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Dear Sirs

FRED 82 *Draft amendments to FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland and other FRSs – Periodic Review ('FRED 82')*

Ernst & Young LLP welcomes the opportunity to comment on FRED 82.

Most of the amendments proposed are to FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* and to FRS 105 *The Financial Reporting Standard applicable to the Micro-entities Regime*. Given our client base, we have responded on the amendments proposed to FRS 102, but not those proposed to FRS 105. However, we would question the proportionality of making changes to the revenue model in FRS 105 for micro-entities.

We have responded to your specific questions in the attachment to this letter and, in the Appendix, have raised further comments, by section of FRS 102, on areas not specifically asked about in the consultation questions, or where we have provided further detail about our response.

We are supportive of the periodic review to amend FRS 102, based on an IFRS-based solution. This is consistent with the FRC's objective of high-quality understandable financial reporting proportionate to the size and complexity of the entity and users' information needs - applying generally, an IFRS-based solution (unless this does not meet the over-riding objective).

However, a particular challenge in this periodic review is whether to and, if so, how to introduce requirements based on IFRS 9 *Financial Instruments*, IFRS 15 *Revenue from Contracts with Customers* and IFRS 16 *Leases* into UK GAAP, given that these IFRS Accounting Standards are more complex and include far more technical language than some older IFRS Accounting Standards. In achieving its objective for financial reporting, the FRC needs to consider the context that FRS 102 is applied by a wide range of entities, including financial services entities and some entities with complex revenue recognition or large numbers of leases - but, predominantly, reporters have less complex business models and transactions. This provides a challenge for the FRC to ensure that there is not an undue cost burden introduced which outweighs the benefits of improved accounting. In that context, we agree with the FRC's deferral of a conclusion as to whether to align FRS 102 with the expected credit loss (ECL) model of financial impairment set out in IFRS 9 and agree that any proposals should be set out in a later FRED. We believe that it is important that the FRC continue its outreach with users and preparers in determining the appropriate way forward. However, at a minimum, we believe that banks, building societies and certain other financial institutions should be in scope. There may be merit in considering earlier implementation of an ECL model (even under a simplified approach) for such entities, considering the superiority of an expected credit loss model compared to an incurred losses one, as recent crises have demonstrated (e.g. Covid).

Revenue recognition

We support the introduction of the new revenue requirements into FRS 102. Given that FRS 102 is applied by a wide range of entities, including some Public Interest Entities (under the proposed new definition[1]) and entities with more complex revenue recognition, we believe it is appropriate to bring IFRS 15's principles into UK GAAP, notwithstanding the resulting costs of transitioning to the new revenue recognition requirements. We do recommend some changes to the proposals in revised Section 23 *Revenue*. In many cases, these are to align the wording more closely with IFRS 15 in order to avoid inadvertent differences of interpretation.

Leases

We question whether the proposed revised Section 20 *Leases* will have a proportionate benefit for all FRS 102 reporters and users of their financial statements. We have concerns regarding the complexity and costs of aligning the lease accounting model with IFRS 16, even with the simplifications permitted. Indeed, in our view, the number of optional simplifications permitted risks undermining one of the stated benefits of reflecting IFRS 16 in FRS 102 – being improved comparability across entities applying FRS 102. Our experience from IFRS 16 implementation projects is that the required lease-by-lease analysis can result in significant cost and effort for many entities. Moreover, technical questions on lease accounting (e.g., substitution rights) which address important areas of principle with the potential for wide application continue to be addressed by the IFRS Interpretations Committee (IFRIC) and the IASB. We consider it important that there is a compelling case that the benefits to users exceed the costs to preparers before introducing new requirements. If this is not the case, this might run contrary to general public policy desires to promote competitiveness and growth, and the attractiveness of investing in the UK. We would encourage the FRC to outreach to preparers and users to understand what information is important (and a better understanding of the costs involved to preparers in transitioning to and maintaining an 'on balance sheet lease model').

Consequently, we believe that now is still too early to implement a mandatory IFRS 16-based solution into UK GAAP. An alternative approach which the FRC might consider would be to allow an option for preparers to apply IFRS 16, similar to the option to apply IFRS 9 in Sections 11 and 12 of FRS 102, and for extant Section 20 (i.e., off-balance sheet accounting model for operating leases) to remain. However, should the FRC decide to proceed with the leasing proposals in revised Section 20, we do recommend some changes to the proposed requirements, in particular in relation to certain of the new "optional simplifications" and highlight areas where additional guidance may be useful.

FRS 103 Insurance Contracts

We do not agree with the proposed changes to paragraphs IG2.4-6A of the Implementation Guidance to FRS 103. These proposals try and align revenue recognition for insurance contracts to the proposed revised Section 23 of FRS 102. Instead of these changes, we believe the FRC should wait until it has completed its consideration of how to align FRS 103 with IFRS 17 *Insurance Contracts* (as discussed in A20 of the Basis for Conclusions of FRED 82). The FRC will then be able to review the standard in a complete and cohesive way rather than making piecemeal changes. We believe the proposed changes will lead insurers to change existing accounting practice to a basis which is inconsistent with either previous accounting practice under IFRS 4 *Insurance Contracts* or IFRS 17 and will have unintended consequences.

Deferral of effective date of revised FRS 102 and additional guidance to support implementation

[1] '*Restoring trust in audit and corporate governance - Government response to the consultation on strengthening the UK's audit, corporate reporting and corporate governance systems*, Department for Business, Energy & Industrial Strategy, May 2022. Restoring trust in audit and corporate governance: government response to consultation on strengthening the UK's audit, corporate reporting and corporate governance systems (publishing.service.gov.uk)

Our experience from IFRS 15 and IFRS 16 implementation projects is that the required contract-by-contract or lease-by-lease analysis, in particular, results in significant cost and effort. Therefore, it is important that entities have sufficient time to properly implement the proposed requirements for revenue recognition and leases (should the FRC proceed with the new model). We have significant concerns over the proposed implementation date. We believe this could be challenging for some entities and do not support an initial application date earlier than 1 January 2026. We note that IFRS reporters had a lengthy period to implement IFRS 15 and IFRS 16. We consider that there needs to be at least 2 years between publication of a final standard and the initial application date of the revised standards.

We would encourage Staff educational guidance to support the implementation of the new proposals, particularly the new requirements for revenue recognition and leases (should the FRC proceed with the proposed model). In some cases, additional examples and guidance in the new sections may be helpful.

Status of IFRS Interpretations Committee ('IFRIC') discussions

The proposed revisions to Section 20 and Section 23 are closely based on IFRS 15 and IFRS 16; much of the language is identical, even if there is less detailed guidance. Accordingly, we consider that the FRC should monitor and assess how FRS 102 will be impacted by future IFRIC agenda decisions on a timely basis (and any resulting impact of Post-implementation Reviews of these IFRS Accounting Standards). An increasingly frequent question is whether IFRIC agenda decisions should be applied in UK GAAP, especially when IFRS Accounting Standards and FRS 102 use similar wording. While there is no direct read-across within FRS 102, a preparer must ensure any policy applied results in relevant and reliable information. Accordingly, there is a concern over whether preparers need to continually monitor developments in IFRS Accounting Standards and can sustain different accounting treatments when, for example, an IFRIC agenda decision determines a particular view (especially where the requirements in FRS 102 and IFRS accounting standards are identical or near-identical). See, for example, our comments on 'cloud computing' in the response to Question 2.

If you have any matters arising concerning the content of our response, please contact me on [redacted].

Yours faithfully

[redacted]

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Question 1: Disclosure
Do you have any comments on the proposed 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?

Generally, the level of disclosure in FRS 102, including the amendments proposed in FRED 82, appears appropriate.

