the ASB will need to remove the amendments it made to its proposals in these areas. However, the proposed EU Accounting Directive would not permit financial statements prepared in accordance with either the IFRS for SMEs or IFRS with reduced disclosure, without amendments being required to comply with the Directive.

We, therefore, welcome the ASB's efforts to identify and address areas of conflict, e.g. requiring companies implementing FRS 102 to follow UK company law formats (rather than additionally having to comply with those formats previously included in the FRSME). However, as identified in our comments on formats under draft FRS 101 (in 'Significant comments on the content of the proposals'), the same issue applies to entities applying FRS 101.

We note that the ASB has made a number of modifications, including recognition and measurement differences, to eliminate incompatibilities with EU Accounting Directives, so that draft FRS 101 and draft FRS 102 comply with company law. While various amendments have been made to IFRS in order to comply with European directives, non-amortisation of goodwill (albeit this will only impact acquisitions of unincorporated businesses) has been retained, which would require use of the 'true and fair override'. While we understand why the ASB would be keen to minimise accounting differences in this area, we ask the ASB to reconfirm that the use of the 'true and fair override' is appropriate (see our comments in Appendix 2). In addition, we consider that the ASB should explicitly highlight the areas and provide additional guidance where the requirements of draft FRS 101 or draft FRS 102

would require a 'true and fair override' (including situations where the requirements of these standards would lead to unrealised profits being included in the profit and loss account). See our comments in Appendix 2 to this letter.

We also note that the ASB will consult on the future of the FRSSE in light of the proposed changes to EU Accounting Directives to simplify the requirements for small companies. We will comment on the proposals for small companies when this further consultation is published. We note that the proposed changes may prevent Member States from mandating additional disclosures for small companies, and, therefore, it would be difficult to require small companies to apply FRS 102 unamended. However, small companies may choose to apply FRS 102. Consequently, we consider that section 9 of draft FRS 102 should contain an exemption from consolidation for companies subject to the small companies regime (which could be extended to entities which would meet the definition if they were UK companies).

ASB/UITF guidance and interpretations of FRS 102

We would ask the ASB or the UITF to set out the process for responding to requests for additional guidance. It is important that any interpretations are made after due process. We recommend that the ASB liaise with the IASB/SME Implementation Group concerning Q&As issued by that group, monitor any potential conflicts of interpretation and clarify the position in the event of a conflict.

While it is helpful in the consultation process for the ASB Staff to publish Q&As (and provide supporting resources), it is not, in our view, an appropriate vehicle for interpretations unless there is an established due process for the issuing of such Q&As such as exposure for comment by constituents and approval by the ASB. It is important that UK entities understand the status of any guidance issued. We would normally expect interpretation issues to be addressed by way of a UITF interpretation, or where issues are not significant enough to require an Interpretation, a UITF Information Sheet should be issued.

Process for review of FRS 102

The ASB needs to set out its process for the future review of FRS 102, and to what extent this will be driven by the timing of either changes to EU adopted IFRS or amendments to the IFRS for SME. It is important that UK entities have a clear idea of:

- ▶ the stability of the FRS 102 proposals, prior to implementation;
- ▶ the criteria and objectives for implementing new IFRSs and IFRS interpretations that the ASB will apply; and
- ▶ the due process for consultation on changes to FRS 102.

We support a regular update of FRS 102 which considers, using published criteria, to what extent new IFRSs and IFRICs incorporated into EU adopted IFRS should be implemented. However, it is important that UK entities have a stable platform where significant amendments to implement new IFRSs into FRS 102 are not mandatory. Given the scope of FRS 102, any new requirements need to be workable and capable of being implemented properly by a wide range of entities. We strongly support the ASB's decision to amend the final standard, effective 1 January 2015, only in respect of IFRS 9, once finalised and not to amend it for any further new IFRSs that may be published by that date.

If it is intended that FRS 102 is amended to reflect a significant new IFRS, we would encourage a later mandatory implementation date than the IFRS itself to allow time for practical implementation issues to be identified. The ASB should, however, consider whether it is feasible to implement changes to permit early adoption of amendments to FRS 102 from the same effective date as under EU adopted IFRS.

On the other hand, there may be scope for a more frequent 'Improvements' initiative and/or an active role for the UITF to clarify the requirements of FRS 102, respond to requests for additional guidance and fix any identified problems. It is likely that further issues will emerge as UK entities start to implement the proposals requiring a need for ongoing guidance.

While the ASB has made some amendments to draft FRS 102 to comply with UK company law, other amendments are improvements to the IFRS for SMEs. We encourage the ASB to work with the IASB to ensure such amendments are considered when the latter is reviewed later in 2012.

Structure of this letter

In Appendix 1 to our letter, we set out responses to the questions raised by the ASB. In Appendix 2, we set out legal considerations in respect of the proposals; and in Appendices 3 to 5, we set out specific recommendations to modify draft FRS 100, draft FRS 101 and draft FRS 102, respectively. While these Appendices are relatively lengthy, we believe that many of the issues that we have identified would give rise to practical difficulties in implementing the new standards and are capable of resolution. Where appropriate, we have suggested ways of addressing these issues. We request that the ASB addresses the issues identified from this consultation, including our detailed comments in Appendices 2 to 5, prior to finalising the standards.

We are grateful to the ASB for publishing the exposure drafts. We hope you find our comments helpful. For the avoidance of any doubt this is not a confidential reply. We wish you every success with the rest of the consultation process. If you would find it useful, please contact me if you wish to discuss any of the points raised in this letter.

Yours sincerely



Tony Clifford
Partner, Financial Reporting Group

Appendix 1 - Responses to ASB questions

We set out our responses to the specific questions raised by the ASB below.

Question 1

Do you agree that the proposals in FREDs 46 to FRED 48 achieve the project objective to enable users of the financial statements to receive high-quality, understandable financial reporting proportionate to the size and complexity of the entity and user's information needs?

We agree with the proposals in FREDs 46 to 48 (drafts FRS 100 to FRS 102) subject to the reservations expressed below.

Draft FRS 100

Overall, we consider the framework set out in draft FRS 100 is well thought out.

However, we consider that there is a lack of clarity over transition arrangements, as explained further in Appendix 3. The other area where we have concerns relates to the definition of a financial institution, specifically the consequences of the definition for retirement benefit funds and the applicability of the financial institution disclosures in group accounts.

Transition to FRS 102

Situations might arise where an entity would want to reapply FRS 102 after its initial application. An example is where an entity had, say, moved to IFRS but later became part of a group whose members applied FRS 102 rather than IFRS in their financial statements. The BIS proposals, if implemented, would also permit companies to move from 'IAS accounts' (i.e. EU adopted IFRS) to 'Companies Act accounts' (such as those prepared under FRS 101 or FRS 102) for any reason, no more than once within a specified time period, say five years. In light of this, we highlight the following concerns over the transition arrangements to FRS 102.

Paragraph 35.2 of draft FRS 102 permits an entity to be a first time adopter only once. It goes on to say that 'the special exemptions, simplifications and other requirements in [section 35] do not apply to the re-adoption.' We believe that the ASB needs to clarify whether paragraph 35.2 requires an entity re-applying FRS 102 to 'grandfather' first time adoption accounting used when FRS 102 was applied for the first time, or requires full retrospective application of FRS 102 on its re-adoption. If full retrospective application is required, this could clearly give rise to significant practical difficulties, in respect of business combinations but also many other areas.

Since the IASB has amended IFRS 1 to clarify that an entity can be a first time adopter of that standard more than once, we ask the ASB to consider whether a similar amendment should be made to the FRS 102. This could ease the difficulties of restating transactions, particularly business combinations (that had been accounted for under IFRS 3R), under the different requirements of FRS 102.

We include detailed comments on specific transition exemptions in our comments on section 35 in Appendix 5. We set out where we consider the ASB should clarify, amend or add additional transitional exemptions. In particular, we ask the ASB to consider clarifying the transitional arrangements for goodwill lives and service concessions. In addition, it may be helpful to clarify the requirements for the discontinuance of hedge accounting should relationships under IAS 39 (or its replacement) not be of a type permitted by section 12 (assuming that the entity did not choose to continue to apply IAS 39 (or its replacement)). We also recommend that the ASB consider whether to include additional guidance from Appendix C4 and C5 of IFRS 1 in relation to the accounting treatment of pre-transition business combinations not restated, and whether to introduce an exemption for subsidiaries held as part of an investment portfolio which were previously consolidated (see our comments on paragraph 9.9A in Appendix 5).

Definition of financial institution

Retirement benefit funds

Retirement benefit funds have been identified as financial institutions and, therefore, are required to give additional financial instruments disclosures which would perhaps be of limited added value for readers of retirement benefit fund accounts. In light of the content (only a statement of net assets), usage and limited circulation of many retirement benefit fund financial statements, the ASB should carefully consider the cost-benefit analysis of requiring retirement benefit funds to give the additional disclosures for financial institutions. The ASB should also clarify whether the disclosures specified, such as actuarial liabilities, would form part of the financial statements, as this would impact the scope of the audit. Many of the specified disclosures are currently required in the Trustees' Report and therefore are outside the audited financial statements. See our responses to Q4 and Q6.

Application of financial institution disclosures in group accounts

Paragraphs 34.17 to 34.30 of draft FRS 102 specify additional disclosures for financial institutions. The definition of a 'financial institution' included in the Glossary to draft FRS 102 is the same as included in paragraph 5 of draft FRS 100. However, it would appear that these disclosures would not be required if the reporting entity was not itself a financial institution, as defined. For example, a group may contain material financial institution subsidiary undertakings (potentially, all its principal subsidiary undertakings may be financial institutions) but if the holding company is not itself a financial institution, it would appear that no disclosures are required in the group accounts. We recommend that the ASB address the applicability of paragraphs 34.17 to 34.30 to group accounts.

Draft FRS 101

We support the reduced disclosure framework set out in draft FRS 101, including its extension to all qualifying entities, and the need for additional disclosures for financial institutions. We consider it appropriate that these exemptions apply to individual financial statements, and not to consolidated financial statements which may be prepared by qualifying entities.

We have the following observations on the reduced disclosure framework (which are explained in more detail in Appendix 4):

IFRS 12

In our view, an exemption from disclosures in IFRS 12 should be given to qualifying entities that are not financial institutions. As explained in Appendix 4, only entities which prepare separate financial statements together with consolidated financial statements are outside the scope of IFRS 12 for their separate financial statements. Consequently, as drafted, all IFRS 12 disclosures are required for qualifying entities that are either themselves (intermediate) parents that do not prepare group accounts or stand-alone subsidiaries.

IFRS 2

Paragraph 8(a) excludes the use of reduced disclosure exemptions for 'a group arrangement involving equity instruments of an entity other than the parent'. We consider that reduced disclosures should be available where a group share-based payment arrangement involves equity instruments of other group entities (but not of the entity itself), provided the entity is included in publicly available consolidated accounts containing equivalent disclosures. We are also not clear why the requirements to disclose the financial effect (paragraph 51 of IFRS 2) are included in the disclosure exemptions.

Financial instruments

Paragraph 4 sets out certain disclosures, required by company law, where a qualifying entity has financial liabilities held at fair value, which are neither held as part of a trading portfolio nor are derivatives. From our reading of paragraph 36(4) of Schedule 1 of the Regulations, the scope of the additional financial instruments disclosures under the Regulations would appear to also cover other financial instruments carried at fair value in accordance with IAS 39 (or IFRS 9, once adopted by the EU) which are listed in paragraphs 36(3) of Schedule 1 of the Regulations.

Paragraph 36(4) of Schedule 1 of the Regulations permits certain types of financial instruments to be included at fair value, where permitted under IFRSs adopted by the EU on or prior to 5 September 2006 "provided that the disclosures required by such accounting standards are made". We are unclear how the ASB has determined which disclosures to include in paragraph 4 in order to comply with the Regulations since the disclosures specified are neither the full IFRS 7 disclosures nor, say, only paragraphs 9 to 11 of IFRS 7 (i.e. the disclosures labelled in that standard as applying specifically to financial assets or financial liabilities at fair value through profit or loss). It would be helpful if the ASB could reconfirm its legal analysis, and explain the scope of paragraph 4 and the disclosures specified in the Legal Appendix accompanying the final standard.

Related party transactions

The ASB should include the clarification made in paragraph 38 of Appendix IV of FRS 8 in respect of the scope of the exemption from disclosing transactions involving wholly owned subsidiaries (assuming this exemption is not removed by proposed changes to EU Accounting Directives).

Minority shareholder objection

While the provisions on shareholder objection set out in paragraph 7(a) of draft FRS 101 appear to be loosely based on those in section 400 of Companies Act 2006 in respect of the exemption from preparing group accounts, it is unclear to us whether the requirement to communicate (and the ability of the minority to object) is a 'one off' event upon adoption of draft FRS 101 or applies to each financial year. Also as drafted, it appears to require a shareholder who meets the stated thresholds to

object, whereas the Companies Act 2006 refers to shareholders in aggregate. The requirement should be clarified.

Formats

UK companies applying the Companies Act 2006 will need to follow the formats in Schedules 1 to 3 of SI 2008/410 ('the Regulations') or Schedule 1 of SI 2008/409, as applicable. We therefore strongly recommend the ASB to require entities within the scope of the Regulations using FRS 101 to follow the company law requirements rather than additionally needing to comply with IAS 1.

For most companies, the key difficulty is presenting the current-non-current analysis required by IAS 1 on the face of the balance sheet. However, the conflict between the presentational requirements of IAS 1 and the Regulations will be particularly acute for those companies applying Schedules 2 or 3 of the Regulations where there is no flexibility to adapt the formats. In particular, companies following Schedule 3 of the Regulations present up to two technical accounts and one non-technical account in the profit and loss account, with transfers between these. This would make it difficult for insurance companies to present an income statement that complies with IAS 1.

We note that paragraph 60 of IAS 1 has been amended to require an entity within the scope of Schedule 2 of the Regulations to follow the format shown in that schedule. This is a curious comment as clearly all entities within the scope of the Regulations need to comply with the formats. We therefore wonder whether the intention is that entities within the scope of Schedule 2 need not provide a current-noncurrent analysis. If this is the case, the wording needs to be clarified. However, as explained in Appendix 2 to this letter, insurance companies applying Schedule 3 would need the same relief.

Goodwill

While various amendments have been made to IFRS in order to comply with European directives, non-amortisation of goodwill (albeit this will only impact acquisitions of unincorporated businesses) has been retained, which would require use of the 'true and fair override'. Unlike the position under FRS 10 where entities using the override determine that goodwill has an indefinite life, this override would be available to all companies applying IFRS with reduced disclosure, regardless of any special circumstances. While we understand why the ASB would be keen to minimise accounting differences in this area, we ask the ASB to reconfirm that the use of the 'true and fair override' is appropriate.

Paragraph A61 (q) now requires (like draft FRS 102), reversal of impairment loss of goodwill if and only if the reasons for the impairment loss have ceased to apply, mirroring the requirements of the Directive (although this amendment may not be required if proposed changes to the European Accounting Directives proceed). There is less guidance on this issue than previously included in FRS 11, and the ASB could consider whether it would be useful to include the FRS 11 guidance.

Draft FRS 102

We support the use of FRS 102, as a replacement to UK GAAP and the reduced disclosure framework set out in section 1 of that draft standard.

The comments on the reduced disclosure framework under draft FRS 101 apply equally to that under draft FRS 102.

The covering letter highlights our greatest concerns and includes general comments on: the application of the hierarchy under draft FRS 102, ASB/UITF guidance and interpretations on FRS 102, compliance with company law and the process for review of FRS 102. We have also addressed specific ASB consultation questions later in this Appendix 1 and transitional issues under the draft FRS 100 above.

Another general comment is that we have identified a number of issues, which should not be regarded as a non-exhaustive list, with the scope of certain sections in draft FRS 102. We would ask the ASB to pay particular attention to the scope of the financial instruments sections 11 and 12 and to address our comments on paragraphs 11.7 and 12.3, embedded derivatives (in section 11 comments), and insurance contracts (included at the end of the Appendix) in Appendix 5. We have concerns that the scope of section 12 is perhaps inadvertently drafted so as to include contracts such as non-financial contracts where embedded derivatives would be considered closely-related under IAS 39, liabilities for share appreciation rights over the parent's equity and financial guarantee contracts. As a result, such contracts would be required to be accounted for at fair value through profit and loss which would be more onerous accounting than under full IFRS.

The ASB has made a number of helpful amendments to draft FRS 102 in response to issues identified in the consultation on FREDs 43 to 45, but we highlight the following significant concerns over specific amendments made by the ASB:

Taxation

We believe that the new section 29 that proposes a 'timing differences plus' approach which aims to give in most cases the same answer as IFRS, is based on a flawed conceptual approach. There is a conflict between its competing objectives of a 'timing differences plus approach' and its requirement that deferred tax represents the future tax consequences of transactions and events recognised in the financial statements of the current and previous periods. It is also unclear to what extent 'manner of recovery', which is alluded to in certain paragraphs, is relevant to the measurement of deferred tax. There are also a number of internal inconsistencies. The combination of no sound conceptual foundation and inconsistent guidance means that it is then difficult to interpret the requirements of section 29 as it has limited guidance or conflicting requirements.

Consequently, section 29 appears to leave open (and sometimes imply a different answer to) a number of practical issues on which there is currently either clear guidance (or a clear consensus) under FRS 16/19 (or IAS 12). For example, paragraph 29.10 requires that "where the amount attributed for tax purposes to assets (other than goodwill) and liabilities that are acquired in a business combination differs from their fair value, deferred tax shall be recognised to reflect the **future tax consequences** with a corresponding adjustment to goodwill" (our emphasis). We suspect that the intention of paragraph 29.10 is to require recognition of deferred tax on temporary differences (although that term is not used in section 29) on initial recognition of assets and liabilities acquired in a business combination, consistent with IAS 12. However, such differences would be 'permanent differences' (which are prohibited from recognition by paragraph 29.11). In addition, there is no guidance on the meaning of 'future tax consequences'. Under IAS 12, deferred tax would be provided on acquired intangible assets (with no tax base) recognised on consolidation. However, such an acquired intangible asset has no future (cash) tax consequences. The requirements of paragraph 29.10 are, therefore, unclear. Other areas where the treatment is unclear include the treatment of guidance on capital allowances subject to claw-back, determining substantively enacted tax rates, rollover relief, share based payments, allocation of tax and offsetting. In addition, the disclosure requirements are not

clearly explained and include disclosures not required by either UK GAAP or IFRS. There is a more detailed discussion of our comments on section 29 in Appendix 5.

In our view, the ASB needs to reconsider the approach and redraft this section to make it workable for UK entities. Rather than trying to develop simplified rules designed to result in the same treatment as under IAS 12, the ASB should focus on one basic principle, and make only limited modifications to that principle, where necessary.

Treatment of ESOPs and EBTs

We believe that draft FRS 102 disturbs the established consensus for the treatment of ESOPs (and EBTs) under UK GAAP and now includes various internal inconsistencies between the requirements of sections 2, 9 and 28. Most significantly, inconsistencies arise because section 9 appears to require an entity (which is a parent) to consolidate an ESOP but an entity (which is not a parent) would treat the ESOP as an 'intermediate payment vehicle' (under sections 2.53 to 2.56) and would recognise the assets of the intermediary in its own accounts. The treatment proposed in draft FRS 102, therefore, implies a different treatment in the individual accounts of entities that are parents and other entities. It is not clear whether this is intentional and we do not understand the conceptual basis for this distinction. We strongly recommend that the ASB reviews these inconsistencies and reconsiders the model for ESOPs. Since IFRS does not specify whether ESOPs are to be consolidated or treated as an extension of the sponsoring entity, we recommend that the ASB does not alter the position under UK GAAP and that FRS 102 should continue to treat ESOPs as an extension of the sponsoring entity. We highlight various further drafting issues in the discussion of paragraphs 9.10 and 9.25 in Appendix 5.

Merger accounting

We recognise that inclusion of material from FRS 6 on merger accounting provides helpful guidance on an area not specifically addressed in IFRS (but where practices have developed) and continuity of treatment under existing UK GAAP. However, there have been practical difficulties in applying FRS 6 to certain group reconstructions, and its criteria for applying merger accounting are stricter than company law and IFRS practice. We do not believe that it is appropriate to incorporate all of the strict criteria for applying merger accounting to group reconstructions into draft FRS 102 and, therefore, ask the ASB to reconsider whether all the FRS 6 criteria that have been introduced are necessary. There is a more detailed discussion of this issue in our comments on section 19 in Appendix 5.

Other areas of draft FRS 102 that give us significant concern are highlighted below. Where appropriate, we have proposed amendments which we consider could easily be made to reduce the reporting burden. These areas include:

Cash flow statements

Section 7 does not provide for certain cash flows to be presented on a net basis. In the absence of such a requirement, and the general requirements of section 2.52 in relation to not offsetting assets and liabilities, or income and expenses, the netting of any type of cash flows would appear to be prohibited. We recommend that paragraph 22 of IAS 7, which permits netting of cash flows in certain circumstances, is added to Section 7.

Group accounts

Paragraph 9.3 does not mention the exemption from preparation of group accounts by companies subject to the small companies regime. However, small companies may choose to apply FRS 102 and use this exemption available under the Act. This is not in accordance with earlier ASB messages that the requirement to prepare group accounts (under draft FRS 102, as is the case under EU adopted IFRS) would be based on company law. We recommend that the exemption is included.

Paragraph 9.31 introduces the requirements of UITF 31 into draft FRS 102. This could conflict with paragraphs 9.18A and 9.19 which require a retained interest in a disposed subsidiary to be included initially at its fair value. A similar conflict appears in EU adopted IFRS and is being considered by the IFRIC and IASB, and the ASB therefore should monitor any developments. In light of the conflict, there is likely to be diversity of practice in respect of accounting for subsidiaries or businesses transferred to a jointly controlled entity or associate. This conflict would not have been in the original IFRS for SMEs (based on IAS 27 rather than IAS 27R). Therefore, the ASB could consider whether to revert to the original wording as section 9 is mainly based on the original IAS 27, but this would lead to a difference between draft FRS 102 and current IFRS in this regard. If the wording in paragraphs 9.18A is retained, the ASB should clarify whether it should be extended to cover loss of control, rather than simply disposals of subsidiaries.

There is a restriction that a subsidiary held as part of an investment portfolio cannot be treated as an 'asset held exclusively for resale' in accordance with paragraph 9.9A where it has previously have been consolidated. We note that this would mean that entities are required to apply the requirements of paragraph 9.9A to subsidiaries that have not previously been consolidated but are prohibited from applying the requirements to subsidiaries that have been previously consolidated (e.g. because this was the requirement under existing UK GAAP as interpreting the exclusion in the Act), even if they have a similar function in the business. We recommend that the ASB consider, subject to legal advice, whether transitional relief should be extended to first time adopters of FRS 102 to account for all investments in subsidiaries held as part of an investment portfolio at the date of transition as 'assets held exclusively for resale' in accordance with paragraph 9.9A, even if these subsidiaries were previously consolidated.

