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Mei Ashelford

Financial Reporting Council

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125 London Wall

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By email to: ukfrs@frc.org.uk

Dear Ms Ashelford

**FRED 67 *Draft amendments to FRS 102 – Triennial review – Incremental improvements and clarifications***

Deloitte LLP welcomes the opportunity to comment on the Financial Reporting Council's FRED 67 *Draft Amendments to FRS 102 – Triennial review – Incremental improvements and clarifications.* We have set out our responses to the consultation questions in Appendix 1 and some further comments in Appendix 2.

Overall we agree with the draft amendments to FRS 102 as set out in FRED 67. We are pleased to note that many of the issues we have drawn to the attention of the FRC in connection with the triennial review have been addressed in these proposals. However, there are a few outstanding issues which we refer to in Appendix 1 and Appendix 2 which should be considered.

We would be happy to discuss our letter and the draft proposals with you. If you have any questions, please contact Joanna Mithen on 020 7303 6697 or jmithen@deloitte.co.uk or Ken Rigelsford on 020 7007 0752 or krigelsford@deloitte.co.uk.

Yours sincerely

**Veronica Poole**
National Head of Accounting and Corporate Reporting
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**Appendix 1**

**Responses to detailed questions**

**Question 1 Overall do you agree with the approach of FRED 67 being to focus, at this stage, on incremental improvements and clarifications to FRS 102? If not, why not?**

We agree that FRED 67 should focus on incremental improvements and clarifications arising from the experience of stakeholders in applying FRS 102. Although we do consider it useful to consider and discuss the proposed more fundamental changes (in relation to the implementation of IFRS 9 *Financial Instruments*, IFRS 15 *Revenue from Contracts with Customers* and IFRS 16 *Leases*) we feel that publishing detailed proposals at this time would be premature given there is currently no practical experience of how UK listed companies have implemented the requirements of these standards.

**Question 2 FRED 67 proposes to amend the criteria for classifying a financial instrument as 'basic' or 'other'. This will mean that if a financial instrument does not meet the specific criteria in paragraph 11.9, it might still be classified as basic if it is consistent with the description in paragraph 11.9A.**

**Do you agree that this is a proportionate and practical solution to the implementation issues surrounding the classification of financial instruments, which will allow more financial instruments to be measured at amortised cost, whilst maintaining the overall approach that the more relevant information about complex financial instruments is fair value? If not, why not?**

We agree with the proposal to amend the criteria for classifying financial instruments as 'basic' or 'other'. The nature of the current rules-based approach means that it cannot capture every eventuality. As a consequence, under the current approach it is possible that an instrument may be classified as 'other' and measured at fair value through profit or loss when amortised cost measurement would appropriately capture the risks. The introduction of a principle-based description is a helpful fall-back in these circumstances. We also welcome the retention of the current criteria, as it will continue to allow a simple rules-based assessment in the majority of cases. The retention of the criteria will also mean that entities that have previously assessed their financial instruments as 'basic' will not have to revisit their assessment as a result of the proposed amendment. We therefore believe that this is a proportionate and practical solution to most implementation issues raised by stakeholders.

The classification of loans with two-way compensation clauses has been one of the more prominent implementation issues raised by stakeholders. As noted in the Corporate Reporting Council's Advice to the FRC, the IASB has an ongoing project on Symmetric Prepayment Options considering similar issues. We agree that any relevant developments in IFRS should be considered as part of the finalisation of these amendments. However, this should not delay a clear and proportionate solution under FRS 102. We feel that explicit requirements for these instruments should be included in the revised standard. However, it should not be assumed that any proposed amendment to IFRS 9 should simply be copied into FRS 102.