We comment on the disclosures proposed for revised Sections 20 and 23, i.e., the main areas of change, in our responses to Questions 6 and 7. Our principal other comments relate to the disclosures proposed for small entity financial statements.

<u>Small entity financial statements disclosures</u>

In relation to Section 1A *Small Entities*, we agree with the emphasis on the requirement for small entity financial statements to give a true and fair view which may necessitate inclusion of additional disclosures beyond those specifically mandated. However, for UK small entities, a number of new disclosures have been added to Appendix C as required disclosures, if material.

The FRC has not set out a clear rationale for how it has determined these specific disclosures are to be required for UK small entities (although the added disclosures appear focused on providing more information on some commitments not reflected in the balance sheet). We believe that there should be a rationale provided as to why these particular disclosures are considered material and relevant to small entities.

We concur with the disclosures that were previously in Appendix E being mandated, but we are not convinced that all the new disclosures are proportionate for small entities.

Share-based payment (new paragraph 1AC.31C) – In our experience, small entities provide share-based payments, and it is appropriate that disclosures proportionate to this size of entity are given. We support disclosure of the share-based payment expense and any liability for cash-settled schemes (FRS 102.26.23) but question the need for a full roll-forward of share options required by FRS 102.26.18(b). It is relevant to understand the extent of share-based payment plans but this could be understood if the outstanding number of options and weighted average exercise price (with comparatives) were given.

Deferred tax (new paragraph 1AC.36A) – We question the need for the deferred tax disclosures set out in paragraphs 29.27(c), (e) and (f), particularly given that current tax is not required to be disclosed. The selection of these disclosures looks a piecemeal approach to which tax disclosures are important for small entities. (More generally, we question the relevance to FRS 102 reporters of the information required by paragraph 29.27(c), which is a disclosure not included in IFRS Accounting Standards, given the additional cost to derive the information required.)

Provisions (new paragraph 1AC.31B) – We question the need for small entities to give *all* the disclosures on provisions and contingent liabilities in FRS 102.21.17, where the seriously prejudicial disclosure is taken. Certain of these disclosures are not required by IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* but relate to minimum company law disclosures for large and medium-sized companies (but not small companies). It is hard to see why further disclosures beyond the minimum disclosures required by IAS 37.92 (i.e., the general nature of the dispute, together with the fact that, and reason why, the information has not been disclosed) might be necessary for small entity financial statements to give a true and fair view.

Related party disclosures (paragraph 1AC.35) – We found the drafting of paragraph 1AC.35 on related party disclosures unclear as to whether fuller disclosures are to be required (at a minimum) for the limited categories of related parties specified by company law applicable to small entities (as in current Section 1A) or are to be required for *all* related parties. It would be useful if this could be clarified.

However, we would support the inclusion of disclosures on the maturity of debt (including leases) for small entities. We note that disclosure of the maturity of leases is not currently required by the proposed revised Section 20 but believe this is a relevant disclosure that should be required for *all* FRS 102 reporters.

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?

Given the overriding objective to base FRS 102 on an IFRS-based solution, it makes sense to update Section 2 *Concepts and Pervasive Principles* to align with the 2018 Conceptual Framework as that will help comparability and understandability across the two GAAPs. This is important as Section 10 *Accounting Policies, Estimates and Errors* allows companies to refer to full IFRS Accounting Standards.

The 2018 Conceptual Framework sits outside IFRS Accounting Standards (unlike FRS 102) although it is referenced by IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* when an entity is developing an accounting policy which is not dealt with explicitly in IFRS Accounting Standards (similar to Section 10 of FRS 102). The 2018 Conceptual Framework provides guidance both to standard setters and to entities applying IFRS Accounting Standards when they need to refer to the Framework in order to develop an appropriate accounting policy. Under FRS 102, it is possible that the Framework may be referred to more often, as FRS 102 is less detailed than IFRS Accounting Standards.

We note below areas addressed in the IASB's Conceptual Framework where we believe further guidance would be helpful to include in revised Section 2:

Stewardship – We are concerned that the concept of stewardship has been downgraded, whereas we consider it remains a fundamental objective of corporate reporting. The information concerning the financial position, performance and cash flows set out in the financial statements helps users assess management's decisions over strategy, business model, and the management of risks as set out in the strategic report. Therefore, we believe stewardship should be included as a named concept in paragraph 2.5(b) rather than merely an 'also' final sentence in paragraph 2.7. This could be achieved by inserting "(management stewardship)" at the end of paragraph 2.5(b). We note that the concept of stewardship has more prominence in the IASB's Conceptual Framework as CF1.4 cross references to CF1.22 and CF1.23 where stewardship is explicitly discussed.

Accruals – This concept is also alluded to in paragraph 2.7 but not sufficiently explained nor named as such. We would expect the fundamental accounting concepts set out in company law – going concern, consistency (or comparability), prudence, accruals basis and offset – to be addressed clearly in the revised Section 2.

Materiality - In our view, the explanation of materiality as "an entity-specific aspect of relevance based on the nature or magnitude, or both, of the items to which the information relates in the context of an individual entity's financial report" (CF2.11) is a helpful summary and reminds preparers that a standard-setter cannot set a uniform quantitative threshold for materiality. We recommend this explanation is included in the definition of 'material' in paragraph 2.12.

Recognition of an asset – Paragraphs 2.59 and 2.60, as drafted, are contradictory because while paragraph 2.59 acknowledges there are some cases where an item meeting the definition of an 'asset', 'liability' or 'equity' is not recognised, paragraph 2.60 states that failure to recognise an item that meets the criteria cannot be rectified by additional disclosure. It may be necessary to include some guidance about instances in which it is appropriate to not recognise an asset, liability or equity meeting the criteria, taken from the IASB's Conceptual Framework, CF5.7-5.11 in order to make these two paragraphs consistent.

Recognition of a liability – paragraph 2.45 omits the guidance in CF4.38 that a liability might not be recognised if the probability of transfer of an economic resource is low. While Section 21 *Provisions and Contingencies* uses the term 'liability' in a different way to the proposed revised Section 2, this underpins why contingent liabilities might not be recognised and we consider this guidance should be added.

Substance of contractual rights – we are unclear why there is no guidance included in proposed revised Section 2 based on CF4.59-4.62 in the IASB's Conceptual Framework.

Question 2: Concepts and pervasive principles
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?

We agree that the extant definitions of an 'asset' and 'liability' should continue to be used in Section 18 *Intangible assets other than Goodwill* and Section 21 respectively, given that this provides consistency with IFRS Accounting Standards. The FRS 102 Glossary entries for 'intangible assets' and 'provisions' (which are unchanged in FRED 82) reference the 'asset' and 'liability' definitions in the Glossary (which are changed in FRED 82) and, therefore, may need to be amended for consistency with paragraphs 18.4A and 21.4A. Alternatively, it may be appropriate to amend the Glossary definitions of an 'asset' and 'liability' to add a rider that certain sections of FRS 102 have their own definitions of an 'asset' and 'liability'.

Paragraph 22.3 also overrides the definition of a 'liability' in proposed revised Section 2 and refers to "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*" [emphasis added]. This potentially introduces an inconsistency with paragraph 22.1(a) - which uses the Glossary definition of a 'liability' (the latter is consistent with proposed revised Section 2) in connection with the scope of Section 22 *Liabilities and Equity* - and with the Glossary definition of a 'financial liability' (as this references the Glossary definition of a 'liability'). Moreover, it is not clear that all financial liabilities would meet the criteria in paragraph 22.3 (as amended by FRED 82) that "the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits". There is no such modification made in IAS 32 *Financial Instruments: Presentation* and this amendment might be best deleted.

Question 2: Concepts and pervasive principles
Do you have any other comments on the proposed revised Section 2?

