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For the attention of: **Jenny Carter**

Your ref

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Greg McIntosh

28 April 2023

Dear Jenny

Response to FRED 82 – Periodic Review of UK GAAP

We welcome the opportunity to respond to the Financial Reporting Council's (FRCs) request for comments on Financial Reporting Exposure Draft 82 which updates the suite of UK accounting standards to take account (inter alia) of developments in international financial reporting standards since the last triennial review in 2017.

We agree with the alignment of FRS 102 with the lessee accounting provisions of IFRS 16 *Leases* and the revenue accounting model of IFRS 15 *Revenue from Contracts with Customers*, although we have some concerns about the detailed proposals in the FRED which are set out in the Appendix.

Even with the proposed simplifications, the revised Section 20 of FRS 102 is considerably longer than the Section it replaces. Whilst the FRC could seek to further simplify the content of Section 20 and refer to existing guidance in IFRS 16, we do not believe there is benefit in this due to the limited remaining opportunities for simplification over and above those already suggested in the FRED.

We also believe that the timetable for implementation is short given that the new standards are likely to be approved at the end of 2023 and given the extensive nature of the changes to the leasing and revenue sections of FRS 102. The timetable is significantly shorter than the time allowed by the IASB for entities adopting IFRS 15 and IFRS 16 for the first time.

Finally, we do not believe that it is advisable for the FRC to make changes to FRS 103 to align the standard with the revised revenue accounting model in FRS 102, when this could have a significant impact on accounting for gross written premiums. We believe that FRS 103 should be left unamended until decisions are made on the alignment of UK GAAP with IFRS 17.

Our detailed responses to the questions raised in the Invitation to Comment are set out in the Appendix.

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Please contact Greg McIntosh on [redacted] should you wish to discuss any of our comments further.

Yours sincerely

KPMG LLP

KPMG LLP

Appendix 1

Question 1: Disclosure

Do you have any comments on the proposed overall level of disclosure required by FRS 102?

Do you believe that users of financial statements prepared under FRS 102 will generally be able to obtain the information they seek? If not, why not?

We have made some detailed comments on the proposed disclosures in the Appendix, but we have no comments on the proposed overall level of disclosure required by FRS 102 and believe that users of financial statements prepared under FRS 102 will generally be able to obtain the information they seek.

Question 2: Concepts and pervasive principles

The proposed revised Section 2 Concepts and Pervasive Principles of FRS 102 and FRS 105 would broadly align with the IASB's 2018 Conceptual Framework for Financial Reporting.

The IASB's Exposure Draft Third edition of the IFRS for SMEs Accounting Standard (IASB/ED/2022/1) contains similar proposals. The FRC considers it appropriate that FRS 102 and FRS 105 should be based on the same concepts and pervasive principles as IFRS Accounting Standards including the IFRS for SMEs Accounting Standard, given the FRC's aim of developing financial reporting standards that have consistency with global accounting standards.

The FRC has made different decisions from the IASB in some respects in developing proposals to align FRS 102 and FRS 105 with the 2018 Conceptual Framework in a proportionate manner.

Do you agree with the proposal to align FRS 102 and FRS 105 with the 2018 Conceptual Framework? If not, why not?

This FRED, and IASB/ED/2022/1, propose to continue using the extant definition of an asset for the purposes of Section 18 Intangible Assets other than Goodwill and the extant definition of a liability for the purposes of Section 21 Provisions and Contingencies of FRS 102. This is consistent with the approach taken in IAS 38 Intangible Assets and IAS 37 Provisions, Contingent Liabilities and Contingent Assets which use the definitions of an asset and a liability from the IASB's 1989 Framework for the Preparation and Presentation of Financial Statements. Do you agree with this approach? If not, why not?

Do you have any other comments on the proposed revised Section 2?

We agree with the proposal to align FRS 102 with the 2018 Conceptual Framework. We also agree with the FRC's approach of following the proposals contained in IASB/ED/2022/1, with appropriate changes to align FRS 102 with the 2018 Conceptual Framework in a proportionate manner. We recognise that this results in a doubling of the size of Section 2, but as the proposed wording is already a significant distillation of the 2018 Framework, we do not believe that it would be of benefit to users to cut the wording any further.

We have no comments on the proposed changes to FRS 105.

We also agree with the proposal that FRS 102 should continue using the extant definition of an asset for the purposes of Section 18 Intangible Assets other than Goodwill and the extant definition of a liability for the purposes of Section 21 Provisions and Contingencies.

We have the following detailed comments on the revised Section 2 of FRS 102:

Recognition criteria

Paragraph 2.60 refers to 'those criteria' but no criteria are actually mentioned either in this paragraph or in paragraph 2.59. We suggest that the paragraph should specifically refer to relevance and faithful representation to avoid any confusion.

