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Submitted via email: ukfrsperiodicreview@frc.org.uk

29 April 2023

Dear Sirs

FRED 82 - Draft amendments to FRS 102, 'The Financial Standard applicable in the UK and Republic of Ireland and other FRSs.'

Grant Thornton UK LLP (Grant Thornton) welcomes the opportunity to comment on the Financial Reporting Council's (FRC) consultation FRED 82 - Draft amendments to FRS 102, 'The Financial Standard applicable in the UK and Republic of Ireland and other FRSs'.

Grant Thornton UK LLP is a leading financial and business adviser with offices in 26 locations nationwide and more than 25,000 individual and 15,000 corporate and institutional clients. The Grant Thornton global organisation is one of the world's leading organisations of independent assurance, tax and advisory firms. Grant Thornton member firms operate in over 100 countries.

We are generally supportive of the proposal in FRED 82 to revise Section 23 of FRS 102 to align it with IFRS 15, 'Revenue from Contracts with Customers', with some simplifications. However, we are not convinced that the proposed reliefs provide all that much benefit to users. We do not support the proposal to make similar amendments to FRS 105.

We are not persuaded that the benefits will outweigh the costs of implementing an on-balance sheet leasing model based on a simplified version of IFRS 16, 'Leases', for most FRS 102 preparers. In the absence of clear demand from users of FRS 102 financial statements for operating leases to be recognised on balance sheet, we recommend that the needs of most users could be addressed through focussed enhancements to disclosures about material leases.

However, if the FRC consider that the on-balance sheet leasing model is appropriate for FRS 102 preparers, we have made some suggestions of other simplifications that may make it less burdensome.

We are supportive of an effective date of 1 January 2025. However, if the on-balance sheet model is included in the final standard, the FRC should not underestimate the time that it will take FRS 102 preparers to transition to both the new revenue and leasing accounting models. In this context, we would be supportive of a phased implementation date with earlier adoption permitted.

We set out our detailed responses to each of the questions raised in the attached Appendix.

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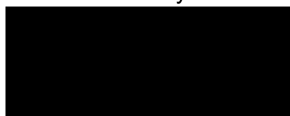
If you have any questions on our response, or wish us to amplify our comments, please feel free to contact me.

Yours faithfully



Jonathan D Shaw

Director, NAS- Financial Reporting
For Grant Thornton UK LLP

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Appendix – Responses to specific questions

Appendix
Responses to specific questions

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?

Subject to specific comments we make relating to proposed disclosure requirements concerning the recognition of revenue and the proposed lease accounting model, we generally agree that the level of disclosure should be sufficient for most users of financial statements prepared under FRS 102. However, we, as an accounting firm, are not users of such accounts and as such the views of entities that are should be given greater attention.

Question 2: Concepts and pervasive principles

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

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

We agree with the FRC's proposal to align both FRS 102 and FRS 105 with the 2018 conceptual framework. However, we do make comments in response to question 3 below concerning the treatment of 'own credit risk' in the measurement of financial liabilities at fair value. If the FRC concludes that the treatment of 'own credit risk' should be an accepted difference between IFRS and UK GAAP, it would be helpful for this aspect to be dealt with in Section 2 of FRS 102, 'Concepts and Pervasive Principles'.

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?

Alignment of fair value definition to IFRS 13

We support the alignment of the definition of fair value with that in IFRS 13. However, we consider that FRS 102 should clarify whether certain aspects of the principles in IFRS 13 will then equally apply to FRS 102 users. Our most significant concern relates to "own credit" adjustments to derivative fair values. Overall, we observe that applying IFRS 13 principles to FRS 102 users could involve additional cost and complexity.

IFRS 13 specifically requires that non-performance risk should be reflected in fair value [IFRS 13.42]. Therefore, when an entity is carrying out a fair value exercise on a derivative liability, adjustments to that fair value can be necessary for changes in the entity's own credit. In contrast, the existing version of FRS 102 applied a definition of fair value in relating to the amount to settle a financial liability. On

this basis, under existing FRS 102 it is commonly seen as a policy choice whether an entity adjusts a derivative liability for own credit (as evidenced in GAAP texts).

Aligning the definition of fair value with the IFRS 13 concept of transferring a financial liability to a third party may imply that own credit adjustments would then become mandatory. If this is the case, this could be a significant change in practice for many entities. Further, this could involve additional cost to those entities, particularly those with derivative liabilities. However, unlike IFRS 13, FRED 82 does not propose any specific reference to own credit / non-performance risk. Therefore, as drafted the proposals could lead to an unintended source of diversity between IFRS and FRS 102 preparers. We recommend that in finalising the proposals the FRS 102 position on own credit risk/non-performance risk is specifically considered.

Of secondary importance, we note that IFRS 13 illustrative example 7 contains an example which emphasises that an interest swap fair value entered into by a corporate entity could be in a different market to the market to which a bank uses. IFRS 13 technically fair values a derivative based on a hypothetical transaction of how much an entity would pay or receive in transferring that derivative to a third party in the same market and of similar credit risk [IFRS 13.34]. Such transactions are typically hypothetical in nature (eg corporates rarely transfer derivatives to other corporates). In contrast, most common software models for derivative valuations calculate fair values based on how contractual terms compare to observable market data generated from the inter-bank market together with credit risk adjustments, as necessary.