Company law context

While Appendix III *Note on legal requirements* (and Appendix IV *Republic of Ireland legal references*) to FRS 102 address many of these issues, company law constrains accounting for certain entities. For example, paragraph 2.104 states that "Therefore, all income and expenses are, in principle, included in that statement. Items of income or expense are presented in other comprehensive income only when explicitly permitted or required by this FRS" but does not mention the existence of company law restrictions over *when* an unrealised profit can be presented in profit or loss. FRS 102.5.8 acknowledges "An entity shall recognise all items of income or expense in a period in profit or loss unless an FRS requires or permits otherwise, or unless prohibited by the Act" and so there is no conflict with paragraph 2.104, but it would be appropriate to include the "or unless prohibited by the Act" within revised Section 2. The Companies Act 2006 may also restrict the choice of measurement basis (for example, the use of fair value for financial instruments). It would be helpful if revised Section 2 acknowledged such company law constraints in appropriate places, or even referred to this point in a preamble to the section.

Potential changes to practice

The part of proposed revised Section 2 that is likely to have most impact in practice is the section on 'the elements of financial statements' as this addresses the definitions of an 'asset', 'liability' and 'equity' as well as new guidance in paragraph 2.41 on 'control' in the context of the definition of an 'asset' (which is similar to concepts expressed in IFRS 15, IFRS 16 and IAS 38, but further from 'risks and rewards' which may have been used in the past). We believe this new guidance may have potential to impact some existing UK GAAP practices where there is limited guidance within the current version of FRS 102 (for example, 'cloud computing'). In our view, the additional guidance on 'control' is aligned with that in the IASB's Conceptual Framework (CF4.19-21). While there is no change to the guidance on 'control' in Section 18 of FRS 102 (IAS 38 contains specific guidance) this is likely to make it more difficult to reach a different conclusion on the accounting for customisation and configuration costs compared to the IFRIC agenda decision. The significance of this change to Section 2 may not be obvious from the main sections of FRS 102, so this may be an area to draw attention to preparers in the Basis of Conclusions accompanying a revised standard and any Staff educational guidance (or similar) issued to assist preparers and users of FRS 102, once revised.

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?

We are supportive of the proposal to align FRS 102 with the definition and guidance in IFRS 13 *Fair Value Measurement*, reflecting current valuation practices. However, we note that in simplifying the requirements in IFRS 13 for FRS 102, IFRS 13's guidance on the application of fair value measurement to liabilities and an entity's own equity instruments has been excluded from the proposals. Whilst the definition of 'fair value' (the transfer notion for the fair value of a liability) in paragraph 2A.2 implies that 'own credit risk' is included within the fair value of an entity's own liability (and this implication would be familiar to those familiar with IFRS 13), there would be benefit in an explicit statement that both 'own credit risk' and 'non-performance risk' are included within the new fair value definition. We consider the appropriateness of including ‘own credit risk’ in the fair value of liabilities later in the response to this question. It would also be useful to address the fair value of a demand liability (similar to IFRS 13).

In addition, whilst the proposals acknowledge that the best evidence of fair value is an unadjusted quoted price in an active market (paragraph 2A.13) the proposals do not include the additional guidance contained in IFRS 13 that the fair value of a portfolio of financial instruments is the product of the number of units of the instrument and its quoted market price (P x Q). Divergence may arise in practice if some entities interpret the lack of guidance in Section 2A to mean that P X Q is not required in all circumstances.

Paragraph 2A.9 introduces the concept of ‘highest and best use’ without providing a definition of the term within FRS 102. The definition of ‘highest and best use’ should be provided and examples included of how the principle might be applied in practice to common non-financial assets, for example, real estate. Indeed, in general, there are no illustrative examples in Section 2A. In addition, paragraph 2A.12 requires the ‘valuation premise’ to be considered when determining fair value with no further guidance. An explanation of the concept of the ‘valuation premise’ should be added to the section explaining how it affects fair value measurement.

While we believe that new Section 2A is generally appropriate and proportionate, additional staff educational guidance with examples illustrating the concepts would be beneficial.

<u>Other comments</u>

The Companies Act 2006 requires that the fair value accounting rules may only be applied where there are reliable fair values. We, therefore, agree that it is important to have guidance on this area. Our understanding is that paragraph 2A.16 sets out when a specific valuation technique would be expected to give a reliable measure of fair value, and paragraph 2A.18 sets out when a fair value selected from a range of valuations can be considered a reliable fair value.

Paragraph 2A.16(b) proposes that a valuation technique would arrive at a reliable measure of fair value if the inputs to the valuation technique “are reasonable". We suggest that this is expanded in line with paragraph 12.18 of the IFRS for SMEs Exposure Draft to explain that the inputs to the valuation technique "reasonably represent market expectations and measures of the risk return factors inherent in the asset".

Paragraph 2A.19 proposes an exception to measuring an item at fair value if the “*variability in* the range of reasonable fair value measures is significant and the probabilities of the various measures within the range cannot be assessed” [emphasis added]. While we recognise that the reference to “variability in the range” is the corollary of the requirement in paragraph 2A.18 which explains when a fair value of an asset selected from a range of reasonable fair value measures is reliable, paragraph 2A.5 of the current version of FRS 102 (and its equivalents in the IFRS for SMEs, paragraph 11.31 and in the IFRS for SMEs Exposure Draft, paragraph 12.20) omit the italicised words. We, therefore, consider that the meaning of “variability in the range of reasonable fair value measures” is open to interpretation and should be clarified. For example, is this phrase meant to refer to situations where the range of reasonable fair value measures is significant or does it take into account the variability (or distribution) of those reasonable fair value measures (e.g., whether most reasonable fair values are clustered in a narrow range or widely dispersed)?
Although paragraphs 2A.16-2A.20 are derived from the existing Appendix 2A to FRS 102 (and are broadly consistent with the text in the current version of the IFRS for SMEs and the IFRS for SMEs Exposure Draft), some parts of paragraph 2A.5 in existing FRS 102 which caution that reliable fair values might be available, have been omitted. We believe these words should be reinstated otherwise this might imply the bar for establishing reliable fair values has lowered.

We have considered the appropriateness of the inclusion of ‘own credit risk’ in the fair value of liabilities. In practice for corporates (other than banking and insurance entities), fair value measurement of liabilities is most likely to involve derivative liabilities. While including ‘own credit risk’ may require some entities to make specific adjustments, where material, which could necessitate additional cost for FRS 102 reporters, this does seem to be appropriate and reflects symmetry between the valuations of assets and liabilities.

Due to company law restrictions (set out in paragraph 36 of Schedule 1 to *The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008* (‘the Regulations’) and its equivalents), a liability (other than a derivative) may only be fair valued if this would be permitted by IFRS 9, i.e., because it eliminates or reduces an accounting mismatch or due to fair value management or where the instrument includes a non-closely related embedded derivative that is not separated. The fair value accounting rules, however, require *all* fair value movements on liabilities to be recognised in profit or loss whereas IFRS 9 generally requires fair value movement on financial instruments designated at fair value attributable to ‘own credit risk’ to be presented in other comprehensive income. This would not include derivatives as these are required to be at fair value through profit or loss.

Where FRS 102 reporters apply IFRS 9 as a policy choice for the recognition and measurement of financial instruments, we would expect that a ‘true and fair override’ must be applied, consistent with the existing position under FRS 101.A2.7F (and if this is also the FRC’s view, we believe this should be clarified in Appendices III and IV of the revised standard). However, we support the default accounting treatment that all fair value movements are recognised in profit or loss where Sections 11 and 12 or IAS 39 are applied. (We would question whether the presentation of fair value movements attributable to ‘own credit risk’ in other comprehensive income meets the criteria for a ‘true and fair override’ as well as adding further complexity). While we recognise that there is a tension with the use of a ‘true and fair override’ if IFRS 9 is applied, there are already similar precedents, e.g., a ‘true and fair override’ is applied as goodwill is not amortised under FRS 101 (aligning with IFRS accounting), but goodwill amortisation is mandated under FRS 102 (consistent with the requirements of company law).