Financial instruments

Sections 11 and 12 do not require the identification (and where appropriate, separation) of embedded derivatives in non-financial contracts. However, the effects of paragraph 12.3(d), 12.3(f) and 12.4 could mean that a significant number of non-financial contracts would be required to be accounted for at fair value through profit and loss. This would lead to complexities for entities in valuing the contracts and significant volatility in recorded results. While entities have the opportunity to apply IAS 39 instead of the detailed rules in sections 11 and 12 of the draft FRS 102, this would be onerous for an entity that does not otherwise significantly transact in financial instruments. We recommend that the ASB perform outreach to assess the practical implementation issues of sections 11 and 12 - in particular, whether many contracts would be required to be accounted for at fair value under section 12, and whether an approach involving separation of embedded derivatives would work better. We consider that this should form part of the consultation on the re-exposure of these sections when IFRS 9 is finalised.

Section 11 has no guidance on the circumstances in which offsetting of a financial asset and liability is required, equivalent to paragraphs 42 to 50 of IAS 32. Paragraph 2.52 prohibits all offsetting unless specifically permitted within draft FRS 102. In the absence of specific guidance within section 11, we

therefore presume that all offsetting is prohibited. We doubt that it is the ASB's intention that the offsetting rules for financial instruments under draft FRS 102 would differ to those under EU adopted IFRS and recommend that the offsetting rules in IAS 32 be included within section 11.

Although paragraph 11.24 on impairment of financial assets may be superseded by IFRS 9, it contains no requirement for a collective assessment for loans already individually assessed and found not to be impaired (as in paragraph 64 of IAS 39). Consequently, any entity with a loan portfolio would probably see a reduction in impairment provisions compared to existing UK GAAP and IAS 39. We, therefore, recommend that if guidance based on IFRS 9 (when finalised) is not implemented, guidance for a collective assessment of loans already individually assessed and found not to be impaired is added to paragraph 11.24.

The financial asset derecognition rules in paragraph 11.33(c) differ from those contained in EU adopted IFRS (particularly paragraph 20 of IAS 39). The derecognition rules in draft FRS 102 derive from those included in the IFRS for SMEs, that were based on an exposure draft of new control-based derecognition rules which were never adopted into IFRS. They appear to require derecognition even where the transferor retains some significant risks and rewards of ownership of a financial asset, provided the transferee has the practical and unilateral ability to sell the asset in its entirety to an unrelated third party. The practical impact of this is that financial assets subject to most sale and repurchase ('repo') and stock lending transactions would be derecognised under draft FRS 102 but not under EU adopted IFRS, IFRS 9 or current UK GAAP. In our view, this would be inappropriate and we recommend that draft FRS 102 be amended to align the financial asset derecognition rules with that of EU adopted IFRS.

Based on paragraphs 11.38 and 22.8 on derecognition of a financial liability on issue of an equity instrument, it would seem that a gain should be recognised when a financial liability is derecognised on issuance of an equity instrument. However, the exemptions in IFRIC 19 have not been included in draft FRS 102. Such transactions are common within group situations and we would ask the ASB to consider including appropriate exemptions in line with IFRIC 19.

We note that where a hedge of a net investment in a foreign operation is undertaken in accordance with the simplified provisions in paragraphs 12.23 to 12.25, there is no reclassification of the cumulative exchange differences on disposal or partial disposal of the foreign operation. This is consistent with the fact that there is no reclassification of the cumulative exchange translations on disposal of the net investment in the foreign operation. However, if a hedge of a net investment in a foreign operation is undertaken under IAS 39, the cumulative exchange differences on the hedging instrument would be reclassified on the disposal or partial disposal of the foreign operation, but under section 9.18A (unlike IAS 21), the gross cumulative exchange differences on the net investment in the foreign operation would not be reclassified on disposal or partial disposal of a foreign operation. Hence, use of IAS 39 by an entity otherwise using FRS 102 would give rise to an asymmetrical treatment of the cumulative exchange differences. This is not a satisfactory outcome and we believe that the accounting should be the same whether IAS 39 or section 12 is applied to the hedge of a net investment.

Paragraph 11.48A of the draft FRS 102 specifies disclosures which are required when the entity has financial instruments at fair value that are not held as part of a trading portfolio and are not derivatives. We understood that this paragraph is intended to set out disclosures required by paragraph 36(4) of Schedule 1 of the Regulations. Paragraph 36(4) of Schedule 1 of the Regulations permits certain types of financial instruments to be included at fair value, where permitted under IFRSs adopted by the EU on or prior to 5 September 2006 "provided that the disclosures required by such

accounting standards are made". However, if this was the intention, we note that the scope of paragraph 11.48A is considerably wider than the scope of the company law disclosure requirement and would in fact cover all financial assets and liabilities that are not held as part of a trading portfolio and are not derivatives. Its scope would include financial assets designated at fair value or available for sale financial assets, where an entity applying FRS 102 applies IAS 39 recognition and measurement rules, and most financial instruments in the scope of section 12. We are also unclear how the ASB has determined which disclosures to include in paragraph 11.48A in order to comply with the Regulations. It would be helpful if the ASB could reconfirm its legal analysis, and explain the scope of paragraph 11.48A and the disclosures specified in the Legal Appendix accompanying the final standard. See our comments in Appendix 2.

Business combinations

The accounting in section 19 is closer to the requirements of IFRS 3 than IFRS 3R, and like IFRS 3, contains no guidance on the distinction between contingent consideration and compensation. We would recommend that the ASB includes the requirements of paragraph 84 of FRS 7 (rather than the specific requirements of IFRS 3R, which are currently being discussed by IFRIC). This would extend the continuation of existing UK GAAP, and require the use of judgement in assessing whether the substance of the agreement is payment for the business acquired or an expense such as compensation for services or profit sharing. If more specific requirements based on IFRS 3R are included in the IFRS for SMEs following its review, and amendments are made to generally update this section in line with IFRS 3R, it may be appropriate to include additional guidance on contingent consideration/employee compensation in FRS 102 at that stage.

Section 19 (business combinations) includes no exceptions to the fair value model for employee benefits (e.g. defined benefit pensions) and deferred taxation. Under draft FRS 102, it appears that these items must be fair valued on a business combination but then subsequently measured under the relevant sections, which will cause large revaluation movements. As this would not be the case under existing UK GAAP or EU adopted IFRS, we doubt this is the intention. In particular, we recommend that section 19 includes the equivalent requirements to those in paragraphs 24 to 26 of IFRS 3R in respect of the recognition and measurement of employee benefits and deferred taxation, but referring to section 28 and to section 29, respectively.

Goodwill lives

While we believe that the general requirements of section 35 would require retrospective adjustment, there is no explicit guidance explaining how an entity should deal with transitional adjustments to the useful life of goodwill. There may be uncertainty over this issue, particularly because UITF 27 (which will be withdrawn) considered changes in goodwill lives from indefinite to, say, 20 years and concluded that a change in useful life must be accounted for prospectively. In addition, the requirements on amortisation of goodwill are included in paragraph 19.23 (and strictly first time adopters need not apply section 19 to pre-transition business combinations). This is a material issue faced by many entities and we therefore consider it important, for the avoidance of doubt, that the ASB clarifies the treatment of adjustments to lives of goodwill on transition to FRS 102.

While UK GAAP does not currently give guidance on how to determine the life of goodwill, it may also be helpful to provide further guidance to ensure that entities understand that five years is only used where they cannot estimate the life reliably (rather than as a default life that entities can choose to use).

Provisions and contingencies

Important requirements are included in the Appendix to section 21 (Provisions and contingencies) which is stated as accompanying but not part of section 21 (and consequently not mandatory). For example, section 21 excludes the IAS 37 bold paragraph requirements (included in paragraphs 48, 61, 63, 66, 72, 78 and 80) on taking future events into account in measuring provisions, the use of provisions, future operating losses, onerous contracts and restructuring costs. We believe the ASB should include these requirements within the body of section 21.

Revenue

Section 23 omits any guidance in respect of financial services fees (contained in paragraphs IE 14 to 19 of IAS 18). As financial services entities, including banks and asset managers, are now within the scope of FRS 102, we believe that the IAS 18 guidance in respect of these transactions should be included.

Share-based payment

As a general theme, many of the important requirements of FRS 20/IFRS 2 are in the detail and particularly in the Implementation Guidance (IG). The main text of IFRS 2 would, in many circumstances, not naturally be read in the way intended (as indicated by the IG), without this extra detail. Therefore, care needs to be taken to ensure that by removing the detail, unintentionally different answers are not given by section 26 compared to FRS 20/IFRS 2, particularly as entities previously applying the FRSSE, which choose to apply FRS 102, may be unfamiliar with the requirements of FRS 20/IFRS 2. An example is in relation to cash-settled share-based payment where section 26.14, as drafted, requires changes to the fair value of the liability to be recognised in profit or loss for the period (as opposed to being spread over the vesting period as required by paragraphs 32 and 33 of FRS 20/IFRS 2). See comments on section 26 in Appendix 5 on problems arising from the current drafting of this section.

Areas where section 26 has limited guidance include cancellations and settlements and it is possible that the absence of guidance could give rise to different accounting answers to FRS 20/IFRS 2. It is not clear whether this is intended and these are areas that the ASB should consider clarifying.

Section 26 (unlike FRS 20/IFRS 2), as drafted, scopes out group share-based payment plans not involving equity instruments of, or a liability based on the value of equity instruments of the reporting entity. Section 26 permits (but does not require) members of the group whose employees receive a share based payment award granted by another group entity to recognise and measure the share based payment expense on the basis of a reasonable allocation of the expense in the group. Therefore it appears that there is no requirement to account for such group share-based payment plans. However, where the reporting entity has a liability based on the value of equity instruments of another group entity, say its parent, this could inadvertently be within the scope of section 12 (financial instruments) because it is not a share-based payment, as defined in section 26 and the Glossary (see paragraph 12.3(i)). We presume that it is the intention that section 26 scopes out group share-based payment plans involving equity instruments of another group entity (to provide simpler requirements than FRS 20/IFRS 2). However, we recommend that the ASB amends the scope of section 12 to exclude schemes where the reporting entity has a liability based on the value of equity instruments of another group entity and includes requirements for such schemes to be accounted for as cash-settled share based payment schemes under section 26.

The transitional requirements for share-based payments (paragraph 35.10(b)) state that a first time adopter, previously applying FRS 20 'Share-based payment', is prohibited from making any amendment on transition to this FRS for share-based payment transactions. We consider that these transitional arrangements need to be clarified. There are accounting differences between FRS 20 and section 26, e.g. in respect of share-based payment plans where the reporting entity has the choice of settlement in shares or cash, as well as differing scope and less guidance in section 26. As drafted, this transitional rule could imply that different requirements are applied to pre-transition and post transition share based payments. If companies applying FRS 20/IFRS need to modify their current accounting, the treatment on transition needs to be clearly explained. Presumably, paragraph 35.10(b) should also refer to IFRS 2.

In addition, given that all UK entities, except those applying the FRSSE, are already applying FRS 20/IFRS 2, we recommend that there should be a choice of policy for entities as to whether to apply FRS 20/IFRS 2 or the simplified provisions in section 26. It would add additional burden for such entities to be required to evaluate whether the treatment remains appropriate under section 26, or to amend the treatment of existing schemes where there are differences e.g. in respect of accounting for schemes where the reporting entity has a choice of settlement in equity or cash. This principle of opting into IFRS in certain areas has already been established in relation to financial instruments.

Impairment

Paragraph 27.17 (estimates of cash flows for impairment) states that "the entity **may** wish to use **any** recent financial budgets or forecasts to estimate the cash flows, if available. To estimate cash flow projections beyond the period covered by the most recent budgets or forecasts an entity **may** wish to extrapolate the projections based on the budgets or forecasts using a steady or declining growth rate for subsequent years, unless an increasing rate can be justified" (emphasis added). We recommend that the more prescriptive language in paragraph 33 of IAS 36 in respect of financial budgets/forecasts, which is closer to existing UK GAAP, is substituted for the vaguer language in paragraph 27.17.

Paragraph 27.27 introduces a methodology for allocating goodwill for impairment testing, where goodwill cannot be allocated to individual cash generating units (or groups of cash generating units) on a non-arbitrary basis, which is not included in UK GAAP or IFRS. It requires such goodwill to be tested at the level of either (a) the acquired entity in its entirety, if the goodwill relates to an acquired entity that has not been integrated; or (b) the entire group of entities, excluding any entities that have not been integrated, if the goodwill relates to an entity that has been integrated. We have concerns that 'integrated' is defined in a legalistic way as 'means the acquired business has been restructured or dissolved into the reporting entity or other subsidiaries' rather than reflecting how management monitors the performance of the business. We also consider that the requirements could lead to testing at a relatively high level. It is also not clearly set out how impairment testing operates if some goodwill is allocated to CGUs on a non-arbitrary basis, but other goodwill cannot be. For example, is paragraph 27.27 intended to be a 'second stage' test after testing goodwill at the level of CGUs (or groups of CGUs) first? Our main concern is that, since this methodology is neither IFRS nor UK GAAP, it is difficult to assess how it will operate as there is no practical experience of its interpretation. We strongly encourage the ASB to carry out outreach with its constituents, to identify any implementation and interpretation difficulties.

Paragraph 27.28 amended the IFRS for SMEs to require goodwill impairment reversals if and only if the reasons for the impairment loss have ceased to apply. While this amendment may no longer be required if proposed changes to the European Accounting Directive proceed, the ASB should consider

whether to reinstate the existing guidance in paragraphs 60(a) and 61 of FRS 11 into draft FRS 102. Paragraphs 27.30 (b) and 27.31(b) require the reversal of impairment to be included in profit and loss. We consider that these requirements should be updated to include the requirements of IAS 36, paragraph 119 on reversals of impairments of revalued assets. The IFRS for SMEs did not envisage revaluations and therefore had no need for that paragraph. It would also be helpful to include paragraphs 114-115 of IAS 36 which clarify that a reversal of impairment does not occur simply because of the passage of time.

No disclosures are required about assumptions used in impairment calculations. There is also no requirement to explain the reasons for impairments or reversals thereof. Such disclosures were previously required under FRS 11. We consider that this omission is a serious deficiency in draft FRS 102 and that information about assumptions used in impairment calculations is important for users of the financial statements. We believe that section 27 should be amended to include the disclosure requirements currently contained in paragraph 126 of IAS 36 (amounts of impairment losses and reversals by class of asset) and additionally in paragraphs 69 to 73 of FRS 11. This would give the key financial effects and the disclosures currently required under UK GAAP, thereby not leading to a deterioration in quality of disclosure by current UK GAAP reporters.

Employee benefits

We recommend that a definition of a qualifying insurance policy is added to the Glossary of Terms. In addition, paragraph 28.15 requires all plan assets to be recorded at fair value. However, it does not include the requirements of IAS 19 (paragraphs 104 and 104D) defining how the fair value of an insurance policy should be measured. This measure of 'fair value' specified in IAS 19 would not generally be an arm's length market price for such an insurance policy, and this omission of relevant guidance is significant.

Paragraph 28.19 sets out a 'simplified method' where the entity is not able, without undue cost or effort, to use the projected unit method to measure its defined benefit obligation and cost. However, in our view, the specified method is unlikely to reduce the burden for entities, given that triennial actuarial valuations are already obtained for retirement benefit schemes. We also consider that the 'simplified method' would result in poor quality financial information (and understate the true liability) compared to FRS 17 valuations. We recommend that the ASB delete this section. Instead, the ASB could consider whether to include the text of paragraph 35 of FRS 17 which states that "Full actuarial valuations by a professionally qualified actuary should be obtained for a defined benefit scheme at intervals not exceeding three years. The actuary should review the most recent actuarial valuation at the balance sheet date and update it to reflect current conditions." This would clarify that preparers need only update the financial assumptions annually, which would continue practices under UK GAAP and reduce the burden of applying the projected unit method. This contrasts with IFRS, where paragraph 45 of IAS 19 requires that "an entity shall determine the present value of defined benefit obligations and the fair value of any plan assets with sufficient regularity that the amounts recognised in the financial statements do not differ materially from the amounts that would be determined at the end of the reporting period".

Paragraph 28.22 states that "an entity shall recognise a plan surplus as a defined benefit plan asset only to the extent that it is able to recover a surplus either through reduced contributions in the future or through refunds from the plan" with no further guidance. None of the content of IFRIC 14, which gives detailed guidance on pension surplus recognition, has been transferred into section 28. Given that there are significant differences in surplus recognition between FRS 17 and IFRIC 14, the lack of any guidance on how to measure a surplus through reduced contributions or through refunds from the

plan, is likely to result in significant diversity in practice. We recommend that the ASB include guidance on surplus recognition based on either FRS 17 or IFRIC 14. More generally, we consider it critical that the ASB clarify whether or not IFRIC 14 is intended to apply more widely as this can lead to recognition of an additional liability in certain circumstances, which would not be the case under UK GAAP.

A related concern is that paragraphs 34.55 to 34.61 on funding commitments (which address in what circumstances an entity should recognise a liability, where it has made a commitment that it will provide resources to another party) could be read as requiring (directly or under the hierarchy in FRS 102) that entities must provide for the schedules of contributions agreed with the Trustees, where they exceed the recorded retirement benefit fund deficit. Recognising a liability for future contributions would be a significant departure from UK GAAP and it would be important to provide clear guidance on what constitutes a refund in order to align with IFRIC 14. We have separately recommended the deletion of the section on funding commitments.

The ASB has amended draft FRS 102 to include the requirements of paragraph 34A of IAS 19 on group plans in individual financial statements (new paragraph 28.38). In our experience, relatively few UK companies with group defined benefit plans have accounted for these under IFRS (rather than under UK GAAP) in the individual financial statements. As drafted, the requirements of paragraph 34A are difficult to interpret and can give rise to significant practical implementation issues in terms of establishing whether there is a 'contractual agreement or stated policy' or identifying 'the group entity which is legally responsible for the plan', as explained further in Appendix 5. We recommend that the current requirements in paragraph 9 of FRS 17, which are well understood, are retained.

We consider that all entities participating in defined benefit plans (including plans that share risks between entities under common control) should disclose committed payments to the plan. This provides essential information over the funding of the scheme.

Going concern

Section 32 does not include the requirements contained in paragraphs 14 to 16 of IAS 10 that an entity shall not prepare its accounts on a going concern basis if management determines after the reporting date either that it intends to liquidate the entity or to cease trading or that it has no realistic alternative but to do so. We believe that this guidance should be included in section 32, and that section 2 (concepts and pervasive principles) should be extended to address the going concern basis (based on paragraph 25 of IAS 1).

Funding commitments

We are not convinced that the addition of paragraphs 34.55 to 34.61 (and the associated guidance) on funding commitments is helpful in addressing the accounting treatment of funding commitments. We consider that this section, which applies to all entities (not just public benefit entities that will likely have further guidance in SORPs) does not clearly articulate the concept of a 'performance condition', contains a number of internal inconsistencies and there will be uncertainty over its application. IFRS and UK GAAP do not contain comparable requirements. We are unclear why FRS 12/IAS 37 does not already provide sufficient guidance, and we recommend that this section is deleted.

Specialised industries

Our response to Q5 provides further comments on agriculture and service concessions. However, as we recommend modifications to the treatment included set out in draft FRS 102, we summarise the key issues below.

Agriculture

We disagree with the model proposed in draft FRS 102. Given the wide scope of entities that can apply FRS 102, we believe that reporting entities should have a choice of policy in applying the cost or fair value models in relation to biological assets, rather than the approach in paragraph 34.2 of draft FRS 102 which requires use of the fair value model unless fair value cannot be readily determinable without undue cost or effort.

Service concessions

We support the proposals in draft FRS 102 for service concessions to apply an intangible asset or financial asset model, consistent with EU adopted IFRS. We also support transitional rules that would permit continuation of UK GAAP accounting for pre-transition service concessions. Many service concession entities have only one service concession and, therefore, continuing their existing accounting would represent a significant reduction in reporting burden. We believe that paragraph 35.10(i) achieves this but some have suggested that the wording is ambiguous. In addition, the paragraph simply states there is no requirement to apply paragraphs 34.12 to 34.16 to pre-transition service concession arrangements but does not address what the reporting entity should do instead. As drafted, therefore, it could give entities a free range to adopt different policies to their service concession arrangements. Therefore, we ask the ASB to clarify whether it was the intention of paragraph 35.10(i) that a reporting entity which chooses not to apply paragraphs 34.12 to 34.16 to pre-transition service concessions should continue with its previous accounting under UK GAAP (or IFRS, as appropriate) for the service concession arrangement.

We also consider that those entities wishing to account for pre-transition service concessions using the intangible asset or financial asset models set out in paragraphs 34.12 to 34.16 should also have access to the transitional arrangements set out in IFRIC 12.

Extractive industries

We disagree with the proposals in draft FRS 102 and consider that entities in the extractive industries should be required to apply IFRS 6 in respect of exploration and evaluation activities, and appropriate scope outs for expenditure covered by IFRS 6 should be included in sections 17 (property, plant and equipment) and 18 (intangible assets other than goodwill). This would significantly reduce uncertainty over the treatment of exploration expenditure under draft FRS 102, and put entities applying FRS 102 on a level playing field with IFRS reporters.

We also consider that the transition arrangements in paragraph 35.10(j), which permit a 'deemed cost' at the date of transition of the carrying amounts under full cost accounting (subject to an impairment test at that date under section 27), need to be redrafted to reflect the content of IFRS 1 D8A. This is because it is necessary to allocate the carrying amount to individual assets for subsequent depreciation and impairment purposes. Impairment testing of exploration and evaluation assets should be performed in accordance with IFRS 6, if draft FRS 102 is amended to require entities in the extractive industries to apply that standard to its exploration and evaluation assets (rather than

requiring entities to allocate exploration and evaluation assets to CGUs as would be required if testing for impairment in accordance with section 27).

Insurers

We highlight specific implementation issues in relation to IFRS 4 at the end of Appendix 5 to this letter.

Reference to EU adopted IFRS for specialised industry models described in section 34 which are based on IFRS

The specialised industry section 34 briefly describes models for agriculture and service concessions (i.e. the cost and fair value models for agriculture, and the intangible asset and financial asset models for service concessions) which are based on models included in EU adopted IFRS. These are generally, by their nature, complex areas where entities prefer to have guidance to be able to implement the requirements effectively rather than having minimal guidance with a risk of inconsistency in application and diversity of application. In our view, there is insufficient guidance included in draft FRS 102 for preparers to implement these models without reference to EU adopted IFRS. In these specialised areas, we consider that the burden of requiring entities to make reference to EU adopted IFRS will be outweighed by the clear benefits of drawing on the body of practical experience in implementing the relevant IFRSs (which has not yet been established for the requirements in draft FRS 102). Consequently, in our view, these sections should reference directly the guidance in IAS 41 and IFRIC 12 respectively.