**Question 3 FRED 67 proposes that a basic financial liability of a small entity that is a loan from a director who is a natural person and a shareholder in the small entity (or a close member of the family of that person) can be accounted for at transaction price, rather than present value (see paragraph 11.13A). This practical solution will provide relief to small entities that receive non-interest-bearing loans from directors, by no longer requiring an estimate to be made of a market rate of interest in order to discount the loan to present value. Do you agree with this proposal? If not, why not?**

We agree with the proposed amendment to FRS 102 to allow small entities to account for loans from directors at transaction price rather than at present value. We also welcome the amendment issued in May 2017 to make this proposal effective immediately as this prevents small entities from having to comply with

the current present value accounting required for their first year of FRS 102 adoption before this proposed amendment becomes effective.

The proposed new paragraph 11.13A refers to a loan from "a director who is a natural person and a shareholder of the small entity (or a close member of the family of that person)". It is not immediately clear from the proposals why the exemption should not be available to a loan from a shareholder who is not a director although we acknowledge that in most cases both conditions will be met. The key point seems to be that the loan is made by a shareholder in their capacity as a shareholder rather than as a lender. Whether or not they are a director seems incidental. We believe that this point requires more consideration and highlights a broader issue about whether an equivalent exemption should be provided for loans from members of a small LLP. Designated members are not the equivalent of directors.

We understand that the reason for restricting the exemption to loans from directors may be to ensure that the existence of the loans is disclosed. However, we note that small companies must also disclose transactions with "owners holding a participating interest in the company" and that small LLPs must disclose transactions with "members of the LLP that are related parties".

We would not support the extension of the exemption to intragroup loans within small groups. The same considerations are not relevant to such loans and it is open to such groups to charge a market rate of interest on such loans.

**Question 4 FRED 67 proposes to amend the definition of a financial institution (see the draft amendments to Appendix I: Glossary), which impacts on the disclosures about financial instruments made by such entities. As a result, fewer entities will be classified as financial institutions. However, all entities including those no longer classified as financial institutions, are encouraged to consider whether additional disclosure is required when the risks arising from financial instruments are particularly significant to the business (see paragraph 11.42). Do you agree with this proposal? If not, why not?**

We welcome the proposed amendment to the definition of a financial institution, as will many entities that previously struggled to reconcile their activities with the current definition. We also agree with the proposal to remove retirement benefit plans from the list in the definition given that separate disclosure requirements for such entities are already included in Section 34 of FRS 102.

The proposed amendment will be helpful in ensuring that group treasury companies will fall within the definition of a financial institution only when their principal activity is similar to one of the entities listed in the definition (e.g. a bank). This will require the exercise of judgement based on the particular facts and circumstances. The FRC should clarify that the statement made in relation to group treasury companies in paragraph 37 of the Accounting Council's Advice to the FRC on FRS 102 is superseded following the amendment.

We welcome the amendment proposed to paragraph 11.42 requiring all entities, regardless of whether they meet the definition of a financial institution or not, to consider whether the risks arising from financial instruments are particularly significant to their business and, if so, to assess whether additional disclosure is required. This will ensure that disclosure made is appropriate based on the entity's specific business and operations. However, a qualifying entity which is not a financial institution is exempt from paragraph 11.42 and therefore would not be required to consider the new requirement. It may be preferable to relocate the new requirement into a separate paragraph if it is intended that qualifying entities should be subject to it.

We also believe that the definition of a financial institution should be amended to delete the reference to stockbrokers. A stockbroker provides a service of buying and selling investments on behalf of third parties and, unless engaged in other activities, would not be substantially exposed to risks relating to financial instruments. Removal of stockbrokers from the definition would also avoid suggestions that entities such as insurance brokers should be regarded as financial institutions by analogy.

It would also be helpful if the FRC could clarify that a unit trust which is primarily engaged in property investment is not a financial institution. Comparable funds investing in property, for example those established as Scottish partnerships, are not caught by the definition.