Question 3: Fair value
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?

Yes, we agree. However, we note that FRS 102.26.11 currently states the “weighted average share price” is used as an input for an option pricing model. We believe that the reference should be to “the current price of the underlying shares” instead to ensure consistency with IFRS 2.B6(c).

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 agree with the FRC's deferral of a conclusion as to whether to align FRS 102 with the expected credit loss (ECL) model of financial impairment set out in IFRS 9 and agree that any proposals should be set out in a later FRED. We acknowledge that recognising impairment based on ECLs is superior conceptually to an incurred loss model. However, for many FRS 102 reporters, the resulting costs and complexity may not be justified particularly where any ECL is likely to be immaterial. In other cases, however, it may be material and relevant to calculate impairment using ECLs.

We are not convinced by the IASB's proposals in IASB/ED/2022/1. EY Global's response stated that "We do not agree with the proposal to introduce an expected credit loss (ECL) model into the Standard for certain financial assets, as set out in paragraph 11.26A. In our view, the mandating of the ECL model (albeit the simplified model) for some financial assets imposes a workload on SMEs disproportionate to the benefit to users of their financial statements, especially as there are inherent complexities in the simplified approach of the ECL model".

For many entities that have short-term trade receivables and contract assets, there may not be material differences between the provisions that were calculated in practice on an incurred loss basis to those calculated using ECLs. There may be limited cost-benefit in forcing such entities to recognise ECLs. We further note that intra-group lending would fall within the IASB's proposed ECL model. There may also be limited cost-benefit in calculating ECLs on intra-group loans particularly where such loans are quasi-equity in nature. The application of ECLs to such loans, which are sometimes poorly documented or where the documentation does not reflect the substance of the arrangement, is commonly an area of challenge. However, in other cases, intra-group loans are more substantive in nature. Therefore, particular care would be needed in terms of determining which categories of financial assets should be subject to the ECL model if such a hybrid approach is used. In general, we recognise that any hybrid approach involves compromises and could add complexity. Such an approach would ultimately be justified on pragmatic cost-benefit grounds rather than on the basis of principles.

Compared to the scope of the IFRS for SMEs, FRS 102 reporters span a wide range of entities. The recognition and measurement of ECLs might be particularly relevant to banks, building societies and certain other financial institutions. We, therefore, understand the FRC's preliminary view that it may be appropriate for certain scope of entities to recognise and measure ECLs. If this route was used, we agree that this scope of entities is not the same as the current list of financial institutions, for example, some financial institutions (such as investment trusts) hold assets at fair value, and others may not be subject to significant credit risk. At a minimum, we agree that banks, building societies and certain other financial institutions should be in scope. There may be merit in considering earlier implementation of an ECL model (even under a simplified approach) for such entities.

Any criteria for an alternative scope of entities that must apply ECLs would need to be carefully described. There is anecdotal evidence that the current definition of a financial institution already gives rise to some structuring to avoid being caught by the requirements for these types of entity. A binary decision of being in or out of ECL by entity type could have a significant impact on the amount of impairment recognised and be an incentive for further structuring. This option would be easier to evaluate in the context of some specific proposals from the FRC. However, we believe that if this route were to be applied, it would be appropriate for FRS 102 to provide even for a simplified version of ECLs rather than forcing this population of entities to apply IFRS 9, with its attendant complexity. For those entities that wish to apply IFRS 9 to the recognition and measurement of financial instruments, that option is already available.

As noted above, there are difficulties in determining how ECLs might best be introduced and most approaches are likely to have their drawbacks. Accordingly, we have mixed views within the UK firm on this matter.

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?

We agree with the proposal to prevent an entity from newly adopting IAS 39.

We have reviewed the version of IAS 39 on the FRC website. [2017-01-IAS-39-Blue-book_CR.pdf (frc.org.uk)](2017-01-IAS-39-Blue-book_CR.pdf). FRS 102.11.2 explains that where an entity chooses IAS 39 or IFRS 9, it applies the scope of the relevant standard to its financial instruments. For both IAS 39 and IFRS 9, this requires a degree of interpretation, because the scope paragraphs cross refer to other IFRS Accounting Standards (and presumably the intention (and practice) is to scope out the equivalent sections within FRS 102, although this is not clearly explained). However, IAS 39 is silent in respect of covering impairment considerations for contract assets and its scope exclusions in respect of leases are based on IAS 17 *Leases*, which is a different model to proposed revised Section 20. It would be appropriate to include clearer guidance on how the scope paragraphs in IFRS 9 and IAS 39 should be interpreted in general, and, in particular, to clarify that contract assets are assessed for impairment under IAS 39 and that the derecognition of lease liabilities is addressed by IAS 39.

Question 5: Other financial instruments issues
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 do not believe these amendments should be removed in the version of FRS 102 to be issued following this FRED. We understand that USD LIBOR is currently expected to continue in synthetic form until September 2024, which will be within the comparative period if the revised FRS 102 is first applied for periods beginning on or after 1 January 2025. Prior to removing the existing guidance on IBOR reform, the FRC would need to be clear that all reforms had occurred by the beginning of the comparative period when the revised FRS 102 first becomes effective.

In time, we believe the Phase 1 amendments will run their course and could be safely removed. This is less clear however with the Phase 2 amendments since these explain how, for example, to measure a cash flow hedge reserve on transition to a new interest rate benchmark. The removal of the IBOR reform guidance would need to have prospective effect to avoid having to undo the benefits applied by the reform guidance.

The FRC may wish to monitor the IASB's own deliberations, if any, on when these amendments have served their purpose. We note that retaining the amendments will do no harm.

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?

As noted in the covering letter, we question whether the proposed revised Section 20 - requiring mandatory application of the on-balance sheet lease accounting model from IFRS 16 - will have a proportionate benefit for all FRS 102 reporters and users of their financial statements. We have some concerns regarding the complexity and costs of aligning the lease accounting model with IFRS 16, even with the simplifications permitted. Our experience from IFRS 16 implementation projects is that the required lease-by-lease analysis can result in significant cost and effort for many entities. Moreover, in our view, the number of optional simplifications permitted risks undermining one of the stated benefits of reflecting IFRS 16 in FRS 102 – being improved comparability across entities applying FRS 102 (paragraph B20.4 of FRED 82). We consider that the costs and efforts that would be required by many FRS 102 reporters to apply an aligned Section 20 at the current stage of IFRS 16's life cycle may not be justified by benefit to users. We consider that the current disclosure requirements of Section 20 are detailed and transparent for a user to understand the nature of an entity's lease arrangements and the rights and obligations arising from these arrangements. However, if proposals to reflect IFRS 16 are deferred to the next periodic review, the FRC may wish to provide additional guidance over the preparation of the operating lease commitments disclosure and supplementary disclosures concerning break clauses and indexation of rentals. We would encourage the FRC to outreach to preparers and users to understand what information is important.

We note also that:

- Since implementation of IFRS 16, there have been many IFRIC discussions and agenda decisions related to implementation issues. There is a concern over whether FRS 102 reporters would be expected to reflect IFRIC agenda decisions that apply to areas where IFRS 16 and FRS 102 have identical or very similar wording. In our view, we do not believe that it would be reasonable to expect an FRS 102 reporter to monitor IFRIC discussions or agenda decisions.

- The IASB decided not to align IFRS for SMEs with IFRS 16 due to cost-benefit considerations, and took the decision to wait in order to obtain more information on entities' experience of applying IFRS 16. In our experience, many implementation issues are still arising on IFRS 16, for example determining the impact of substitution rights on the assessment of whether a contract contains a lease (IFRIC agenda decision finalised in April 2023). We would support the FRC taking a similar approach to the IASB, and considering amending FRS 102 to align with IFRS 16 during a future review of the standard, once the IFRS 16 Post-implementation Review has been completed.

