BY
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FRS 100-105 Triennial Amendments applicable 1st January 2019 Part 2

In the last edition of Accountancy Plus, Robert Kirk outlined some of the principal amendments to FRS 102 that were published last December. In this second article on the subject, he will continue his review of the main changes to that standard.

Since the last publication of Accountancy Plus in March 2018, the Financial Reporting Council (FRC) have now incorporated the changes into a revised FRS 102 together with issuing fresh updated copies of all the other local standards due to the consequential changes inflicted on them by the changes to FRS 102. All of these documents are available free of charge to download from www.frc.org.uk and readers should be encouraged to download their own copies. However, the implementation date is to be applied to financial statements commencing on or after 1st January 2019 apart from a couple of exemptions and in the Republic of Ireland, the changes being made to FRS 105 and FRS 102 Section 1A are being permitted to be backdated to 2015 to avoid having to make two changes in two years.

As per my last article I am tackling the changes Section by Section but only concentrating on the principal amendments. I will start with Section 13.

Section 13 Inventories

A very minor reduction in disclosure is being implemented which results in there no longer being a requirement to disclose the amount of inventories recognised as an expense. No explanation has been provided for this but presumably the information is superfluous since it would be expected that most inventories will be expensed to cost of sales.

Section 14 Investments in associates and Section 15 Investments in joint ventures

Reporting entities have a choice of either recording these investments at cost or at fair value. However, until now, if the fair value model had been adopted there was always the excuse that a reliable measure could not be found without undue cost or effort and therefore the reporting entity reverted back to cost until a reliable measure could be found. The FRC felt that because the cost model had always been and still is an option, the exemptions fulfilled no practical purpose so the undue cost or effort exemption is now withdrawn.

Section 16 Investment Property

Similar to the previous sections, until now, Section 16 only required investment property whose fair value could be reliably measured without undue cost or effort to be accounted for under that particular section. Where fair value could not be obtained without undue cost or effort, the property was accounted for using the cost model in Section 17 *Property, Plant and Equipment*.

However, the expectation in the standard was that all properties should be able to get a reliable fair value measure for investment property and thus, in reality, the cost model was superfluous. This has led to problems where a parent has rented out property to a fellow member of the group as a gain/loss had to be recorded in the parent company's books but from a consolidation view no gain/loss has occurred thus causing extra work at consolidation to remove the unrealized gain/loss. To help alleviate this problem, the FRC has introduced an

accounting policy choice for **groups only** which rent out investment property to other group members. The accounting policy option contained in paragraph 16.4A allows a group to measure investment property at fair value through profit or loss or at cost less depreciation and impairment (via Section 17). Almost certainly the second option will be the more popular choice among groups.

Under the revised **transitional** arrangements, the good news is that group members who have been using fair value for properties rented out to other group members until now under FRS 102 may adopt those values as their **deemed cost** on transfer to Section 17.

The downside to this is that the FRC believes that most reporting entities can easily obtain a fair value for their investment properties and hence the undue cost or effort exemption has been removed. Therefore, investment property which is not rented out to another group member will now be required to be measured at fair value through profit or loss. For those having to switch out of cost to fair value there will be associated deferred tax (potential capital gain) consequences in order to comply with paragraph 29.16 of FRS 102.

Under paragraph 16.4B when only part of a property is rented to another group entity and the remainder is used for other purposes (such as being rented to an external third party or owner-occupied i.e. mixed use), the option in paragraph 16.4A **only applies** to the **component** of that property that is **rented to another group entity**.

A number of additional paragraphs have been inserted to clearly identify the appropriate accounting treatment when there is a change in usage as follows:

- 16.9A When a property **ceases** to meet the definition of an investment **property** (e.g. it becomes owner-occupied or inventory), the **deemed cost** for subsequent accounting as PP&E (per Section 17) or inventory (per Section 13) shall be its fair value at the date of change in use.
- 16.9B If an **owner-occupied** property becomes an **investment property**, an entity shall apply **Section 17** up to the date of change in use. The entity must treat any difference at that date between the carrying amount of the property per Section 17 and its fair value in the same way as a revaluation in accordance with Section 17.
- 16.9C For a transfer from **inventories to investment property** that will be carried at fair value, any difference between the fair value of the property at that date and its previous carrying amount must be recognised in **profit or loss**.