Underlying example 7 in IFRS 13 is the issue that typically if a corporate enters into a transaction with a bank on an arm's length terms and pays a nil transaction price, one might expect a model to also arrive at nil value. However, because of the inherent bank profit margin between the different markets, the fair values produced by models would typically show a liability amount on that transaction date. The fair value on that date would be nil, but if that model is carried forward without calibration this inherent difference can then impact the fair value immediately after initial recognition. In most cases this is not material, but where this is significant it can lead to complex judgements around model calibrations. This is particularly relevant in longer term derivatives where the impact can be more significant.

We observe that as most FRS 102 preparers are corporate entities (as opposed to banks) and derivatives are highly common, the issues we describe above could become relevant to FRS 102 preparers. The use of the IFRS 13 definition of fair value definition can by consequence mean that corporate entities could have added cost and complexity.

As described above, we consider the primary area of concern is the issue of own credit/non-performance risk where we consider guidance should be provided on how these risks should be dearly with in measuring fair value under the standard. In respect of the potential added complexity of the areas emphasised by IFRS 13 example 7, it would be helpful if the basis of conclusions acknowledged the different nature of the new definition of fair value in respect of a liability (relating to the value in transferring to another entity of similar nature), and how this can involve additional judgement in areas such as those described in example 7 of IFRS 13 relating to derivative valuations for corporate entities.

Share-based payment

We support the proposed consequential amendment to Section 26 Share-based Payment of FRS 102.

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Question 4: Expected credit loss model

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?

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?

Do you have any comments on which entities should be required to apply an expected credit loss model?

We agree with the FRC's proposals to defer the alignment of FRS 102 with the expected credit loss (ECL) principles set out in IFRS 9. 'Financial Instruments'.

We do not consider that the ECL principles should need to be applied by all FRS 102 preparers. In our experience, we have found that many IFRS preparers have found the principles difficult to apply to balances such as amounts due from subsidiary undertakings and when done so properly, the resulting credit loss provision was not materially different to that computed using the existing incurred loss model methodology. However, we do agree that an ECL based approach should be applied by those entities whose business is to enter either lending or financing activities of some sort, and, therefore, their pricing of such transactions will most likely be influenced by their assessment of the customer's credit risk.

Question 5: Other financial instruments issues

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?

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 agree with the FRC's proposal to prevent entities from newly adopting IAS 39.

We agree that the temporary amendments made to FRS 102 in December 2019 and December 2020 concerning IBOR reforms have served their purpose for UK based preparers. However, this may not be the case for other interest benchmark reforms in other countries. Considering this, it may be helpful to leave the temporary amendments in place until the next periodic review is carried out.

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Question 6: Leases

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?

Our general view on proposed alignment of Section 20 with IFRS 16

We are not convinced that the benefits of aligning Section 20 with IFRS 16's principles will outweigh the costs. We think that the cost of complying with an on-balance sheet lease accounting model from IFRS 16 could be significant for many businesses, even with the proposed simplifications. This is likely to have a disproportionate impact on smaller businesses. We are not persuaded that the application of the proposed leasing model will produce decision useful information for the users of accounts of 'not for profit' organisations such as charitable entities.

The IASB cited cost-benefit considerations as the main reason for not incorporating IFRS 16 into the IFRS for SMEs in its Exposure Draft IASB/ED/2022/1. Similarly, we think more time is needed to consider the full impact on FRS 102 reporters of adopting an IFRS 16 leasing model within Section 20. Additionally, waiting for the IASB's post implementation review of IFRS 16, and the next review of the IFRS for SMEs, may inform further simplifications that could be made.

We observed that a reason cited by the FRC for adopting the IFRS 16 leasing model within Section 20, is to achieve efficiency within Groups. However, in our view, FRS101 already provides a means for group efficiency by allowing qualifying entities within groups to align with the recognition, measurement, and disclosure requirements of IFRS with certain disclosure exemptions. Therefore, it is not clear to us why group efficiency is cited as a reason for aligning Section 20 with IFRS 16. Many companies within groups specifically choose to apply FRS 102 as the simpler accounting requirements is more suited to the size and nature of their business.

We note that the FRC believes that users would benefit from the information provided through an on-balance sheet lease accounting model. We understand that a key part of the case for introducing IFRS 16 itself was based on clear evidence that users of IFRS financial statements were commonly making adjustments to treat operating lease commitments as a form of debt, but not necessarily in a consistent manner. It is not clear to us that users of FRS 102 financial statements are commonly making such adjustments. If, however, there is clear evidence that the current version of Section 20 is not meeting user needs then we suggest that the FRC first considers whether this issue could be addressed through focussed enhancements to disclosure requirements about lessees' material operating leases (such as information about renewals, contingent rent, escalation clauses and restrictions).

Having said this, we appreciate that aligning Section 20 with IFRS 16's principles is consistent with the FRC's general policy to keep FRS 102 broadly aligned with international accounting standards. We also accept that the combination of on-balance sheet presentation and increased disclosure may provide users with enhanced information. However, we think that significant further simplifications are needed for this to be proportionate.