- We are unclear on the accounting principles supporting many of the optional simplifications (as further explained below), which appear to be rule-based, rather than principles-based.

- An alternative approach to the mandatory adoption of a modified IFRS 16 model would be to allow an option for preparers to apply IFRS 16, similar to the option to apply IFRS 9 in Sections 11 and 12 of FRS 102, and for extant Section 20 (i.e., off-balance sheet accounting model for operating leases) to remain. For those entities that choose to apply IFRS 16, we would support the disclosure exemptions provided in FRS 101 being incorporated into paragraph 1.12 of FRS 102. This approach would provide the flexibility to allow entities to apply IFRS 16 should they wish to do so, whilst avoiding significant cost and effort for entities that do not wish to apply IFRS 16. It would also avoid the diversity introduced by the number of optional simplifications proposed in FRED 82.

Comments on simplifications introduced into Section 20

Should the FRC proceed with the alignment of Section 20 to the principles of IFRS 16, we set out below some specific points for the FRCs consideration:

- *Initial measurement of the lease liability (paragraph 20.52)* – We welcome the simplifications proposed to make it easier for a lessee to determine a discount rate. However, we believe that it is unclear in what circumstances the lessee's incremental borrowing rate or obtainable borrowing rate would not be readily obtainable. Paragraph 20.52 notes that this would be the case only in exceptional circumstances, but it is unclear how this is intended to be interpreted in practice. We believe that this is an area where additional guidance would be beneficial.

- *Lease modifications (paragraph 20.78)* - We believe that the optional simplification for lease modifications may be difficult to interpret and judgemental to apply in practice. Judgement may be required to determine whether a decrease in consideration for a lease is commensurate with the stand-alone price for the decrease in scope (paragraph 20.78(b)). Further, it is unclear what is meant by the term 'incidental' in paragraph 20.78(a) as this term is not defined.

  In light of the simplifications proposed to make it easier for a lessee to determine a discount rate, we question the necessity of the simplification regarding the circumstances in which a revised discount is required in accounting for a lease modification. We note also that the optional simplification will reduce comparability with IFRS 16 reporters, and between FRS 102 reporters.

- *Reassessment of the lease liability (paragraph 20.72)* – Paragraph 20.72 permits a lessee to remeasure the lease liability using an unchanged discount rate when there is a change in the lease term or a change in the assessment of an option to purchase the underlying asset if the value of each lease payment for the remainder of the lease term is unaffected by the change in the lease term. We believe that the meaning of 'value' in this context may be unclear. For example, whether it is intended to mean absolute value or present value. We suggest the FRC consider whether the word 'amount' may be clearer than 'value'.

  In addition, we believe that this optional simplification may give rise to application questions, for example with regards to scenarios that have similar economic impacts. Consider a 2-year lease with lease payments of £100 per month. If the lease term was extended by 6 months, with lease payments remaining at £100 per month, we understand that paragraph 20.72 would permit the use of an unchanged discount rate. However, if the lease was extended by 6 months and the payment terms changed to £300 per quarter, we believe that paragraph 20.72 would require the use of a revised discount rate, although the total lease payments are the same in both cases. If our understanding is incorrect then some additional guidance may be beneficial.

  In light of the simplifications proposed to make it easier for a lessee to determine a discount rate, we question the necessity of the simplification regarding the circumstances in which a revised discount is required when there is a change in the lease term or a change in the assessment of an option to purchase the underlying asset. We note also that the optional simplification will reduce comparability with IFRS 16 reporters, and between FRS 102 reporters.

- *Practical expedients to account for contracts containing multiple lease components as a single lease when a single lease component is at least half of the total lease consideration (paragraph 20.34)* – It is unclear how depreciation of the right-of-use asset is impacted if the simplification is used when each component has a different useful life. Paragraph 20.62 requires that depreciation guidance in Section 17 *Property, Plant and Equipment* is applied. FRS 102.17.16 requires that if components of an item of property, plant and equipment have significantly different patterns of consumption of economic benefits, each major component should be depreciated separately over its useful life.

  In addition, it is unclear how the practical expedient would be applied if the lease components are split 50:50. We suggest the expedient is removed, or the threshold to apply the expedient is increased, e.g., to at least 90% of the total consideration. This threshold would be consistent with the '90% test' often used in practice by FRS 102 reporters in assessing whether the present value of lease payments is considered 'substantial' to the fair value of the leased asset when classifying a lease as a finance lease. It would also reduce the likelihood of a material impact when applying the optional simplification.

- *Optional simplification on sale and leaseback accounting (paragraph 20.128)* – We welcome the optional simplification. If the transaction is at fair value, we would support deferral of a gain. However, it is unclear what accounting principles would support deferral of a loss where the transaction is at fair value, and we would find it helpful for the rationale to be clarified or this accounting to be revisited.

  In addition, we believe that it would be helpful for the FRC to clarify how they would expect a sale and leaseback transaction with variable lease payments to be accounted for. Would the FRC expect the IFRS 16 amendment *Lease Liability in a Sale and Leaseback* issued in September 2022 to be applied?

- *Optional simplification on accounting for changes in variable lease payments resulting from a change in an index or a rate (paragraph 20.74)* - We do not support this optional simplification. It would reduce comparability between FRS 102 reporters and IFRS 16 reporters and we believe it is not consistent with the principle of recognising lease liabilities on-balance sheet. For entities with long leases subject to market rent reviews, use of the optional simplification could result in the recognition of a lease liability that does not reflect the commercial reality of an entity's obligation.

- *Transfer of a lease to another entity that is included in the same consolidated financial statements (paragraph 20.80)* - It is not clear what principles in accounting support the optional simplification in paragraph 20.80. We believe that the usual requirements of Section 20 should be applied to such transactions. We do not believe FRS 102 allows similar simplifications when entities transfer other assets and liabilities between group entities.

- *Low value asset exemption (paragraphs 20.9-14)* - We believe that it may be more judgemental to determine the value of an underlying asset at the start of the lease than when new (as required by IFRS 16), and no quantitative indication is given as to what is meant by low value. Paragraph 20.13 notes that judgement will be required for certain types of assets, but it is unclear how that judgement should be made if no indicative value is provided. This may lead to inconsistency in application and lack of comparability. Therefore, we believe the assessment of 'low value' should be made at the start of the lease based on the asset value when new, with a threshold provided for those assets where judgement is required.

- *In substance fixed lease payments (paragraph 20.55)* - It is unclear why paragraph 20.55 does not include the example of in-substance fixed lease payments in IFRS 16.B42(a)(ii) - "payments that are initially structured as variable lease payments linked to the use of the underlying asset but for which the variability will be resolved at some point after the commencement date so that the payments become fixed for the remainder of the lease term". In practice, the variability in lease payments could be resolved shortly after lease commencement. We believe that an example consistent with IFRS 16.B42(a)(ii) should be included otherwise it could result in recognised lease liabilities not reflecting the full known amount of the lessee obligations.

- *Dilapidations provisions (paragraphs 20.51, and 20.60-61)* – We believe that the proposed wording of paragraphs 20.51 and 20.60 could result in all changes to the estimated costs expected to be incurred in restoring an underlying asset being recognised as part of the cost of the right-of-use asset. We believe that this may not always be appropriate. For example, the cost of removing leasehold improvements may instead be recognised as part of the cost of property, plant and equipment in accordance with FRS 102.17.10. We suggest:
  - Paragraph 20.60(c) should cross refer to paragraph 20.50(d) instead of paragraph 20.61;
  - Paragraph 20.61 (and the cross reference to it in paragraph 20.50(d)) could then be removed.