Relevance

There is a separate section (paragraph 2.64) on existence uncertainty but not one addressing the low probability of outflow, although it is referred to in 2.64. We recommend that a separate section is added to address this issue.

Question 3: Fair value

The proposed Section 2A Fair Value Measurement of FRS 102 would align the definition of fair value, and the guidance on fair value measurement, with that in IFRS 13 Fair Value Measurement. Do you agree with this proposal? If not, why not?

Do you agree with the proposed consequential amendment to Section 26 Share-based Payment of FRS 102 to retain the extant definition of fair value for the purposes of that section? If not, why not?

We support the alignment of Section 2A with the principles of IFRS 13.

We note that the proposed revision of Section 2A does not specifically address the treatment of own credit risk in measuring the fair value of financial liabilities as set out in IFRS 13.42 and therefore we may see diversity in how this is accounted for in practice. Given the complexity of valuing own credit risk and the nature of the entities applying FRS 102 we support the pragmatic approach adopted in the FRED.

We agree that Section 26 should retain the extant definition of fair value for the purposes of applying the share-based payments provisions of the standard.

Question 4: Expected credit loss model

The FRC intends to defer its conclusion as to whether to align FRS 102 with the expected credit loss model of financial asset impairment from IFRS 9 Financial Instruments pending the issue of the IASB's third edition of the IFRS for SMEs Accounting Standard. Any proposals to align with the expected credit loss model will therefore be presented in a later FRED. Do you agree with this approach? If not, why not?

In IASB/ED/2022/1 the IASB proposes to retain the incurred loss model for trade receivables and contract assets, and introduce an expected credit loss model for other financial assets measured at amortised cost. The FRC's preliminary view is that, in the context of FRS 102, it may be appropriate to require certain entities to apply an expected credit loss model to their financial assets measured at amortised cost, but allow other entities to retain the incurred loss model. Do you agree with this view? If not, why not?

Based on stakeholder feedback received to date, the FRC does not intend to use the existing definition of a financial institution to define the scope of which entities should apply an expected credit loss model. The FRC's preliminary view is that it may be appropriate to define the scope based on an entity's activities (such as entering into regulated or unregulated credit agreements as lender, or finance leases as lessor), or on whether the entity meets the definition of a public interest entity. Do you have any comments on which entities should be required to apply an expected credit loss model?

We understand the FRC's proposal to defer its conclusion in respect of the expected credit loss model. However, we believe that FRS 102 is a standard most often applied by SMEs and thus it should be simple and cost effective for smaller entities to apply. We believe that the costs of applying an expected credit loss model for SMEs outweigh the benefits and that a better approach would be to retain an incurred loss model for all financial assets measured at amortised cost, for all entities applying FRS 102.

Consequently, we do not agree with the suggestion that it may be appropriate in a future revision of FRS 102 to require certain entities to apply an expected credit loss model to their financial assets measured at amortised cost, but to allow other entities to retain the incurred loss model.

We believe that smaller regulated entities and credit institutions may lack the modelling expertise to apply the expected credit loss model in a consistent and cost-effective manner. As noted above, we believe a better approach would be to retain an incurred loss model for all financial assets measured at amortised cost, for all entities applying FRS 102. We recognise that this will embed inconsistencies in accounting across jurisdictions, but smaller regulated entities and credit institutions who wish to be comparable in the market are likely to already have adopted IFRS 9.

Question 5: Other financial instruments issues

When it has reached its conclusion as to whether to align FRS 102 with the expected credit loss model, the FRC intends to remove the option in paragraphs 11.2(b) and 12.2(b) of FRS 102 to follow the recognition and measurement requirements of IAS 39 *Financial Instruments: Recognition and Measurement*. This intention was communicated in paragraph B11.5 of the Basis of Conclusions to FRS 102 following the Triennial Review 2017. In preparation for the eventual removal of the IAS 39 option, the FRC proposes to prevent an entity from newly adopting this accounting policy. Do you agree with this proposal? If not, why not?

Temporary amendments were made to FRS 102 in December 2019 and December 2020 in relation to interest rate benchmark reform (IBOR reform). The FRC intends to consider, alongside the future consideration of the expected credit loss model, whether these temporary amendments have now served their purpose and could be removed. Do you support the deletion of these temporary amendments? If so, when do you think they should be deleted? If not, why not?