**Question 5 FRED 67 proposes to remove the three instances of the 'undue cost or effort exemption' (see paragraphs 14.10, 15.15 and 16.4) that are currently within FRS 102, but, when relevant, to replace this with an accounting policy choice. The FRC does not intend to introduce any new undue cost or effort exemptions in the future, but will consider introducing either simpler accounting requirements or accounting policy choices, if considered necessary to address cost and benefit considerations.**

**As a result, FRED 67 proposes:**

**(a) an accounting policy choice for investment property rented to another group entity, so that they may be measured at cost (less depreciation and impairment) whilst all other investment property are measured at fair value (see paragraphs 16.4A and 16.4B); and**

**(b) revised requirements for separating intangible assets from the goodwill acquired in a business combination, which will require fewer intangible assets to be recognised separately. However, entities will have the option to separate more intangible assets if it is relevant to reporting the performance of their business (see paragraph 18.8 and disclosure requirements in paragraph 19.25B).**

**Do you agree with these proposals? If not, why not?**

We agree with the proposal to remove the instances of the 'undue cost or effort exemption' currently included in FRS 102. We believe there was a risk that the one for investment property was being applied inconsistently in practice. Those in Sections 14 and 15 were unnecessary given the existing accounting policy choice. The accounting policy choices proposed relating to the accounting for investment property rented to another group entity and for separating intangible assets from goodwill acquired in a business combination offer a proportionate solution which is preferable to an undue cost or effort exemption in such situations.

We also agree with further simpler accounting requirements or accounting policy choices being introduced in future if these are considered necessary to address cost and benefit considerations. However, we do not believe that it is necessary to rule out completely the possibility of providing undue cost or effort exemptions in future. They may be the best way to address circumstances that are not currently foreseen.

While we agree with the proposed solution to intangible assets acquired in a business combination, we are aware of some disagreement about which kinds of intangible assets should be recognised if the proposals are implemented. FRED 67 refers to the proposal as being similar to old UK GAAP but it is not exactly the same. FRS 10 permitted an asset to be recognised based on custody without legal or contractual rights, although this was rare in practice. It would be helpful, and aid consistency of interpretation, if the revised standard could contain some common examples of those intangible assets that must be recognised and of those that are not required to be recognised.

The new disclosure requirement in paragraph 19.25B about the nature of any additional intangibles that have been recognised separately appears to be required only in the year in which the business combination takes place. If the intention is that this information must be disclosed on an ongoing basis, the requirement might better be placed in Section 18. We also believe that consideration should be given to requiring a qualitative description of the factors that make up goodwill. This would be similar to the requirement in paragraph B64(e) of IFRS 3 but of perhaps even greater significance under FRS 102 because more intangibles will be subsumed within goodwill.

**Question 6 Please provide details of any other comments on the proposed amendments, including the editorial amendments to FRS 102 and consequential amendments to other FRSs.**

We have included a list of detailed comments on the proposed amendments in Appendix 2 below.

**Question 7 FRED 67 includes transitional provisions (see paragraph 1.19). Do you agree with these proposed transitional provisions? If not, why not?**

**Have you identified any additional transitional provisions that you consider would be necessary or beneficial? Please provide details and the reasons why.**

We agree with the proposed transitional provisions and do not believe that any additional ones are required.

**Question 8 Following a change in legislation the FRC is now required to complete a Business Impact Target assessment. A provisional assessment for these proposals is set out in the Consultation stage impact assessment within this FRED.**

**The overall impact of the proposals is expected to be a reduction in the costs of compliance. In relation to the *Consultation stage impact assessment*, do you have any comments on the costs or benefits identified? Please provide evidence to support your views of the quantifiable costs or benefits of these proposals.**

We do not have any comments on the costs and benefits identified in relation to the Consultation stage impact assessment and we agree that the draft amendments to FRS 102 contained in FRED 67 will have a positive impact on financial reporting and will reduce the costs of compliance for entities applying FRS 102.