Section 17 Property, plant and equipment

There are only minor changes being introduced to Section 17. Where an entity has adopted component accounting if it is not practicable for an entity to identify the carrying amount of the replaced part it can instead be estimated using the current cost of the replacement part as a proxy for the original cost of the replaced part and under Section 17.31A an entity will have to disclose the carrying amount at the end of the period of investment property rented to another group entity, when the entity has chosen to account for such properties using the cost model.

Section 18 Intangible assets and Section 19 Business combinations and goodwill

Under FRS 102, at present, reporting entities are required to recognise more intangible assets in an acquisition than what was previously the case under old Irish GAAP. This was introduced to help to breakdown goodwill into its constituent parts but it has involved considerable additional costs for acquiring companies.

Under the revised Section 18.8 an intangible asset acquired in a business combination will only be **recognised separately** from goodwill when all the following **three conditions** are satisfied:

(a) the recognition criteria set out in paragraph 18.4 are met I.e. probability of future benefits and reliably measured;
(b) the intangible asset arises from contractual or other legal rights; and
(c) the intangible asset is separable (i.e. capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged either individually or together with a related contract, asset or liability).

In addition, a reporting entity has an option to **choose** to recognise intangible assets separately from goodwill for which **condition (a) and only one of (b) or (c) above is met**. However, when an entity exercises that option the policy must be applied **to all** intangible assets in the **same class** (i.e. having a similar nature, function or use in the business), and must be applied consistently to all business combinations. In their basis of conclusions, the FRC recognise that **Licences, copyrights, internet domain names** would be examples of categories of intangible asset that may be treated as a separate class, however, further subdivision may be appropriate, for example, where different types of licences have different functions within the business. The FRC mentions customer lists, customers relationships and secret recipes as examples of intangibles that would probably fail the criteria.

Another change introduced by Section 18.28A when, as part of a business combination, an acquirer chooses to recognise intangible assets separately from goodwill that meet condition **(a) and only one of (b) or (c)** in paragraph 18.8, the acquirer will need to **disclose the nature** of those intangible assets and the reason why they have been separated from goodwill.

A number of other minor clarifications have also been introduced into Section 19 as follows:

- **Contingent consideration** must be discounted if the time value of money is material
- **The cost** of a business combination must be **adjusted if events** that were expected to occur do **not materialise**
- **Unwinding of discount** must be charged as a finance cost in profit and loss of period it arises
- **Non-controlling interests** must be stated using the **proportion of net assets** i.e. the parent entity approach but not the single entity approach which means the goodwill reported will only be that which is attached to the acquirer's share of the business acquired i.e. the parent entity approach
- Because of the changes in the reporting of intangibles in an acquisition the FRC felt it was important to require reporting entities to provide a **qualitative description** of the nature of **intangible assets** included in **goodwill.**

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Section 23 Revenue

Although the FRC has postponed the implementation of IFRS 15 Revenue from contracts with customers from being implemented into the FRS it has made a couple of amendments in relation to pre-contract costs and to clarify how to distinguish between a principal and agency relationship.

Normally pre- contract costs in relation to tendering for contracts would be written off immediately to profit and loss on the grounds that there is no probability of future income being earned at that stage. However, a new paragraph, Section 23.17A, has been inserted which will permit the inclusion of pre- contract costs as part of the contract costs but only if they can be separately identified and measured reliably and it is probable that the contract will be obtained.

An additional example has been inserted in Section 23 to illustrate the distinction between a principal and an agent and this is largely based on which party is exposed to the significant risks and rewards in the contract. The example emphasises that all facts and circumstances must be considered in making that decision. The example does, however, provide the features that one would expect for a principal relationship to exist as follows:

- the entity has the primary responsibility for providing the goods or services to the customer or for fulfilling the order, for example by being responsible for the acceptability of the products or services ordered or purchased by the customer;
- the entity has inventory risk before or after the customer order, during shipping or on return;
- the entity has latitude in establishing prices, either directly or indirectly, for example by providing additional goods or services; and
- the entity bears the customer's credit risk for the amount receivable from the customer.

The example also emphasises that an agent can only record its commission under the contract as revenue and not the amounts collected on behalf of the principal.

Conclusion

Some of these amendments will have considerable impact on a minority of companies particularly those in group scenarios with inter group investment properties and for those acquirers who have recorded unusual intangibles on their balance sheet which are no longer acceptable.

My next article in September will continue the review of the remaining amendments to FRS 102 as well as covering some of the more important consequential changes to the other local standards.