While there are clearly a number of significant issues highlighted in relation to draft FRS 102, we believe that judicious drafting and additional clarifications will resolve many of them. We have identified further but less significant drafting issues in Appendices 2 and 5. Where appropriate, we have suggested ways of addressing these issues. We would not be surprised if more issues emerge as companies start to implement these proposals and we request the ASB to address the issues identified from this consultation, including our detailed comments in Appendices 2 to 5, prior to finalising the standards.

Question 2

Which alternative do you prefer and why?

(a) As proposed in FRED 47, a qualifying entity that is a financial institution should not be exempt from any of the disclosure requirements in either IFRS 7 or IFRS 13; or

(b) A qualifying entity that is a financial institution should be exempt in its individual accounts from all of IFRS 7 except for paragraphs 6, 7, 9(b), 16, 27A, 31., 33, 36, 37, 38, 39, 40 and 41 and from paragraphs 92-99 of IFRS 13 (all disclosure requirements except the disclosure objectives)

We agree that financial institutions should give enhanced financial instruments disclosures. It would be inappropriate for, say, a bank to give limited information on its financial instruments, even if these are included within equivalent disclosures in publicly available group accounts in which the bank is

included. It is important that the risk exposure and impact on the financial statements is understood at the level of the financial institution. It is, however, important that 'financial institution' is appropriately defined and we have comments on that in our response to Q4 below.

Of the two alternatives presented, we prefer alternative (a). The list in alternative (b) remains lengthy, the rationale for those disclosures included is not clear, and this truncated IFRS 7 disclosure is unlikely to significantly reduce the reporting burden. It will be easier for financial institutions to understand what is required if they implement IFRS 7 in full. In addition, alternative (a) has the advantage that future amendments made by the IASB to IFRS 7 will be picked up by financial institutions. If alternative (b) was adopted, the ASB would need to monitor any future amendments and consider whether it was appropriate for financial institutions to give the additional disclosures required by those amendments.

Question 3

Do you agree with the proposed scope for the areas cross-referenced to EU-adopted IFRS as set out in section 1 of FRED 48? If not, please state what changes you prefer and why?

We agree with the proposed scope.

Question 4

Do you agree with the definition of a financial institution? If not, please provide your reasons and suggest how the definition might be improved.

We understand that the list of entities included within the definition of financial institution has been developed following informal discussion with various representative bodies (3.23 of Revised Financial Reporting Exposure Draft: Part 1: Explanation).

The implication of being a financial institution is:

- ▶ for financial institutions applying FRS 101, there is no exemption from the disclosure requirements of IFRS 7 and IFRS 13, and
- ▶ for financial institutions applying FRS 102, there is no exemption from the disclosures of section 11 and 12 for qualifying entities and there are additional disclosures required by section 34.

As explained further below, this definition leads to financial instruments disclosures which will be more onerous for and perhaps be of limited added value for readers of retirement benefit fund accounts.

Retirement benefit funds

We understand why retirement benefit plans have been identified as financial institutions, given their role in holding financial instruments for the purposes of funding retirement benefits, and therefore the significance of financial assets to their balance sheets. However, many retirement benefit plans have a more limited 'customer base' than other entities listed as financial institutions, being the employees (or former employees or dependants) of the sponsoring employer.

The key question is whether it is appropriate for retirement benefit plans to make the same financial instruments disclosures as other financial institutions in their financial statements. In determining this, it is important to have regard to the different characteristics of retirement benefit plans. In particular, we note that:

(a) there is no requirement for retirement benefit plans to prepare publicly available financial statements although the financial statements are available for the regulator, HMRC (and members can request a set but in practice, rarely do so). Regulators also have access to regulatory returns, copies of recovery plans and to any other information that they might require;

(b) the financial statements of retirement benefit plans focus on the statement of net assets held by the retirement benefit fund (and therefore, unlike the financial statements of the other entities listed as financial institutions, do not present the full financial position of the fund);

(c) current UK GAAP does not require the audited financial statements of a pension scheme to show the actuarial liabilities. Such information will be based on the assumptions agreed by the trustees of the pension scheme and would therefore not be comparable across entities (if comparability is an objective of the proposals).

Investment risk disclosures are relevant for defined contribution (albeit that information is given for the fund as a whole, rather than members' individual funds) and defined benefit schemes, but the financial statements exclude information on the strength of the employers' covenant which is critical to assessing the funding risk of a defined benefit pension scheme. Therefore, the additional disclosures proposed will only contribute to a partial understanding of the risks facing the fund.

The financial instruments disclosures proposed are significantly more extensive than the current disclosure requirements for retirement benefit plans. To provide quality disclosures will clearly add to the costs of preparation and audit (particularly if the further information required by paragraphs 34.31 to 34.46, such as the actuarial valuation of liabilities, was required to form part of the audited financial statements - see our response to Q6). Many retirement benefit plans are relatively small, do not have the specialist expertise in-house and make use of third party administrators.

In light of the content, usage and limited circulation of many retirement benefit fund financial statements, the ASB should carefully consider the cost-benefit analysis of requiring retirement benefit funds to give the additional disclosures for financial institutions. An alternative approach that the ASB could consider is to remove retirement benefit funds from the list of financial institutions and include the disclosures considered important for retirement benefit funds specifically in the section 'Retirement Benefit Plans: Financial Statements' (paragraphs 34.31 to 34.46).

Question 5

In relation to the proposals for specialist industries, the ASB would welcome views on:

(a) Whether, and if so, why the proposals for agriculture activities are considered unduly arduous? What alternatives should be proposed?

(b) Whether the proposals for service concession arrangements are sufficient to meet the needs of preparers?

(a) Agriculture

Overview

We disagree with the model proposed in draft FRS 102. Given the wide scope of entities that can apply FRS 102, we believe that reporting entities should have a choice of policy in applying the cost or fair value models in relation to biological assets, rather than the approach in paragraph 34.2 of draft FRS 102 which requires use of the fair value model unless fair value cannot be readily determinable without undue cost or effort.

Draft FRS 102 proposes that the fair value model (i.e. fair value less costs to sell) shall be used for biological assets for which fair value is readily determinable without undue cost or effort. Agricultural produce is measured at fair value less costs to sell at the point of harvest. While we recognise that these proposals are likely to allow more entities to use the cost model for biological assets than under IAS 41, we consider that the current proposals remain too arduous for the wide range of entities that could apply FRS 102. These entities may vary significantly in terms of their size, sophistication and access to specialist resources.

Based on experience of implementing IAS 41, we consider that many entities prefer the cost model for biological assets because it is closer to what is used in their management accounts and there may be a general reluctance to use fair value as it is viewed as inappropriately reflecting future profits in profit and loss today (as well as giving rise to fluctuations in fair value in profit or loss). However, forestry companies often are keen to measure the forest at fair value.

We would therefore recommend that the ASB simply gives companies within the scope of paragraphs 34.1 to 34.10 the choice of applying the cost model (which may be closer to what is applied under UK GAAP) or the fair value model (which is required under IAS 41, unless fair value cannot be measured reliably) to biological assets. This would be consistent with other sections in draft FRS 102, where a choice of policies is now permitted.

It is important that the scope of paragraphs 34.1 to 34.10 and the requirements of the cost and fair value models are adequately defined, and key fair value measurement guidance included. Not all of the key terms, important for the scope of this section, are well defined. In addition, the cost model and fair value model are insufficiently well explained. We set out our key concerns on application of the cost and fair value models below, but Appendix 5 includes more detailed comments.

In our view, the most effective way of achieving this is if the definitions in the Glossary are aligned with those in IAS 41, and the requirements on applying the cost and fair value models repeat or reference the relevant paragraphs of IAS 41.

Cost model

Paragraph 34.8 states that the entity shall measure at cost less any accumulated depreciation and any accumulated impairment losses, those biological assets whose fair values are not readily determinable without undue cost or effort. However, this does not provide adequate guidance on how to determine depreciation or impairment charges, what to do with reversals of impairment, whether to reassess depreciation rates etc. For IFRS reporters, this is covered in paragraph 33 of IAS 41 by references to IAS 2, IAS 16 and IAS 36 (although arguably these references do not provide sufficient guidance for the treatment of biological assets). Equivalent references will be required, at a minimum, for entities applying FRS 102.

It is also unclear, under the proposals, whether moving onto the cost model is a one-off decision at inception or whether entities are permitted or indeed required to move to fair value if fair value is subsequently reliably measurable without undue cost or effort. A requirement to move from the cost to fair value model in these circumstances would be consistent with the treatment of biological assets under EU adopted IFRS where the presumption of reliable fair value measurement was rebutted on initial recognition (paragraph 30 of IAS 41) and with the treatment of investment properties under paragraphs 16.1 and 16.8 of draft FRS 102. There is, however, scope for diversity of practice as it could be argued that since paragraphs 34.1 to 34.10 are silent, management may apply judgement, or alternatively that it is necessary to reference section 16 of draft FRS 102 under the GAAP hierarchy in paragraph 10.5(a) of draft FRS 102.

The ASB should clarify the requirements on any transfer from the cost to the fair value model (and vice versa) should fair value become or cease to be readily determinable without undue cost or effort. If a choice of policy was permitted, guidance would still be needed on the situation where the fair value model is adopted but fair value ceases to be readily determinable without undue cost or effort.

Fair value model

Draft FRS 102 does not actually address where changes in fair value less costs to sell should be recorded, i.e. in profit or loss. It also omits important fair value measurement guidance in IAS 41, essential to the effective and consistent operation of the fair value model. This includes the guidance in paragraphs 15-16 and 21-23 of IAS 41. These paragraphs deal with the grouping of biological assets with significant attributes in measuring fair values, the fact that contract prices are not necessarily relevant in determining fair value (but future contracts to sell biological assets or agricultural produce may be onerous contracts), and important guidance on discounted cash flow methodologies.

In addition, all of the fair value measurement guidance included in draft FRS 102 is based on (but differs in some respects from) the current version of IAS 41 (rather than the version as amended by IFRS 13, which will be effective from 1 January 2013) for those entities preparing financial statements in accordance with IFRS. It is not clear whether this is intentional and if so, what the rationale would be.

In our view, it would be appropriate to either repeat or reference the relevant paragraphs of IAS 41 describing the fair value model.

Government grants

We note that the requirements on government grant requirements (which are included in IAS 41) are instead covered by section 24 of draft FRS 102.

Under IAS 41, unconditional grants for biological assets measured at fair value less costs to sell are recognised when they become receivable (or if conditional, when the conditions are met). If the biological asset is measured at cost, IAS 20 is applied. Under draft FRS 102, there is a choice of policy of using a 'receivable - entitlement' treatment or an IAS 20 accruals treatment, which would not depend on whether the asset is carried at cost or at fair value less cost to sell.

While draft FRS 102 sets out two models for accounting for grants (a policy choice), this flexibility would permit entities to choose to account for grants consistent with the requirements in IAS 41 if they wished. Therefore, we are not concerned that grants are not addressed in section 24.

(b) Service concession arrangements

Overall approach

For the reasons discussed below, we are not convinced that the requirements for service concession arrangements are sufficient to meet the needs of preparers.

Like IFRIC 12, the model for service concessions included in paragraphs 34.12 to 34.16 of draft FRS 102 includes a financial asset and an intangible asset model but there is less guidance on its operation. It appears likely that the accounting is supposed to be the same as in IFRIC 12, but there is lack of clarity over the scope of this section and no explicit guidance (or cross reference to relevant guidance in draft FRS 102) on revenue recognition for construction/upgrade services, borrowing costs and items provided to the operator by the grantor. In addition, it is not clear that the description of the intangible asset model requiring initial measurement of the intangible asset 'at fair value' complies with IFRIC 12. IFRIC 12 IE 14 clarifies that the operator recognises the intangible asset at cost, being the fair value of consideration transferred to acquire the asset - i.e. the fair value of consideration received or receivable for the construction services delivered.

Accounting for service concessions is a complex area and in light of the limited guidance in draft FRS 102, entities with service concession arrangements are highly likely to need to refer to IFRIC 12, and benefit from the practical implementation experience developed under that interpretation. A wide range of approaches might otherwise be available under draft FRS 102 in implementing the two models, and reference to IFRIC 12 would therefore significantly reduce diversity of practice, and give more certainty over acceptable accounting treatments.

Therefore, we consider that a more effective approach than brief descriptions of the intangible and financial assets models would be to reference IFRIC 12 directly but to highlight that:

- ▶ the entity must capitalise or expense borrowing costs, depending on the policy adopted under FRS 102; and
- ▶ financial assets are to be accounted for under sections 11 and 12 - which would permit application of IAS 39/IFRS 9 for recognition and measurement purposes.

However, such an approach would need to be reviewed in the light of changes to IFRS, specifically changes to the standards on financial instruments and revenue recognition.

Transition

Paragraph 35.10(i) states that a first time adopter is not required to apply paragraphs 34.12 to 34.16 to service concession arrangements entered into before the date of transition. Such a transitional arrangement is more generous than that available under IFRS 1/IFRIC 12, since it appears to 'grandfather' existing UK GAAP accounting under FRS 5 Application Note F. A key question is whether the accounting in FRS 5 Application Note F is consistent with other aspects of draft FRS 102 (which are not scoped out in the transitional rules).

Many entities are set up for single service concession projects, which are often of a long-term nature, and the economics of the funding will have had regard to the accounting treatment of the project. We would therefore support a 'grandfathering' of the UK GAAP accounting. We believe that paragraph 35.10(i) achieves this but some have suggested that the wording is ambiguous (particularly as UK

GAAP is based more on 'risks and rewards' compared to 'control' under IFRS, although the requirements on leases in section 20 of draft FRS 102 and IAS 17 both use a 'risks and rewards' model). In addition, the paragraph simply states there is no requirement to apply paragraphs 34.12 to 34.16 to pre-transition service concession arrangements but does not address what the reporting entity should do instead. As drafted, therefore, it could give entities a free range to adopt different policies to their service concession arrangements. Therefore, we ask the ASB to clarify whether it was the intention of paragraph 35.10(i) that a reporting entity which chooses not to apply paragraphs 34.12 to 34.16 to pre-transition service concessions should continue with its previous accounting under UK GAAP (or IFRS, as appropriate) for the service concession arrangement.

We also consider that those entities wishing to account for pre-transition service concessions using the intangible asset or financial asset models set out in paragraphs 34.12 to 34.16 should have access to the transitional arrangements set out in IFRIC 12.

Question 6

The ASB is requesting comment on the proposals for the financial statements of retirement benefit plans, including:

- (a) Do you consider that the proposals provide sufficient guidance?
- (b) Do you agree with the proposed disclosures about the liability to pay pension benefits?

(a) Do the proposals provide sufficient guidance?

We note that the ASB has decided that the SORP on Financial Reports of Pension Funds is to be updated to provide guidance on FRS 102 supplementing that in section 34. We support the update of the SORP and would anticipate that the proposals, supplemented by more detailed guidance in the SORP, will provide sufficient guidance. However, we consider that the ASB should clarify which requirements of sections 34.1 to 46 should be 'part of the financial statements' or 'alongside the financial statements', and hence not audited. We also set out specific areas that are unclear below.

Location of disclosures

While the section is titled 'Retirement benefit plans: financial statements' and paragraph 34.31 indicates the requirements of 34.2 to 46 should be applied in the **financial statements**, the detailed requirements refer to alternative presentations, with confusing and sometimes inconsistent terminology used. For example, other paragraphs refer to 'as part of the financial statements', 'either as part of the financial statements, or alongside the financial statements', 'as part of the financial statements or presented alongside the trustees' report', 'either as part of the financial statements or in a separate report'. See our specific comments on the location of the disclosure of the actuarial valuation of liabilities at (b) below.

Many of the specified disclosures are already required by statute in the Trustees' Report, which is issued together with the audited financial statements. Where there is a choice, many schemes may therefore prefer to continue with the status quo.

The clarity over the location of the disclosures is not aided by apparent duplication of certain disclosures in the separate sections dealing with defined contribution plans and defined benefit plans.

It may make sense to integrate the disclosures in paragraphs 34.42 to 34.46, as appropriate, into the separate sections and to cut out any unnecessary duplication in requirements.

Specific areas where additional clarity is required

We note that paragraphs 34.34 and 34.45 require for a defined contribution scheme, 'a description of the funding policy'. It is not clear what is expected here, since contribution rates of members and employers are relevant for defined contribution schemes.

In addition, we are not clear why paragraphs 34.38-34.39 are not equally relevant for defined contribution schemes.

There is a potential conflict in that the financial statements require a statement of net assets available for benefits, with the net assets measured at fair value using the guidance in paragraphs 11.27-11.32 (which covers financial assets only). Changes in fair value must be recognised in profit or loss or the Fund account. However, if the simplified provisions of section 11.14 are adopted, bonds would be carried at amortised cost. This means that retirement benefit funds adopting FRS 102 would need to adopt a policy of applying IAS 39 to all financial instruments (as permitted by paragraph 11.2) in order to carry their net assets at fair value. If this is the intention, we consider that this should be clarified in this section dealing with retirement benefit plans.

(b) Do you agree with the proposed disclosures about the liability to pay pension benefits?

We agree that information on the actuarial present value of retirement benefits, based on the most recent valuation prepared by trustees, would be useful, although we note that some valuation information is already included in the Trustees' Report.

However, the limitations of this information should be recognised. In particular, the strength of the fund cannot be fully assessed without information on the employer's covenant. We also note that draft FRS 102 requires such valuations to be based on the assumptions adopted by the trustees as being appropriate for the scheme and, therefore, the valuations would not be comparable across entities if financial statements were publicly available (although draft FRS 102 would require disclosure of the significant actuarial assumptions and the actuarial method used).

The ASB should specify whether the disclosure of the actuarial present value of retirement benefits is to be based on the triennial valuations or the annual updates to the valuations.

We also consider that the ASB should clarify the location of the disclosure of the liability to pay pension benefits, and specifically whether it is intended to form part of the audited financial statements. The proposed disclosure of the actuarial present value of retirement benefits is included in paragraph 34.43, which is silent as to the location, although paragraphs 34.35 and 37 indicate that actuarial information may be included 'either, as part of the financial statements, or alongside the financial statements' and paragraph 34.38 refers to 'either as part of the financial statements or presented alongside the trustees report'. It is not clear whether it is intended that the disclosure forms part of the audited financial statements or not (e.g. is 'alongside the financial statements' meant to imply that the disclosure must be referred to from the financial statements, and therefore would form part of the financial statements?).

Question 7

Do you consider that the related party disclosure requirements in section 33 of FRED 48 are sufficient to meet the needs of preparers and users?

We agree with the related party disclosure requirements in section 33 of FRED 48 (draft FRS 102) with one proviso.

The wording in paragraph 33.1A regarding the wholly owned subsidiary exemption does not include the clarification in paragraph 38 of Appendix IV of FRS 8 which states that that the exemption "should only be applied where all subsidiary undertakings which are a party to the transaction are wholly owned, directly or indirectly, by the ultimate controlling entity of the group". We believe this clarification ought to be included within section 33 and, without it, the exemption may be interpreted differently than how it is currently interpreted under FRS 8.

Question 8

Do you agree with the effective date? If not, what alternative date would you prefer and why?

We agree with the proposed effective date of periods beginning on or after 1 January 2015 for entities applying FRS 100 and FRS 101 or FRS 102.

We also agree with the proposal that early application is permitted for accounting periods beginning on or after the date of issue of these standards, subject to the additional requirement for a public benefit entity that it must also apply a public benefit SORP which has been developed in accordance with those standards.

The two factors that, in our view, could give rise to a need to consider a delay to the mandatory implementation date include:

- ▶ any slippage in the finalisation and effective date of IFRS 9; and
- ▶ the need to consider, and possibly consult further on or allow adequate time for implementation, on further technical amendments to draft FRS 102 to ensure that it is a workable standard in the UK environment. This includes adequate time for the SORP bodies to update the SORPs that remain under the new proposals.

Should there be a significant delay to finalisation of draft FRS 102, we believe that the ASB should proceed with issuing draft FRS 101. In our experience, many entities are interested in taking advantage of IFRS with reduced disclosures at the earliest opportunity, as this permits consistent recognition and measurement principles with IFRS used for group reporting purposes while reducing the burden of the disclosures required by full IFRS.

We noted in our response to the consultation on FREDs 43 to 44 that certain key aspects of the proposals are conditional on changes to the Act. Since then, BIS has consulted on 'relevant change in circumstances' in sections 395 and 403 of the Act to permit subsidiaries currently preparing accounts under EU IFRS to switch to preparing 'Companies Act' accounts, either using EU adopted IFRS (with

reduced disclosures) or FRS 102. That consultation has closed, with some support for relaxation of the restriction. We note that BIS is now considering its response to the consultation on rules on reverting from 'IAS accounts' to 'Companies Act accounts' and has indicated it may publish draft legislation later this year. If it does so, it is likely that any change to be made would be available in time for implementation of the ASB proposals.

Question 9

Do you support the alternative view, or any individual aspect of it?

We do not support the alternative view.

Appendix 2 – Legal considerations

We set out below our comments on legal considerations in respect of the ASB's proposed modifications made to EU IFRS (with reduced disclosures) and to the IFRS for SMEs in developing draft FRS 102. This supplements our comments in the covering letter and our responses to Questions 3, 6 and 20 included in Appendix 1 to our letter. We highlight additional concerns where company law may be incompatible with the proposals. We hope the ASB will consider the issues raised in this Appendix, and amend its proposals or include additional clarification on the legal considerations, where appropriate.

This appendix concentrates on the situations that we consider are likely to come up more frequently in practice.

Draft FRS 100

Transition to draft FRS 101

- ▶ Companies transitioning to draft FRS 101 need to consider whether adaptations need to be made in accordance with Appendix A1 (in order to comply with company law). We consider it would be helpful if the ASB could provide examples of where it considers that measurement of assets and liabilities on transition could give rise to amounts that do not comply with the Directives.
- ▶ We note that D17 is not an option under IFRS 1 so it is not clear what 'election' is referred to in A61(b). In addition, A61(a) and (b) do not state what companies would do if applying the rules in D16 and D17 would give rise to measurements of assets and liabilities that do not comply with the Act.

Draft FRS 101

Format of primary statements

- ▶ We believe that the requirement for qualifying entities that are UK companies to comply with both Schedule 1 (or 2 or 3) to the Regulations *and* the presentational requirements in IAS 1 is unnecessarily complex and onerous (as illustrated by the ASB's draft case studies). We also consider that certain aspects of the current/non-current analysis of assets and liabilities under IAS 1 are incompatible with the Regulations. For more complex companies it is difficult to see how additional lines and subtotals can make such classifications compatible.
- ▶ The conflict between the presentational requirements of IAS 1 and SI 2008/410 will be particularly acute for those companies applying Schedule 2 or 3 of SI 2008/410, where there is no flexibility to adapt the formats. The matter is especially complex for insurance companies who are required to present technical and non-technical accounts under Schedule 3 and, in some cases, required to show transfers between these technical accounts. This would make it difficult for insurance companies to present an income statement that complies with IAS 1.