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**Appendix 2**

**Other issues**

These issues are listed in paragraph order rather than order of importance.

| Para | Issue |
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| 1A.4A | We agree that it is helpful for Section 1A to refer to this legal requirement but it would be better if the footnote was incorporated into the main text. The words would then follow more closely the legal requirement for the wording of the statement. As drafted, the proposed requirement refers to the financial statements having been prepared in accordance with "this regime" rather than in accordance with "the provisions applicable to companies subject to the small companies regime". |
| 5.9B | We agree with the proposed amendments but it may be useful to clarify that gains or losses on remeasurement of investment property can be excluded from operating profit as is commonly done under IFRSs in accordance with EPRA guidance.<br><br>We agree that profits and losses on sales of fixed assets should normally be included in operating profit but the proposed paragraph seems to create an inflexible rule with no exceptions. This is of particular concern because the reference to "fixed assets" includes investments as well as all tangible and intangible assets. If the reference to profits and losses on sales of fixed assets is retained, it should be qualified in some way to be clear that there can be exceptions. |
| 7.5 | We agree with the proposed amendments to (c) and (d) but it is unclear why they refer to joint ventures but not to associates. |
| 9.13(d) | We agree with the proposed amendment but the paragraph seems to assume that some amount was initially recognised on a business combination whereas many subsidiaries will have been held since their incorporation. Therefore (i) should refer to an amount recognised "if any" and (ii) should refer to the date of the combination "or other acquisition". |
| 9.26 | Group structures are often complex and a subsidiary may be wholly owned from the perspective of the ultimate parent but not from the perspective of individual investing companies. For example, a parent may own 90 per cent of the shares in Subsidiary A whilst the remaining 10 per cent of the shares are owned by Subsidiary B. From a group perspective Subsidiary A is wholly-owned. However, Subsidiary B has an investment in 10 per cent of the shares of Subsidiary A. This does not appear to meet the definition of a subsidiary, associate or jointly controlled entity from the perspective of subsidiary B and so arguably it falls outside the scope of paragraph 9.26 and should be accounted for at fair value in accordance with Section 11 (unless its fair value cannot be measured reliably). However, this seems an onerous unintended consequence of the drafting and it would be helpful to clarify that the investment does fall within paragraph 9.26. There can be no useful purpose in accounting for the 10 per cent investment at FVTPL when the remaining 90 per cent investment can be held at cost less impairment. |
| 9.33A | We agree with the new paragraph which provides helpful clarification and is derived from paragraph 7 of UITF Abstract 38. However, we believe that it would be useful to retain the reference to the entity being a co-operative owned by its employees because this provides useful context. The second sentence of the proposed text could be amended to say "For example, when the company is a co-operative, owned by its employees, and all of the shares are held …..". |
| Example 7 following 11.9A | "The mortgage also does not comply with the description…" should be "The mortgage is also inconsistent with the description" for consistency with other examples. |
| Example 9 following 11.9A | "In addition, the loan does not comply with the description…" should be "In addition, the loan is inconsistent with the description" as above for consistency with the other examples |