Simplifications in revised Section 23

As noted above, we not convinced that the benefits of aligning Section 20 with IFRS 16's principles will outweigh the costs and would prefer the FRC to consider some focused improvement to disclosure at this stage. However, if the FRC does decide to pursue broader alignment with IFRS 16

we have some suggestions for further simplifications that may help to address our concerns about proportionality.

We are supportive of the proposed simplifications from IFRS 16 that have been proposed in the exposure draft, particularly in respect of the additional discount rate options offered. However, as comparability between FRS 102 preparers could be affected by the discount rate applied, we recommend that the discount rate used to measure the lease liability should be disclosed.

Other areas where simplifications could be considered:

A straightforward approach to reducing the burden on FRS102 reporters could be to broaden the recognition exemption in such a way that only material operating leases either individually or in aggregate (eg property leases, vehicle leases etc) are required to be presented on-balance sheet. This will ensure that most entities' most significant leasing arrangements are on balance sheet.

Further simplifications to consider:

i. Determining the lease term (paragraphs 20.38 – 20.47)

Based on our experience, determining the lease term is an area that often requires significant judgement. We considered retaining the existing guidance in Section 20 to determine lease term since preparers are familiar with this approach and it is simpler to apply.

ii. Reassessment of the lease liability (paragraphs 20.70- 20.75)

Remeasurement of the lease liability is also an area that could be significantly simplified for FRS102 preparers. Although applying an unchanged discount rate is made optional in certain instances in Section 20, we considered that requiring an unchanged discount rate in all instances will significantly reduce and simplify the efforts of preparers to assess whether an unchanged discount rate option is available and, if not, to then determine a revised discount rate. However, we note that where the original discount has been revised by applying the requirements of paragraph 20.75 then it will be that rate, not the original rate that should be used.

iii. Disclosures (20.85-20.91)

Most of the disclosure requirements from IFRS 16 have been included in the proposed amendments to Section 20. We considered whether reducing the disclosure requirements for lessees is more appropriate given the requirements of FRS102 preparers and users of these accounts. Several disclosures mentioned in paragraphs 20.86 seem excessive given that these were not previously required for FRS102 preparers, for example the requirements to disclose the total cash outflow from leases and income from subleasing right-of-use assets.

Other matters

The proposed presentation requirements in paragraphs 20.81-20.82 appears to conflict with the detailed company law formats in Schedule 1 to SI 2008/410. For example, the proposed amendments provides that the right-of-use assets can either be presented separately on the statement of financial position or within the same line as that within which the corresponding underlying assets would be presented if they were owned. It is not clear how a company applying the company law formats would be able to separately present the ROU-asset on the balance sheet given that the current company law formats do not have format line item on the balance sheet for ROU-assets.

If the FRC does decide to pursue broader alignment of Section 20 with IFRS 16, we suggest that the FRC explains how the proposed presentation requirements in Section 20 are compliant with the company law formats.

It is not uncommon for commercial properties to be in the holdover period under the Landlord and Tenant Act 1954. Accordingly, it would be helpful for guidance to be provided to enable preparers to determine how the lease term should be determined for leases that are subject to this UK legislation.

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We have commented above on the disclosure requirements that appear to be excessive. However, from a comparability perspective we recommend that preparers should disclose which of the simplifications they have adopted in applying Section 20 of FRS 102.

Question 7: Revenue

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?

General

We support the decision and proposed approach to align Section 23 of FRS 102 to IFRS 15, with targeted simplifications. We have some comments on the specific proposals, and suggestions for further simplification, as set out below.

In our experience the existing version of Section 23 no longer provides sufficient (or in some cases any) guidance on various revenue recognition topics that are widely relevant in practice. Given the importance of revenue to most entities' financial statements we think standard-setting activity is necessary and believe aligning with IFRS 15's principles will be an effective way to address the deficiencies.

Despite our support, the challenges that many FRS 102 preparers will face should not be underestimated. Transitioning to IFRS 15 was challenging for many IFRS preparers. In many cases, we found the ultimate impact on revenue recognition was minor, but a significant transitional effort was still needed. IFRS 15 continues to give rise to frequent implementation questions. While the IFRS market has now gained extensive experience, we anticipate that the finance teams of most FRS 102 preparers will face a considerable learning curve. In our experience, companies need additional guidance to properly understand and apply IFRS 15's principles. The extensive available guidance (implementation examples accompanying IFRS 15, IFRS IC agenda decisions, TRG minutes, accounting firms' published guidance etc) is of course a useful resource but could also be become burdensome if companies face pressures to achieve identical outcomes to IFRS 15.

For these reasons, our initial preference was for a more 'targeted,' limited scope approach. However, we acknowledge that this approach brings its own risks and challenges. We understand that the IASB (in the context of updating the IFRS for SMEs) and the FRC have already considered and rejected such an approach. However, in view of the sheer volume of IFRS 15-based guidance and associated navigational challenge, we think that the FRC should consider developing some more limited illustrative guidance on selected key topics outside FRS 102 itself to help preparers apply Section 23.