We believe a better way forward would be to retain the availability of the IAS 39 accounting policy choice until the IASB's Dynamic Risk Management project is finalised and the option to apply IAS 39 hedge accounting in IFRS 9 is removed. The proposal to prevent an entity from newly adopting an IAS 39 policy may have unintended consequences, including limiting the flexibility available to new start-up entities (which by their nature are likely to be smaller and less sophisticated). Furthermore, we note the current proposal could be further clarified in respect of group situations. For example, assume the entities in an existing group apply IAS 39 through the existing accounting policy choice. The group then sets up a new subsidiary. It seems counter-intuitive to prevent this new entity from aligning its policy with other group entities.

We agree that the temporary amendments relating to interest rate benchmark reform don't need to be retained indefinitely. However, we understand that there are still some IBOR exposures that are yet to transition. Thus, we would support retaining these amendments until the IASB deletes them from IFRS standards.

Question 6: Leases

FRED 82 proposes to revise the lease accounting requirements in FRS 102 to reflect the on-balance sheet model from IFRS 16 *Leases*, with largely-optional simplifications aimed at ensuring the lease accounting requirements in FRS 102 remain cost-effective to apply. An entity electing not to take these proposed simplifications will follow requirements closely aligned to those of IFRS 16, which is expected to promote efficiency within groups.

Do you agree with the proposals to revise Section 20 of FRS 102 to reflect the on-balance sheet lease accounting model from IFRS 16, with simplifications? If not, why not?

Have you identified any further simplifications or additional guidance that you consider would be necessary or beneficial?

We believe in the benefits derived from a single set of globally consistent financial reporting standards, and so support the principle of aligning Section 20 of FRS 102 with IFRS 16. We also support the overall goal of promoting efficiency within groups given that a proportion of FRS 102 preparers will already be applying IFRS 16 in preparing group returns.

The FRC has simplified the lessee accounting provisions of the IFRS 16 in the proposed amendments and we agree with this approach. We have made detailed comments on some of the proposed simplifications below. Notwithstanding these simplifications, the new Section 20 is significantly longer than the section it replaces and this may be seen as inconsistent with the rest of the standard, with the exception of the revised Section 23.

The FRC could seek to reduce the content of Section 20 further and rely on existing guidance on IFRS 16 to fill in the gaps for preparers, users and auditors, but we do not believe that the effort involved in this process would be justified given the limited opportunities for simplification over and above those already adopted in the FRED.

We have identified areas of clarification and potential drafting changes which the FRC may wish to consider and these are set out below.

Interest rate

Paragraph 20.52 states that lease payments should be discounted using the interest rate implicit in the lease, if that can be readily determined. If the interest rate implicit in the lease cannot be readily determined, the lessee shall use the lessee's incremental borrowing rate ('IBR') or the lessee's obtainable borrowing rate ('OBR'). In exceptional

cases, where the lessee's IBR or OBR cannot be readily determined, the lessee shall use the gilt rate.

Whilst we appreciate the goal of simplifying certain aspects of IFRS 16, providing four different possibilities of discount rate could undermine the recognition of a lease liability as a form of financing specific to each entity, as well as the comparability of financial statements between entities. Given that preparers of financial statements including finance lessees (when lessee accounting) are already required to determine the IBR (if the interest rate implicit in a lease cannot be readily determined) under the existing version of FRS 102 (paragraph 20.10), and, by its very nature, the OBR should be readily obtainable by the majority of entities, it is not clear why the inclusion of an option to use the gilt rate is necessary. We are also concerned that the use of the gilt rate will significantly overstate the right of use asset and the lease liability.

If the decision is made to retain the option of the gilt rate, it is also not clear what exceptional circumstances might exist when the IBR or OBR would not be readily obtainable, and quite how "exceptional" these cases are expected to be. The current drafting is open to interpretation and there is a risk that the gilt rate may be used more often than intended on the grounds of exceptionality.

In addition, paragraph 20.53 allows public benefit entities to choose to replace the lessee's OBR with the rate of interest otherwise obtainable on their deposits held with financial institutions. Given that these entities would be able to use the gilt rate (if this option is retained), it is not clear why allowing a further rate which would not reflect the cost of financing for the transaction would be appropriate.

We also note that Paragraph 1.44(a) does not refer to the interest rate implicit in the lease and so suggests that the only choices are the IBR, the OBR and the gilt rate. We acknowledge that it is rare for the lessee to be able to calculate the implicit rate, but as it is drafted this paragraph is inconsistent with paragraph 20.52.

Lease components

Paragraph 20.33 states that "As a practical expedient, a lessee may elect, by class of underlying asset, not to separate non-lease components from lease components, and instead account for each lease component and any associated non-lease components as a single lease component. A lessee shall not apply this practical expedient if one of the components of the contract is a derivative."