- ▶ We therefore strongly recommend the ASB to require entities within the scope of the Regulations using FRS 101 to follow the company law requirements rather than additionally needing to comply with IAS 1.
- ▶ We note that paragraph 60 of IAS 1 has been amended to require an entity within the scope of Schedule 2 to follow the format shown in that schedule. This is a curious comment as clearly *all* entities within the scope of the Regulations need to comply with the formats. We therefore wonder whether the intention is that entities within the scope of Schedule 2 need not provide a current-noncurrent analysis. If this is the case, the wording needs to be clarified. However, insurance companies applying Schedule 3 would need the same relief.

Unrealised profits

- ▶ The Regulations require that only realised profits are included in the profit and loss account (although other parts of the Regulations provide exceptions, e.g. the fair value option which would apply to, say, financial instruments, agriculture and investment properties). Inclusion of unrealised profits in the profit and loss account requires use of the 'true and fair override'.
- ▶ Appendix 1 to draft FRS 101 does not address the issue of realised profits. However, the requirements of IFRS will result in unrealised profits being recognised in the profit and loss account in certain situations, e.g. exchanges of dissimilar property, plant and equipment under IAS 16.
- ▶ Where there are unrealised profits recognised in the profit and loss account under IFRS, the ASB will need to consider whether the treatment should be amended, by say, requiring qualifying entities using IFRS with reduced disclosures to recognise the gains in other comprehensive income. Alternatively, where the IFRS treatment is maintained, a 'true and fair override' will be required. While it will not be practicable to identify all the situations where this is the case, we recommend that Appendix 1 to FRS 101 includes the material in Appendix A3.16 to A3.19 to draft FRS 102, and explains that a 'true and fair override' will be required where unrealised profits are included in the profit and loss account.

Other areas that may require a 'true and fair override'

Goodwill non-amortisation

- ▶ For qualifying entities, IFRS 3R's requirement to recognise an immediate gain in respect of negative goodwill has been amended by paragraph AG1(c) in order to comply with EU accounting directives. However, no amendment has been made to impose a presumption of a five year useful life for goodwill if an entity is unable to make a reliable estimate of its useful life as per paragraph 19.23 of draft FRS 102. Instead, the IFRS requirement not to amortise goodwill (albeit it only impacts goodwill on acquisition of unincorporated businesses) has been retained. While we understand why the ASB would be keen to minimise accounting differences in this area, this could be regarded as an inconsistent approach to other situations giving rise to conflict with EU accounting directives, where amendments to IFRS have been made in draft FRS 101.
- ▶ It is acknowledged in Appendix A1.10 to draft FRS 101 that a 'true and fair override' is required (as under company law, goodwill has a finite life) and that this is not a new instance of the use of the override. However, we would point out that FRS 10 required entities to

determine that goodwill is regarded as having an indefinite life (and demonstrate that the goodwill is durable and capable of continued measurement). The ASB propose that use of the override would be available to all companies applying IFRS with reduced disclosure, regardless of any special circumstances. We ask the ASB to reconfirm that the use of the 'true and fair override' is appropriate.

Financial instruments - measurement

Contingent consideration

- ▶ Application of the fair value option in Schedule 1 of the Regulations to the items otherwise excluded from the fair value option in paragraphs 36(2) and 36(3) of Schedule 1 of the Regulations is only permitted (in accordance with paragraph 36(4)) where the treatment is in accordance with IFRSs (i.e. IAS 39), as adopted on or before 5 September 2006 and where the disclosures required under IFRS are given (see the comments below).
- ▶ Therefore, as companies applying IFRS with reduced disclosures are applying IAS 39, in most cases, application of the fair value option will comply with company law. An exception would appear to be the treatment of contingent consideration under IFRS 3R. IFRS 3R requires contingent consideration to be reported at fair value. For contingent consideration classified as a liability, fair value changes are reflected in profit and loss. However, IFRSs, as at 5 September 2006 did not permit this treatment. Therefore, it is not clear that the IFRS 3R treatment of contingent consideration would be permitted under company law for IFRS reporters using reduced disclosures. It appears this restriction to refer to IFRS as at 2006 may be removed in the proposed changes to the European Accounting Directives (although any changes would then need to be implemented into UK company law).
- ▶ As only individual financial statements can take advantage of IFRS with reduced disclosures, this conflict is only likely to arise in connection with combinations with unincorporated businesses. However, we consider that the ASB should confirm whether there is a conflict, and if there is, determine whether an amendment should be made to draft FRS 101, or whether it would be appropriate to make use of a 'true and fair override'.

Financial instruments - disclosures

Scope

- ▶ Paragraph 4 sets out the disclosures required where a qualifying entity (which is not a financial institution) taking advantage of IFRS with reduced disclosures has financial liabilities held at fair value which are neither held as part of the trading portfolio nor are derivatives. NB This scenario falls within paragraph 36(2) of Schedule 1 of the Regulations (see comments above on 'Financial instruments - measurement').

Our reading of the legislation is that the scope of these disclosures should be extended to cover other financial instruments carried at fair value in accordance with IAS 39 (or IFRS 9, once adopted by the EU), as listed in paragraph 36(3) of Schedule 1 of the Regulations.

Disclosures specified

- ▶ We are also unclear how the ASB has determined the disclosures specified in paragraph 4 (i.e. the disclosures which are required by the Regulations), since the disclosures listed are neither the full IFRS 7 disclosures nor, say, only paragraphs 9 to 11 of IFRS 7 (i.e. the disclosures labelled in that standard as applying specifically to financial assets or financial liabilities at fair value through profit or loss).
- ▶ The equivalent issue in respect of draft FRS 102 is discussed in our comments on that standard. We note that the disclosures specified in paragraph 4 of draft FRS 101 and paragraph 11.48A are not entirely consistent with each other (see comments under draft FRS 102 in this Appendix),
- ▶ Paragraph 36(4) of Schedule 1 of the Regulations refers to 'the disclosures required by such accounting standards are made' without being specific as to which disclosures are required. Arguably, this could be interpreted as meaning *all* disclosures for financial liabilities per IFRS 7 (as this was adopted prior to 5 September 2006, as referred to in paragraph 36(4)). This indeed appears to be the implication of Legal Appendix A1.7 which refers to 'all relevant IAS disclosures are required for instruments designated at fair value'.

Clearly, the ASB have taken a more restricted view that not all the IFRS 7 disclosures are required. One approach, if supported by legal advice, might be to require the disclosures given in paragraphs 9 to 11 of IFRS 7 (i.e. the disclosures specified for financial assets or financial liabilities at fair value through profit and loss) but the ASB has added other disclosures. We are not clear how it has determined these as, for instance, paragraph 27B(C)(i) and (e) might also be pertinent for financial liabilities (and assets) at fair value through profit and loss.

- ▶ It would be helpful if the ASB could reconfirm its legal analysis, and explain the scope of paragraph 4 and the disclosures specified in the Legal Appendix accompanying the final standard.

Draft FRS 102

Format of primary statements

- ▶ Paragraph 4.2 refers to the 'Regulations' (defined in the Glossary as referring only to The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (LMCR)). There appears to be no option for companies that wish to apply FRS 102 and meet the criteria of the Small Companies Regime to use the formats permitted by Schedule 1 to The Small Companies and Groups (Accounts and Directors' Report) Regulations 2008 (SCR).
- ▶ We recommend that draft FRS 102 is amended to permit entities subject to the Small Companies Regime to use the formats permitted by Schedule 1 to the SCR. This is particularly the case, in light of the proposed changes to EU Accounting Directives which

would prohibit Member States from adding additional disclosure requirements for small companies.

Unrealised profits

- ▶ Appendix A3.16-19 addresses this issue in the context of investment property and living animals and plants (where the fair value option in the Regulations permits changes in fair value to be recognised in profit and loss). However, it does not clarify the approach to be taken where there is a conflict between the requirements of draft FRS 102 and the requirement of the Regulations that only realised profits are included in the profit and loss account.
- ▶ Paragraph 2.44 requires recognition of income and expenses in the profit and loss account unless draft FRS 102 classifies these items as other comprehensive income. Therefore, where draft FRS 102 is silent, the gain or loss would be reflected in profit and loss. Consequently, there are a number of situations where the requirements of draft FRS 102 would lead to recognition of unrealised profits in the profit and loss account (and this would therefore require use of the 'true and fair override'). Examples (non-exhaustive) include:
 - ▶ Paragraph 9.18A - requiring the retained interest on disposal of a subsidiary to be measured at fair value at the date of disposal, and included in the profit or loss on disposal;
 - ▶ Paragraphs 13.4A and 13.5A - initial recognition of inventories held for distribution, or through a non-exchange transaction may represent a valuation above cost; and
 - ▶ Paragraphs 17.14 and 18.13 - exchanges of non-monetary assets (property, plant and equipment; intangibles).
- ▶ Where there are unrealised profits recognised in the profit and loss account under FRS 102, the ASB will need to consider whether the treatment should be amended, by say, requiring entities using FRS 102 to recognise the gains in other comprehensive income. Alternatively, where the FRS 102 treatment is maintained, a 'true and fair override' will be required. We recommend that Appendix 1 to FRS 101 includes the material in Appendix A3.16 to A3.19 to draft FRS 102, and highlights instances of the 'true and fair override' where unrealised profits are included in the profit and loss account.

Other areas that may require a 'true and fair override'

We consider that the ASB should also highlight other areas where the treatment in draft FRS 102 may require a 'true and fair override'. These would appear to include (a non-exhaustive list):

- ▶ paragraph 19.8-19.10: reverse acquisitions (see UITF Information Sheet No. 17);
- ▶ paragraphs 14.4B and 15.9B: investments in associates/jointly controlled entities in an investment portfolio are carried at fair value through profit and loss in the consolidated and individual financial statements. The Act would require use of the equity method for investments in associates/jointly controlled entities in consolidated financial statements.

Financial instruments - measurement

- ▶ Application of the fair value option to the items otherwise excluded from the fair value option in paragraphs 36(2) and 36(3) of Schedule 1 of the Regulations is only permitted (in accordance with paragraph 36(4)) where the treatment is in accordance with IFRSs (i.e. IAS 39), as adopted on or before September 2006 and where the disclosures required under IFRS are given (see the comments under draft FRS 101 above).

Draft FRS 102 permits (or requires) use of the fair value option for certain financial instruments that would fall within paragraph 36(2) and (3), and therefore this treatment only complies with company law, if it would be permitted under IAS 39 (and the disclosures required by IFRSs are given). Under IAS 39, financial assets can only be designated at fair value through profit and loss, under strict criteria. The application of this to investments in subsidiaries, associates and jointly controlled entities is discussed below.

Investments in subsidiaries, associates and jointly controlled entities (separate or individual financial statements)

- ▶ Paragraph 9.26 states that investors that are parents may account for investments in subsidiaries, associates and jointly controlled entities in their separate financial statements at: cost less impairment, at fair value with changes in fair value reflected through revaluation reserve (i.e. the alternative accounting rules) or at fair value with changes in fair value reflected through profit and loss in separate financial statements (which would use the fair value option under company law).

Paragraphs 14.4 and 15.9 state that investors that are not parents may account for investments in associates and jointly controlled entities in their (individual) financial statements using the cost model or at fair value with changes in fair value reflected through a revaluation reserve (i.e. the alternative accounting rules). Therefore, investors that are not parents are not permitted to account for investments in associates and jointly controlled entities at fair value through profit and loss in their (individual) financial statements.

It is not clear why the fair value through profit and loss treatment is permitted for investors that are parents (but not for other investors), as the restrictions in paragraphs 36(2) to 36(4) of Schedule 1 of the Regulations would apply equally to investors that are parents and those that are not. We recommend, for consistency, that sections 14.4 and 15.9 are amended to permit this treatment. We note, however, that, in many cases, the IAS 39 criteria to designate investments in subsidiaries, associates and jointly controlled entities at fair value through profit and loss may not be met.

Interestingly, section 11 permits entities applying FRS 102 to apply the recognition and measurement rules of IAS 39. However, paragraphs 9.26, 14.4 and 15.9 would appear to preclude use of the 'available for sale' treatment (which differs in some respects from revaluation at fair value under the alternative accounting rules) for investments in subsidiaries, associates and jointly controlled entities in separate or individual financial statements. If this is not the intention, the ASB may wish to consider amending the requirements of paragraphs 9.26, 14.4 and 15.9.

- ▶ In contrast, paragraphs 9.9A, 14.4B and 15.9B require investors with investments in subsidiaries, associates and jointly controlled entities held as part of an investment portfolio

to be accounted for at fair value with changes in fair value reflected through profit and loss in the (individual and, where applicable, consolidated) financial statements. Paragraph 9 of IAS 39 supports this treatment as it permits an entity to designate at fair value through profit and loss: a group of financial assets, financial liabilities (or both) managed and evaluated on a fair value basis (meeting the specified criteria).

- ▶ We consider that section 14 (and sections 9 and 15) should include supplementary requirements which explain the company law considerations in paragraph 36 of Schedule 1 of the Regulations, refer to the restrictions over use of the fair value option in IAS 39 and highlight the need for additional disclosures (see comments on financial instruments - disclosures below).

Financial instruments - disclosures

Scope

- ▶ Paragraph 11.48A sets out disclosures for financial instruments held at fair value that are neither held as part of a trading portfolio nor are derivatives. We understood that this paragraph is intended to set out disclosures required by paragraph 36(4) of Schedule 1 of the Regulations. However, if this was the intention, we note that the scope of paragraph 11.48A is considerably wider than the scope of the company law disclosure requirement and the scopes of paragraph 4 of draft FRS 101 and paragraph 1.8 of draft FRS 102.

Our reading of the legislation is that paragraph 36(4) of Schedule 1 of the Regulations would cover only the financial instruments carried at fair value which are listed in paragraphs 36(2) and (3) of that schedule. As drafted, paragraph 11.48A would apply to financial assets designated at fair value through profit and loss and available for sale assets (if IAS 39 accounting rules are applied) and most financial instruments accounted under section 12 of draft FRS 102.

By contrast, paragraph 1.8 of draft FRS 102 requires the disclosures in paragraph 11.48A to be given by a qualifying entity (that is not a financial institution) taking advantage of the reduced disclosure framework which has financial liabilities held at fair value through profit and loss, which are neither part of a trading portfolio or derivatives. This scenario falls within paragraph 36(2) of Schedule 1 of the Regulations. Financial institutions get no section 11 and 12 disclosure exemptions under the reduced disclosure framework.

- ▶ In our view, the scope of the disclosures for qualifying entities using the reduced disclosure framework under FRS 102 (paragraph 1.8) should be extended to cover other financial instruments carried at fair value in accordance with IAS 39 (or IFRS 9, once adopted by the EU) which are listed in paragraph 36(3) of Schedule 1 of the Regulations. However, the ASB may wish to reconfirm whether the scope of paragraph 11.48A for entities not using the reduced disclosure framework is appropriate or wider than intended.

Disclosures specified

- ▶ We are also unclear how the ASB has determined the disclosures specified in paragraph 4 (i.e. the disclosures which are required by company law where financial instruments listed in paragraphs 36(2)-(3) of Schedule 1 of the Regulations are carried at fair value (using the fair value option in company law).

- ▶ The equivalent issue in respect of draft FRS 101 is discussed in our comments on that standard. As discussed in the section on draft FRS 101, paragraph 36(4) of Schedule 1 of the Regulations refers to "the disclosures required by such accounting standards are made" without being specific as to which disclosures are required. Arguably, this could be interpreted as meaning *all* disclosures for financial liabilities per IFRS 7. Clearly, the ASB have taken a more restricted view that not all the IFRS 7 disclosures are required. One approach, if supported by legal advice, might be to require the disclosures given in paragraphs 9 to 11 of IFRS 7 (i.e. the disclosures specified for financial assets or financial liabilities at fair value through profit and loss) but the ASB has added other disclosures.
- ▶ We note that paragraph 11.48A is not consistent with the disclosures specified in paragraph 4 of draft FRS 101. It misses out disclosures based on paragraphs 9(a), 9(b), 9(d), 11(b) of IFRS 7. However, paragraph 11.48A(f) additionally requires disclosure of information to enable users to evaluate the nature and extent of exposure to relevant risks arising from financial instruments, as at the end of the reporting period. Draft FRS 101 does not specify the equivalent disclosures in paragraphs 31 to 32 of IFRS 7.
- ▶ It would be helpful if the ASB could reconfirm its legal analysis, and explain the scope of paragraphs 1.8, 11.48A and the disclosures specified in paragraph 11.48A in the Legal Appendix accompanying the final standard.

Merger accounting

- ▶ The ASB has added additional requirements in paragraphs 19.27 to 19.33, based on FRS 6, to permit use of merger accounting to 'combinations of entities or business combinations under common control'. Under the FRS 6 criteria, use of merger accounting is likely to be applicable to fewer combinations than would be out of scope of IFRS 3R (which would not require the relative rights of the ultimate shareholders or the minority's interest in the net assets to remain unchanged). These conditions are also not requirements of UK company law.
- ▶ Under UK GAAP, it is not uncommon for a 'true and fair override' to be used for certain group reconstructions not meeting the strict criteria (including compliance with company law). Paragraph 78 of FRS 6 which helps support this approach has not, however, been included in draft FRS 102. We recommend that the part of this paragraph which states that "Acquisition accounting would require the restatement at fair value of the assets and liabilities of the company transferred, and the recognising of goodwill, which is likely to be inappropriate in the case of a transaction that does not alter the relative rights of the ultimate shareholders" is included. Modifications to the wording may be required if the criterion for merger accounting that the relative rights of the ultimate shareholders is unchanged is relaxed. The paragraphs could also usefully highlight in what circumstances company law permits merger accounting (as currently included in the Legal Appendix to FRS 6).
- ▶ There is more detail on our recommendations in our comments on paragraphs 19.27 to 19.33 in Appendix 5.
- ▶ We note that the removal of merger accounting is being discussed as part of the proposed changes to the EU Directives. Removing merger accounting would impact the accounting for group reconstructions and should these proposals proceed, the ASB would need to amend paragraphs

Goodwill lives

- ▶ Paragraph 19.23 of draft FRS 102 requires that goodwill is amortised over its (finite) useful life, which is presumed to be five years where it cannot be reliably estimated. We note that this change appears to anticipate proposed changes in EU Accounting Directives. At present, UK company law takes advantage of a Member State option which permits goodwill to have a longer life than five years provided the period and reasons are disclosed. It is proposed that this Member State option is removed from the Directive. However, if this is not the case, the ASB may want to consider whether to delete reference to the five year life (even if the requirement to use a finite life is retained). See our further comments on 19.23 and section 35 in Appendix 5.

Group accounts exemptions

- ▶ Paragraph 9.3 of draft FRS 102 does not mention the exemption from preparation of group accounts by companies subject to the small companies regime. However, small companies may choose to apply FRS 102 and use this exemption available under the Act. This is not in accordance with earlier ASB messages that the requirement to prepare group accounts (under FRS 102, as is the case under EU adopted IFRS) would be based on company law. We recommend the exemption is included.

Appendix 3 – Proposed further modifications to draft FRS 100

We set out below modifications that we propose to draft FRS 100. We have focused on areas where we believe there is risk of uncertainty in interpreting the requirements or significant diversity in practice arising, areas where further clarification is needed, and areas where simple amendments could reduce the burden to preparers or correct what appears to be inadvertent drafting. We ask the ASB to consider making amendments in these areas.

Definition of a financial institution (paragraph 5(g))

Retirement benefit funds

- ▶ Retirement benefit funds have been identified as financial institutions, and therefore are required to give additional financial instruments disclosures which would perhaps be of limited added value for readers of retirement benefit fund accounts. In light of the content (only a statement of net assets), usage and limited circulation of many retirement benefit fund financial statements, the ASB should carefully consider the cost-benefit analysis of requiring retirement benefit funds to give the additional disclosures for financial institutions. The ASB should also clarify whether the disclosures specified, such as actuarial liabilities, would form part of the financial statements, as this would impact the scope of the audit. Many of the specified disclosures are currently required in the Trustees' Report and therefore are outside the audited financial statements. See our responses to Q4 and Q6.

Application of financial institution disclosures in group accounts

- ▶ Paragraphs 34.17 to 34.30 of draft FRS 102 specify additional disclosures for financial institutions. The definition of a 'financial institution' included in the Glossary to draft FRS 102 is the same as included in paragraph 5 of draft FRS 100. However, it would appear that these disclosures would not be required if the reporting entity was not itself a financial institution, as defined. For example, a group may contain material financial institution subsidiary undertakings (potentially, all its principal subsidiary undertakings may be financial institutions) but if the holding company is not itself a financial institution, it would appear that no disclosures are required in the group accounts. We recommend that the ASB address the applicability of paragraphs 34.17 to 34.30 to group accounts.

Transition

FRSSE

- ▶ There is a lack of clarity over the transition arrangements. Paragraph 16(d) of draft FRS 100 states that an entity transitioning to the FRSSE shall apply the transitional arrangements set out in the FRSSE. It is unclear where these transition arrangements were located in the amendments made to the FRSSE. We consider that transition arrangements or additional guidance needs to be included in respect of the revised presumed life of capitalised goodwill and intangibles.

Draft FRS 101

- ▶ See our comments in Appendix 2.

Draft FRS 102

Reduced disclosure framework

- ▶ Paragraph 19 states that a qualifying entity transitioning to FRS 102 may take account of the reduced disclosure framework set out in FRS 102 in its first year of application. It is not clear why this paragraph was needed or what was meant by the reference to the first year of application, e.g. whether the reduced disclosures are available for comparatives. We recommend that the meaning of this paragraph, including the reference to the first year of application is clarified.

First time adoption

- ▶ Situations might arise where an entity would want to reapply FRS 102 after its initial application. An example is where an entity had, say, moved to IFRS but later becomes part of a group whose members apply FRS 102 rather than IFRS in their financial statements. The BIS proposals, if implemented, would also permit companies to move from 'IAS accounts' (i.e. EU adopted IFRS) to 'Companies Act accounts' (such as those prepared under FRS 101 or FRS 102) for any reason, no more than once within a specified time period, say five years. In light of this, we highlight the following concerns over the transition arrangements to FRS 102.
- ▶ Paragraph 35.2 of draft FRS 102 permits an entity to be a first time adopter only once. It goes on to say that 'the special exemptions, simplifications and other requirements in [section 35] do not apply to the re-adoption.' We believe that the ASB needs to clarify whether paragraph 35.2 requires an entity re-applying FRS 102 to 'grandfather' first time adoption accounting used when FRS 102 was applied for the first time, or requires full retrospective application of FRS 102 on its re-adoption. If full retrospective application is required, this could clearly give rise to significant practical difficulties, in respect of business combinations but also many other areas.
- ▶ Since the IASB has amended IFRS 1 to clarify that an entity can be a first time adopter of that standard more than once, we ask the ASB to consider whether a similar amendment should be made to the FRS 102. This could ease the difficulties of restating transactions, particularly business combinations (that had been accounted for under IFRS 3R), under the different requirements of FRS 102.
- ▶ We include detailed comments on specific transition exemptions in our comments on section 35 in Appendix 5. We set out where we consider the ASB should clarify, amend or add additional transitional exemptions. In particular, we ask the ASB to consider clarifying the transitional arrangements for goodwill lives and service concessions. In addition, it may be helpful to clarify the requirements for the discontinuance of hedge accounting should relationships under IAS 39 (or its replacement) not be of a type permitted by section 12 (assuming that the entity did not choose to continue to apply IAS 39 (or its replacement)). We also recommend that the ASB consider whether to include additional guidance from Appendix C4 and C5 of IFRS 1 in relation to the accounting treatment of pre-transition business combinations not restated, and whether to introduce an exemption for subsidiaries held as part of an investment portfolio which were previously consolidated (see our comments on paragraph 9.9A in Appendix 5).