We are not convinced that the changes should be extended to FRS 105. We think this will be disproportionate and are concerned that most micro-entities will find it very challenging to implement the proposals in a high-quality manner.

Proposed simplifications/amendments

We think the proposals strike a good balance between in terms of the level of detail included and omitted compared to IFRS 15. We also welcome the IASB's and FRC's efforts to improve understandability by using plainer language and a more sequential structure.

Turning to the proposed recognition and measurement simplifications, it appears the FRC has prioritised enabling consistent outcomes to IFRS 15, including for reasons of efficiency within groups that apply IFRS. The proposed simplifications are therefore mostly optional and, in our view, will offer only limited reliefs to preparers. Optional simplifications also come at a 'price' of reduced consistency

(both among FRS 102 preparers and with IFRS preparers), increased navigational complexity of the standard itself and a risk of reduced transparency for users (unless supported by additional disclosure of the options taken up by entities). For these reasons, we are not fully convinced by several of them. We would prefer to limit the simplifications to those that offer more significant benefits and are also straightforward to understand and apply.

With this in mind, we have concerns with the following specific proposals:

- *'Promise' versus 'performance obligation'* - IFRS 15 uses both these terms but with different meanings (a 'promise' effectively being the gross deliverables and the performance obligations being the distinct sub-set). FRED 82 uses the single term 'promise' but with the same meaning as 'performance obligation' in IFRS 15. While we support the use of only one term in FRS 102 and agree that 'promise' is the simpler term, we would prefer to retain 'performance obligation' to reduce the risk of confusion.

- *Contract modifications* – the proposals in paragraphs 23.14-15 would allow a policy when accounting for a contract modification that adds distinct goods or services at a standalone selling price. An entity could elect to account either a termination of the existing contract and the creation of a new contract, or as a standalone new contract (per IFRS 15). We do not support this proposal as we think this offers only a marginal simplification, as we do not think the standalone new contract approach is burdensome. We would therefore prefer to retain IFRS 15's approach.

- *Principal versus agent* – the proposals in paragraph 23.28 appear to promote the role of 'primary responsibility' from an indicator of an underlying control principle to a determinative factor in its own right. While we agree that IFRS 15's requirements in this area can be challenging to apply, and often involve judgement, we don't think this is the right solution. In our experience, the concept of primary responsibility is not fully clear or consistently understood. Where more than one party is involved in fulfilling a promise each will have its own responsibilities and determining which is or are 'primary' can be challenging. We therefore suggest retaining control as the sole determinative principle, along with supporting indicators – in line with IFRS 15. We also think it is important to set out that:

    - the 'specified good or service' for this purpose can be a right rather than the underlying good or service (this is indirectly addressed in 23.38(c), but only partially)

    - providing a significant integration service is determinative of control

- *Variable consideration constraint* - paragraph 23.46 says that "*an entity shall include in the transaction price an amount of variable consideration… only to the extent that it is highly probable that this amount will become due."* We agree this language is simpler than IFRS 15's double negative expression of the constraint. However, we are also concerned that the interaction with paragraph 23.44 (expected value vs most likely amount) is unclear. For example, we think 23.46 could be interpreted to permit or require excluding any variable consideration amount unless the entire amount is highly probable. We suggest this interaction should be clarified or, alternatively, IFRS 15's expression of the constraint should be retained.

- *Time value of money* – we do not support the proposal in paragraph 23.59 to restrict the practical expedient from separating a financing component to six months. We think it is very hard to justify a shorter period than the 12 months specified in IFRS 15 and also proposed for the IFRS for SMEs.

- *Promises satisfied over time* – we do not agree with the inclusion of paragraph 23.78(b) as a separate criterion in determining whether revenue may be recognised over time. The equivalent text in IFRS 15 is provided in IFRS 15.B4 and is used to assess whether the criterion set out in IFRS 15.35(a) has been met. However, as drafted in FRED 82 it would be permissible to recognise revenue over time for a partly built house without clarifying that in applying FRS 102

23.78(b) the entity taking over the promise would not get access to the work-in-progress controlled by the entity ceasing to deliver the good or service. Therefore, we recommend that this criterion is deleted.

For the avoidance of doubt, we support, or at least do not disagree with, the other proposed simplifications to the recognition and measurement principles. In particular we think the option to fully expense incremental costs of obtaining a contract (paragraph 23.102) is a helpful simplification that is easily understandable.

Other possible simplifications

We think the scope for additional simplifications that will provide significant reliefs in practice but will not result in different outcomes to IFRS 15, is quite limited.

If the FRC is prepared to entertain certain departures, we suggest reconsidering the requirements of paragraphs 23.81-82 concerning a right to compensation to work carried out to date (in the context of the 'promises satisfied over time' assessment). Our experience is that the equivalent IFRS 15 requirements have proven particularly challenging to apply. The assessment is inherent challenging because it considers a hypothetical termination decision that the customer is not contractually entitled to make. Moreover, our understanding is entities cannot normally rely on legal precedent in a UK context because UK courts will reach different decisions based on their view of what is equitable in the circumstances. There are various ways in which the requirement could be simplified – for example by removing this assessment if the contract is non-cancellable. However, if the FRC chooses to keep the proposed requirements, guidance should be provided to preparers about how this assessment should be made in the extant UK legal framework.