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| 11.17 | It would be useful to clarify that the current spot rate can be used for the purposes of calculating amortised cost:<br><br>"When calculating the effective interest rate, an entity shall estimate cash flows considering all contractual terms of the financial instrument (eg prepayment, call and similar options) and known credit losses that have been incurred, but it shall not consider possible future credit losses not yet incurred. **For variable rate financial assets and variable rate financial liabilities the current market rate of interest or inflation index may be used when estimating the contractual cash flows."** |
| 11.19 | It would be helpful to make it clear that 11.19 can be applied to changes for inflation rates:<br><br>"For variable rate financial assets and variable rate financial liabilities, periodic re-estimation of cash flows to reflect changes in market rates of interest **or an inflation index** alters the effective interest rate. If a variable rate financial asset or variable rate financial liability is recognised initially at an amount equal to the principal receivable or payable at maturity, re-estimating the future interest payments normally has no significant effect on the carrying amount of the asset or liability." |
| 11.30 | We agree with the substance of this amendment but the reference to "an asset" should be clear that it refers to an asset measured in accordance with paragraph 11.14(d). |
| 11.41 | We are aware of some disagreement about the interpretation of this paragraph which requires totals for six categories of financial assets and liabilities. The issues are relatively minor (e.g. in which category cash should be included) but have caused a disproportionate amount of debate. However, rather than addressing these issues, we suggest that the requirement is deleted. Much of it duplicates information that would be available from other amounts disclosed to comply with the statutory formats and other disclosure requirements about financial instruments. It seems to be of relatively little value to users of financial statements. Disclosure of the book value of financial instruments that are carried at FVTPL is already required by law. |
| 12.8(b) | The current wording in 12.8(b) refers to cash flow hedges but not to hedges of a net investment in a foreign operation. It should read:<br><br>"hedging instruments in a designated hedging relationship accounted for in accordance with paragraphs 12.23 **or 12.24**; and ..." |
| 12.29(e) | The disclosure requirement relating to hedge ineffectiveness was not updated to correspond to the change in the hedge accounting model. We suggest:<br><br>"the amount, if any, **of any hedge ineffectiveness reported in profit or loss in the period** ~~**excess of the fair value of the hedging instrument over the change in the fair value of the expected cash flows that was recognised in profit or loss for the period**~~. |
| 16.3 | We agree that the reference to "undue cost or effort" should be deleted for consistency with other amendments. However, too much text is proposed to be deleted. The words "and the lessee can measure the fair value of the property interest on an ongoing basis" should be reinstated. Accounting for properties held under an operating lease as investment property is permitted only if it is possible to value them. |
| 16.4 | As amended, this paragraph states that mixed use property shall be separated between investment property and property, plant and equipment. There is no exception to this rule. This is much tougher than the equivalent requirements of IAS 40. Paragraph 10 of IAS 40 requires separation only if the portions could be sold or leased out separately. It clarifies that separation is not required if this test is not met. It also clarifies that if the portions cannot be sold or leased out separately, the property is an investment property only if an insignificant portion is held for use in the production or supply of goods or services or for administrative purposes. Something similar should be included in FRS 102. |
| 16.4A | We agree in principle with the proposed new paragraph but question whether it is necessary to limit the exemption to individual financial statements of the lessor. For example, there seems no reason why the use of the cost model should not be acceptable in the consolidated financial statements of a sub-group which does not include the lessee. |