We note that this wording is different to the equivalent wording in IFRS 16.15. As currently written, paragraph 20.33 would prevent the expedient being used in a lease contract where any component is an embedded derivative. IFRS 16, by comparison, would only require the embedded derivative to be separately accounted for. It is not clear whether

the FRC intended to take a different approach to IFRS 16 and, if so, why this difference to IFRS 16 is necessary.

Paragraph 20.47 notes that when an entity adopts the practical expedient in paragraph 20.34 (when at least half of the total consideration is allocated to a single lease component, a lessee may elect on a lease-by-lease basis not to separate lease components from each other, and instead account for all lease components as a single lease) the term of the unseparated lease is the term of the lease component that contains at least half of the total consideration.

It is unclear how any lease components which are still enforceable past the lease term would be accounted for.

For example, assume a contract where the parties agree to a lease of the first two floors of an office block building with 60% of the consideration allocated to the first floor, which is leased for three years, and 40% to the ground floor, which is leased for five years. In this instance it is not clear how the final two years of the ground floor arrangement would be accounted for.

Whilst we note that the preparer could choose not to apply the practical expedient in this example, we believe that the practical expedient would be more useful to preparers if the guidance was enhanced to cover such situations, which may be common.

Alternately, paragraph 20.47 may benefit from an illustrative example to help readers understand how to apply the practical expedient in such a scenario.

Dilapidations and restoration costs

Paragraphs 20.60 and 20.61 require that all changes in the estimated cost of restoring the asset to a necessary condition as a result of the entity having used the underlying asset during the lease term should be capitalised as part of the right of use asset. Typically, we would expect that wear and tear throughout the lease term of an asset, to the extent that there is an obligation on the lessee to restore the asset to a necessary condition at the end of the lease, would be recognised as a provision and expensed to the profit and loss account. This is on the basis that wear and tear does not enhance the right-of-use asset or create another asset. We suggest considering whether this paragraph should be amended to make clear how such wear and tear provisions are accounted for.

Applying the proposed requirements without further amendment may result in preparers recognising a higher depreciation charge and therefore the profit and loss account impact would take place later in the lease term, than if the provision were expensed immediately.

Changes in lease payments resulting from an index or rate

Paragraph 20.74 notes that a lessee may elect, on a lease-by-lease basis, to either remeasure or not remeasure a lease liability when there is a change in future lease payments resulting from a change in an index or a rate used to determine those payments.

Whilst we appreciate the desire for simplification, it is not clear why remeasuring the lease liability for changes in an index or rate is particularly onerous or would require information which would be difficult to obtain, and therefore whether the simplification is necessary.

The potential unintended outcome of recognising any changes in profit or loss in the period to which they relate may result in significant off-balance sheet financing in some circumstances. For example, in Private Finance Initiative ('PFI') contracts where payments frequently increase with inflation and the contracts are often long-term in nature.

Onerous leases

Paragraph 20.84 states that "Unless applying the recognition exemptions in paragraph 20.5, a lessee shall not recognise any provision in respect of a lease identified as onerous. If a lease is onerous, this will be reflected in the impairment of the right-of-use asset applying Section 27."

In our view this paragraph could be read very broadly and preparers may not recognise an onerous contract in respect of certain non-lease components to which they otherwise would. We suggest the wording of paragraph 20.84 is amended to make it clear that there are circumstances where an onerous contract provision may be necessary relating to the non-lease components of a contract.

Suggested drafting changes to improve understandability and consistency

Paragraph 1.46 – it is unclear how the practical expedient in sub-paragraph (d) could ever be used. Right of use assets measured under paragraph 1.44 would be equal to the lease liability (i.e., already excluding initial costs).

Paragraph 11.7(c) – it is unclear in which scenarios the requirements in paragraphs 11.36 to 11.38 with regards to derecognition of lease liabilities would ever be used given that there are requirements within Section 20 on accounting for lease modifications.

Paragraph 20.11 – the list of example assets might be better placed in an appendix section to simplify the main body of Section 20.

Paragraph 20.16 – we anticipate that contract combination accounting is relevant for other sections of the standard. Consequently, it may be better to put this in Section 2 ‘Concepts and Pervasive Principles’ so that preparers do not infer that this concept is only relevant for leases.

Paragraph 20.43 - this paragraph might be better placed as implementation guidance in an appendix section given that the paragraph refers to how the standard might be implemented.

Paragraph 20.86(i) - It is unclear whether this disclosure is only required in the year of the transaction or in subsequent years too.

Paragraph 20.128(a)(ii) – this sub-paragraph refers to paragraph 20.48. It is not clear how paragraph 20.48 is relevant. This reference appears to be a drafting error.

