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28 August 2020

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Dear Easton

**BDO LLP response to FRED 76: Draft amendments to FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* and FRS 105 *The Financial Reporting Standard applicable to the Micro-entities Regime - COVID-19-related rent concessions***

We welcome the opportunity to comment on 'FRED 76: Draft amendments to FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* and FRS 105 *The Financial Reporting Standard applicable to the Micro-entities Regime - COVID-19-related rent concessions*' (FRED 76).

We do not support the proposed amendments to FRS 102 and FRS 105 that are set out in FRED 76.

In reaching this conclusion, we considered whether the proposed amendments would achieve any of the following potential objectives; more consistent accounting across entities, a simplification in the required accounting, thus reducing costs and complexity in these unprecedented times, or better accounting, i.e. accounting for lease rentals that more faithfully represented an entity's access to the economic benefits of the leased asset. In our view, the amendments would not systemically achieve any of these objectives.

Our analysis of these objectives forms part of our responses to the specific consultation questions, which are set out in the appendix to this letter.

In reality, we consider there to be greater diversity in the accounting response to modifications in finance leases (as opposed, to operating leases), whether due to COVID-19-related concessions or otherwise. However, in our experience, COVID-19-related concessions on finance leases have been rare so we would not recommend any urgent amendments to address them. The FRC might wish to consider broader research of the accounting for finance lease modifications to assess the extent of such modifications and the impact of any diversity in practice. However, we would caution that the development of a single approach to finance lease modifications may prove to be a significant standard-setting activity for which the resulting cost of disruption to existing practices might outweigh the benefits of greater consistency in accounting for relatively rare events.

If you wish to discuss any of the points further, please do not hesitate in contacting me directly.  
Yours sincerely,

Anthony Appleton  
Partner  
For and on behalf of BDO LLP

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*Appendix: Responses to the questions asked in the Exposure Draft*

**Question 1**

**Do you agree with the proposed amendments to FRS 102 and FRS 105? If not, why not?**

We do not agree with the proposed amendments to FRS 102 and FRS 105 that are set out in FRED 76. We provide our specific comments below.

In considering the proposed amendments we have tried to assess them by reference to three potential objectives; whether they lead to more consistent accounting across entities, significantly reduce the cost and complexity through simpler accounting, or result in better accounting, i.e. accounting that represents more faithfully an entity's consumption of the economic benefits received under the lease.

Consistent accounting

Although the required treatment of a modification of an on-going operating lease, such as a COVID-19-related rent concession is not explicitly stated in the standards it can, in our view, be clearly inferred - the revised aggregate future minimum lease payments, along with any amounts currently recognised on the balance sheet for, for example, past rent free periods, should be recognised on a straight-line basis prospectively over the remaining lease term. We do not consider there to be significant diversity of views on this interpretation.

Therefore, any residual uncertainty amongst some stakeholders about the current requirements could be removed through clarification by the FRC without changing the required accounting. This could be done without further standard-setting activity via the feedback statement at the end of the consultation period or by adding an explicit clarification in the standards.

We also consider that some of the proposed criteria to qualify for relief under the proposed amendments could actually lead to inconsistent treatment. For example the proposed paragraph 20.15D(c) of FRS 102 and 15.16B(c) of FRS 105 refer to there being "no significant change to other terms and conditions" however there is no further guidance on what constitutes a "significant change". Entities with very similar lease modifications may interpret this differently and end up applying differing treatments.

While it may be rare, we have also identified instances for lessors where the parent of a group reports under IFRS but has subsidiaries reporting under FRS 102. As the IFRS rent concession amendments did not change the accounting for lessors, the mandatory amendments to FRS 102 may lead to further inconsistency within groups or adjustments being required between the group and subsidiary accounting.

Simpler accounting

In our view, the interpretation of the standards as set out above does not lead to undue complexity. Entities will already be applying a straight-line model to expense recognition and updating this for the waived payments is straightforward.

Furthermore, the proposed amendments do not clarify the treatment of amounts previously recognised on the balance sheet, such as for previous rent free periods. It is not clear whether the release of such amounts should continue during the COVID-19-related concession period or should be fully or partially deferred if the current rent concession is only partial.

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If the release of previously recognised balances is deferred to the end of the rent concession agreement, then the prospective straight-line expense recognition will have to be recalculated anyway, consistent with the accounting currently required under the common interpretation set out above.

Although such cases will be rare, there may be some entities (for example those with April, May or June year ends) that will have filed accounts before the amendments are finalised. Given the amendments are mandatory, such entities will have to restate their treatment next year, increasing complexity.

*Better accounting*

The proposed amendments may lead to 'better' accounting in simple scenarios where, for example, there is a total waiver of the rents due and the entity has no access to the property/asset during the concession period and it is not used by the entity for any purpose, including the storage of other assets. In such cases, it is arguable that no expense should be recognised if the entity receives no economic benefit from the use of the asset.

However, such examples are likely to be rare with rent concessions being only partial or some access to the property being retained for administrative or security purposes or for carrying out alternative supplementary revenue generating activities. Furthermore, supporting the deferral of rents on the grounds that economic benefits are not being generated from the use of the asset might throw into doubt the accepted treatment of recognising rental expenses during a period an entity is fitting out a property in preparation for its intended use.

*Question 2*

*Do you agree with the proposed effective date for these amendments? If not, what difficulties do you foresee?*

If the proposed amendments are made, the proposed effective dates should ensure that all possible COVID related rent concessions are covered. However, we do foresee some difficulties, however rare, for any entities reporting before the amendments are finalised. Such entities will be required to retrospectively restate in future accounting periods.

*Question 3*

*The proposed amendments to FRS 102 require a lessee to disclose those changes in lease payments recognised in accordance with paragraph 20.15C. The Basis for Conclusions describes the reasons for this proposal and the existing disclosures required by FRS 102 relevant to this transaction.*

*Do you consider that these disclosure requirements are sufficient to meet the needs of users?*

As noted above the proposed amendments do not give consideration to pre-existing balances held in relation to leases. We recommend you consider what disclosures are necessary once you have considered the treatment of them.

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*Question 4*

*In relation to the Consultation stage impact assessment, do you have any comments on the costs and benefits identified? Please provide evidence to support your views.*

As set out in our response to question 1 above we do not agree that the proposed amendments will deliver all of the costs and benefits set out in the consultation stage impact assessment. In relation to points three and four of the assessment please see our responses above under the heading of "consistent accounting". Considerations linked to point six are covered under the "simpler accounting" heading above.