Appendix 4 - Proposed further modifications to draft FRS 101

We set out below modifications that we propose to draft FRS 101. We have focused on areas where we believe there is risk of uncertainty in interpreting the requirements or significant diversity in practice arising, areas where further clarification is needed, and areas where simple amendments could reduce the burden to preparers or correct what appears to be inadvertent drafting. We ask the ASB to consider making amendments in these areas.

Paragraph 4 - reduced disclosures for a qualifying entity which holds financial liabilities which are neither part of a trading portfolio nor derivatives

- ▶ See our comments on draft FRS 101 ('Financial instruments - measurement and financial instruments - disclosure') in Appendix 2.

Paragraph 7(a) - minority shareholder objections to the disclosure exemptions

- ▶ The mechanism to protect minority shareholders, as drafted, appears vague. The procedure(s) for informing shareholders of use of the disclosure exemptions, together with the timescale for doing so and for shareholders to make an objection are not stated. It is also unclear whether the requirement to communicate (and the ability of the minority to object) is a 'one off' event upon adoption of FRS 102 or applies to each financial year. We recommend that the ASB make it clearer how a minority shareholder is informed of the proposals and how it communicates any objection to the entity. Also, as drafted, it appears to require a shareholder who meets the stated thresholds to object, whereas the Companies Act 2006 refers to shareholders *in aggregate*. The requirement should be clarified.
- ▶ A possible model is provided by Sections 400 and 401 of the Companies Act 2006 which permit minority shareholders holding, in aggregate, more than half of the remaining shares or 5% of the total allotted shares, to object. However, the timescale of 'not later than six months after the end of the financial year' would need to be amended, given that public and many private companies may have filed their financial statements before that time. The mechanism should, perhaps, refer to a time limit after the minority shareholders have been informed and clarify whether this is an annual requirement or a one-time requirement (until the minority shareholders inform the company of an objection, again with a specified time limit in relation to the financial year in question).

Paragraph 8 - disclosure exemptions - IFRS 12

- ▶ Qualifying entities are given no exemption from any of the disclosure requirements of IFRS 12. The rationale for this is explained in Appendix A2.9 of draft FRS 101 where it is stated that "no disclosure exemptions in IFRS 12 are necessary because they have already been provided by paragraph 6(b) of IFRS 12".
- ▶ The exemption in paragraph 6(b) of IFRS 12 applies only to the separate financial statements of holding companies which also prepare consolidated accounts. Holding companies that do not prepare consolidated accounts and entities which do not have subsidiaries are within the scope of IFRS 12. Consequently, as drafted, all IFRS 12 disclosures are in scope for qualifying entities that are either themselves (intermediate) parents that do not prepare group accounts or stand-alone subsidiaries.

- ▶ We do not believe that it is sensible to exempt a non financial institution from all IFRS 7 disclosures but no IFRS 12 disclosures. Therefore, we consider that qualifying entities which are not financial institutions should be given an exemption from the disclosure requirements of paragraphs 24 to 31 of IFRS 12 where equivalent disclosures are included in the consolidated financial statements of the group in which the qualifying entity is included.

Paragraph 8(a) - disclosure exemptions - IFRS 2

- ▶ The reduced disclosure exemption is not available for a 'group arrangement involving equity instruments of an entity other than the parent'. The term 'group arrangement' is not defined.

This distinction between equity instruments of the parent and other group entities is presumably made on the basis that the publicly available consolidated financial statements in which the reporting entity is included would include information about share based payment arrangements of the parent entity. However, since all share based arrangements within the group would be within the scope of IFRS 2, the consolidated financial statements would presumably also include information about share based payment arrangements involving equity instruments of other group members. We are therefore, unclear why the reduced disclosure exemption only refers to the parent entity.

We consider that IFRS 2 disclosure exemptions should not be available where the entity's own equity instruments are used in share based payment (whether solely for the entity's own employees, or also for those of other group members). However, we consider that IFRS 2 disclosure exemptions should be available where a group arrangement involves equity instruments of other group entities.

- ▶ We would also question why the disclosures in paragraph 44 (c) and (d) of IFRS 2 are required (which would apply to share options of the entity or any group entity), but not the disclosures in paragraph 51 of IFRS 2 which disclose the financial effect of the share based payments.

Paragraph 8(l) - related party exemption

- ▶ The wording in respect of the wholly owned subsidiary exemption is virtually identical to the wording in paragraph 3(c) of FRS 8. However, Appendix IV, paragraph 38, of FRS 8 clarifies that the exemption in paragraph 3(c) "should only be applied where all subsidiary undertakings which are a party to the transaction are wholly owned, directly or indirectly, by the ultimate controlling entity of the group". We would recommend that this clarification is included within draft FRS 101 (and draft FRS 102) to ensure that this exemption is interpreted in the same way as FRS 8.

Format of primary statements

- ▶ See our response to Q1 in Appendix 1, and Appendix 2.

Goodwill non-amortisation

- ▶ See our comments on draft FRS 101 (goodwill non-amortisation) in Appendix 2.

Appendix 5 – Proposed further modifications to draft FRS 102

We set out below modifications that we propose to draft FRS 102. We have focused on areas where we believe there is risk of uncertainty in interpreting the requirements or significant diversity in practice arising, areas where further clarification is needed, and areas where simple amendments could reduce the burden to preparers or correct what appears to be inadvertent drafting. We ask the ASB to consider making amendments in these areas.

Certain of these comments repeat comments on similar issues raised in Appendix 4 in respect of draft FRS 101, but have been repeated in full to enable Appendix 5 to be referred to as a stand-alone document setting out the full issues identified in draft FRS 102. We have indicated where a similar issue is dealt with in draft FRS 101.

Comments in relation to insurance contracts have been included in a separate section at the end of this Appendix.

Section 1

For all the items identified in section 1, we have identified the same issues in relation to draft FRS 101.

Paragraph 1.8 – reduced disclosures for a qualifying entity which holds financial liabilities which are neither part of a trading portfolio nor derivatives

- ▶ See our comments on draft FRS 102 (financial instruments – measurement and financial instruments – disclosure) in Appendix 2.

Paragraphs 1.8 and 1.12(e) – share based payment

- ▶ The reduced disclosure exemption is not available for a 'group arrangement involving equity instruments of an entity other than the parent'.
- ▶ The term 'group arrangement' is not defined and this reduced disclosure exemption needs clarification, because unlike FRS 20/IFRS 2, many group share based payment arrangements appear to be outside the scope of section 26. They would, therefore, also be presumably outside the scope of its disclosures of share-based payment arrangements (since such arrangements do not meet the Glossary definition of share-based payment transactions). It is difficult to define the scope of the reduced disclosure exemption before clarifying the intended accounting treatment of section 26 for group share based payment arrangements (see our comments on section 26).
- ▶ We consider that more detailed disclosure is relevant where the entity's own equity instruments are used in share based payment (whether for the entity's own employees, or for those of other group members). However, this disclosure should only be required where a share based payment is accounted for under section 26. We note that for those entities that are UK companies, disclosure of all share options is required under the Regulations (whether or not these are share-based payments).
- ▶ If the section 26 disclosures are intended to apply to group share based payment arrangements, we consider that the reduced disclosure exemptions should be extended to

group arrangements involving equity instruments of other group entities (other than the reporting entity). In our view, paragraphs 26.18(a) and 26.22 (which are not included in the reduced disclosure exemptions) provide adequate detail for share based payment arrangements involving the equity instruments of other group entities, particularly as there appears to be no requirement to recognise a share-based payment charge where the reporting entity's employees receive equity instruments of other entities.

Paragraph 1.11 - minority shareholder objections to the disclosure exemptions

- ▶ The mechanism to protect minority shareholders, as drafted, appears vague. The procedure(s) for informing shareholders of use of the disclosure exemptions, together with the timescale for doing so and for shareholders to make an objection are not stated. It is also unclear whether the requirement to communicate (and the ability of the minority to object) is a 'one off' event upon adoption of FRS 102 or applies to each financial year. We recommend that the ASB make it clearer how a minority shareholder is informed of the proposals and how it communicates any objection to the entity. Also, as drafted, it appears to require a shareholder who meets the stated thresholds to object, whereas the Companies Act 2006 refers to shareholders *in aggregate*. The requirement should be clarified.
- ▶ See our further comments in Appendix 4 on this matter.

Section 4

Paragraph 4.2 - accounting formats

- ▶ See our comments on draft FRS 102 (accounting formats) in Appendix 2.

Section 5

Paragraph 5.7B - requirements applicable to both approaches

- ▶ We consider this should refer to discontinued operations (i.e. plural) rather than to a discontinued operation.

Section 6

- ▶ We note that this section does not require disclosure of proposed dividends, as would be required by paragraph 137 of IAS 1, although this would be required by UK companies applying FRS 102 under paragraph 43 of Schedule 1 of the Regulations. We would recommend inclusion of this disclosure.

Section 7

- ▶ Section 7 does not provide for certain cash flows to be presented on a net basis. In the absence of such a requirement, and the general requirements of section 2.52 in relation to not offsetting assets and liabilities, or income and expenses, the netting of any type of cash flows would appear to be prohibited. We recommend that paragraph 22 of IAS 7, which permits netting of cash flows in certain circumstances, is added to Section 7.

Paragraph 7.12 - foreign currency cash flows

- ▶ This paragraph should also refer to 'or at exchange rates that approximate the actual rates (for example, a weighted average exchange rate for the period)', as permitted by IAS 7.27.

Section 9

Paragraph 9.3 - requirement to present consolidated financial information

- ▶ This section does not mention the exemption from preparation of group accounts by companies subject to the small companies regime. We recommend the exemption is included. See our comments in Appendix 2.

Paragraph 9.6 - currently exercisable options or convertible instruments

- ▶ This paragraph is less prescriptive than either IAS 27 or IFRS 10, and implies that an entity would use judgement in assessing whether currently exercisable options or convertible instruments give rise to control, as defined.
- ▶ While this could lead to diversity of practice in the assessment of whether such arrangements give rise to control, it does allow entities to focus on the substance of these arrangements (rather than solely whether potential voting rights are currently exercisable). It also gives more flexibility for reporting entities that are companies to ensure that only subsidiary undertakings, as defined in section 1162 of the Act are consolidated. In particular, section 1162 defines a parent undertaking as including many situations similar to those in paragraph 9.5 but adds, inter alia, that it has the 'power to exercise, or actually exercises, dominant influence'. We therefore do not propose an amendment.

Paragraph 9.9A - asset held exclusively for resale (investment portfolio)

- ▶ This paragraph amends the definition of 'asset held exclusively for resale' to extend it to investments in subsidiaries held as part of an investment portfolio. This implements, to the extent permitted by company law, the proposals in the exposure draft amending IFRS 10. If these do not proceed, this paragraph may need to be redrafted.
- ▶ The fair value model described in paragraph 9.9A appears to be using the fair value option. This is not permitted under paragraph 36(3) of Schedule 1 of the Regulations unless it would be permitted under paragraph 36(4) of that Schedule and the disclosures required by IFRSs are given. This requires, for example, that it would be permitted under IAS 39, as adopted prior to September 2006. While this is likely to be the case, we consider that the ASB should

incorporate these legal requirements and specify the disclosures that will be required (see our comments on draft FRS 102 (financial instruments - measurement and financial instruments - disclosure) in Appendix 2 above.

- ▶ There is a restriction that a subsidiary cannot previously have been consolidated (similar to that in paragraph 25 of FRS 25 in the previous defining phrase for 'assets held exclusively for resale', and perhaps necessary to prevent abuse of this consolidation exemption). We note that this would mean that entities are required to apply the requirements of paragraph 9.9A to subsidiaries that have not previously been consolidated but are prohibited from applying the requirements to subsidiaries that have been previously consolidated (e.g. because this was the requirement under existing UK GAAP as interpreting the exclusion in the Act), even if they have a similar function in the business.

We recommend that the ASB consider, subject to confirming that this would meet the requirements of section 405(3)(c) of the Act (which permits exclusion of a subsidiary undertaking where 'the interest of the parent company is held exclusively with a view to subsequent resale'), whether transitional relief should be extended to first time adopters of FRS 102 to account for **all** investments in subsidiaries held as part of an investment portfolio at the date of transition as 'assets held exclusively for resale' in accordance with paragraph 9.9A, even if these subsidiaries were previously consolidated.

Paragraphs 9.10 and 9.25 - ESOPs and EBTs

- ▶ Paragraph 9.10 implies that an ESOP is a special purpose entity to be consolidated by a parent entity (rather than treated as an extension of the sponsoring entity as under UK GAAP). This would mean that in its separate financial statements, the parent entity would not include the assets and liabilities of the ESOP, whether or not consolidated financial statements are prepared. However, this would appear to be inconsistent with paragraphs 2.53 to 2.55 (which apply to all financial statements). Paragraphs 2.53 to 2.55 are based on UITF 32 and would require payments to an Employee Share Ownership Plan ('ESOP') or Employee Benefit Trust ('EBT') to be treated as an exchange of one asset for another. This treatment is consistent with treating an ESOP/EBT as an extension of the sponsoring entity but not consistent with a consolidation model, where *prima facie*, a payment made would give rise to an expense (or loan, if recoverable) in the separate financial statements.
- ▶ By contrast, paragraph 9.25 requires an entity that is not a parent to apply paragraphs 2.53 to 2.55 to arrangements to facilitate employee shareholdings under remuneration schemes in its financial statements. Entities that are not parents would therefore treat the ESOP or EBT as an extension of the sponsoring entity - and this would put them in a different position to parent entities in their separate financial statements. We do not understand the conceptual basis for the distinction drawn between parents and other entities.

It is not clear whether this is intentional. We would ask the ASB to review these requirements and to reconsider the model for ESOPs and resolve inconsistencies. Since IFRS does not specify whether ESOPs are to be consolidated or treated as an extension of the sponsoring entity, we recommend that the ASB does not alter the position established under UK GAAP to treat ESOPs as an extension of the sponsoring entity.

- ▶ We have also noted a number of drafting issues, which give rise to inconsistencies in accounting treatment. We would ask the ASB to review the requirements and resolve these inconsistencies and any unintended accounting treatments:
- ▶ We note that, unlike UITF 32, paragraphs 2.52 to 2.55 do not scope out pension funds. We consider that paragraphs 2.52 to 2.55 should scope out post-employment and long-term benefit funds accounted for under section 28 of draft FRS 102.

This is important to avoid an inconsistency with paragraph 28.3 which requires the cost of employee benefits to be treated as a liability, **after deducting** amounts paid either directly to the employees **or as a contribution to an employee benefit fund**. It is difficult to see how the requirement in section 28.3 could be consistent with paragraph 2.54 which has a rebuttable presumption that the entity making a payment to an intermediary has simply exchanged one asset for another and paragraph 2.55 which states that an asset will cease to be recognised as an asset of the entity when, for example, the asset of the intermediary vests unconditionally with the beneficiaries.

- ▶ Paragraph 28.3 is also not consistent with EU adopted IFRS (which distinguishes between payments to an ESOP or EBT which would not reduce the liability to employees, as opposed to contributions which become plan assets of a long-term or post-employment defined benefit plan, or contributions to a post-employment defined contribution plan). We recommend that the requirements for each type of employee benefit are set out separately in section 28, as is the case in paragraphs 10, 44, 54 to 56 and 128 of IAS 19.
- ▶ In passing, we note that paragraph 9.25 is under a heading 'separate financial statements' in section 9 addressing consolidated and separate financial statements. However, it appears that (unlike IAS 27), paragraphs 9.24, 14.1 and 15.1 limit the concept of separate financial statements to investors that are parents only. It is therefore an odd place to include this requirement.

Paragraphs 9.18-9.19 and 9.31 - UITF 31 conflict with recording retained interest of a disposed subsidiary at fair value

- ▶ We note that paragraph 9.31 introduces the requirements of UITF 31 into draft FRS 102. This could conflict with paragraphs 9.18A and 9.19 which require a retained interest in a disposed subsidiary to be included initially at its fair value. In light of the conflict, there is likely to be diversity of practice in respect of accounting for subsidiaries or businesses transferred to a jointly controlled entity or associate. Company law requires that only realised profits are included in the profit and loss account, and there is therefore also a concern that the treatment in paragraphs 9.18A and 9.19 may lead to unrealised profits being included in the profit and loss account,

This conflict would not have been in the original IFRS for SMEs (based on IAS 27 rather than IAS 27R). Therefore, the ASB could consider whether to revert to the original wording for paragraphs 9.18A and 9.19, but this would lead to a difference between draft FRS 102 and current IFRS in this regard.

- ▶ A similar conflict has already been identified between IAS 27 and SIC 13 (and IAS 27R and IAS 28R). At the March 2012 IFRIC meeting, the IFRIC expressed support for full gain recognition on the loss of control of a business, whether housed in a separate legal entity or

not, and has referred the issue to the IASB. If the wording is retained, we would recommend that the ASB monitor any actions taken by the IASB to resolve this conflict, and consider their inclusion in FRS 102.

- ▶ In light of the requirements of IFRS, we also consider that the ASB should clarify that the treatment in paragraph 9.18A also applies where there is a loss of control of a subsidiary as well as a disposal.

Paragraph 9.26 - Parent accounting treatment for investments in its separate financial statements

- ▶ See comments on draft FRS 102 (financial instruments - measurement and financial instruments - disclosure).

Section 10

Paragraph 10.11 - applying changes in accounting policies

- ▶ Paragraph 10.11(b) addresses the situation where the entity has elected to follow IAS 39 instead of the simplified provisions in sections 11 and 12 of draft FRS 102. This paragraph needs to be adapted to address amendments to IFRS 9 as well.
- ▶ If an entity instead moves from applying the simplified provisions in sections 11 and 12 of draft FRS 102 to applying IAS 39/IFRS 9, presumably it will be able to access any transitional provisions in those standards under paragraph 10.11(a). However, the ASB should consider whether any specific transitional arrangements would be appropriate, once IFRS 9 is finalised.

Section 11

Paragraph 11.7- Scope

- ▶ A number of the financial instruments included in this paragraph would not be basic financial instruments, as defined in section 11.8, and therefore would not need to be scoped out of section 11, but the scope outs can do little harm. See our further comments under paragraph 12.3.

Paragraph 11.8 - Definition of basic financial instruments

- ▶ Since the IFRS for SMEs was originally published, IFRS 9 has been amended. We would recommend that the definition of basic financial instruments is aligned, where appropriate, with the contractual characteristics test. For example, there are no provisions dealing with extension options. The objective must be that **common features of loans and other financial instruments that would be expected to be classified as basic financial instruments, do not give rise to failure to meet the detailed criteria for a basic financial instrument.**

Embedded derivatives in non-financial items

- ▶ Sections 11 and 12 do not require the identification (and where appropriate, separation) of embedded derivatives in non-financial contracts. However, the effects of paragraph 12.3(d), 12.3(f) and 12.4 could mean that a significant number of non-financial contracts would be required to be accounted for at fair value through profit and loss. This would lead to complexities for entities in valuing the contracts and significant volatility in reported results.
- ▶ While entities have the opportunity to apply IAS 39 instead of the detailed rules in sections 11 and 12 of the draft FRS 102, this would be onerous for an entity that does not otherwise significantly transact in financial instruments. We recommend that the ASB perform outreach to assess the practical implementation issues of sections 11 and 12 - in particular, whether many contracts would be required to be accounted for at fair value under section 12, and whether an approach involving separation of embedded derivatives would work better. We consider that this should form part of the consultation on the re-exposure of these sections when IFRS 9 is finalised.

Offsetting a financial asset and a financial liability

- ▶ Section 11 has no guidance on the circumstances in which offsetting of a financial asset and liability is required, equivalent to paragraphs 42 to 50 of IAS 32. Paragraph 2.52 prohibits *all offsetting unless specifically permitted within draft FRS 102*. In the absence of specific guidance within section 11, we therefore presume that all offsetting is prohibited.
- ▶ We doubt that it is the ASB's intention that the offsetting rules for financial instruments under draft FRS 102 should differ from those under EU adopted IFRS and recommend that the offsetting rules in IAS 32 be included within section 11.

Paragraph 11.24 - impairment

- ▶ Although this wording may be superseded by IFRS 9, it contains no requirement for a collective assessment for loans already individually assessed and found not to be impaired (paragraph 64 of IAS 39). Consequently, any entity with a loan portfolio would probably see a reduction in impairment provisions compared to existing UK GAAP or IAS 39.
- ▶ We therefore recommend that, if guidance based on IFRS 9 (when finalised) is not implemented, guidance for a collective assessment of loans already individually assessed and found not to be impaired is added to paragraph 11.24.

Paragraph 11.27 - fair value hierarchy

- ▶ The draft FRS 102 sets out a fair value hierarchy that differs to that used in IFRS 7. Financial institutions applying draft FRS 102 must analyse financial instruments included at fair value using the hierarchy in draft FRS 102 (paragraph 34.22). In our view, relatively few financial instruments may fall within item (b) in the hierarchy. In our view, it would be more informative to apply the three level hierarchy set out in IFRS 7 and we would ask the ASB to consider whether this should be amended.

- ▶ This paragraph should read “Paragraph 11.14(c)(i) requires an investment in ordinary shares or preference shares to be measured at fair value **if the shares are publicly traded** or if the fair value of the shares can be measured reliably.”

Paragraph 11.33 - derecognition of a financial asset

- ▶ The financial asset derecognition rules in paragraph 11.33c are different to those contained in EU adopted IFRS (paragraph 20 of IAS 39). The derecognition rules in draft FRS 102 derive from those included in the IFRS for SMEs, that were based on an exposure draft of new control-based derecognition rules which were never adopted into IFRS. They appear to require derecognition even where the transferor retains some significant risks and rewards of ownership of a financial asset, provided the transferee has the practical and unilateral ability to sell the asset in its entirety to an unrelated third party unilaterally.
- ▶ The practical impact of this is that financial assets subject to most sale and repurchase ('repo') and stock lending transactions would be derecognised under draft FRS 102 but not under EU adopted IFRS, IFRS 9 or current UK GAAP. In our view, this would be inappropriate and we recommend that draft FRS 102 be amended to align the financial asset derecognition rules with that of EU adopted IFRS.
- ▶ The second example given in paragraph 11.35 of draft FRS 102 states that a transferor would not derecognise receivables sold to a bank if it retains the risk of slow payment or non-payment. As written, the conclusion doesn't follow from the text of the standard, since retention of some significant risks and rewards would not automatically preclude derecognition. In this fact pattern it is probable that the bank does not have the practical ability to sell the receivables since it would lose the value of the guarantees provided by the transferor, but the example does not make this logic clear.