Glossary – the ‘lessee’s obtainable borrowing rate’ is defined as “The rate of interest at which a lessee could borrow, over a similar term, an amount equal to or greater than the total undiscounted value of lease payments to be included in the measurement of the lease liability.” In our view, the reference to “or greater than” creates a risk that some entities may infer a rate for amounts far exceeding the relevant lease payments and therefore apply a higher discount rate than what would be considered appropriate.

We suggest that the reference to “or greater than” is caveated in some way to avoid inappropriately high discount rates being applied.

Glossary – ‘lease incentives’ are defined as “Incentives provided by the lessor to the lessee to enter into a new or renew an operating lease. Examples of such incentives include up-front cash payments to the lessee, the reimbursement or assumption by the lessor of costs of the lessee (such as relocation costs, leasehold improvements and costs associated with pre-existing lease commitments of the lessee), or initial periods of the lease provided by the lessor rent-free or at a reduced rent.” This definition is unchanged from the current version of FRS 102.

It is not clear why the definition of ‘lease incentives’ has not been based on the equivalent definition in IFRS 16 which states “Payments made by a lessor to a lessee associated with a lease, or the reimbursement or assumption by a lessor of costs of a lessee”. There is a risk that this could lead to unintended disparities in accounting treatment between FRS 102 and IFRS 16.

We suggest that the definition of ‘lease incentives’ is amended to match the definition in IFRS 16 Appendix A.

Question 7: Revenue

FRED 82 proposes to revise the revenue recognition requirements in FRS 102 and FRS 105 to reflect the revenue recognition model from IFRS 15 *Revenue from Contracts with Customers*. The revised requirements are based on the five-step model for revenue recognition in IFRS 15, with simplifications aimed at ensuring the requirements for revenue in FRS 102 and FRS 105 remain cost-effective to apply. Consequential amendments are also proposed to FRS 103 and its accompanying Implementation Guidance for alignment with the principles of the proposed revised Section 23 of FRS 102.

Do you agree with the proposals to revise Section 23 of FRS 102 and Section 18 of FRS 105 to reflect the revenue recognition model from IFRS 15, with simplifications? If not, why not?

Have you identified any further simplifications or additional guidance that you consider would be necessary or beneficial?

We are supportive of the revisions to Section 23 of FRS 102 to align with the principles and definitions used in IFRS 15 and moving to a transfer of control model, but have concerns over some of the detailed proposals as set out below.

Whilst we are generally supportive of changes to Section 18 of FRS 105 to include guidance consistent with the five step IFRS 15 model we do question whether concepts such as the following are applicable to micro entities:

-Sales-based or usage-based royalties (para 18.32)
-Licensing (paras 18.62 to 18.69)

Scope

We suggest amending paragraph 23.2 by adding a sentence at the start to explain in simpler terms that “An entity may earn revenue from sources other than contracts with customers, such as rental income and interest income, which should be accounted for within the scope of another section”, as our experience shows that preparers struggle with this concept.

Reference to Promises instead of Performance obligations

We note that, starting with Step 2 guidance in para 23.3 and then elsewhere in Section 23, the term ‘promises’ is used in place of performance obligations. Promise is defined as “An obligation to transfer a good or service (or bundle of goods or services) that is distinct.” This would appear to be consistent with IFRS 15.22 and the identification of a performance obligation although it is unclear from the guidance why the reference has

been made to "promise" rather than "performance obligation" when there is no obvious intent to change the meaning or interpretation here. This may lead to confusion as the way IFRS 15 is drafted it refers to 'promises contained in a contract' and evaluation of promised goods/services to determine which ones constitute separate performance obligations.

Bill-and-hold arrangements

IFRS 15 has specific guidance in place regarding bill-and-hold arrangements (IFRS 15.B79-B82). These do not appear to have been carried over to the draft proposals although we were unclear why this is not the case. Arrangements such as this appear within the UK and the guidance in IFRS 15 is useful in identifying when it is appropriate to recognise revenue under those arrangements. "We recommend guidance is added in regard to such arrangements.

Enforceability

We noted that para 23.11 refers to parties to a contract having present enforceable rights and obligations, however there is no guidance provided to explain how an entity might determine whether or not it has 'enforceable rights and obligations' in a contract. Consideration should be given to adding guidance as set out in IFRS 15.10.

Modifications

We note para 23.15 introduces a choice for an entity to account for a modification as a separate contract when the modification increases the scope because of additional goods or services promised that are distinct from those in the contract. Part (b) refers to "*an appropriate adjustment to that price to reflect the circumstances of that contract*". It is not clear what an *appropriate adjustment* might be. It would be helpful if this can be explained by way of examples. Also, this is different from the modification guidance in IFRS 15. It would be helpful to understand the reason for proposing a different approach than what is in IFRS 15.