- *Leases that become onerous before lease commencement* – Applying paragraph 20.84, a lessee would recognise an onerous lease provision only for low value or short-term leases. Under IFRS Accounting Standards, IAS 37.5(c) is clear that onerous lease provisions should be recognised for leases that become onerous before lease commencement. This requirement appears to be missing from FRED 82.

In addition, we have noted in the Appendix some further drafting points for consideration.

Question 6: Leases
Have you identified any further simplifications or additional guidance that you consider would be necessary or beneficial?

As noted above, we question whether the proposed revised Section 20 will have a proportionate benefit to all FRS 102 reporters and users of their financial statements at this current time. However, should the FRC decide to proceed with the alignment, as noted in our response to the first part of Question 6 above, we believe that additional guidance on the following areas would be beneficial:

- Further guidance on, and / or examples of, exceptional circumstances in which a lessee's incremental borrowing rate or obtainable borrowing rate is not readily determinable.

- Guidance on how entities should account for a sale and leaseback transaction containing variable lease payments.

- Guidance on recognition of onerous lease provisions for leases that become onerous before lease commencement.

- We believe that the wording in IFRS 16.B42(a)(ii) ("payments that are initially structured as variable lease payments linked to the use of the underlying asset but for which the variability will be resolved at some point after the commencement date so that the payments become fixed for the remainder of the lease term") should be added to paragraph 20.55.
- Guidance on lessor lease classification particularly for any contractual changes in lease payments occurring between inception date and commencement date and for leases that

include land and buildings elements. Section 20 is silent on these while IFRS 16.B53-B57 contains guidance, which would be welcomed in revised Section 20.

- Additional guidance on presentation of the right-of-use asset when Part 1 General Rules and Formats of Schedule 1 to the Regulations are applied.

- The guidance on determining lease term (paragraphs 20.38-47) is similar, but not identical, to that in IFRS 16. We believe that it would be helpful for the FRC to provide some additional guidance on how the principles should be applied in practice, in particular with reference to UK specific issues, such as the impact of Security of Tenure rights under the Landlord and Tenant Act 1954.

  In addition, we believe that IFRS 16.B35 should be incorporated into the guidance on lease term – "If only a lessee has the right to terminate a lease, that right is considered to be an option to terminate the lease available to the lessee that an entity considers when determining the lease term. If only a lessor has the right to terminate a lease, the non-cancellable period of the lease includes the period covered by the option to terminate the lease."

  We believe that paragraph 20.40 should also make reference to an option to purchase the underlying asset, consistent with IFRS 16.B37. We note that paragraph 20.102g(d) makes reference to a purchase option and, in doing so, cross-refers to paragraphs 20.40-43.

- With the introduction of a number of optional simplifications and practical expedients available for a lessee, we would welcome a requirement for lessees to disclose which optional simplifications had been applied, in order to aid comparability.

- No guidance has been provided addressing lessee involvement with the underlying asset before commencement date. We believe that it would be helpful to preparers to include some guidance equivalent to IFRS 16.B43-B47.

- For entities that do not apply the optional simplification in paragraph 20.74, we believe that it may be helpful to provide additional guidance on when a lessee should recognise changes in lease payments arising from a rent review. In practice in the UK, the negotiations between the lessee and the lessor often take some time to complete and it may be helpful to provide educational guidance on the accounting required in such cases.

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?

As noted in the covering letter, we have responded on the amendments proposed to FRS 102, and not those proposed to FRS 105. However, we would question the proportionality of making changes to the revenue model in FRS 105 for micro-entities.
Given that FRS 102 is applied by a wide range of entities, including Public Interest Entities (under the proposed new definition) and entities with more complex revenue recognition, we believe it is

appropriate to bring in IFRS 15's principles into UK GAAP, notwithstanding the attendant costs of transitioning to the new revenue recognition requirements. Our experience from IFRS 15 implementation projects is that the required contract-by-contract analysis, in particular, results in significant cost and effort. Therefore, it is critical that entities have adequate time to properly implement the new requirements. In our view, this would not support an implementation date any earlier than periods beginning on or before 1 January 2026.

Given the closeness of the requirements in IFRS and the proposed revised Section 23, we believe that the FRC should monitor and assess how FRS 102 will be impacted by future IFRIC agenda decisions on a timely basis (and any resulting impact of the Post-implementation Review of IFRS 15). There is a concern over whether FRS 102 reporters would be expected to reflect IFRIC agenda decisions that apply to areas where IFRS 15 and FRS 102 have identical or very similar wording. In our view, we do not believe that it would be reasonable to expect an FRS 102 reporter to monitor IFRIC discussions or agenda decisions.

<u>FRS 103</u>

We do not agree with the proposed changes to paragraphs IG2.4-6A of the Implementation Guidance to FRS 103. These proposals try and align revenue recognition for insurance contracts to the proposed revised Section 23 of FRS 102. Contracts within the scope of FRS 103 are excluded from the scope of Section 23 so we do not believe it is correct to align revenue recognition in FRS 103 with Section 23. Further, the changes appear to be based on the mistaken assumption that 'written premiums' are revenue. This is not the case. 'Earned premiums' are equivalent to revenue in Section 23. Instead of these changes, we believe the FRC should wait until it has completed its consideration of how to align FRS 103 with IFRS 17 (as discussed in A20 of the Basis for Conclusions of FRED 82). The FRC will then be able to review the standard in a complete and cohesive way rather than making piecemeal changes. We believe the proposed changes will lead insurers to change existing accounting practice to a basis which is inconsistent with either previous accounting practice under IFRS 4 or IFRS 17 and will have unintended consequences.

Question 7: Revenue
Have you identified any further simplifications or additional guidance that you consider would be necessary or beneficial?

If the FRC propose to include a simplified revenue recognition model within revised Section 23, we have comments on the following areas:

- *Promise vs Performance Obligation*

Section 23 uses the term 'promise' rather than 'performance obligation'. We understand that this is intended to make the language accessible rather than implying different accounting since the term 'promise' is defined in a similar way to a performance obligation. However, Section 23 uses the word 'promise' both for distinct promises and for other promises in the contract. The word 'promise' is also used in IFRS 15 but in IFRS 15 there is a clear distinction between 'promise' and 'performance obligation', with the latter being either a distinct individual promise or a group of promises which is distinct. Thus, the use of 'performance obligation' helps in differentiating distinct promises from any other promises in a contract. The use of 'promise' instead of 'performance obligation' might also create confusion for preparers and users familiar with IFRS 15; we therefore consider that the terminology should be aligned.

- *Contract modifications*

Paragraph 23.15 does not require contract modifications to be accounted as separate contracts where certain criteria are met, but does permit this treatment. We prefer alignment with IFRS 15.20 which requires accounting for a contract modification as a separate contract where certain criteria are met (i.e., not optional). This supports the basic principle that accounting is done at contract level. For contract modifications resulting in additional distinct goods and services and a price reflecting the standalone selling price (SSP) of those additional goods and services, IFRS reporters will account for two separate contracts while preparers applying paragraph 23.14(a) will only have one contract to account for but using a blended price (prospective adjustment). This will result in differences in the amounts of revenue to be recognised in certain circumstances (e.g., where existing and new contracts have different contract periods). Moreover, accounting for a separate contract is easier in practice and better depicts the substance of a contract with distinct goods and services sold at their SSP.

Further, paragraph 23.13 does not include the guidance in IFRS 15.19 which states that contract modification may exist even if the price is not yet agreed, and thus, an entity will estimate the price following the variable consideration guidance, including constraining such estimates. This is important, particularly in the construction sector, and its inclusion would prevent differences in timing of accounting for modifications between IFRS 15 and proposed revised Section 23. Without its inclusion, preparers applying proposed revised Section 23 might be accounting for modifications later than those applying IFRS 15.