Disclosures

The proposals incorporate most of the disclosure themes requirements of IFRS 15, albeit with less detail. This would be a significant increase to Section 23's existing requirements. The Basis for Conclusions explains the FRC's reasoning for requiring a description of the nature of the goods or services promised (paragraph 23.124, which we support) but does not address the other new requirements.

In the absence of further explanation, or clear evidence of user demand, we find the proposals somewhat disproportionate and out of balance with other sections of FRS 102. We think many of IFRS 15's disclosures have a capital market orientation (ie they are aimed at the needs of analysts seeking to populate valuation models). We support bringing such requirements into FRS 102 only if there is clear evidence of demand from users of FRS 102 financial statements.

We think the following proposals should be reconsidered:

- *paragraph 23.122(b): impairment losses on receivables and contract assets* - this proposal appears duplicative given that paragraph 11.48(c) of FRS 102 already requires disclosure of impairment losses by class of financial asset

- *paragraph 23.126: information about certain unsatisfied promises - this* proposal would provide some insight into order backlog although not necessarily a complete picture (due to the optional exemptions). We think the corresponding requirement of IFRS 15 is targeted at the needs of analysts and may not be suitable for FRS 102 - see for example IFRS 15.BC348

- *paragraph 23.123(b) and (c): revenue recognised relating to opening contract liabilities and performance in prior period(s)* – like the preceding comment we feel these are also more capital market-oriented disclosures that are disproportionate for FRS 102.

If these proposals are removed, the disclosures (considering both Section 23 and other requirements of FRS 102) would provide information on the following areas, which we consider to be more appropriate and proportionate in an FRS 102 context:

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- the nature of the goods and services provided and relate contractual arrangements
- the components (disaggregation) of revenue
- revenue-related balance and impairments (to the extent not covered elsewhere)
- material accounting policy information, key judgements, and major sources of estimation uncertainty.

Other comments

- *paragraph 23.17: explanation of probability of collection criterion:* this states that *"the probability of collection] criterion … is met when the customer has the ability and intention to pay the consideration when due*." While IFRS.15.9(e) uses the same phrase, the purpose is to clarify that the assessment focuses only credit-related risks and not on other factors (e.g. price concessions) that may result in the stated contract price never becoming due in full. FRED 82's separation of paragraphs 23.16(e) and 23.17 could cause confusion as 23.17 seems to be a separate (and somewhat inconsistent) criterion.

- *paragraph 23.33: non-refundable fees that give customer a right to renew*: we find this paragraph confusing. We think it is intended to address situations the fee relates to both non-optional services and renewal options, but the wording implies the fee is entirely for the renewal option. The wording also implies that the optional simplification in 23.35 is not available is this circumstance but we are not sure if this is what the FRC intends.

- *paragraph 23.42*: this states that "*for the purposes of determining the transaction price, an entity shall assume that the goods or services will be transferred to the customer in accordance with the existing contract and that the contract will not be cancelled, modified or renewed*" [emphasis added]. We note that the optional approach in paragraph 23.26 considers expected renewals. This inconsistency should be clarified by adding something along the lines of: "subject to the requirements of paragraph 26, where applicable".

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? 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 are supportive of the transitional provisions that have been proposed in FRED 82. However, we are cognisant of the amount of work that preparers will have to complete to meet the requirements of the proposed changes to both the revenue and lease accounting models. Considering this, we would be supportive of a phased implementation date with the revenue accounting model becoming effective from 1 January 2025 and lease accounting from either 1 January 2026 or 2027 with the option to early adopt the lease accounting model should it be implemented in the new standard.

Question 9: Other comments Do you have any other comments on the proposed amendments set out in FRED 82?

We set out below comments on some of the proposed amendments set out in FRED 82 as well as on financial reporting matters that are not addressed in FRS 102 and, in our view, should be dealt with soon.

Section 8 – Notes to the Financial Statements

We would welcome more guidance in FRS 102 relating to the disclosure of significant estimation uncertainties such as key assumptions and sensitivity analysis which is provided by IAS 1.129.

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Section 9 – Consolidated and Separate Financial Statements

We recommend that a definition of 'dominant influence' is provided.

Section 11 – Basic Financial Instruments

Non-substantial debt modification

FRS 102.11.37 contains guidance in respect of accounting for substantial modifications. It is, however, silent about how to account for non-substantial modifications. That is where the contract terms are altered but there is not a derecognition event. We observe that GAAP texts contain varying views in how to account for this in FRS 102. Some GAAP texts consider that FRS 102.11.20 directly applies while other GAAP texts conclude that section 11 does not give guidance and so a no gain or loss position could apply.

We observe that in IFRS, the general position is a gain or loss should be recognised per IFRS 9 5.4.3/IFRS 9 B5.4.6 as emphasised in IFRS 9 BC4.253. IFRS 9 5.4.3 and B5.4.6 are broadly consistent with FRS 102.11.20. However, in IFRS there can, in some cases, be arguments that the changes can be economically equivalent to a floating rate change, and as such IFRS 9 B5.4.5 (equivalent to FRS 102.11.19) might be more relevant. An example of this could be a floating rate loan which is prepayable without penalty, and that loan is amended with a change in margin.