Principal vs agent considerations

We feel that the simplifications proposed in the ED could actually make the principal vs agent decision more complicated under FRS 102 than under IFRS 15 (for instance there is a potential conflict between paragraph 23.38(a) and paragraphs 23.38(b) and 23.38(c) in the FRED). Also, generally speaking, more entities would be likely to be considered to be acting as principal under the proposals than under IFRS 15.

We therefore feel that the FRC should apply the IFRS 15 model that is focused solely on 'control', but with additional guidance on how to identify 'control'. Accordingly, we believe the FRC should add the guidance in IFRS 15.32-33 and IFRS 15.B35 (to provide

guidance on control) to the text proposed in the ED. The criterion set out in 23.38(a) should be retained as an indicator of control and 23.38(b) and (c) would not be required.

Para 23.38 (b) – the wording implies that only when inventory is recorded on the Balance sheet, an entity will be considered to be a principal. If this is retained in the standard then this wording should be clarified to make it clear that this is one factor to take into account in determining whether an entity is acting as a principal or agent.

Variable consideration

Para 23.43 states that variable consideration included in the transaction price shall reflect the amount that is "*expected to become due, determined in accordance with paragraphs 23.44 to 23.50*". Para 23.46 states that variable consideration included in the transaction price shall be recognised only to the extent that it is "*highly probable that this amount will become due when the uncertainty associated with the variable consideration is subsequently resolved.*"

The amount included might be different under the two scenarios mentioned above –

(i) *expected to become due* – gives the most likely amount or a sum of probability weighted amounts. It does not appear to take into account any other conditions/restrictions to which the amount to be recognised may be constrained; and

(ii) *highly probable that this amount will become due when the uncertainty associated with the variable consideration is subsequently resolved* –there are no examples of what type of uncertainties are being referred to which entities can/cannot take into account when estimating the amount of variable consideration to be included.

It would be helpful to clarify on what basis the variable amount is to be included in the transaction price.

Time value of money

Paragraph 23.59 indicates that there is no need to adjust for the effects of the time value for money where the period between when the goods or service are transferred and when the customer pays for the goods or service is six months or less. B23.10 and B3.11 comments on why six months has been chosen although it is difficult to see why six months has been chosen compared to the 12-month period applied elsewhere.

Over time criteria

We do not agree with the content of subparagraph 23.78(b) being treated as a separate criterion. The equivalent text in IFRS 15 is not considered a separate criterion, but rather

an outcome of applying the criterion which has been transposed to subparagraph 23.78(a).

We consider that it has the potential to be misinterpreted without the qualification that the entity taking over the promise would not get access to the work in progress of the entity ceasing to deliver under the promise. For example, without this clarification it could be argued that a part-built house would meet 23.78(b).

We recommend then that subparagraph 23.78(b) should be deleted, with the example given in it instead being dealt with under 23.78(a).

We also consider the example given in 23.78(c) unhelpful, as it does not provide any guidance as to how to assess that the entity is obtaining control as the asset is created or enhanced. We recommend that guidance is added to address this point.

Warranties

It is unclear why paragraph 23.26 cross-references paragraphs 23.16-24 given those paragraphs discuss how to identify a separate promise, whereas paragraph 23.26 has already concluded that a separate promise exists.

A forward or a call option

In Paragraph 23.87B to 23.87D there is no obvious guidance on how to account for a situation when the option lapses unexercised. IFRS 15.B69 provides on this under IFRS 15.

Output method based on units delivered

We note that the method set out in subparagraph 23.92(b) would seem to allow “units to be delivered” on a broader basis than under IFRS 15. For example, there is no consideration of whether material WIP exists. We recommend the FRC reflect on whether this is appropriate.

Disclosure

Lastly, we recommend separating the requirements related to contract assets from those for contract liabilities, as this will simplify the understanding and application of the disclosure.

Question 8: Effective date and transitional provisions

The proposed effective date for the amendments set out in FRED 82 is accounting periods beginning on or after 1 January 2025, with early application permitted provided all amendments are applied at the same time. Do you agree with this proposal? If not, why not?

FRED 82 proposes transitional provisions (see paragraphs 1.35 to 1.60 of FRS 102 and paragraph 1.11 of FRS 105).

In respect of leases, FRED 82 proposes to permit an entity to use, as its opening balances, carrying amounts previously determined in accordance with IFRS 16. This is expected to provide a simplification for entities that have previously reported amounts in accordance with IFRS 16 for consolidation purposes, promoting efficiency within groups. Do you agree with this proposal? If not, why not?

