BY
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The First Triennial Review of FRS 102 – The key changes are announced

Robert Kirk discusses FRED 67 – Draft Amendments to FRS 102.

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The Financial Reporting Council (FRC) has completed its first triennial review of FRS 102 and has proposed a number of changes to the standard to make the document clearer and easier to apply. The proposed changes are contained in *FRED 67 Draft Amendments to FRS 102 – Triennial Review 2017* (March 2017).

The FRC has decided, however, not to include any changes in relation to the forthcoming major developments in full IFRS - *IFRS 15 Revenue recognition from contracts* with customers, IFRS 16 Leases and the expected loss model in IFRS 9 Financial Instruments. These will be implemented in the next review and will not be effective until accounting periods commencing on or after the 1st January 2022.

Most of the proposed changes in FRED 67 have resulted from responses to stakeholder concerns. The proposed changes are organised into three separate sections, as follows:

- The principal amendments set out Section by Section in FRS 102.
- Proposed editorial amendments to FRS 102 together in one section; and
- Consequential amendments to other FRSs together – FRS 100, FRS 101, FRS 103, FRS 104, and FRS 105.

Although the document is 140 pages in length the principal amendments are contained in the first section comprising of approximately 40 pages. This article will concentrate on these as they will obviously have the greatest impact.

Principal Changes to FRS 102

Section 1 Scope

Reference is made for the first time to the application of SORPs and the circumstances in which they apply. In addition, reporting entities will be permitted to introduce the changes proposed by FRED 67 early as long as all of the proposed amendments are implemented at the same time.

Small entities applying Section 1A will now have to provide a compulsory Statement of Compliance with Section 1A of FRS 102 – until now it was merely encouraged.

Section 3 Financial Statement Presentation

A new section will require that care should be taken over too much aggregation causing material information to be obscured and thus undermining the understandability of the financial statements. Immaterial notes, however, are not required unless those disclosures are required by legislation.

Section 4 Statement of Financial Position

FRED 67 removes the need to provide a reconciliation of the number of shares outstanding at the beginning and at the end of the year.

Section 5 Statements of Comprehensive Income and Income Statement

The requirement to analyse expenses by either function or nature specifically has been removed but an analysis is still required in the income statement or in the notes.

Section 7 Statement of Cash Flows

No specific reference is made to either adopting profit before or after tax as the starting point for the indirect method – instead a MEASURE of profit or loss is adjusted for non-cash transactions, working capital and non-operating income and expenses.

However, the main change is the new requirement to prepare a net debt reconciliation similar to that formerly required by FRS 1 so that the cash flow generated during the period can be reconciled to the net debt on the balance sheet.

Section 9 Consolidated and Separate Financial Statements

The updated rules in IFRS 10 on how to identify when one entity controls another have not been incorporated. However, this could result in special purpose entities avoiding consolidation so instead additional disclosures are proposed in the accounts. In addition, FRED 67 states that two or more subsidiaries may only be excluded from consolidation if they are not material when taken together.

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Sections 11 and 12 Financial Instruments

There are a number of important proposed changes in this part of the standard as this has created the most criticism from stakeholders.

- **Definition of basic financial instrument**
  FRED 67 has been relaxed in relation to the detailed conditions in paragraph 11.9 of FRS 102 to be defined as basic. An additional paragraph 11.9a introduces a description of a basic financial instrument to support the detailed conditions and it is hoped that a relatively small number of financial instruments that previously breached the detailed conditions will now qualify as basic and therefore will be measured at amortised cost rather than at fair value.

- **Director/Shareholders loans to company**
  The proposal in this area has been deleted from FRED 67 and made immediately effective in the UK (pending legislation in Ireland). Please see details on same in our Financial Reporting News Section.

- **Definition of a financial institution**
  The definition of what constitutes a financial institution is being changed which will remove references to 'generate wealth' and 'manage risk'. This should reduce the number of institutions required to provide the enhanced disclosures required under Section 34 of FRS 102.

- **Removal of retirement benefit plans from definition of financial institution**
  Retirement benefit plans are now removed from the list of financial institutions.

Section 13 Inventories

There will no longer be a requirement to disclose the amount of inventories recognised as an expense but there will be a new requirement to provide a reconciliation of impairment losses and reversals for the period.