While the IFRS position is not without areas of debate, the absence of guidance in FRS 102 is a source of diversity in practice. We recommend that guidance on non-substantial debt modifications is provided in FRS 102.

Recognition of dividend income

FRED 82 has proposed a new paragraph relating to timing of recognition of dividends. We expect that this is intended to relate to dividend income arising from equity financial assets, and do not expect this to apply to dividend payments (where section 22 would determine whether those are part of a financial liability). However, we recommend that the wording in FRS 102.11.14A is amended to 'Dividend income from equity investments is recognised in profit or loss when….'

Section 14 – Investments in Associates

We welcome the additional guidance given on determining the existence of 'significant influence'. However, we would appreciate the inclusion of 'the intentions of management and the financial ability to exercise or convert potential rights should disregarded in assessing whether potential voting rights contribute to significant influence' which would be consistent with the guidance in IAS 28.8.

Section 19 – Business Combinations and Goodwill

We would welcome additional guidance to be given in FRS 102 on the identification of pre-existing relationships and on the appropriate accounting treatment for put and call options over a non-controlling interest at the date of acquisition. In addition, it would be appreciated for greater clarity on the accounting for contingent consideration in a business combination which is a relatively common feature of sale and purchase arrangements in the UK.

We note that under IFRS 3, negative goodwill is not recognised on the balance sheet whereas under FRS 102, to comply with the requirements of the Companies Act 2006, it is. However, it would be helpful for guidance to be provided on determination of the period over which non-monetary assets are recovered where assets such as investment property are carried at fair value.

Section 22 – Liabilities and Equity

FRED 82 proposes to add the following to FRS 102.22.3, "For the purposes of this section, a liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits".

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We are unclear on the rationale for this proposed amendment. However, we consider that this clause could both lead to a fundamental change in the definition of a financial liability and a significant difference compared to IAS 32. Further, this additional sentence to FRS 102.22.3 would conflict with FRS 102.22.3A. This proposed sentence appears to be based on the IFRS conceptual framework definition of liabilities as opposed to the definition of a financial liability.

We note that under FRS 102.22.3A (which is consistent with IAS 32.25), a contractual obligation to pay cash which is contingent on an event outside the entity's control is normally a financial liability. This is the case even if the outflow of cash is less than probable (ie not expected). For example, consider a contract where an entity is required to pay £1M should its owners change control within the next two years. Under FRS 102.22.3A this would be a financial liability even if it was not "expected" that a change of control event would occur in that two-year period. In contrast, this new proposed sentence in FRED 82 would imply this is not a financial liability.

We recommend that this proposed new sentence to FRS 102.22.3 is not added to FRS 102. However, if this is the FRC's intended outcome we would appreciate this to be clarified in the Basis for Conclusions.

Apparent conflict between FRS 102.22.8A and FRS 102.11.38 relating to some non-basic financial instruments

We draw the FRC's attention to a potential flaw in the existing version of FRS 102 which has not been addressed by the proposals. FRS 102.22.8A sets out three cases where an extinguishment of a financial liability by the issue of equity instruments is scoped out of FRS 102.22.8, and in these circumstances requires that no gain or loss is recognised because of the transaction. One of those circumstances is where the extinguishment is in accordance with the original terms of the financial liability. Those scope exclusions broadly mirror IFRIC 19 in IFRS, although IFRIC 19 does not directly specify the accounting for scoped out transactions.

The reference to no gain or loss in the context of conversion features which are part of the original terms is logical where the debt-to-equity conversion relates to a convertible bond which is classed as a compound instrument. In many cases, in convertible bonds which are non-basic this also leads to a logical conclusion as the fair value movements will already have been reflected in the fair value measurement of the loan. However, a conflict arises in some types of convertible loans which are non-basic. Specifically, this relates to convertible loans with the following features:

- the holder has an unconditional right either now or at a date in the future to demand cash (giving rise to a demand feature)
- the holder also has a right to convert into a number of equity shares but where the conversion terms fail the "fixed for fixed" test in FRS 102 section 22. Consequently, the entire loan is classified as a non-basic instrument in section 12
- The demand feature rule in FRS 102.12.11 applies such that the fair value from the issuer's perspective sets a minimum value which exceeds the fair value from the holder's perspective.

For example, consider a convertible bond where the holder could contractually immediately demand £1 million or could choose to convert into a number of shares. Consider that the fair value of the shares the holder could convert into was £300,000. While the holder has the right to demand £1 million, the circumstances are such that the holder would only recover cash of a lower amount because the issuer is unable to repay £1 million in full. Say the fair value of the entire loan from the holder's perspective is £300,000, but from the issuer's perspective, FRS 102.12.11 means that the fair value is measured at £1 million. The holder then exercises their option under the original terms to convert the debt into equity (with a fair value of £300,000).