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| 16.7 | There is a typo in the mark-up although this does not affect the amended text. In the first sentence the word "cannot" which is shown struck-through should be "can". |
| 18.12 | We agree with the substance of this proposed amendment but it needs to be clarified that only **government** grants are required to be accounted for in accordance with Section 24 and that the grants within the scope of Section 34 are only those received by PBEs. |
| 22.8 | The scope of this exemption from the use of fair value appears to extend to circumstances where assets other than investments in subsidiaries are acquired with the benefit of group reconstruction relief. For example, this could apply to a trade and assets transfer or the transfer of an individual item of property. However, it is unclear whether the guidance in paragraph 24 of Appendix IV (about the value at which the asset is recognised) can be applied by analogy in these circumstances because it refers only to investments in subsidiaries. It would be helpful if the FRC's view on this could be clarified. |
| 22.18 | Even though there is an exemption for common control transactions, we believe that the requirement for disclose the fair value of distributions in kind is onerous. The owners will hold two assets with the combined value of the previous single investment and will normally have approved the transaction in question. They may not need to know the value of the two separate investments and the cost of obtaining a valuation may not be justified. The 2015 amendments to the IFRS for SMEs introduced an undue cost and effort exemption from the requirement to measure distributions at fair value. |
| 22 Appendix | We agree with the proposed new example but the wording would be improved by replacing "rather than" with "which is not".<br><br>It may be possible for the derivative in this example to be measured at cost if the value of Entity A's own equity is not reliably measureable. The example says it will be measured at FVTPL because it is non-basic. The easiest way to address this is to add "Entity A's equity instruments are listed, and traded in an active market" to the end of the first paragraph. |
| 23A.39 | We appreciate that this wording about acting as an agent is taken from IAS 18 but we are concerned that, in a UK context this paragraph may be misunderstood. It says that "one feature indicating that an entity is acting as agent is that the amount the entity earns is predetermined, being either a fixed fee per transaction or a stated percentage of the amount billed to the customer". There are many instances when an entity receives no agency commission but should be seen as acting as principal because it has not disclosed that it is acting as agent. This is consistent with proposed paragraph 23A.38(a) which requires consideration of whether the entity has primary responsibility for providing the goods or services to the customer. However, we are concerned that too much prominence will be given to paragraph 23A.39 even if paragraph 23A.38(a) would lead to a different conclusion. |
| 29.11A | We are unclear why the proposed new general requirement to consider the manner in which an entity expects to recover or settle the carrying amount of the asset of liability applies only to assets and liabilities within the scope of paragraph 29.11 (i.e. those arising on business combinations). This requirement seems to be intended to provide a context for paragraphs 29.15 and 29.16 which provide specific rules in specific cases but do not say what to do outside of those specific cases. If that is the intention, the new requirement should apply to the measurement of all deferred tax assets and liabilities and not just to those first recognised on business combinations – as it does under IAS 12.<br><br>However, a better solution would be to delete paragraphs 29.15 and 29.16 and for FRS 102 to remain silent on this issue. Absent any specific requirements, it seems likely that the old UK GAAP practice of computing deferred tax on a capital gains tax basis for revalued assets would prevail as being the more intuitive answer for those unfamiliar with IAS 12. |
| 30.13 | We agree with the proposed amendment to clarify that any exchange profits that are unrealised should be reported in OCI rather than profit or loss to comply with legal requirements. However, it is unclear whether the subsequent reversal of such profits would be reported in OCI or in profit or loss. |
| 30 | FRS 102 prohibits the recycling of foreign currency translation differences reported in OCI in paragraph 9.18A and paragraph 30.13. However, this seems to leave several gaps because FRS 102.9.18A addresses only consolidated accounts and FRS 102.30.13 addresses only the |

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| | part of the net investment in a foreign operation that relates to monetary items. So the requirements don't seem to address:<br>• the disposal of a foreign operation in the context of individual accounts;<br>• the disposal of all of the operations of a business where the functional currency is different from the presentation currency (which is basically the same thing but with the disposal of the whole of the business rather than just part of it).<br>It seems obvious that recycling is not permitted or required in either of these circumstances but FRS 102 does not say so. |
| A4.40F | This new paragraph about the exemption from disclosure of intragroup related party transactions states that the exemption may not be applied to transactions between entities in an intermediate parent's sub group (including the intermediate parent itself) and the entities in the larger group if the intermediate parent is not wholly owned by the parent of the larger group. This seems stricter than required by law which just requires any subsidiary party to the transaction to be wholly-owned by **a** member of the group. It may be preferable to avoid commenting on this issue in the absence of any definitive interpretation of the law. |
| Glossary | Sub-paragraph (c) of the definition of a small entity refers to "a company incorporated under company law". This should strictly refer to UK and RoI company law even though the entity in question may be subject to the laws of another country. |
| FRS 100.AG 10 | Paragraph AG10 (which FRED 67 does not propose to amend) states that if no disclosure is made in the consolidated financial statements on the grounds of materiality, the relevant disclosures should be made at the subsidiary level if material in those financial statements. This is an odd requirement. It is clear that the consolidated disclosures can be in aggregate or abbreviated form and they, therefore, provide no information about the amounts involved for any particular subsidiary using the exemption. The purpose of the 'equivalent' disclosures is, therefore, not to provide a user of the financial statements of a subsidiary with information about that subsidiary (but rather to ensure that information about the group is adequate for users' needs). It therefore appears curious that a subsidiary will lose the benefit of the exemption merely because the amounts are not material at group level. This should be reconsidered. |
| FRS 101.7 | The reference to "paragraphs 8 to 9" should be to "paragraphs 7A to 9" for consistency with paragraph 5. |