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1 September 2020

Easton Bilsborough
Financial Reporting Council
8th Floor, 125 London Wall
London,
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via email: ukfrs@frc.org.uk

Dear Easton,

FRED 76: Draft amendments to FRS 102 and FRS 105 (July 2020)

We welcome the opportunity to comment on the FRCs proposed amendments to FRS 102 and FRS 105 in light of similar amendments being made to IFRS.

Whilst we strongly support the proposed amendments, which we believe will have a positive impact on relevance and consistency by reporting entities within the UK, we propose one amendment to the proposed criteria as shown below, and suggest further consideration is given as to whether finance lease rent concessions should also be included in scope.

As we agree with the remainder of the amendments we have not set out detailed responses to each question.

Amendments to Operating leases

The use of “payments originally due on or before 30 June 2021” as a cut-off date for rent concessions is consistent with the amendment to IFRS 16 Leasing but is nevertheless arbitrary and may see similar transactions treated differently.

We are seeing lessors and lessees attempting to negotiate rent reductions due to Covid-19 that provide regular (albeit reduced) cash inflow for the landlord with a corresponding rent reduction for the lessee by spreading the rent concession over 12 months.

For example, rather than providing an immediate concession of a quarter’s rent, a 12-month rent reduction may be negotiated. In such cases, a rent reduction over 12 months to 30 June 2021 would be captured by this amendment but a 12-month rent reduction to 31 July 2021 or 30 September 2021 would not.

As the Coronavirus Job Retention Scheme winds down, with employers required to pay a greater share of employee wages we expect tenants to now be negotiating rent concessions with landlords, and so a rent concession negotiated in the run up to September rent quarter for the next 12 months would also not be within the scope of the amendment. Whilst this was important under IFRS due to the on-balance sheet nature of operating leases, given operating leases are off balance sheet under UK GAAP, we consider the FRC could be more lenient than the IASB.

We therefore suggest any rent reductions **originating** before 30 June 2021 which are clearly related to Covid-19 and span 18 months or less, rather than payments falling due before 30 June 2021, are included within scope.

This means the amendments would not be so time limited and would still be relatively simple and consistent to apply to operating leases which under UK GAAP are off balance sheet, unlike under IFRS.

Without a change along the lines suggested above, it also means the standards may need to be updated if rent concessions are still being given to struggling businesses in 2021 once the Furlough Scheme has ended. Even if the standards are then subsequently updated, the inconsistency will continue as outlined above as those with 12 month rent concessions given in July – December 2020 wouldn't have been able to apply the concession in their 31 December 2020 accounts.

Amendments to Finance leases

We note in the basis of conclusions that "no amendments are proposed for changes in lease payments for finance leases" [paragraph 9] which we consider to be a missed opportunity to provide clarity to preparers.

Our understanding is that the derecognition requirements in section 11.36-38 would apply to the forgiveness of finance lease payments which is alluded to in the basis of conclusions "to which the requirements of Section 11 Basic Financial Instruments and Section 20 Leases of FRS 102 apply."

We would therefore request the FRC includes guidance to clarify that the derecognition requirements of section 11 would mean that forgiveness of finance lease payments are credited to profit or loss in the period the concession is intended to compensate (ie this would clearly provide consistency between those who use finance leases and those who use operating leases to fund their assets).

We would also request that the FRC clarifies whether the subsequent measurement requirements in paragraph 20.11, which refers to 11.15 to 11.20 are mandatory, and includes a reminder that the general principle of materiality applies. It is therefore for the preparer to consider whether any deferments of payments due under a finance lease are likely to have a material effect on applying the effective interest method. By doing so agreements to defer payments which do not increase the overall amount payable would not require the finance lease liability to be recomputed (ie the effective interest method would simply carry the liability forward for deferred payments at the end of the period).

It would also be helpful for the FRC to issue guidance as to whether the rent concession issued by landlords could be an event which causes a lessee to reconsider whether a lease is a finance lease or an operating lease under 20.8.

Should you wish to discuss any matters included in this letter please contact Danielle Stewart OBE (danielle.stewartOBE@rsmuk.com).

Yours sincerely,

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