- *Customer options to acquire additional goods and services that provide a material right*

IFRS 15 does not provide bright lines on what is a 'material' right. However, paragraph 23.35 provides a means of avoiding accounting for a material right as a separate promise, if the right is not "significant to the accounting for the individual contract". Nevertheless, it still leaves room for judgement on what is considered 'significant', therefore, further guidance is needed to determine what it means by 'significant' to be able to apply the practical expedient in paragraph 23.35.

Further, paragraph 23.35 is explicit that it must be assessed on an individual contract basis. This would likely exclude material rights that accumulate, such as loyalty or reward programmes (per IFRS 15.B40). Under proposed revised Section 23, an entity might conclude that for each transaction/contract, the loyalty points provided to customer are not significant to that particular transaction/contract, but cumulatively, the points may be material. We therefore prefer revised Section 23 to align with IFRS 15 in this area.

- *Principal versus agent*

While intended to be simpler to apply, the requirements on principal versus agent are worded differently to IFRS 15 and mix some indicators of a principal (such as primary responsibility for fulfilment) with the base principle of obtaining control of a specified good or service (or right to a specified good or service) before that good or service is transferred to a customer.

We prefer alignment with IFRS 15 starting with the base principle of 'control' set out in IFRS 15.B35. This means that to be a principal, the entity should obtain control of specified good/service first before control of that good/service is transferred to a customer. For many entities where the transfer of control is clear, the assessment stops at this point; there is no need to consider the indicators. The three indicators in IFRS 15 are only used to support that base principle of control and we note that these indicators are only examples and not an exhaustive list. Paragraph 23.38 appears to change this such that two of the indicators under IFRS 15.B37 each become conclusive meaning that if any one of these are met, this will conclusively result in an entity acting as principal. Therefore, there is a risk that this may create confusion and differences in outcome compared to applying IFRS 15.

- *Variable consideration*

The guidance on variable consideration is worded differently. Paragraph 23.46 requires an entity to estimate the variable consideration and include it in the transaction price but "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." Under IFRS 15.56, an entity estimates the amount of variable consideration and includes it in the transaction price but "only to the extent that it is highly probable *that a significant reversal in the amount of cumulative revenue recognised will not occur* when the uncertainty associated with the variable consideration is subsequently resolved." [Emphasis added in quotations].

In our view, the amended wording in paragraph 23.46 can be read differently and may result in no variable consideration being recognised until the uncertainty is resolved (particularly if this is interpreted to require the entire variable amount to be assessed as highly probable to become due). Under IFRS 15, if the estimated variable consideration is not nil before applying constraints, an entity expects to recognise some amounts as revenue ahead of the resolution of the related uncertainty. This is because in applying IFRS 15's constraints to estimated variable consideration, it requires an entity to determine the minimum amount of that estimate that can be included in the transaction price provided that if reversed subsequently, that amount is considered not significant compared to cumulative revenue recognised. This will mean that amounts recognised as revenue and timing of revenue recognition related to variable consideration may be different under FRS 102 and IFRS 15. We would prefer the wording to be aligned with IFRS 15 and include relevant indicators of the likelihood and magnitude of revenue reversal.

We also note that paragraph 23.120 should be clear that in assessing amounts entitled to for breakage, the entity should consider the requirements on constraining estimates of variable consideration (similar to IFRS 15.B46). Otherwise, it is not clear how an entity will assess its entitlement to breakage revenue, and we may see significant reversals of revenue if estimates are not constrained.

- *Time value of money*

Unlike IFRS 15, there is no requirement to account for the time value of money for advance consideration (although as proposed revised Section 23 is silent, this would not be prohibited under the GAAP hierarchy). We support this as being proportionate on cost-benefit grounds but note that in the construction industry, some upfront payments received are in substance more in the nature of loans.

In contrast, per paragraphs 23.58 and 23.59, the consideration is adjusted for the time value of money where payment is deferred beyond normal business terms (and interest revenue is presented separately). However, an entity need not adjust the promised consideration if the entity expects, at contract inception, that the period between when the entity transfers the good or service and payment will be 6 months or less. IFRS 15 instead has a practical expedient for not recognising a significant financing component that must be disclosed where the period is 1 year or less. The Basis for Conclusions to FRED 82 states that this period of 6 months was chosen because this is considered to provide useful information and to cover customary trade terms. We believe it would be more cost-efficient to apply if it is aligned with IFRS 15 and permits entities not to adjust for the effects of time value of money if the period between when the entity transfers the good or service and payment will be 12 months or less. We also note an inconsistency of principle since Section 11 *Basic Financial Instruments* requires a non-interest bearing debt instrument which is payable or receivable within one year on normal business terms to be recorded at the undiscounted amount (FRS 102.11.14(a)(ii)).

We also note that IFRS 15.64, which provides guidance on determining the discount rate to use (i.e., the entity should use the discount rate that would be reflected in a separate financing transaction between the entity and its customer at contract inception), is not carried over to proposed revised Section 23. It would be helpful to include this guidance in the proposed revised Section 23.

- *Allocation of discounts and variable consideration*

Proposed revised Section 23 requires discounts and variable consideration to be allocated to all promises on a relative standalone selling price basis unless this basis does not depict the amount of consideration the entity expects in exchange for satisfying each promise in the contract, in which case a method reflecting such an amount is used (paragraphs 23.69-71). However, it is less specific than IFRS 15 as to the alternative methods. To maintain the rigour and discipline of a standalone selling price allocation, we recommend the introduction of a requirement to explain the basis of allocation used.

- *Promises satisfied over time*

The criteria for promises satisfied over time are not identically worded with IFRS 15.35, with which many preparers and users are familiar and which we believe should be used in the proposed revised Section 23.

As currently proposed, if any of the 4 criteria in paragraph 23.78 (compared to 3 criteria in IFRS 15.35) is met, revenue will be recognised over time. The new criterion added is in paragraph 23.78(b) where over time recognition is met if "the entity's work carried out to date would not need to be substantially reperformed if another entity were to fulfil the remainder of the promise to the customer (for example, a freight logistics contract)".

We consider that paragraphs 23.78(a) and 23.78(b) are effectively the same requirement, with paragraph 23.78(b) simply being an example of the application of paragraph 23.78(a) and we consider that it can only be understood and applied properly to qualify for over time recognition if paragraph 23.78(a) is also met. For example, a developer may have a performance obligation under IFRS 15 to build houses and will only transfer control upon completion. Note that part-built houses do not need to be reperformed if another developer is to take over and thus, this scenario strictly meets the criterion under paragraph 23.78(b). In this case, the developer will be required to record revenue over time, instead of at a point in time under IFRS 15. We therefore do not see much merit into identifying these as two separate criteria.

We also believe it is relevant to retain in the proposed revised Section 23 the guidance in IFRS 15.B4 (which has been included partly in paragraph 23.78(b)), as it explains how the criterion in paragraph 23.78(a) should be understood.

- *Repurchase agreements*

The guidance on customer put options is simplified compared to IFRS 15. It draws a distinction between whether it is *probable* the customer will exercise its right (paragraph 23.87E), rather than has a *significant economic incentive* to do so (IFRS 15.B70). If it is probable the customer will exercise its right, an entity accounts as a lease or financing arrangement depending on whether the repurchase price is lower or higher than the original selling price. This differs to IFRS 15.B73 and IFRS 15.B74 which set out further permutations depending on whether the repurchase price is higher or lower than the market value at exercise. To avoid the simplifications resulting in unintended consequences, we prefer alignment with IFRS 15.