Otherwise, FRED 82 proposes to require the calculation of lease liabilities and right-of-use assets on a modified retrospective basis at the date of initial application. Do you agree with this proposal? If not, why not?

In respect of revenue, FRED 82 proposes to permit an entity to apply the revised Section 23 of FRS 102 on a modified retrospective basis with the cumulative effect of initially applying the revised section recognised in the year of initial application. This is expected to ease the burden of applying the new revenue recognition requirements retrospectively by removing the need to restate comparative period information. Unlike IASB/ED/2022/1, to ensure comparability between current and future reporting periods, FRED 82 does not propose to permit the revised Section 23 of FRS 102 to be applied on a prospective basis. However, FRED 82 proposes to require micro-entities to apply the revised Section 18 of FRS 105 on a prospective basis. Do you agree with these proposals? If not, why not?

Do you have any other comments on the transitional provisions proposed in FRED 82?

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 proposal to permit an entity to use, as its opening balances, carrying amounts previously determined in accordance with IFRS 16, which will promote efficiency within groups. We also agree with the mandatory use of the modified retrospective basis of accounting for leases at the date of initial application.

We agree with the proposal to permit entities to apply the revised Section 23 of FRS 102 on a modified retrospective basis with the cumulative effect of initially applying the revised section recognised in the year of initial application. We also agree that entities

should not be given the option of applying the revised Section 23 of FRS 102 on a prospective basis.

We have no comment on the proposal that micro-entities should be required to apply the revised Section 18 of FRS 105 on a prospective basis.

The proposed effective date is for accounting periods beginning on or after 1 January 2025. It is likely that the new standards will be issued in the latter part of 2023, which will only leave a year to allow entities to prepare for significant changes in accounting for leases and revenue. This is significantly shorter than the time given to IFRS preparers adopting IFRS 15 and IFRS 16 for the first time and we question whether this gives entities sufficient time to prepare for the implementation of these changes.

Question 9: Other comments

Do you have any other comments on the proposed amendments set out in FRED 82?

Section 19 - Business combinations

Section 19 has been amended to include additional guidance on contingent consideration, how to identify the acquirer in a business combination and the application of certain elements of the purchase method.

Paragraph 189 refers to paragraph 19.15D (among others), which is inserted as follows:

"19.15D For liabilities and contingent liabilities that would be within the scope of Section 21 Provisions and Contingencies if they were incurred separately rather than assumed in a business combination, an acquirer shall apply paragraph 21.6 to determine whether at the acquisition date a present obligation exists as a result of past events for a provision or contingent liability. Therefore:

(a) the acquirer shall recognise liabilities for terminating or reducing the activities of the acquiree as part of allocating the cost of the combination only to the extent that the acquiree has, at the acquisition date, an existing liability for restructuring recognised in accordance with Section 21; and

(b) the acquirer, when allocating the cost of the combination, shall not recognise liabilities for future losses or other costs expected to be incurred as a result of the business combination."

The statements in (a) and (b) appear to refer to examples of the application of the accounting principle. Therefore, we suggest considering changing the 'Therefore' that precedes sub-paragraph (a) to 'For example'.

Paragraph 195 refers to paragraph 19.25, which is amended as follows (among other changes):

"(cA) for each business combination in which the acquirer holds less than 100 per cent of the equity instruments in the acquiree at the acquisition date, the amount of the non-controlling interest in the acquiree recognised at the acquisition date;

(dA) for contingent consideration arrangements:

(i) the amount recognised as of the acquisition date; and
(ii) a description of the arrangement and the basis for determining the amount of the payment."

In sub-paragraph (cA), it is unclear why it is necessary to make clear that NCI disclosures are required only for business combinations where the acquirer acquires less than 100% of the acquiree (there would not be any NCI if 100% had been acquired) and we propose the sentence start at "the amount of non-controlling interest…"

In relation to sub-paragraph (dA) in respect of contingent consideration, we suggest considering adding disclosure requirements in relation to the range of outcomes, similar to the requirement in IFRS 3.B64(g)(iii), i.e. 'an estimate of the range of outcomes (undiscounted) or, if a range cannot be estimated, that fact and the reasons why a range cannot be estimated. If the maximum amount of the payment is unlimited, the acquirer shall disclose that fact.'

Paragraph 198 refers to paragraph 19.26B, which is inserted as follows:

"19.26B If, in exceptional cases, an entity was unable to make a reliable estimate of the useful life of goodwill arising on a business combination in a previous reporting period, it shall disclose for each such business combination the period over which the goodwill is being amortised, and supporting reasons for the period chosen."