Section 16 Investment Property

FRS 102 replaced local accounting standards in forcing investment properties occupied by or let to a group member to be fair valued with gains/losses reported in profit or loss. These would, of course, be eliminated on consolidation but it has added extra work on consolidation. FRED 67 has now, in paragraph 16.4A, proposed the introduction of an accounting policy choice for group entities to either account for investment properties at fair value through profit and loss or to transfer them to property, plant and equipment and apply the cost model in Section 17 Property, plant and equipment instead in their individual financial statements.

However, a possible downside is the removal of the 'undue cost or effort' exemption from adopting the fair value model for investment properties. The rationale for this is that all reporting entities should be able to reliably measure the fair values for property.

Under proposed transitional arrangements group members who have been using fair value for properties rented out to other group members, already under FRS 102, may adopt those values as their deemed cost on transfer to Section 17.

Section 17 Property, Plant and Equipment

Where an entity has adopted component accounting the proposals state that if it is not practicable for an entity to identify the carrying amount of the replaced part it can be estimated using the current cost of the replacement part as a proxy for the original cost of the replaced part.

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 was previously the case under old Irish GAAP. This was introduced to help breakdown goodwill into its constituent parts but it has involved considerable additional costs for acquiring companies.

Under FRED 67 these intangible assets need no longer be recognised separately from goodwill.

However, any additional intangible assets already recognised under FRS 102 in past acquisitions will continue to be recognised. No prior period adjustment will be required. There will also be an option for companies to continue to recognise these intangibles for future acquisitions as long as the option is applied consistently to classes and an explanation is provided in the accounts as to why that approach was adopted.

Section 23 Revenue

FRED 67 has inserted an additional paragraph 23.3A to provide additional clarification relating to recognising revenue arising from each and every separately identified good or service in a single transaction.

In addition, a new example 27 illustrating how to determine whether or not a reporting entity is acting as a principal or as an agent has been inserted. The decision is largely based on which party is exposed to the risks and rewards associated with the goods or services.

Section 28 Employee Benefits

Under FRED 67 a couple of minor changes are proposed to Section 28;

- The cost of a defined benefit plan may now be presented net of amounts relating to changes in the carrying amount of the right to reimbursement.
- In group defined benefit plans a net defined benefit cost will require the recognition of a corresponding net defined benefit asset or liability in the individual financial statements of any group entity recognising a defined benefit cost.

Section 29 Income Tax

When calculating the tax due on a business combination using the purchase method FRED 67 will require an entity to consider the manner in which the entity expects, at the end of the reporting period, to recover or settle the carrying amount of the income tax asset or liability.

Section 32 Events after the end of the Reporting Period

FRED 67 will remove the need to disclose the fact that an entity's owners or others have the power to amend the financial statements after issue.

Section 33 Related Party Disclosures

FRED 67 has introduced an additional paragraph 33.7A which states that where there is a legal or regulatory requirement to disclose directors' remuneration an entity is exempt from the requirement in paragraph 33.7 to disclose key management personnel compensation as long as the key management personnel and directors are the same.

Section 34 Specialised Activities

Service concessions

It is proposed in FRED 67 that, in a service concession, an operator and a grantor shall disclose information that enables users of the entity's financial statements to evaluate the nature and extent of relevant risks arising from those arrangements. This information should typically include, but is not limited to, a description of the arrangement including any rights, obligations or options arising, and any significant terms of the arrangement that may affect the amount, timing and certainty of future cash flows.

In addition, an operator will be expected to disclose the amount of revenue, profits or losses and other income recognised in the period on exchanging construction services for a financial asset or an intangible asset.

Section 35 Transition to this FRS

A new paragraph 35.12A is being introduced for entities that have applied FRS 102 in previous periods but not in their most recent annual accounts. They will have to disclose the following:

(a) the reason they had stopped applying FRS 102;
(b) the reason they are resuming the application of FRS 102; and

(c) whether they have applied Section 35 or they have applied FRS 102 retrospectively in accordance with Section 10 Accounting Policies, Estimates and Errors.

Effective Date

The effective date being planned for the implementation of FRED 67's amendments is for accounting periods commencing on or after the 1st January 2019 and the comment period for FRED 67 is open until the 30th June 2017.

Conclusion

The changes being proposed under FRED 67 are fairly minor overall and, in general, are clearly designed to try and reduce the cost of complying with the standard whilst at the same time retaining the high quality of financial reporting. In that regard it seems to be fairly successful and the amendments seem reasonable.