While FRS 102 section 12 requires the non-basic debt to be carried at its fair value, due to the demand feature, the issuer carries this at £1 million. FRS 102.22.8A implies that the conversion is on a no gain no loss basis. In contrast, FRS 102.11.38 (which is in scope via FRS 102.12.14) implies a £700,000 gain should be recognised in the income statement.

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In our view, the most appropriate accounting in such a case is to reflect the gain in the income statement. This reflects the crystallisation of an inherent fair value gain. We observe that in IFRS, in IFRIC 19, where a debt for equity swap transaction occurs, in measuring the gain, IFRIC 19 disapplies the demand feature rule (IFRIC 19.7).

We recommend that the sentence in FRS 102.22.8A is amended to the following “In these circumstances there is no gain or loss recognised in profit or loss as a result of such a transaction, other than in the case of a non-basic debt instrument where any remaining gain or loss should be included in the income statement per FRS 102.11.38”.

Section 24 – Government Grants

While the changes to FRS 102 Section 24 are limited in FRED 82, we suggest that this review could be an opportunity to include additional clarity in respect of the definition of a revenue versus asset grant.

Paragraph 24.5C refers to the classification of grants relating to either revenue or assets. We note that in FRED 82 that there is no specific definition of the two grant types, as generally speaking these terms are well recognised, not demanding specific definitions. However, in practice there is some degree of judgment involved where there are mixed grant types. For example, in some single grant agreements, there may be multiple grant elements (i.e., a project which requires construction of an asset along with a revenue element for specific service level output arising for the use of the asset).

In our view, Section 24 of FRS 102 could therefore be further improved by commenting on the treatment of government assistance in which there is a combination of both revenue and capital grants. The Further and Higher Education SORP 2019, Section 17.9 offers some clarity on this matter by stating, ‘Where an institution receives a government grant for a combination of two or more of revenue, land and other capital, the institution must allocate the grant between the revenue, land and other capital elements.’ We suggest, therefore, that Section 24 of FRS 102 includes some additional clarification, like the Further and Higher Education SORP (FEHE) SORP, which offers the users guidance on the treatment of a grant with multiple grant elements.

Furthermore, we note that FRS 102 Section 24 is currently silent on the accounting treatment of grants where the source is mixed between government and non-governmental grant sources, which in practice can be a common scenario, especially where there is multiple funding for one project say on a matched funding basis. Some additional clarity is offered in the FEHE SORP 2019, Section 17.6 which states that, ‘the institution should account for the grant in proportion to the level of grant received from each grantor.’

The inclusion of additional clarity as set out above would aid the users of the accounting standards and preparers of accounts across both the Public Benefit Entities (PBE) and other non-PBE entities who may receive some form of government or non- government grant assistance.

Section 26 – Share-based payment

Graded/staged vesting conditions

We would welcome additional guidance regarding accounting for awards issued which result in graded/staged vesting, for which we are aware that the current lack of guidance in extant FRS 102 leads to diversity in practice. Share-based payment awards of this nature are not uncommon in the UK.

Reference to para 26.14B in para 26.14A

New guidance has been included in paragraph 26.14A-C relating to measurement of the cash-settled liability. Paragraph 26.14A cross refers to paragraphs 26.10 and 26.11. However, we would have welcomed inclusion of clarification that the application of these methodologies for measuring the liability was “*subject to the requirements of 26.14B.*” This would be more consistent with the approach taken in IFRS 2.30 which has the same requirements.

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Reference to "conditions that are not vesting conditions" in para 26.14B

We would expect this to refer to "*non-vesting conditions*" as opposed to conditions which are "*not vesting conditions*."

Reference to net settlement feature in para 26.15B(b)

We might have expected "*net settlement feature*" in paragraph 26.15B(b) to be emboldened as it is a defined term with the Glossary (Appendix I)

Section 28 – Employee Benefits

We would appreciate guidance to be included in FRS 102 to explain how the principal employer in a group scheme accounts for contributions made to the plan by participating employers who treat the plan as a defined contribution plan in accordance with extant FRS 102.28.38.

Section 34 - Specialised Activities

Legacy Income

We welcome the inclusion of paragraph PBE34.70A relating to legacies in the amendments set out in FRED 82. Considering the likely users of this proposed paragraph (mainly Public Benefit Entities), we have consulted the Charities SORP 2019 as part of our review procedures which is the most used accounting guidance in respect of legacy income.

Section 5 of the SORP requires legacy income to meet three criteria: entitlement, probability, and measurement. Whilst the proposed amendments to the FRED 82 clearly refer to recognition of a legacy 'when it is probable… and its value can be measured reliably,' there is no mention of entitlement. Entitlement alone is insufficient to recognise legacy income, however its absence from paragraph PBE34.70A is at odds with the Charities SORP thus potentially leading to unintended consequences and diversity in practice in the area of legacy income. Given that PBEs are likely to refer to guidance in both the Charities SORP and FRS 102, consistency across both publications where possible should be considered, to ensure legacy income is correctly accounted for and, therefore, we recommend inclusion of the entitlement criteria within the proposed paragraph PBE34.70A of FRED 82.

