

FRED 67 Draft amendments to FRS 102
*The Financial Reporting Standard applicable in the UK and
Republic of Ireland*

Triennial review 2017
Incremental improvements and clarifications

response to exposure draft

29 June 2017

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As the world's only professional accountancy body to specialise in public services, CIPFA's portfolio of qualifications are the foundation for a career in public finance. They include the benchmark professional qualification for public sector accountants as well as a postgraduate diploma for people already working in leadership positions. They are taught by our in-house CIPFA Education and Training Centre as well as other places of learning around the world.

We also champion high performance in public services, translating our experience and insight into clear advice and practical services. They include information and guidance, courses and conferences, property and asset management solutions, consultancy and interim people for a range of public sector clients.

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Dear Mei

FRED 67 Draft amendments to FRS 102
The Financial Reporting Standard applicable in the UK and Republic of Ireland
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CIPFA is pleased to comment on the FRC's consultation on this proposed update to FRS 102, which has been reviewed by CIPFA's Accounting and Auditing Standards Panel. Given that CIPFA's primary focus is on public sector and not-for-profit reporting, we have focused our attention on matters relating to charities and other public benefit entities.

In line with FRC's focus on incremental improvement and clarification, we anticipate that the changes will generally have a limited impact on the financial statements of public benefit entities reporting under FRS 102.

However, some of the proposed changes may have unintended consequences, and we have commented on these and other matters at Annex A.

I hope this is a helpful contribution to FRC's work in this area. If you have any questions about this response, please contact Steven Cain (e: steven.cain@cipfa.org, t: +44(0)20 7543 5794).

Yours sincerely

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ANNEX A

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?

CIPFA agrees with this approach.

As we noted in our December 2016 response on the FRC's approach to changes in IFRS, for reasons largely outside the FRC's control, FRS 102 has been subject to more change than was originally expected. This has also necessarily been reflected in dependent documents such as the Charities SORP. Against this background, we welcome the FRC's overarching intention to balance improvement with stability, and the focus of this consultation on incremental improvements and clarifications.

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?

CIPFA agrees with this practical proposal.

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?

CIPFA has no comment to make on this proposal.

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?

CIPFA agrees with the intention of this proposal to provide clearer guidance to users of the standard. However may raise issues for some PBE preparers to interpret.

The proposed drafting deletes text in part (i) of the definition which some preparers find difficult to apply relating to holding financial instruments for generating wealth and managing risk. It replaces it with text which those preparers might find more straightforward to apply, as follows:

- (i) any other entity whose principal activity is similar to those listed above but is not specifically included in that list

We note the FRC's expectation that the reframing of part (i) will result in fewer entities will be classified as financial institutions. It may however raise questions for some public benefit entities which provide finance, but are not using financial instruments for wealth creation or risk management. We are mainly thinking of charities which provide loans at concessionary rates for public benefit purposes.

These entities did not previously need to think very hard on whether they are financial institutions; however, they will now need to consider whether their activity is *similar* to those listed in parts (a) to (g), and whether they are therefore required to provide the disclosures in FRS 102 34.19 to 34.33.

We suggest that the disclosures at 34.19 to 34.33 are designed principally for the financial statements of profit focussed entities, having regard to the needs of the readers of those financial statements. It is not clear that they are suitable for the majority of situations where finance is provided by a public benefit entity.

Some charities act as intermediaries on behalf of members of the public acting as lenders, and the member of the public carries the risk attached to non-repayment, either receiving no loan interest, or a rate of interest which is lower than the commercial rate having regard to the risk profile of the loan recipient. In these cases the charity has no interest in the loan assets or liabilities. Given this, the disclosures at 34.19 to 34.33 seem inappropriate. At the same time, the objectives of the disclosures will be substantially achieved by a simple narrative description of how the charity operates.

Other charities provide similar concessionary rate finance using donated monies. In these cases we still consider that the disclosures at 34.19 to 34.33 will generally be a poor fit, although it may be worth considering them as possible examples of relevant disclosures in line with 11.42, insofar as they are not better covered by transparent and clear description of the objectives of the charity, and how it operates within its chosen locus to provide public benefit through concessionary rate finance.

Against this background, we suggest that it would be helpful if this amendment was reframed so that either public benefit entities are directed to consider 11.42, or directed to consider guidance in a relevant sector SORP (which might, for example, explain that certain activities are not the same as those carried out by financial institutions).

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?

CIPFA agrees with these proposals.

Question 6

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.

CIPFA has one comment to make, where the proposed drafting may have the unintended consequence of overriding specific requirements of the Charities SORP.

Proposed paragraph 3.1B amends FRS 102 so that a statement of cash flows is not required by a small entity 'regardless of which regime it applies in the preparation of its financial statements'.

We understand that this is intended to reduce the reporting burden for smaller private companies, by extending the statement of cash flows exemption to all such companies, regardless of whether they take advantage of the small company reporting regime in part 1A of FRS 102.

However, if applied to charitable companies, it could mean that a statement of cash flows will no longer be prepared by the vast majority of charitable companies. It is not clear to us that this is intended by FRED 67, and it is also not clear that it is appropriate.

The charities sector has a very different view of what constitutes a small or large charity, drawing a very different line to that applied to companies, and attaches greater reporting requirements to charities with a gross income exceeding £500,000 UK or 500,000 euros (Republic of Ireland). These requirements include the preparation of a statement of cash flows.

We recommend that the FRC reviews the paragraph and how it interacts with the requirements of the Charities SORP.

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.

CIPFA has no observations to make on the transitional provisions.

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.

CIPFA has no comments on the costs/benefits identified in relation to the consultation stage impact assessment.

