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29 June 2017

Dear Ms Ashford,

FRED 67 - Draft amendments to FRS 102 – Triennial review 2017 – Incremental improvements and clarifications

We are the Quoted Companies Alliance, the independent membership organisation that champions the interests of small to mid-size quoted companies. Their individual market capitalisations tend to be below £500m.

We welcome the opportunity to respond to the FRC's draft amendments to FRS 102 as part of its triennial review. The Quoted Companies Alliance Financial Reporting Expert Group has examined your proposals and advised on this response. A list of members of the Expert Group is at Appendix A.

Responses to specific questions

Q1 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 with the FRC's approach to make incremental improvements and clarifications to FRS 102, as outlined in FRED 67.

The FRC's original proposal incorporated potential amendments relating to IFRS which would have introduced changes to the current understanding of preparers and users in key accounting areas within the standard. Preparers and users of financial statements prepared in accordance with FRS 102 should be given sufficient time to embed their knowledge and understanding of the standard before it is updated in line with the developments within IFRS.

Q2 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 that the FRC’s proposal to amend the criteria for classifying a financial instrument as ‘basic’ or ‘other’ is a proportionate and practical solution. A number of preparers have experienced difficulty in determining whether, based on the requirements included in paragraph 11.9, an instrument is classified as ‘basic’ for non-standard arrangements.

Updating the examples within this section of the standard to reflect the proposals will also assist preparers to understand the requirements in this area.

Q3 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 are aware that the FRC has subsequently issued an immediate amendment to FRS 102 to reflect the proposed changes in FRED 67 in respect of a loan from a director who is a natural person and a shareholder in a small entity.

We note that as the proposal is an optional measure and not a mandatory one, disclosure of off-market terms could be avoided through the application of the “full” financing transaction requirements set out in FRS 102. Nonetheless, we are aware that many small entities have welcomed the relief from accounting for such loans at their present value.

This notwithstanding, the FRC could look to expand this practical solution to other types of loans – specifically intra-group loans in an owner-managed group. For example, a director/shareholder may provide a loan to a parent of a small group which in turn loans the funds under the same terms to a subsidiary that perhaps is unable to access finance itself. Determining an appropriate market rate for the intercompany loan would be no less difficult than the original director/shareholder loan. The range of possible interest rates that could be applied to the intercompany loan might reduce the relevance and reliability of the financial information that discounting is intended to provide.

We note that one reservation the FRC has in widening the availability of this treatment is an inability to mandate disclosures. In our view, disclosure of the existence of off-market financing between a parent and subsidiary could be argued to be necessary in order to give a true and fair view. We do not consider it appropriate to mandate a potentially more onerous accounting treatment simply because the law does not directly allow the disclosure route to be taken.

Furthermore, we note that there is no guidance for when a small entity ceases to qualify as a small company – or vice-versa. Issuing guidance in this regard should also be considered as it is unclear whether a small entity is expected to revisit initial recognition if it became medium-sized entity at a later date despite the instrument still being outstanding.

The FRC should also clarify if the amendment applies to loans given by members of small LLPs as the current wording (which refers to directors and shareholders) is not clear in this aspect.

Q4 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 agree with the proposal to amend the definition of a financial institution and thereby reducing the volume of financial instrument disclosure requirements within the financial statements.

Q5 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 proposals by the FRC to remove the three instances of the ‘undue cost or effort’ exemption from FRS 102. However, this removal appears to contradict with the direction taken within the IFRS for SMEs.

Although we also agree with the proposed changes with regards to the separating intangible assets from the goodwill acquired in a business combination, further clarity on whether it will be necessary to make an accounting policy choice regarding the nature of intangibles that will be split out under the more relaxed option on day one and apply that consistently from thereon in.

Q6 Please provide details of any other comments on the proposed amendments, including the editorial amendments to FRS 102 and consequential amendments to the other FRSs.

We have no other comments on the proposed amendments, including the editorial amendments to FRS 102 or the consequential amendments to other FRSs.

Q7 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 have not identified any additional transitional provisions which we consider would be necessary or beneficial.

Q8 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.

Although we have no comments which are supported by evidence to add in respect of the costs or benefits identified in the proposals, we believe that there will be benefits to small entities that have loans from directors because they can continue to account for these at transaction price instead of measuring them at their present value.

If you would like to discuss our response in more detail, we would be happy to attend a meeting.

Yours sincerely,

A handwritten signature in blue ink, appearing to read 'T. Ward', with a stylized flourish at the end.

Tim Ward
Chief Executive

Quoted Companies Alliance Financial Reporting Expert Group

Matthew Stallabross (Chairman)	Crowe Clark Whitehill LLP
Matthew Howells (Deputy Chairman)	Smith & Williamson LLP
Jonathan Compton	BDO LLP
Amy Shephard	Deloitte LLP
Gary Jones	Grant Thornton UK LLP
Anthony Carey	Mazars LLP
Rochelle Duffy	PKF Littlejohn LLP
David Hough	RSM
Neil Armstrong	Unattached
Edward Beale	Western Selection Plc