Also included in paragraph PBE34.70A is the guidance that a portfolio approach may be taken for multiple, immaterial legacies. Again, we welcome this inclusion and this alignment with the Charities SORP 5.32. However, we recommend that additional clarification is included here, by clarifying that the portfolio approach should be applied only when legacies are frequent for the entity and that an estimate of the value should be achieved through use of a model or formula. Again, we offer this suggestion as the likely users of paragraph PBE34.70A are most likely to be PBEs who are expected to also refer to the Charities SORP, meaning that consistency is beneficial and important to the users of this section of FRS 102.

Funding Commitments

In relation to funding commitments, paragraph PBE34.59 of FRS 102, we noted that there have been no amendments proposed. However, we do suggest the inclusion of additional clarity in this section to align with existing guidance included elsewhere and to avoid any ambiguity on the accounting for funding commitments.

Paragraph PBE34.59(b) refers to a constructive obligation, defined in the glossary as evidenced by an 'established pattern of past practice,' and a 'valid expectation,' The Charities SORP 2019 in section 7.14 also features that a constructive obligation for a funding commitment exists where the 'commitment is communicated directly to particular beneficiaries or grant recipients.' We suggest that the definition of a constructive obligation in the context of funding commitments is expanded to include direct communication to recipients as a key feature. Given that the likely users of the funding commitments guidance set out in Section 34 are PBEs, the alignment of FRS 102 and the SORP in this area is beneficial and important in our view.

In addition, FRS 102 does not currently refer to the importance of discretion when considering the accounting treatment of funding commitments. Throughout the pandemic we saw examples of funding commitments that could not be fulfilled due to external factors and cash flow issues, but the element of 'discretion' allowed for some flexibility and this in turn has an impact on the accounting treatment.

We note the Charities SORP 7.20 offers some clarity in this area, by referring to 'discretion to avoid expenditure,' which is particularly relevant for assessing whether a liability should be booked or not on initial recognitions. Furthermore, the SORP also provides more guidance where the funding commitment is longer than one year.

We therefore recommend that paragraph PBE34.59 of FRS 102 includes some additional guidance on the 'discretion' element contained within funding commitments, to assist users in determining if a funding commitment should be recognised at the reporting date or not. Furthermore, guidance on any subsequent accounting treatment to consider for multi-year funding commitments where there is discretion in the agreements would also be welcomed.

We wish to highlight that the main users of this section on PBE Funding Commitments will generally tend to be charitable entities, who usually are required to apply the Charities SORP in addition to FRS 102. We consider that without the additional guidance in FRS 102 and the necessary clarity there may potentially be unintended consequences stemming from the ambiguity between the FRS 102 and SORP requirements.

Finally, one minor observation was we note that paragraph PBE34.70B, the term 'right of use asset' should be in bold font due to this being a defined term in the FRS 102 proposed glossary.

Section 35 – Transition to this IFRS

When FRS 102 was first introduced, section 35 contained helpful relief relating to hedge accounting in respect of entities first applying FRS 102.

Specifically, FRS 102.35.9(t)(iii) means that hedge documentation can be prepared and backdated in its effect provided it is prepared by the time the first FRS 102 financial statements are approved. FRS 102.35.9(t)(iii) applies to new hedges entered into during that period. FRS 102.35.9(t)(i) similarly applies to pre-existing hedges.

In contrast, the normal position in FRS 102.12.18 is that hedge documentation is required at hedge inception. This concept is like IFRS and recognises that hedge accounting is a choice, but not one which allows retrospective backdating.

The Section 35 relief was logical when FRS 102 was first introduced due to the timescale of the implementation changes. However, as time has passed the purpose of those reliefs now appears unclear, and may now have unintended consequences, and in some cases could give rise to manipulation.

The first situation which creates a question is for newly incorporated entities. FRS 102.35.1 appears to be such that such entities would be in scope of section 35. This being the case those entities could make use of this "backdating" relief in FRS 102.35.9(t)(iii). We question whether this is intended given this would provide relief not available to other entities, without a clear conceptual basis.

The second situation relates to entities which applied FRS 101 or IFRS, but failed to prepare compliant hedge designation documentation, and then changed to FRS 102. The section 35 relief could then be such that those entities backdate documentation under FRS 102. This could be open to manipulation.

The above situation raises interrelated questions in respect of the scope of section 35 and the application of hedge accounting relief.

We observe that FRS 102.35.9(t)(iii) may no longer be appropriate as newly incorporated entities do not necessarily have any additional burden compared to existing corporates should they enter into hedging contracts.

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We observe that where an entity moves from a previous GAAP which had a similar form of hedge accounting model then the relief in FRS 102.35.9(i) no longer appears appropriate. Therefore, we recommend that this relief is removed or changed in such a way that it only applies where an entity transitioned from a GAAP which did not have a similar hedge accounting model (such as micro entities).

Other areas of financial reporting:

We would appreciate the FRC to consider undertaking standard setting activity to deal with the following matters which are or will become commonplace for FRS 102 preparers. These areas include:

- Software as a service arrangements (SAAS)
- ESG features in loan arrangements
- Crypto currency/Crypto assets
- Electronic payment settlements

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.

We have no comments to make on this.