Paragraph 11.38 and 22.8 - derecognition of a financial liability on issuance of an equity instrument

- ▶ Based on paragraphs 11.38 and 22.8, it would seem that a gain should be recognised where a financial liability is derecognised on issue of an equity instrument. However, the exemptions in IFRIC 19 have not been included in draft FRS 102. Such transactions are common within group situations and we would ask the ASB to consider including appropriate exemptions in line with IFRIC 19.

Paragraph 11.48A - financial instruments at fair value

- ▶ See our comments on draft FRS 102 ('Financial instruments - measurement and financial instruments - disclosure') in Appendix 2.

Section 12

Paragraph 12.3 - Scope

- ▶ We note that IAS 39 scopes out reimbursement rights for provisions accounted for under IAS 39. A similar exemption would be appropriate in sections 11 and 12 so these can be dealt with under section 21. It is not clear why paragraph 12.3 does not mirror the wording in paragraph 11.7 for the equivalent financial instruments outside its scope.
- ▶ We consider that the ASB should look closely at the scope exemption for share based payments. This exempts financial instruments, contracts and obligations to which section 26 applies, except for contracts within the scope of paragraph 12.5 (although many share based payment arrangements would be excluded from the scope of section 11 as they are not basic financial instruments, and from section 12, under section 12.4). However, we have a concern that where the reporting entity incurs a liability because it grants an award over equity instruments of another group entity or an award based on the price of equity instruments of another group entity (for example, a share appreciation right over the parent's equity), such an award could be within the scope of section 12, as it would be outside the scope of section 26.
- ▶ We also have a concern over the treatment of financial guarantee contracts. These appear not to meet the definition of a basic financial instrument in paragraph 11.8. Consequently, it would appear under section 12 that these would be required to be carried at fair value through profit and loss, where the simplified provisions of draft FRS 102 are applied. This is not a satisfactory outcome as such contracts will be common in practice, and it is more arduous accounting than under IAS 39. At present, for entities not applying FRS 26, financial guarantee contracts are generally dealt with under FRS 12 (see paragraph 5 of FRS 12) as FRS 12 only scopes out financial instruments carried at fair value. We consider that section 21 needs to clearly scope out financial instruments dealt with under section 11 and 12. It is also important that sections 11 and 12 clearly state whether financial guarantee contracts are within their scope or not.

Paragraph 12.4(d) - rights under insurance contracts

- ▶ See our comments under insurance contracts at the end of this Appendix.

Paragraph 12.18(a) - hedge accounting

- ▶ This paragraph contains a typo - "or a hedge of a foreign exchange risk in a net investment in a foreign operation;" should read: "or for a hedge of a foreign exchange risk in net investment in a foreign operation:"

Paragraph 12.23 and 12.25 - hedge accounting (variable interest rate risk etc)

- ▶ These paragraphs do not explain how to account for a discontinuance of hedge accounting. Paragraph 12.23 states that the hedging gain or loss is reclassified in profit and loss when the hedged item is recognised in profit or loss or "when the hedging relationship is ended". This latter phrase needs to be defined (and distinguished from a discontinuance of hedge accounting). For example, paragraph 12.25 does not explicitly explain what the accounting treatment is where hedge accounting is discontinued but the expected forecast transaction is

still expected to take place. If a discontinuance of hedge accounting and ending the hedging relationship (undefined) were the same, this would imply that amounts accumulated in other comprehensive income would be reclassified to profit and loss on discontinuance of the hedge accounting, which presumably is not the intention. We therefore recommend the ASB clarify the meaning of hedging relationship, and the treatment on discontinuance of hedge accounting.

- ▶ We are not convinced that the description of the amounts to be recognised in other comprehensive income and profit and loss is consistent with the requirements of paragraph 96 of IAS 39 for cash flow hedges (which sets out a calculation of ineffectiveness). In particular, paragraph 12.23 does not refer to the "excess of **the change in** fair value of the hedging instrument **since inception** over the change in the fair value of the expected cash flows" (our emphasis indicating wording to be added) nor does it include the specific requirements of paragraph 96(a) of IAS 39 explaining what should be reflected in the separate component of equity.
- ▶ Paragraph 12.23 is also not clear that it adequately addresses the accounting for net investment hedges (where effectiveness is not based on the excess of the fair value of the hedging instrument (e.g. a borrowing) over the change in fair value of the expected cash flows of the hedged item, but on the difference between the foreign exchange gains or losses on the net investment, and those on the hedging instrument).
- ▶ We recommend that these paragraphs are redrafted when this section is re-exposed on finalisation of IFRS 9.

Paragraph 12.23 - hedge of a net investment in a foreign operation

- ▶ We note that where a hedge of a net investment in a foreign operation is undertaken in accordance with the simplified provisions in section 12, there is no reclassification of the cumulative exchange differences on disposal or partial disposal of the foreign operation. This is consistent with the fact there is no reclassification of the cumulative exchange translations on disposal of the net investment in the foreign operation.
- ▶ However, we note that if a hedge of a net investment in a foreign operation is undertaken under IAS 39, there would be a reclassification of the cumulative exchange differences in accordance with paragraph 102 of IAS 39 on disposal or partial disposal of a foreign operation. IFRS reporters would also reclassify the cumulative exchange differences on the foreign operation at the same time in accordance with paragraphs 48-49 of IAS 21.
- ▶ However, for entities applying FRS 102, this means that if a hedge of a net investment in a foreign operation is undertaken under IAS 39, the cumulative exchange differences on the hedging instrument would be reclassified on disposal or partial disposal of a foreign operation **but** under section 9.18A (unlike IAS 21), the gross cumulative exchange differences on the net investment in the foreign operation would not be reclassified. Hence, use of IAS 39 by an entity otherwise using FRS 102 would give rise to an asymmetrical treatment of the cumulative exchange differences. This is not a satisfactory outcome and we believe that the accounting should be the same whether section 12 or IAS 39 is applied to the hedge of the net investment in a foreign operation.

Section 13

Paragraph 13.4A - measurement of inventories

- ▶ We are unclear as to the intended purpose of section 13.4A on inventories held for distribution. As drafted, the requirements lack context and are somewhat opaque. Consequently, in our view, this paragraph is unlikely to meet its accounting objective (whatever that might be). We do not recognise an equivalent paragraph in either UK GAAP or EU adopted IFRS.
- ▶ Given the references in the Glossary to 'no or nominal consideration' (hence a difficulty in applying the general requirement to measure inventory at the lower of cost and estimated selling prices less costs to complete and sell) and references to 'service potential', we surmise this may be related to public benefit entities, but it is not marked as a public benefit entity provision. Given the lack of context, we also do not understand why replacement cost is a more relevant measure than cost (as it may well be higher than cost, and therefore represent a revaluation under the alternative accounting rules).

Paragraph 13.5A - cost of inventories

- ▶ We are not clear why this requirement has been inserted and it appears to have wider scope than solely for public benefit entities. We note that there is no equivalent in IFRS, UK GAAP or other sections of draft FRS 102 dealing with property, plant and equipment, intangible assets or investment property.
- ▶ More generally, the ASB should consider carefully whether it should mandate requirements for non-exchange transactions beyond public benefit entities, since non-exchange transactions are not uncommon in groups. For example, transfers of assets are frequently made at book rather than fair values, or by way of gift, between groups. The ASB has already amended the IFRS for SMEs to require disclosure of distributions in specie, rather than require these to be accounted at fair value. It would therefore be odd to require the initial recording of transactions at their fair value.

Section 14

Paragraphs 14.4, 14.4A, 14.4B and 14.9 - measurement: accounting policy selection

- ▶ See our comments on draft FRS 102 ('Financial instruments - measurement and financial instruments - disclosure') in Appendix 2.
- ▶ There is a typographical error. Paragraph 14.4(b) should refer to paragraph 14.10, not 14.9.
- ▶ The requirement for associates that are held as part of an investment portfolio to be measured at fair value with changes in fair value recognised in profit or loss is inconsistent with paragraphs 14.4 and 14.4A. Paragraphs 14.4 and 14.4A need to be adapted to exclude investments in associates held as part of an investment portfolio, e.g. "shall account for all of its investments in associates, **except for investments in associates held as part of an**

investment portfolio which shall be accounted for in accordance with paragraph 14.4B, using ...".

Paragraph 14.9 - measurement: initial recognition

- ▶ This paragraph states that when an investment in associate is recognised initially, an investor shall measure it at the transaction price, excluding transaction costs. There is no equivalent paragraph in respect of accounting for investments in jointly controlled entities carried under this fair value model. Similarly, there are no such requirements when investors that are parents carry investments at fair value in their separate financial statements. The ASB should consider whether sections 14 and 15 should also include similar requirements.
- ▶ However, if paragraph 14.9 is intended to establish an initial cost for the associate, to be revalued to fair value at each reporting date through other comprehensive income (as opposed to through profit and loss), it appears odd that transaction costs would be excluded. We believe the initial cost should include transaction costs.

Section 15

Paragraphs 15.9, 15.9A and 15.9B - measurement: accounting policy selection

- ▶ See our comments on draft FRS 102 (financial instruments - measurement and financial instruments - disclosure) in Appendix 2.
- ▶ The requirement for jointly controlled entities that are held as part of an investment portfolio to be measured at fair value with changes in fair value recognised in profit or loss, is inconsistent with paragraphs 15.9 and 15.9A. Paragraphs 15.9 and 15.9A need to be adapted to exclude investments in jointly controlled entities held as part of an investment portfolio, e.g. "shall account for all of its investments in jointly controlled entities, **except for investments in jointly controlled entities held as part of an investment portfolio which shall be accounted for in accordance with paragraph 15.9B, using ...**".

Section 16

Paragraph 16.6 - measurement at initial recognition

- ▶ We consider it would be helpful if this paragraph included the relevant guidance in paragraphs 26 and 50(d) of IAS 40 in respect of the treatment of investment property interests held under a lease.

Paragraph 16.9 - transfers

- ▶ We note that there is no guidance on the meaning of 'cost', if investment property is transferred to property, plant and equipment or inventories. While deemed cost (based on the carrying amount, i.e. fair value or under the cost model, of the investment property at that

date) would appear acceptable, given the requirements of IAS 40 and paragraph 16.8, other interpretations may be possible.

- ▶ It appears also that the treatment under section 16 for transfers from owner-occupied property to investment property would differ from that in IAS 40, as any uplift would be recognised in profit and loss (not as a revaluation through other comprehensive income).
- ▶ Therefore, it would be helpful if section 16 could clarify the meaning of 'cost' in respect to transfers and that transfers from owner-occupied property to investment property are recognised in profit and loss, in order to avoid diversity of practice.

Section 19

Paragraph 19.6, 19.27-19.33 - combination of entities or business combination under common control

- ▶ The definition of 'combinations of entities or businesses under common control' includes the definition in B1 in IFRS 3 as amended in 2009 ('IFRS 3R') and adds arrangements which would be group reconstructions under FRS 6, paragraph 2. Combinations of entities or businesses under common control are within the scope of section 19 but may be accounted for using the merger accounting method if they meet the criteria in paragraphs 19.27 to 19.33.
- ▶ We note some typographical errors as paragraph 19.6 incorrectly refers to 9.27 to 9.33 and 'merger accounting method' rather than 'the merger accounting method'. In addition, the term 'combinations of entities or businesses under common control' in paragraph 19.6 does not align with paragraph 19.27 (and its title) or with the Glossary.
- ▶ The criteria for applying the merger method of accounting (set out in paragraph 19.27) are based on paragraph 13 of FRS 6, and the application of the merger method of accounting (paragraphs 19.28 to 19.33) is based on paragraphs 16 to 19 of FRS 6. These requirements, therefore, have the benefit of familiarity to UK preparers. This is an area where there is no standard addressing business combinations under common control under IFRS but much practice has developed (which may differ from the merger method of accounting). We note that not all of these group reconstructions would be regarded as **business combinations** or **under common control** under IFRS practice (given the additional guidance on common control in IFRS 3R). However, in many of these situations, accounting such as pooling of interests or continuation accounting would be permitted and we support the ASB's inclusion of additional guidance in this area.
- ▶ However, there are implementation difficulties with applying FRS 6 to many group reconstructions. In addition, under the FRS 6 criteria, use of merger accounting is likely to be applicable to fewer combinations than would be out of scope of IFRS 3R (which would not require the relative rights of the ultimate shareholders or the minority's interest in the net assets to remain unchanged. These conditions are also not requirements of UK company law).

We do not believe that it is appropriate to incorporate all of the strict criteria for applying merger accounting to group reconstructions into draft FRS 102 and ask the ASB to consider whether the criteria in paragraph 13 of FRS 6 for merger accounting are too restrictive, and

whether merger accounting should be available to all 'combinations of entities or businesses under common control' adding that UK companies need to ensure that merger accounting is permitted under UK company law.

- ▶ Under UK GAAP, it is not uncommon for a 'true and fair override' to be used for certain group reconstructions not meeting the strict criteria (including compliance with companies legislation). Paragraph 78 of FRS 6 which helps support this approach has not, however, been included in draft FRS 102. We recommend that the part of this paragraph which states that "Acquisition accounting would require the restatement at fair value of the assets and liabilities of the company transferred, and the recognising of goodwill, which is likely to be inappropriate in the case of a transaction that does not alter the relative rights of the ultimate shareholders" is included. Modifications to the wording may be required if the criterion for merger accounting that the relative rights of the ultimate shareholders is unchanged is relaxed. Paragraph 19.27 could also usefully highlight in what circumstances company law permits merger accounting (as currently included in the Legal Appendix to FRS 6).
- ▶ We also note that paragraph 19.30 (like paragraph 16 of FRS 6) requires comparatives to be restated. While these paragraphs are framed in the context of a parent undertaking combining with a subsidiary undertaking, paragraphs 19 to 28 extend these to other arrangements that achieve similar results. It is common for UK companies to 'merger account' only from the date of transfer for unincorporated businesses meeting the criteria for merger accounting. However, since there are no changes to the requirements of FRS 6, it would appear that this practice could continue. The ASB could consider clarifying that this practice remains appropriate.

Under IFRS practice, there is a choice of presenting comparatives or accounting for a business combination under common control from the point of transfer. However, while paragraph 19.30 is more restrictive than under IFRS, restating comparatives when a UK company combines with its subsidiary undertaking using merger accounting is required under company law. We therefore support the retention of the requirements on comparatives set out in section 19.

Paragraph 19.8 - acquirer

- ▶ This paragraph includes guidance on establishing the acquirer. It is likely that reverse acquisitions may become more common than previously under UK GAAP. This treatment would require a 'true and fair override' (see UITF Information Sheet No. 17) and we consider that the ASB should address the use of the 'true and fair override' in section 19.

Contingent consideration and compensation

- ▶ The accounting in section 19 is closer to IFRS 3 than IFRS 3R, and like IFRS 3, contains no guidance on the distinction between contingent consideration and compensation. We would recommend that the ASB includes the requirements of paragraph 84 of FRS 7 (rather than the specific requirements of IFRS 3R, which are currently being discussed by IFRIC). This would extend the continuation of existing UK GAAP, and require the use of judgement in assessing whether the substance of the agreement is payment for the business acquired or an expense such as compensation for services or profit sharing. If more specific requirements based on IFRS 3R are included in the IFRS for SMEs following its review, and amendments are

made to generally update this section in line with IFRS 3R, it may be appropriate to include additional guidance on contingent consideration/employee compensation at that stage.

Paragraph 19.14 - allocating the cost of a business combination to the assets acquired

- ▶ There are no exceptions to the fair value model for employee benefits (e.g. defined benefit schemes) and deferred taxation. IFRS 3R contains specific exceptions to the recognition and measurement principles for these in a business combination (paragraphs 24 to 26 and 30 of IFRS 3R). Under draft FRS 102, it appears that these items must be fair valued on a business combination but then subsequently measured under the relevant sections, which will cause large revaluation movements. As this would not be the case under existing UK GAAP or EU adopted IFRS, we doubt this is the intention.
- ▶ In particular, we recommend that section 19 includes the equivalent requirements to those in paragraphs 24 to 26 of IFRS 3R in respect of the recognition and measurement of employee benefits and deferred taxation, but referring to section 28 and to section 29 respectively.

Paragraph 19.23 - goodwill lives

- ▶ There is no guidance explaining how an entity should deal with transitional adjustments to the useful life of goodwill. See our comments on section 35. The ASB should clarify the requirements as this issue will be material to many entities.
- ▶ While UK GAAP does not currently give guidance on how to determine the life of goodwill, it may be helpful to provide further guidance on the circumstances in which the life of goodwill can be reliably estimated. In particular, this may be important to ensure that entities understand that five years is only used where they cannot estimate the life reliably (rather than as a default life that entities can choose to use).

Paragraph 19.33

- ▶ There is a typographical error - 'effected' rather than 'affected'.

Section 20

Lease incentives

- ▶ There is no guidance in section 20 on accounting for lease incentives. In EU adopted IFRS this guidance is contained in SIC-15. Under UK GAAP (UITF 28), lease incentives are recognised over the shorter of the lease term or period to when rentals rebase to market. Under IFRS, lease incentives are recognised over the lease term. Both treatments would appear to meet the criteria of the hierarchy in paragraphs 10.4 and 10.5. However, we consider that the ASB should clarify the treatment.

Paragraph 20.1(f) – operating leases that are onerous

- ▶ We are unclear why operating leases that are onerous have been scoped out of section 20. There is no similar scope exclusion in IAS 17. We recommend that onerous operating leases are not explicitly scoped out of section 20 but that section 21 is amended to provide wording similar to paragraph 5(c) of IAS 37.

Section 21**Paragraph 21.1 – scope**

- ▶ We consider that this paragraph should scope out financial instruments (as does IAS 37).

Application guidance

- ▶ We believe that important requirements are included in the Appendix to section 21 which is stated as accompanying but not part of section 21 (and consequently not mandatory). Section 21 excludes the IAS 37 bold paragraph requirements (included in paragraphs 48, 61, 63, 66, 72, 78 and 80) on taking future events into account in measuring provisions, the use of provisions, future operating losses, onerous contracts and restructuring costs.

For example, Section 21 does not define or discuss provisions for restructuring costs. Restructuring costs are included as an example of a provision in paragraph 21A.3 of the Appendix to section 21, although this paragraph does not include the important requirement that expenditures associated with the ongoing activities of the entity should not be provided for.

- ▶ In our view, it is important that the bold paragraphs (and any key accompanying non-bold text) of IAS 37 should be included within the text of section 21. Key terms such as restructuring costs need to be defined in the Glossary.

Section 22

- ▶ We note that section 22 deals with, in simplified terms, the requirements of IAS 32 on puttable instruments and instruments that impose an obligation to deliver a pro rata share of the net assets of the entity only on liquidation.
- ▶ However, we consider it would be helpful if paragraph 22.4(b) were to include the explanation in paragraph 16C of IAS 32 as to why instruments that impose obligations only on liquidation could be liabilities, given paragraph 22.3A(b) excludes obligations that arise only on liquidation.

Section 23

Financial services fees

- ▶ Section 23 omits any guidance in respect of financial services fees (contained in paragraphs IE 14 to 19 of IAS 18). As financial services entities, including banks and asset managers, are now within the scope of FRS 102, we believe that the IAS 18 guidance in respect of these transactions should be included within section 23 (between examples 17 and 18).

Paragraph 23.2 - gross amount disclosures

- ▶ We believe that the disclosures proposed in paragraph 23 may be challenging given that there is no definition of 'gross amount due to/from customers for contract work' other than by reference to EU adopted IFRS. We recommend that the definitions of gross amount due to /from customers for contract work (paragraphs 43 to 44 of IAS 11) are included either within section 23 or in the Glossary of Terms.

Paragraph 23.4 - measurement of revenue

- ▶ We consider that this section would benefit from inclusion of the guidance on principal-agent in IAS 18 IE 21.

Paragraph 23.7- exchanges of goods or services

- ▶ We consider that this section would benefit from better inclusion of the guidance in paragraph 23 of IAS 11, as the current paraphrase of this guidance in paragraph 23.7 misses key components. For instance, reliable estimation also requires reliable estimates of total contract revenue, that contract costs attributable to the contract can be clearly identified and reliably measured, and that it is probable that the economic benefits associated with the contract will flow to the entity.

Other key guidance on construction contracts

- ▶ We also consider that section 23 would benefit from the inclusion of the requirements of paragraph 35 of IAS 11 on when uncertainties over the outcome of the contract being reliably estimated are resolved, and paragraph 36 of IAS 11 on the treatment of changes in estimates (i.e. that they are applied on a cumulative basis).

Section 24

- ▶ The treatment of concessionary loans for public benefit entities is addressed in paragraphs 88 to 98 of IAS 34 but these do not specifically address the treatment of the 'concessionary element'. For other entities, as these are financing transactions, they would be measured using the effective interest method under section 11. However, paragraph 10A of IAS 20 specifically states that the 'concessionary element' is to be treated as a grant. It would be

helpful if section 24 (and section 34 for public benefit entities) could clarify the treatment of concessionary loans.

Section 26

- ▶ As a general theme, many of the important requirements of FRS 20/IFRS 2 are in the detail and particularly in the Implementation Guidance (IG). The main text of IFRS 2 would, in many circumstances, not naturally be read in the way intended (as indicated by the IG), without this extra detail. Therefore, care needs to be taken to ensure that by removing the detail, unintentionally different answers are not given by section 26 compared to FRS 20/IFRS 2, particularly as entities currently applying the FRSE (that choose to apply FRS 102) will previously have applied FRS 20/IFRS 2 and may be unfamiliar with its requirements.
- ▶ In addition, given that all UK entities, except those applying the FRSE, are already applying FRS 20/IFRS 2, we recommend that there should be a choice of policy for entities as to whether to apply FRS 20/IFRS 2 or the simplified provisions in section 26. It would add additional burden for such entities to be required to evaluate whether the treatment remains appropriate under section 26, or to amend the treatment of existing schemes where there are differences e.g. in respect of accounting for schemes where the reporting entity has a choice of settlement in equity or cash. This principle of opting into IFRS in certain areas has already been established in relation to financial instruments.

Paragraph 26.1 and Glossary - scope

- ▶ We note that the definitions in the Glossary and in paragraph 26 are internally inconsistent and also are not entirely consistent with FRS 20/ IFRS 2. This could therefore give rise to diversity in application of the requirements, most significantly in relation to group share-based payments.
- ▶ First, share-based payments involving equity instruments of another group entity are not apparently within the scope of the definition of a 'share-based payment transaction', as the definitions in paragraph 26.1 refer only to "equity instruments of the entity", or "liabilities to the supplier ... based on the price (or value) of the entity's shares or other equity instruments of the entity".