We believe this is additional to the requirements in 19.25(g), which refers to 'the useful life of goodwill, and if this cannot be reliably estimated, supporting reasons for the period chosen' being disclosed in the year of acquisition. It is not clear why it is necessary to disclose each year after acquisition the supporting reasons for the amortisation period chosen.

Appendix to Section 19 - Guidance on Identifying the acquirer

The proposed wording is broadly consistent with the guidance in IFRS 3.B14-B18. However, we note that the proposed wording does not contain guidance on reverse acquisitions as per IFRS 3.B19-B24. The application of Section 19 to certain group reorganisations, for example where the conditions for merger accounting are not met, might result in treatment similar to the reverse acquisition accounting described in IFRS 3.B19-B24. Consequently, we believe that inclusion of guidance on reverse acquisition accounting would be beneficial.

Step acquisitions

We note that the IASB's proposed changes in developing the third edition of the IFRS for SMEs include adding guidance on step acquisition accounting. We appreciate that step acquisition accounting differs between IFRS and FRS 102. However, whilst FRS 102 includes guidance on step acquisition accounting in para 19.11A (aligned with Companies Act requirements), in most cases this approach fails to give a true and fair view and the guidance in A3.18-21 is followed. (A3.21 refers to "rare occasions", but our experience is that a true and fair override is needed in the majority of cases.) Given the prevalence with which the guidance in A3.18-21 is applied compared to the requirements in Para 19.11A, we suggest that it would be helpful to include that guidance in the main body of FRS 102 (chapter 19, perhaps in the newly proposed appendix).

Section 24 – Government Grants

Paragraph 24.5A refers to the recognition of a liability when a grant becomes repayable. We are unsure what the sentence added means – "*The recognition of a new or increased liability for this purpose shall be recognised immediately in income.*" We suggest this is changed to "recognised immediately as a reduction in income rather than as an expense." [this also applicable to the amendment in FRS 105 Section 19.5]

In Paragraph 24.5E the words "*relating to revenue*" have been added. The wording should be changed to clarify that this relates to grants in respect of schemes where expenditure is charged to a revenue account. This comment also applies to the other references to revenue in the paragraphs relating to the accrual model for government grants.

Section 26 – Share based payments

Paragraph 26.13Ab – Ordinarily we would expect that any requirement on the entity to repurchase the equity instruments is considered in the determination of the classification of the scheme.

For example, if an entity issues equity instruments to an employee subject to a 3-year service condition but agrees, whether contractually or through discussions with the

employee, that the entity will repurchase the instrument on vesting – we would often classify this as cash settled under IFRS. This is because the arrangement is designed for the entity to provide cash rather than equity instruments after satisfaction of any vesting conditions.

The proposed paragraph could lead to an interpretation of equity settled classification of the above example.

Paragraph 26.15Ba –We have never seen any schemes where a counterparty has a choice of equity instruments or substantially lower cash value and therefore it is not clear to us when this proposed paragraph would apply. Furthermore, we note that an award which could be settled for a cash value which had no relation to the value of an equity instrument is unlikely to meet the definition of a share-based payment. The glossary definition requires that the cash amount be based on equity value.

FRS 103 Insurance Contracts

Amendments are proposed to the body of FRS 103 to align it with the revised Section 23 of FRS 102. The non-mandatory Implementation Guidance accompanying FRS 103 includes guidance on applying the principles of extant Section 23 of FRS 102 to general insurance contracts. Amendments are proposed to the guidance to bring it into line with the principles in the proposed revised Section 23 for recognising and measuring variable consideration and are limited to the guidance on gross written premiums.

This is non-mandatory guidance, but we are concerned that impact of this guidance coupled with the proposed amendments to FRS 103 could result in significant changes to the recognition of gross written premiums for UK general insurers reporting under FRS 103. Given that FRS 103 allows insurers to continue to apply existing accounting practices, we believe that FRS 103 should be left unamended until decisions are made on the alignment of UK GAAP with IFRS 17.

Question 10: Consultation stage impact assessment

Do you have any comments on the consultation stage impact assessment, including those relating to assumptions, sources of relevant data, and the costs and benefits that have been identified and assessed? Please provide evidence to support your views.

In particular, feedback is invited on the assumptions used for quantifying costs under each of the proposed options (Section 3 of the consultation stage impact assessment); any evidence which might help the FRC quantify the benefits identified or any benefit which might arise from the options proposed which the FRC has not identified (Section 4 of the consultation stage impact assessment); and appropriate data sources to use to refine the assumption of the prevalence of leases by entity size (Table 23 of the consultation stage impact assessment).

We have no comments on the consultation stage impact assessment.