FRS 20/IFRS 2 clearly applies to **both** the entity receiving goods or services under a share-based payment transaction involving equity instruments of the entity (or another group entity) or a liability based on the price or value of equity instruments of the entity (or another group entity), **and** the entity incurring an obligation to settle the share-based payment transaction with the supplier. This different scope is confirmed by the requirement in paragraph 26.16 on group plans where the group entity receiving the services is **permitted** to (but apparently not required to) recognise an expense. Section 26 does not appear to address the accounting by an entity providing such awards at all.

- ▶ Further, we note that the definitions in draft FRS 102 are also internally inconsistent e.g. the definition of 'cash-settled share-based payment transaction' in paragraph 26.1 (and

the definitions in FRS 20/IFRS 2) refer to 'price (or value)' whereas the definition of 'share-based payment transaction' in the Glossary refers to 'price' only.

- ▶ Unlike paragraph 5 of FRS 20/IFRS 2, there is no definition in the Glossary or explanation in the standard of 'goods' so it is unclear what is in scope. As drafted, the scope of FRS 102 would be wider than that of FRS 20/IFRS 2 as paragraph 5 of FRS 20/IFRS 2 scopes out certain items from the term 'goods'.

Paragraph 26.5 - recognition where there are vesting conditions

- ▶ 'Grant date' is a defined term in the Glossary and should be in bold. Section 26 does not contain the guidance in IG4 of FRS 20/IFRS 2, which can require an entity to recognise an expense for services performed under the terms of an award prior to the formal grant date. If the intention is to retain this requirement, we recommend that this is clarified, to avoid diversity of practice.

Paragraph 26.9 - measurement principle

- ▶ The drafting of the third sentence suggests that a specified growth in profit and a specified increase in the share price are definitions, rather than examples, of (respectively) a non-market condition and a market condition. Non-vesting conditions, referred to in the final sentence, are also not defined. We would recommend that definitions are included in the Glossary.
- ▶ It is not at all clear that the last sentence of the paragraph achieves the presumably intended outcome of requiring recognition of an expense for awards with market conditions or non-vesting so long as all other non-market conditions have been met. What the sentence actually says is that, where an award has such a condition, you cannot revisit the day one valuation. Worse, it could be 'back solved' from this that you are allowed to revisit the day one valuation of awards subject to non-market vesting conditions. We would suggest that paragraphs 21 and 21A of IFRS 2/FRS 20 are followed more closely.

Paragraph 26.10 - shares

- ▶ The introduction refers solely to shares but the sub-sections refer to the wider 'equity instruments' and even 'share appreciation rights' (which are supposed to be dealt with under paragraph 26.11). These inconsistencies should be resolved.

Paragraph 26.12 - modifications to the terms and conditions on which equity instruments were granted

- ▶ The references to "in a manner that is beneficial to the employee" and "for example ... by modifying or eliminating a performance condition" in the first sentence are misleading. The issue arises because under FRS 20/IFRS 2, a modification to market conditions (or non-vesting conditions) would not affect the FRS 20/IFRS 2 value of the award (as explained in paragraph B43(c) of FRS 20/IFRS 2) even though it would be beneficial to the employee.

As entities that have not previously applied FRS 20/IFRS 2, would not necessarily be familiar with this guidance, to obtain a consistent treatment, we would recommend that in the first

sentence of paragraph 26.12, the phrase 'in a manner that is beneficial to the employee, ... as follows:' is simply deleted.

We would also recommend that in paragraph 26.12(a), the first sentence is amended to read "If the modification increases the fair value of the equity instruments granted (or increases the number of equity instruments granted) measured **in accordance with paragraphs 26.7-11** immediately before and after the modification". Paragraph 26.12(b) would then read: "**Otherwise**, the entity shall nevertheless continue ..."

- ▶ Paragraph 26.12 (a) does not specifically address the accounting for modifications made post vesting, and we recommend that requirements on this matter is included.

Paragraph 26.13 - cancellations and settlements

- ▶ This paragraph has very limited guidance on cancellations and settlements compared to paragraphs 28 to 29 of IFRS/FRS 20, which could give rise to diversity of practice. In particular, we are surprised that there appears to be no requirement for a settlement at more than fair value of the award to give rise to a further profit and loss charge. It is not clear whether this is intended and we recommend that the ASB clarifies the treatment of cancellations and settlements.

Paragraph 26.14 - cash-settled share-based payment transactions

- ▶ It is not clear that the cash-settled expense is recognised over the service period rather than all on day 1 with re-measurements through profit and loss. Paragraphs 32 and 33 of FRS 20/IFRS 2 make clear that cash-settled awards under those standards are recognised over the service period and we recommend that, if the same treatment is intended in section 26, that guidance is included to this effect in draft FRS 102.

Paragraph 26.16 - group plans

- ▶ The original paragraph included in the IFRS for SMEs (and the FRSME) addressed the treatment by the reporting entity where its parent entity grants a share-based payment award to its employees.
- ▶ The revised paragraph included in section 26 addresses the treatment by the member of the group (i.e. not the reporting entity) that employs the employee providing services under a share-based payment award granted by the reporting entity which is an odd way of setting out the required accounting treatment. The treatment set out is permissive, and therefore it does not set out what other alternatives, e.g. no accounting recognition or computing a full share-based payment charge (as if the transaction was in scope, as under FRS 20/IFRS 2) would be permitted. We recommend that the ASB clarify this matter. See our comments on group share-based payment plans under paragraph 26.1 and Glossary (scope).

Paragraph 26.18(b) - disclosures

- ▶ We note that the disclosure requirement is similar to that in paragraph 45(b) of FRS 20/IFRS 2, but wonder whether the restriction to options is intentional.

Paragraph 26.19

- ▶ This disclosure requirement seems to go beyond FRS 20/IFRS 2 in requiring disclosure of the reason for choosing a particular valuation methodology (paragraph 47 of FRS 20/IFRS 2). However, this may be because use of an option pricing model is not mandated.

Paragraph 26.20

- ▶ We note that this requirement to disclose information about the measurement of the liability for cash-settled share-based payment arrangements goes beyond the disclosure requirements of FRS 20, which is somewhat surprising in a simplified standard.

Paragraph 35.10 (b)

- ▶ The provisions relating to equity-settled awards granted pre-transition but not settled at transition date are unclear. These state that a first time adopter previously applying FRS 20 is prohibited from making amendments on transition for share-based payment transactions.

It is unclear if this requirement is intended to relate to fair value measurements or to require continuation of FRS 20 accounting for all share-based payment transactions at transition (even if the scope of, or accounting treatment would be different under section 26) but not for later transactions. In particular, we note for example, that under section 26, more schemes are likely to be cash-settled compared to under FRS 20/IFRS 2. In addition, it is not clear how this affects companies previously accounting under FRS 20 as part of a group scheme or, for example, estimating an expense under IG4 of FRS 20/IFRS 2 in advance of an actual grant date.

The transitional requirement should also refer to IFRS 2, as some companies may move from IFRS if permitted to do so where there is a 'relevant change in circumstances'.

- ▶ If companies applying FRS 20/IFRS need to modify their current accounting, the treatment on transition needs to be clearly explained.

Section 27

Paragraph 27.17 - estimates of cash flows

- ▶ The narrative paragraph referring to the use of budgets uses different wording to EU adopted IFRS and appears to be permissive rather than mandatory. Paragraph 27.17 states that "the entity **may** wish to use **any** recent financial budgets or forecasts to estimate the cash flows, if available. To estimate cash flow projections beyond the period covered by the most recent budgets or forecasts an entity **may** wish to extrapolate the projections based on the budgets or forecasts using a steady or declining growth rate for subsequent years, unless an increasing rate can be justified" (emphasis added).
- ▶ In contrast, paragraph 33 of IAS 36 states that "an entity **shall** base cash flow projections on **the most** recent financial budgets/forecasts approved by management", and that "projections based on those budgets/forecasts **shall** cover a **maximum period of five years**,

unless a longer period can be justified" and "an entity **shall** estimate cash flow projections beyond the period covered by the most recent budgets/forecasts by extrapolating the projections based on the budgets or forecasts using a steady or declining growth rate for subsequent years, unless an increasing rate can be justified. This growth rate **shall not** exceed the long-term average growth rate for the products, industries, or countries in which the entity operates, or for the market in which the asset is used, unless a higher rate can be justified" (emphasis added).

- ▶ We are unclear why the wording in paragraph 27.17 differs to that in EU adopted IFRS and, in our view, this may give rise to diversity in practice as to whether and which financial budgets and forecasts are used. We recommend that the more prescriptive language in paragraph 33 of IAS 36 in respect of financial budgets/forecasts, which is closer to existing UK GAAP, is substituted for the vaguer wording in paragraph 27.17.

Paragraph 27.27 - allocation of goodwill for impairment testing

- ▶ Paragraph 27.27 introduces a methodology for allocating goodwill for impairment testing, where goodwill cannot be allocated to individual cash generating units (or groups of cash generating units) on a non-arbitrary basis, which is not included in UK GAAP or IFRS. It requires such goodwill to be tested at either (a) the acquired entity in its entirety, if the goodwill relates to an acquired entity that has not been integrated; or (b) the entire group of entities, excluding any entities that have not been integrated, if the goodwill relates to an entity that has been integrated.
- ▶ We have concerns that 'integrated' is defined in a legalistic way as "means the acquired business has been restructured or dissolved into the reporting entity or other subsidiaries" rather than reflecting how management monitors the performance of the business.
- ▶ In many cases, however, an acquired entity may include one or more businesses whose performance are managed and monitored together with other businesses, but which have not been "restructured or dissolved" into another legal entity. In this situation, if the goodwill cannot be allocated to cash generating units (or groups of units) on a non-arbitrary basis, paragraph 27.27 would still require an impairment review at the level of the acquired entity.
- ▶ If the goodwill relates to an entity that has been integrated, the test is done at the level of the entire group of entities, excluding any entities that have been integrated. This wording appears to imply that there is a **single** 'group of entities' that is integrated, and would mean that goodwill which cannot be allocated to CGUs (or groups of units) on a non-arbitrary basis is tested at the level of the entire group excluding any acquired entities that are tested separately under (a).
- ▶ This could lead to testing at a relatively high level. It is also not clearly set out how impairment testing operates if some goodwill is allocated to CGUs on a non-arbitrary basis, but other goodwill cannot be. For example, is paragraph 27.27 intended to be a 'second stage' test after testing goodwill at the level of CGUs (or groups of CGUs) first?
- ▶ Our main concern is that, because the methodology is unlike that in IFRS and UK GAAP, it is difficult to assess how it will operate as there is no practical experience of its interpretation. We strongly encourage the ASB to carry out outreach with its constituents, to identify any implementation and interpretation difficulties.

Paragraph 27.28- reversal of an impairment loss

- ▶ In order to comply with European Accounting Directives, the IFRS for SMEs has been amended to require goodwill impairment reversals if and only if the reasons for the impairment loss have ceased to apply. While this amendment may no longer be required if proposed changes to the European Accounting Directive proceed, the ASB should consider whether to reinstate the existing guidance in paragraphs 60(a) and 61 of FRS 11 into draft FRS 102.

Paragraph 27.30 - reversal where recoverable amount was estimated for an individual impaired asset

- ▶ Paragraphs 114-115 of IAS 36 clarify that a reversal of impairment does not occur simply because of the passage of time. This would be helpful guidance to include in FRS 102.
- ▶ Paragraphs 27.30(b) and 31(b) require the reversal of impairment to be included in profit and loss. We consider that these requirements should be updated to include the requirements of IAS 36, paragraph 119 on reversals of impairments of revalued assets. The IFRS for SMEs did not envisage revaluations and therefore had no need for that paragraph.

Paragraphs 27.32-33 - Disclosures

- ▶ No disclosures are required about assumptions used in impairment calculations. There is also no requirement to explain the reasons for impairments or reversals thereof. Such disclosures were previously required under FRS 11. We consider that this omission is a serious deficiency in draft FRS 102 and that information about assumptions used in impairment calculation is important for users of the financial statements.
- ▶ We believe that section 27 should be amended to include the disclosure requirements currently contained in paragraph 126 of IAS 36 (amounts of impairment losses and reversals by class of asset) and, additionally, paragraphs 69 to 73 of FRS 11.

Section 28

Qualifying and other insurance policies

- ▶ These are referred to as plan assets within the definition of plan assets (of an employee benefit plan) in the Glossary of Terms. However, unlike in IAS 19, there is no definition of a qualifying insurance policy. In the absence of any definition it might be reasonable for a reporting entity to assume that an insurance policy may be 'qualifying' even if it did not meet the definition of a qualifying insurance policy under IAS 19. We recommend that a definition of a qualifying insurance policy is added to the Glossary of Terms.
- ▶ In addition, paragraph 28.15 requires all plan assets to be recorded at fair value. However, it does not include the requirements of IAS 19 (paragraphs 104 and 104D) for determining the fair value of qualifying insurance policies and other insurance policies treated as reimbursement assets which exactly match the timing and amount of some or all of benefits payable under the defined benefit plan. These policies must be measured based on the

present value of the related plan obligations (subject to any reductions if the asset is not recoverable in full). This measure of 'fair value' specified in IAS 19 would not generally be an arm's length market price for such an insurance policy, and this omission of relevant guidance is significant.

Paragraph 28.3(a) - general recognition principle

- ▶ This paragraph attempts to combine the overall objective of IAS 19, and the detailed accounting rules for different types of benefits included in IAS 19 (which are all separately addressed in that standard for good reason).
- ▶ Unfortunately, this then leads to confusion and a general recognition principle that does not work well for any of the individual types of employee benefits. As a result, the general recognition principle is confused and in relation to employee benefit funds and other intermediaries, this leads to contradictions with paragraphs 2.53 to 2.55 of draft FRS 102 (and with the treatment in UK GAAP and IFRS).
- ▶ We therefore consider that the ASB should amend section 28 to delete paragraph 28.3 and its title 'general recognition principle'. Instead, it should include the separate requirements in paragraphs 10 of IAS 19 on short-term employee benefits. Paragraph 28.13 should refer to 'contribution payable to a defined contribution plan'.

Paragraph 28.22 - defined benefit plan asset

- ▶ In respect of the recognition of a plan surplus, paragraph 28.22 states that "an entity shall recognise a plan surplus as a defined benefit plan asset only to the extent that it is able to recover a surplus either through reduced contributions in the future or through refunds from the plan". There is no further guidance. None of the content of IFRIC 14, which gives detailed guidance on pension surplus recognition, has been transferred into section 28. Given that there are significant differences between surplus recognition between FRS 17 and IFRIC 14, the lack of any guidance on how to measure a surplus through reduced contributions or through refunds from the plan, is likely to result in significant diversity in practice. We recommend that the ASB include guidance on surplus recognition based on either FRS 17 or IFRIC 14.
- ▶ More generally, we consider it critical that the ASB clarify whether or not IFRIC 14 is intended to apply more widely as this can lead to recognition of an additional liability in certain circumstances, which would not be the case under UK GAAP. See our comments in the covering letter and Q1 of Appendix 1.
- ▶ A related concern is that paragraphs 34.55 to 34.61 on funding commitments (which address in what circumstances an entity should recognise a liability, where it has made a commitment that it will provide resources to another party) could be read as requiring (directly or under the hierarchy in FRS 102) that entities must provide for the schedules of contributions agreed with the Trustees, where they exceed the recorded retirement benefit fund deficit. Recognising a liability for future contributions would be a significant departure from UK GAAP and it would be important to get clear guidance on what constitutes a refund in order to align with IFRIC 14. We have separately recommended the deletion of the section on funding commitments.

Paragraph 28.19 - Simplified actuarial valuation model

- ▶ Paragraph 28.19 sets out a 'simplified method' where the entity is not able, without undue cost or effort, to use the projected unit method to measure its defined benefit obligation and cost. However, in our view, the specified method is unlikely to reduce the burden for entities, given that triennial actuarial valuations are already obtained for retirement benefit schemes. We also consider that the 'simplified method' would result in poor quality financial information compared to FRS 17 valuations, and the effect of the simplifications would understate the true liability (since it would discount future cash flows which have not reflected the effect of future salary increases etc.). We recommend that the ASB delete this section.
- ▶ Instead, the ASB could consider whether to include the text of paragraph 35 of FRS 17 which states that "Full actuarial valuations by a professionally qualified actuary should be obtained for a defined benefit scheme at intervals not exceeding three years. The actuary should review the most recent actuarial valuation at the balance sheet date and update it to reflect current conditions." This would clarify that preparers need only update the financial assumptions annually, which would continue practices under UK GAAP and reduce the burden of applying the projected unit method. This contrasts with IFRS, where paragraph 45 of IAS 19 requires that "an entity shall determine the present value of defined benefit obligations and the fair value of any plan assets with sufficient regularity that the amounts recognised in the financial statements do not differ materially from the amounts that would be determined at the end of the reporting period".

Paragraph 28.38 - Group plans

- ▶ The ASB has amended draft FRS 102 to include the requirements of paragraph 34A of IAS 19 on group plans in individual financial statements (new paragraph 28.38). In our experience, relatively few UK companies with group defined benefit plans have accounted for these under IFRS (rather than under UK GAAP) in the individual financial statements. As drafted, the requirements of paragraph 34A are difficult to interpret and can give rise to significant practical implementation issues in terms of establishing whether there is a 'contractual agreement or stated policy' or 'the group entity which is legally responsible for the plan', as explained further in Appendix 5.
- ▶ If read literally, it would appear that few companies will have a 'contractual agreement or stated policy for charging the **cost** of the defined benefit plan as a whole **measured in accordance with this [draft] FRS** to individual group entities' since any allocation will be of contributions based on actuarial valuations (not the IAS 19 cost, which is not even defined). Given limited guidance, there is likely to be diversity in interpretation. Under IFRS, the basis of conclusions IAS 19 BC10-10J provides helpful guidance in interpreting these paragraphs.
- ▶ If there is no contractual agreement or stated policy, this would then put emphasis on **which** 'group entity is legally responsible for the **plan**'. Paragraph 34A gives little insight as **to the meaning of the group entity (singular)** that is 'legally responsible for the plan'. However, many retirement benefit plans have more than one sponsoring employer (and the sponsoring employer may well include a service entity with no assets (and therefore the contributions are in practice sourced from other group entities). In addition, the pensions regulator can require any entities in the group to contribute to a retirement benefit plan deficit.

- ▶ Given these difficulties in interpretation, we recommend that the current requirements in paragraph 9 of FRS 17, which are well understood, are retained.

Paragraph 28.411 and 41A - Disclosures for defined benefit plans

- ▶ Paragraph 28.41A includes disclosures for defined benefit plans that share risks between entities under common control, which are based on paragraph 34B of IAS 19. However, for entities accounting for the contribution payable, it excludes the disclosures in paragraph 28.41(e) and (k), i.e. the roll-forwards of plan assets and defined benefit obligations (and hence the surplus/deficit) and the principal actuarial assumptions, where equivalent disclosures would be required by IFRS reporters. This surely is an oversight and we ask the ASB to rectify this.
- ▶ We consider that all entities participating in defined benefit plans (including plans that share risks between entities under common control) should disclose committed payments to the plan. This provides essential information over the funding of the scheme.

Section 29

- ▶ In our view, this section is conceptually flawed, contains a number of internal inconsistencies, does not necessarily achieve the intended objective of a 'timing differences approach' that in most cases gives the same answer as IFRS, and leaves open a number of practical issues on which there is currently either clear guidance (or a clear consensus) under FRS 16/19. We consider that it needs rework to provide workable accounting guidance.
- ▶ The conceptual problems start in paragraph 29.2 which "requires an entity to recognise the current and future tax consequences of transactions and other events that have been recognised in the financial statements." It states that deferred tax represents "the future consequences of transactions and events recognised in the financial statements of the current and previous periods".
- ▶ However, paragraphs 29.6 to 29.11 then require deferred tax to be recognised only on timing differences (with some exceptions) and fair value adjustments in a business combination. These items are, however, only a subset of the 'future tax consequences of transactions and events'. For example, a decision to buy a non-deductible building rather than a deductible item of property, plant and equipment is a transaction which can be argued to have the future tax consequence that the entity will pay more tax than if it had bought the property, plant and equipment instead. Therefore, per paragraph 29.2, it gives rise to deferred tax; except that, per paragraphs 29.6 to 29.11, it does not. Moreover, the argument that, in this example, there is a future tax consequence of buying a non-deductible asset derives from a reading that 'future tax consequences' has the same meaning as in IAS 12. One could equally argue that a non-deductible item has no future tax consequences.
- ▶ The significance of these inconsistencies is that it is then difficult to interpret the key requirements of section 29, since the section has limited guidance. Some detailed issues identified with the drafting of section 29 are identified below.

Paragraphs 29.8, 29.10, 29.11

- ▶ There are a number of contradictions between these paragraphs. Paragraph 29.10 requires recognition of deferred tax on differences between the 'amount attributed for tax purposes' and the carrying amount of items recognised on a business combination. All such items are actually permanent differences (since they are either permanent differences to the acquiree, or differences that have arise from cumulative book/tax differences in the acquiree's, but not the acquirer's, financial statements). However, paragraph 29.11 prohibits recognition of deferred tax on permanent differences.
- ▶ As a minimum, the drafting of paragraph 29.10 should make it clear that it over-rides paragraph 29.11.
- ▶ However, more substantially, we consider that the ASB needs to re-think paragraph 29.10. There is a case under a timing difference approach for some allocation of post-acquisition tax paid to pre-acquisition net assets. For example, if the acquiree has stock at cost of 70 which it sells for 100 in the post-acquisition period, the subsidiary will record a profit of, and pay tax on, 30. In the purchase price allocation, however, the stock may have been uplifted to 90, such that the group makes a post-acquisition profit of only 10, but still pays tax on 30. In such a case there is an argument for saying that tax on the 20 uplift is in effect a pre-acquisition liability that should itself be in the purchase price allocation. However, we do not see the argument for a general 'tax effecting' of purchase price allocation adjustments under a timing difference approach.
- ▶ Moreover, it is not entirely clear what paragraph 29.10 means by requiring provision for the 'future tax consequences'. Consider an acquisition in which the entity allocates a fair value of 100 to intangible assets which, because they exist only on consolidation, have no tax base. We presume that 29.10 is intending recognition of deferred tax on the difference of 100, but based on the words, and in the absence of the guidance in IAS 12 as to what is meant by 'future tax consequences', one could argue that no provision is required. In support of this view, it could be argued: (a) it makes no difference at all to future cash tax whether this 100 is allocated to intangibles or goodwill; (b) it is clear that the entity would not provide any deferred tax on goodwill and therefore, the entity may consider it appropriate not to provide on intangible assets either. Given that IAS 12 would require provision of deferred tax on the 100, and the ASB's objective is in most cases, to align with IAS 12 accounting, this is unlikely to be the intention. However, given that draft FRS 102 is a 'stand alone' document, it is not appropriate that it can be interpreted only by reference to another document issued under a different body of GAAP.
- ▶ Paragraph 29.10 also ignores another important issue - manner of recovery. See comments on paragraphs 29.15 to 29.16 below.

Rollover relief and indexation

- ▶ We are not clear how rollover relief and indexation is dealt with under paragraphs 29.6 to 29.11. A strict reading would require the reporting entity to account for rolled-over gains (because there has been book income that has not yet been taxed) but that this gain cannot be reduced by indexation (because indexation never appears in the books and only appears in the tax computation in the year of disposal). This does not, however, appear to be a sensible outcome in terms of reflecting the future tax consequences of transactions already

recognised in the financial statements. Moreover, it is unclear what the ASB's intention was in this regard.

Paragraph 29.12 - meaning of 'substantively enacted'

- ▶ We would recommend retaining the clarification of the meaning of 'substantively enacted' in the UK currently in paragraph 15 of FRS 16, and paragraph 40 of FRS 19. It has only been the existence of the current definition that has ensured consistency of treatment of a number of recent UK tax changes under both UK GAAP and IFRS.

Paragraphs 29.15 and 29.16 - manner of recovery of assets

- ▶ These two paragraphs lack the context they have in IFRS. In paragraph 51 of IAS 12, there is a general requirement to have regard to the manner of recovery/settlement of assets/liabilities, for which the paragraphs from which these provisions have been derived provide further interpretative guidance. This general requirement is not reproduced here so the reader is not quite clear whether to infer, in cases not covered by these paragraphs that:
 - ▶ no regard should be had to the manner of recovery; or
 - ▶ the manner of recovery should be assumed to be not through sale.
- ▶ In any event, if a timing difference approach is adopted, the manner of recovery is arguably irrelevant, since in many cases the deferred tax relates to an already claimed tax benefit. This is illustrated by the apparent contradiction between paragraphs 29.8 and 29.15. For example, an entity may receive allowances on a revalued building with a high residual value (i.e. in accounting terms, almost non depreciable). If the entity intends to sell that building after the period for any 'claw-back' of allowances has expired, the entity would normally get a tax deduction of cost and pay no tax. In that case, paragraph 29.15 says to provide no tax. However, paragraph 29.8 says that the entity should continue to provide for deferred tax on the allowances claimed until the claw-back period has actually expired.
- ▶ In passing, we note, that the language of paragraph 29.16 also does not reflect the conclusion of the IFRIC (November 2011) that the presumption of recovery through sale could be rebutted in circumstances other than where there is a business model whose objective is to consume substantially all of the economic benefits.
- ▶ In our view, these issues arise because it is difficult to determine a clear conceptual approach underlying section 29, leading to inconsistencies. Rather than trying to develop simplified rules designed to result in the same treatment as under IAS 12, the ASB should focus on one basic principle, and make only limited modifications to that principle, where necessary.

Paragraph 29.17 - measurement of both current and deferred tax

- ▶ This paragraph appears to permit discounting of current tax assets although it is not clear that this is intended. If so, we consider this to be inappropriate, as illustrated by the following example.
- ▶ Assume the entity is currently recognising a deferred tax asset (undiscounted) for loss carry-forwards of 100. It is now in a position where it can utilise the loss against the tax return for

the current year. That tax return is due for settlement after the balance sheet date. The entity records the current tax at its discounted amount of 95. This creates a tax expense of 5 as the tax asset 'flips' from deferred to current - i.e. when recovery of the asset becomes more certain, an expense is recognised.

Paragraph 29.20 - value added tax

- ▶ It is unclear why VAT is dealt with in section 29 (income tax) since VAT is not an income tax. To avoid the inference that VAT is now an income tax, we would suggest that this is included, as appropriate, in section 23 (revenue) and the relevant sections on assets.

Paragraph 29.21 and 22 - allocation in comprehensive income and equity

- ▶ These paragraphs should refer to tax expense or tax income.
- ▶ We would also expect these paragraphs to set a 'default' for tax where there is no corresponding transaction to relate it to. Currently UK GAAP sets the profit and loss account as the default where the corresponding transaction has not been reflected in the statement of recognised gains and losses.
- ▶ However, even if the profit and loss account is taken as the 'default position,' it is not clear what treatment is expected for tax relief on share based-payment transactions in excess of the profit and loss charge. It could be argued that it still goes to the profit and loss account, but it is possible that others might argue that it should go to equity, by analogy with IFRS, now that there is reference to tax on transactions in equity that is not currently in UK GAAP (which distinguishes only the statement of recognised gains and losses and profit and loss account).
- ▶ We note that section 29 does not specify the deferred tax treatment of share based payment transactions, although in the absence of further guidance, it would appear from paragraph 29.6 that a timing differences approach (as under UK GAAP but not IFRS) is intended. We recommend that the ASB clarify this matter.

Paragraph 29.24 - offsetting

- ▶ The test included here will not align with that in IAS 12, if that is the intention, and cannot be applied. The test for deferred tax offset in IAS 12 is not (as in paragraph 29.24) that the actual deferred tax balances can be legally offset, but that they relate to legal entities whose current tax balances can be offset (compare paragraphs 71 and 74 to IAS 12).

Paragraph 29.25 - disclosures

- ▶ The overall disclosure objective refers to tax 'consequences' without clarity as to what this means.

Paragraph 29.26

- ▶ It is unclear why (b) and (d) refer only to current tax but not also to deferred tax and why (e) refers only to deferred tax but not also to current tax.

Paragraph 29.27(b)

- ▶ It is unclear what disclosures were intended by this paragraph. If a tax reconciliation is required, the disclosure needs to be much clearer as an "explanation of the significant differences" could simply be a narrative statement e.g. 'the main differences arise from overseas tax rates'.
- ▶ If a tax reconciliation is intended, the paragraph is requiring one different from the current requirements in two respects. The current requirement in UK GAAP is to explain why current tax accounted for in the profit and loss account is different from the product of profit before tax and the tax rate. The proposed requirement is to compare tax accounted for in comprehensive income "to amounts reported to tax authorities". This raises two issues. First, "amounts reported to tax authorities" is (presumably) the total tax return (which would include amounts accounted for in equity, e.g. potentially 'excess' current tax relief on share based payments, if that was the ASB's intention). This implies that the "explanation" may need to refer to items that would not appear in a FRS 19 tax reconciliation. Second, as a matter of drafting, it does not make it clear whether it means amounts reported to tax authorities in the current year or in prior years.

Paragraph 29.27(c)

- ▶ We note this disclosure goes well beyond existing requirements in IFRS or UK GAAP, and could be difficult for many entities to prepare. We would suggest, instead, retaining a more general requirement to disclose the effects on current and future tax charges as included in the first sentence of paragraph 64 of FRS 19.

Paragraph 29.27(d)(f)

- ▶ While the drafting is unclear and could be improved, we presume that what is actually being sought is an explanation of changes in the effective tax rate of the entity, rather than an explanation of changes in the national tax rate applicable to it.

Section 30**Paragraph 30.1 - scope**

- ▶ This states that sections 11 and 12 deal with the accounting for financial instruments denominated in a foreign currency. Section 11 does not address this area and section 12 addresses foreign currency hedges. As there appears to be adequate guidance in section 30 itself, we recommend that the final sentence is amended to refer only to hedge accounting.

Paragraphs 30.12 to 30.13 - net investment in a foreign operation

- ▶ Section 30 does not contain a definition of a foreign operation. As there is a difference in definition between SSAP 20 (where a foreign branch can be simply "a group of assets and liabilities which are accounted for in foreign currencies") and IAS 21, there may be diversity in practice as to how a foreign operation is constituted. We believe that section 30 or the

Glossary of Terms should be amended to include the definition of a foreign operation per paragraph 8 of IAS 21.

Section 31

- ▶ Section 31 follows closely the requirements of IAS 29, but we wonder whether it should include the guidance in IAS 29, paragraph 35 and IAS 21, paragraphs 39, 42-43 on consolidating entities in hyperinflationary and non-inflationary economies.

Section 32

Paragraph 32.8 - dividends

- ▶ We believe that this paragraph should include the clarification of 'declared' (in respect of dividends) contained in paragraph 13 of IAS 10.

Going concern

- ▶ Section 32 does not include the requirements contained in paragraphs 14 to 16 of IAS 10 that an entity shall not prepare its accounts on a going concern basis if management determines after the reporting date either that it intends to liquidate the entity or to cease trading or that it has no realistic alternative but to do so. We believe that this guidance should be included in section 32, and that section 2 (concepts and pervasive principles) should be extended to address the going concern basis (based on paragraph 25 of IAS 1).

Section 33

Paragraph 33.1A - scope

- ▶ The wording in respect of the wholly owned subsidiary exemption is virtually identical to the wording in paragraph 3(c) of FRS 8. However, Appendix IV, paragraph 38, of FRS 8 clarifies that the exemption in paragraph 3(c) "should only be applied where all subsidiary undertakings which are a party to the transaction are wholly owned, directly or indirectly, by the ultimate controlling entity of the group". We would recommend that this clarification is included within FRS 102 (and FRS 101) to ensure that this exemption is interpreted in the same way as FRS 8.

Section 34

Agriculture

- ▶ See our response to Q5(a) which highlights more general concerns over the application of the models, and comments on specialised industries in the covering letter. In addition, we highlight the following drafting issues. Some amendments may not be required if there is a direct reference to IAS 41 for the fair value model, as we propose.

Paragraph 34.3(c)

- ▶ The reference to "without undue cost or effort" should be removed as this should not affect recognition. It would also be irrelevant if a move to a free choice of the fair value and cost models, as we propose, is implemented.

Paragraphs 34.4, 34.5 and 34.9

- ▶ This paragraph needs to specify that a gain or loss arising on initial recognition at fair value less costs to sell, or from a change in fair value less costs to sell is included in profit or loss **in the period in which it arises** (similar to paragraph 26 of IAS 41).
- ▶ This wording then needs to be repeated in paragraphs 34.5 and 34.9 dealing with agricultural produce (similar to paragraph 28 of IAS 41).

Measuring fair value less costs to sell

- ▶ Draft FRS 102 provides no guidance on how to define classes of biological assets. Paragraph 15 of IAS 41 helps to clarify that entities should group items by significant attributes, e.g. age, quality etc. This is more helpful guidance than 'class' when measuring fair value. However, we agree that disclosures should be based on classes of biological assets.
- ▶ In addition, paragraph 16 of IAS 41 deals with two common issues - using future contracted prices as a basis for fair value and onerous contracts.
- ▶ We recommend this helpful fair value measurement guidance is included in FRS 102.

Paragraph 34.6(a)

- ▶ This paragraph is worded differently from paragraph 17 of IAS 41, on which it is based. We would recommend aligning the wording in the last sentence to read "... For example, if an entity has access to two active markets, it would use the price existing in the market expected to be used".

Paragraph 34.6(d)

- ▶ Paragraph 34.6(d) is similar to guidance provided in paragraph 20 of IAS 41. Paragraphs 21 to 23 of IAS 41 provide important guidance for discounted cash flow calculations and, if an IAS 41 approach is retained, will be needed.

The guidance in IAS 41 is needed because discounted cash flow calculations are problematic in agriculture, particularly because entities generally prefer to include multiple harvests. The unit of account in IAS 41 is the individual biological asset (e.g. a tree in a forest) or agricultural produce, but assets can be grouped in order to facilitate measurement of fair value. Draft FRS 102 uses the same wording, which indicates the unit of account would also be the individual biological asset or agricultural produce. Under IAS 41, consistent with measuring the fair value of the individual assets, multiple harvests can only be considered for bearer biological assets (but only until they are culled/replaced). Only a single harvest can be considered for consumable biological assets, such as trees.

Paragraph 34.7(c)

- ▶ This proposed disclosure requirement is consistent with paragraph 50 of IAS 41 and gives relevant information; however, it is not always done well in practice - usually because entities do not manage their assets for internal reporting purposes based on the fair value model. For example, it is not unknown for some entities to make the disclosures based on the cost model and add a fair value increment at the end. We also note that a reconciliation is required for the fair value model, but not where the cost model is used. However, if a choice of cost or fair value models was permitted, perhaps companies applying the fair value model are more likely to align their internal reporting in this way.

Paragraph 34.8

- ▶ As discussed further in the response to Q5(a), the definition of the cost model is inadequate.

Paragraph 34.10

- ▶ Presumably, paragraph 34.10(b) should refer to why 'fair value is not readily determinable without undue cost or effort', given the requirements of paragraph 34.2. It would not be relevant if a choice of cost and fair value models was permitted, as we propose.
- ▶ We are unclear why there is no disclosure of depreciation and impairment charges under the cost model.

Definitions

- ▶ We recommend that the definitions of 'agricultural activity' and 'biological transformation' are amended or included respectively, to align with IAS 41. These are critical in setting the scope of the requirements. We also recommend that paragraph 6 of IAS 41 is included, as it provides useful guidance on these definitions.
- ▶ A definition of 'harvest' may also be useful as it is referred to in the text of the section on agriculture.
- ▶ If references to 'active market' and 'fair value less costs to sell' in the text of the section on agriculture were included in bold, they could refer to the definitions in the Glossary. However, we consider that the definition of 'fair value less costs to sell' does not identify the key requirement that 'costs to sell are the **incremental** costs directly attributable to the disposal of an asset, excluding finance costs and income taxes' and provide the additional guidance in

paragraph 9 of IAS 41 that transportation costs are a component of fair value. This is an important definition in agriculture.

Section 34

Service concessions

- ▶ See our response to Q5(b).

Section 34

Extractive industries

- ▶ Section 34.11 requires that entities engaged in extractive activities shall account for expenditure on the acquisition or development of tangible or intangible assets for use in extractive activities by applying sections 17 and 18. However, section 17.3 and 18.3 scope out "mineral rights and mineral reserves, such as oil, natural gas and similar non-regenerative resources" from section 17 (property, plant and equipment) and section 18 (intangible assets). There is no scope out from section 27 (impairment of assets).
- ▶ It remains unclear how section 34.11 interacts with these scope outs and in particular, whether exploration expenditure can be capitalised under draft FRS 102. However, in our view, either this section 34.11 and the scope outs need to permit accounting consistent with current UK GAAP, or to permit accounting used by counterparts currently applying IFRS, and should not be more restrictive than the latter.
- ▶ We also consider that entities in the extractive industries should be required to apply IFRS 6 in respect of exploration and evaluation activities, and appropriate scope outs for expenditure covered by IFRS 6 should be included in sections 17 (property, plant and equipment) and 18 (intangible assets other than goodwill). This would significantly reduce uncertainty over the treatment of exploration expenditure under draft FRS 102, and put entities applying FRS 102 on a level playing field with IFRS reporters.
- ▶ Paragraph 35.10(j) permits a first time adopter using full cost accounting under its previous GAAP to measure its oil and gas assets (those used in the exploration, evaluation, development or production of oil and gas) on the date of transition at the amount determined under the entity's previous GAAP, and to test those assets for impairment at the date of transition under section 27. However, in our view, a similar approach to IFRS 1 D8A is needed to allocate development and production assets to the underlying assets on a pro rata basis based on reserve volumes or valued as the date of transition. This is essential for the purposes of subsequent depreciation, and impairment testing under section 27. The exploration and evaluation assets should be tested for impairment in accordance with IFRS 6, if draft FRS 102 is amended to require entities in the extractive industries to apply that standard to exploration and evaluation assets (rather than requiring entities in the extractive industries to allocate exploration and evaluation assets to CGUs as would be required if testing for impairment in accordance with section 27).

Section 34

Retirement benefit plans

- ▶ See our response to Q4 and 6.

Section 34

Heritage assets

- ▶ The ASB has implemented the main requirements of FRS 30 into section 34. However, this does not include the guidance in paragraph 21 of FRS 30 that valuations may be made by any method that is appropriate and relevant. We are unclear whether this is intentional and the ASB may wish to consider whether it would be helpful to retain it. In the absence of this guidance, valuations of heritage assets would presumably need to reflect fair value under section 17, which may be difficult to obtain. Consequently, in our view, entities may be more likely to retain a cost method (or potentially, deemed cost at transition).
- ▶ In addition, unlike FRS 30, this section does not address donations and the requirement that donations should be included at valuation (or the disclosure of the nature and extent of significant donations). This may be perhaps because this treatment is covered by grants section - but if so, a cross reference would be helpful.

Section 34

Funding commitments

- ▶ This new section on funding commitments, which addresses issues of particular relevance to, say, charities, is not restricted to public benefit entities. There are no equivalent requirements in UK GAAP and IFRS and, in our view, the existing guidance of section 21 (based on IAS 37) in relation to executory and onerous contracts should suffice.
- ▶ An entity recognises a liability for a funding commitment if and only if it cannot realistically withdraw from the obligation and the other party's entitlement to the resources is not subject to performance-related conditions. Commitments made which are performance-related are recognised when those performance conditions are met.

The concept of 'performance condition' does not appear to be well articulated and unless this is clear, there will be uncertainty over whether commitments need to be provided for. The definition in the Glossary states that a 'performance condition' is "a requirement that specifies that the resource is either to be used by the recipient as specified, or if not so used, to be returned to the donor." However, the guidance in draft FRS 102 does not clearly address when restricted funds (say, for charities) constitute a performance condition.

- ▶ It may be relevant to include adequate guidance for public benefit entities, but, in our view, it would be appropriate if more detailed guidance is given in the relevant public benefit SORP

and paragraphs 34.55 to 34.61 (and the accompanying guidance) were deleted from FRS 102.

Section 35

Paragraph 35.2 - scope

- ▶ Draft FRS 102 states that an entity can be a first time adopter only once. See our comments in Appendix 3 and our response to Q1.

Paragraph 35.9- procedures for preparing financial statements at the date of transition

- ▶ It may be helpful to clarify the requirements for the discontinuance of hedge accounting should relationships under IAS 39 (or its replacement) not be of a type permitted by section 12 (assuming that the entity did not choose to continue to apply IAS 39 (or its replacement)).

Paragraph 35.10 - procedures for preparing financial statements at the date of transition

- ▶ In general, this paragraph contains considerably less detail than the equivalent provisions in IFRS 1. However, this will not be problematic provided the exemptions in section 35 can be clearly applied, as it is likely that reference will be made to IFRS 1, so far as it does not conflict with FRS 102. We highlight below situations where we consider the ASB needs to clarify, amend or include additional transitional exemptions.

Business combinations

- ▶ IFRS 1 Appendix C includes detailed guidance on the treatment of pre-transition business combinations not restated under IFRS 3R. There is no such guidance in section 35 and consequently, there may be a lack of clarity as to whether, for example, the specific reliefs included therein, are accessible to companies applying FRS 102. In particular, the ASB may wish to consider introducing exemptions based on IFRS 1 Appendix C4 and C5.

Share-based payment

- ▶ See our comments on section 26.

Deferred tax

- ▶ Paragraph 35.10(h) exempts the reporting entity from recognition, at the date of transition, of deferred tax assets and liabilities relating to differences between “the tax basis and the carrying amount of any assets or liabilities for which recognition of those deferred tax assets or liabilities would involve undue cost or effort”. However, “tax basis” is not a term used in section 29 (taxation), which is based on a ‘timing differences plus’ approach, or in the Glossary. See our comments on section 29. It is therefore, not clear whether this transition exemption, as drafted, is operable.

- ▶ We ask the ASB to reassess, in the context of section 29 (or any updated section 29) what this transition exemption is designed to achieve and revise its wording accordingly to achieve the intended objective.

Service concession arrangements

- ▶ See our responses to Q1 and Q5(b).

Extractive industries

- ▶ See our comments on section 34 and our response to Q1.

Areas not addressed in section 35

Designation of financial assets on transition

- ▶ There are no transitional rules included in section 35. Entities applying FRS 102 can, as a choice of policy, apply IAS 39 and, therefore, it would seem appropriate that transitional rules are included.

Assets and liabilities of subsidiaries, associates and joint ventures

- ▶ There are no requirements addressing the situation where a subsidiary/associate/joint venture becomes a first time adopter later than the reporting entity and vice versa. This situation could well exist in practice and it would seem sensible to provide the requirements.

Transitional adjustments for disclosures in respect of financial instruments and insurance contracts

- ▶ When EU adopted IFRS was applied in 2005, there were exemptions available in respect of comparative disclosures for financial instruments and insurance contracts. These exemptions no longer exist since a decision to adopt EU adopted IFRS is now voluntary for an entity.
- ▶ In order to reduce the reporting burdens for entities in their first year of adoption of FRS 102, we recommend that the comparative disclosures in respect of sections 11 and 12, and the additional disclosures for financial institutions in paragraphs 34.17 to 34.30 and IFRS 4 be made voluntary.

Assets held as part of investment portfolio

- ▶ We recommend that the ASB consider, subject to confirming that this would meet the requirements of section 405(3)(c) of the Act (which permits exclusion of a subsidiary undertaking where 'the interest of the parent company is held exclusively with a view to subsequent resale'), whether transitional relief should be extended to first time adopters of FRS 102 to account for **all** investments in subsidiaries held as part of an investment portfolio at the date of transition as 'assets held exclusively for resale' in accordance with paragraph 9.9A, even if these subsidiaries were previously consolidated.

Transitional adjustments in respect of goodwill and intangible amortisation

- ▶ While we believe that the general requirements of section 35 would require retrospective adjustment, there is no explicit guidance explaining how an entity should deal with transitional adjustments to the useful life of goodwill. There may be uncertainty over this issue, particularly because UITF 27 (which will be withdrawn) considered changes in goodwill lives from indefinite to, say, 20 years and concluded that a change in useful life must be accounted for prospectively. In addition, the requirements on amortisation of goodwill are included in paragraph 19.23 (and strictly first time adopters need not apply section 19 to pre-transition business combinations). This is a material issue faced by many entities and we therefore consider it important, for the avoidance of doubt, that the ASB clarifies the treatment of adjustments to lives of goodwill on transition to FRS.

Insurance contracts - further amendments

- ▶ As draft FRS 102 has been amended to require insurance contracts to be accounted for under IFRS 4 (paragraph 1.6), the following additional amendments to facilitate this need to be included in draft FRS 102:
 - ▶ paragraph 12.3 should exclude all insurance contracts within the scope of IFRS 4 from section 12 (as rights and obligations under an insurance contract are excluded from IAS 39);
 - ▶ paragraph 18.3 should be amended to exclude deferred acquisition costs and intangible assets arising from an insurer's contractual rights under insurance contracts within the scope of IFRS 4 from the scope of section 18 (as per paragraph 3(g) of IAS 38);
 - ▶ section 19 should be amended to provide an exemption to the reclassification of an insurance contract in accordance with IFRS 4 where there is a business combination (as per paragraph 17(b) of IFRS 3);
 - ▶ paragraph 21.1 should be amended to exclude insurance contracts within the scope of IFRS 4 from the scope of section 21 (as per paragraph 5(e) of IAS 37);
 - ▶ paragraph 23.2 should be amended to exclude insurance contracts within the scope of IFRS 4 from the scope of section 23 (as per paragraph 6(c) of IAS 18); and
 - ▶ paragraph 27.1 should be amended to exclude deferred acquisition costs and intangible assets arising from an insurer's contractual rights under insurance contracts within the scope of IFRS 4 from the scope of section 27 (as per paragraph 2(h) of IAS 36).