Unlike IFRS 15.B64, paragraph 23.87A does not clarify whether the repurchased asset could be substantially the same as the asset sold or another asset of which the asset originally sold is a component. The proposed wording implies that the exact asset originally sold will have to come back in order to apply the repurchase guidance. This could create an accounting difference between IFRS 15 and proposed revised Section 23 and we believe it would be helpful to include the guidance on what a repurchased asset comprises from IFRS 15.B64.

- *Licensing*

To determine that granting of a licence is a promise to provide a right to access the entity's intellectual property (over time recognition of revenue), an IFRS reporter is required to meet all of the three criteria in IFRS 15.B58. These criteria appear to be split between paragraphs 23.97 and 23.98. However, the proposed paragraph 23.97 is explicit that meeting either one of the two criteria is conclusive to treat the granting of a licence as a right to access. This difference could result in an inconsistent outcome between FRS 102 and IFRS 15 preparers. Please see the Appendix to this letter for a drafting suggestion.

Further, to ensure consistency of application between FRS 102 preparers, we believe that it is important to retain in the revised Section 23 the factors that an entity needs to disregard when determining whether a licence provides a 'right to access' or a 'right of use', as set out in IFRS 15.B62.

- *Costs of obtaining or fulfilment of contracts*

Paragraphs 23.102-103 provide a choice of expensing or capitalising costs of obtaining a contract that are expected to be recovered. If an entity adopts capitalisation of such costs, there is also a choice to expense such costs if the amortisation period will be 1 year or less. IFRS 15 requires capitalisation where the criteria are met, although there is a practical expedient not to capitalise if the period of amortisation is 1 year or less. We support the inclusion of this policy choice but note that paragraph 23.128 only requires disclosure if an entity chooses to expense cost of obtaining contracts with amortisation of 1 year or less. We believe an entity should also disclose whether the option not to capitalise such costs at all was taken.

We do not find it clear (in paragraph 23.111) what parts of Section 27 *Impairment of Assets* are relevant for assets recognised under paragraph 23.102 or 23.107 and suggest this is clarified. There seem to be some differences in approach to IFRS 15 where an impairment loss is recognised in accordance with IFRS 15.101 (the equivalent of paragraph 23.112) and then the asset is included in a cash generating unit for the purposes of an impairment test under IAS 36 *Impairment of Assets*. Further, impairment reversals should also be addressed.

When assessing impairment of capitalised contract costs, paragraph 23.113 requires using the transaction price yet to be received which may include constrained variable consideration, unlike IFRS 15.102 which specifies that it would include the unconstrained amount. We believe paragraph 23.113 should clarify that the transaction price yet to be received is not adjusted for the variable consideration constraint.

For costs of fulfilling a contract, we note that the nature of costs relating directly to a contract is not explained. We therefore believe that it is important to include the examples set out in IFRS 15.97 and also the guidance in IFRS 15.98 as to which costs must be expensed as incurred. This will help reduce diversity in practice in accounting for customer contracts as well as in establishing provisions for onerous contracts.

- *Presentation and disclosure*

We recognise that paragraph 23.121 requires a disaggregation of revenue using similar categories to under current Section 23. However, we believe that it is confusing to require this as the default analysis with a disaggregation of revenue permitted on the alternative basis in paragraph 23.121A (which is closer to the disaggregation required under IFRS 15). We believe that paragraph 23.121 should be removed.

We would welcome additional guidance on presentation when Part 1 General Rules and Formats of Schedule 1 to the Regulations are applied.

With the introduction of a number of options available, we would welcome the addition of disclosure requirements concerning the options applied to aid comparability.

- *Other areas:*

We have noted, in the Appendix to this letter, various other areas where additional guidance will likely be necessary. We also included in the Appendix to this letter drafting suggestions in certain areas.

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?

We disagree with a proposed effective date of 1 January 2025, as we believe that this date may be challenging for some entities, particularly those with a high volume of leases or with complex lease arrangements. We note that IFRS reporters had a considerably longer period to implement IFRS 15 and IFRS 16. Moreover, while many IFRS reporters did not ultimately change the revenue recognition policies, a rigorous contract-by-contract review exercise was needed to establish that and for some companies, there were significant impacts arising from, in particular, point in time/over time guidance or principal/agent guidance. Entities with long-term contracts, software or significant revenue contract modifications, for example, would need to carefully analyse their nature.

There would be also little time available for parallel running for those entities that wanted to understand real-time the impact of the lease and revenue proposals, meaning adjustments would often be determined after the event.

We would therefore not support a mandatory implementation date earlier than 1 January 2026, although early application could be allowed. Given that the key changes in FRED 82 relate to leases and revenue recognition, we would suggest that all amendments continue to be applied at the same time (rather than introducing a staggered implementation date).

Question 8: Effective date and transitional provisions
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?

We agree with the transitional provisions for leases. While this removes some options that were used by IFRS reporters, it provides simplicity and greater comparability across FRS 102 reporters.

There are IFRS reporting groups where FRS 102 is applied at the individual UK subsidiary level. We agree it may be helpful to offer the option to carry forward the carrying amounts previously determined in accordance with IFRS 16 as opening balances. As the proposals are mainly in line with IFRS 16, albeit that there are options to adopt simpler treatments, it should be possible to keep close to the figures for leases used in group reporting. We are not quite sure why the ability to apply the amounts determined under IFRS 16 did not apply to the sale and leaseback provisions in paragraphs 1.51-1.53 (see paragraph 1.41 which scopes out these paragraphs).

We note that paragraph 1.37 requires the adjustment to current year profit or loss to be disclosed (to the extent practicable). This may be onerous to establish and was not required for IFRS reporters on transitioning to IFRS 16. It would also be clearer if the words “in relation to the section only” referred to “in relation to Section 20 only”. Moreover, we found that the reconciliation of operating lease commitments to lease liabilities was a valuable disclosure on transition and would recommend this was included.

Question 8: Effective date and transitional provisions 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?

We agree with the transitional provisions for revenue set out in FRED 82 for FRS 102 reporters, i.e., modified retrospective approach or fully retrospective. We agree that the revised Section 23 should not be applied on prospective basis. For some companies, that could lead to a long run off period where different accounting is applied to different revenue contracts. This would distort comparability across periods and an understanding of performance. It would be clearer if the words “in relation to the section only” included in paragraph 1.56 referred to “in relation to the revised Section 23 only”.

We are not convinced that it is appropriate to change the revenue recognition requirements in FRS 105 for micro-entities. However, if these are changed, we agree that for proportionality reasons, a prospective basis should be used.

Paragraph 1.58(b) (one of the practical expedients when retrospectively applying revised Section 23) applies to “completed contracts that have variable consideration and are completed before the end of reporting period”. This wording differs to IFRS 15.C5(b) which refers to “completed contracts that have variable consideration”. ‘Completed contracts’ are assessed at the date of initial application so it is not clear what “completed before the end of the reporting period” means if applying revised Section 23 retrospectively.

Question 8: Effective date and transitional provisions 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 note that there are no transitional provisions in relation to the new fair value measurement requirements. We believe these need to be applied prospectively to fair value measurements, as was the case when IFRS 13 was introduced. If this was not the case, it may be necessary to revisit past transactions and accounting (including business combinations).

We agree that most of the proposed amendments in FRED 82, excepting leases and revenue, should be capable of implementation without transitional relief and therefore a retrospective approach is appropriate and aids comparability, which is a general principle in the conceptual framework (proposed revised Section 2) and a fundamental accounting principle in the Companies Act 2006. It is therefore important that changes are retrospective, unless there are good reasons to offer relief. This is consistent with the general approach applied in the December 2017 amendments to FRS 102.

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

We have the following key points:

Statutory formats

It would be helpful to preparers for the FRC to provide guidance on the classification of lease assets and liabilities, revenue contract assets and liabilities where statutory formats are used (which is commonly the case for FRS 102 reporters). We would welcome clarification as to whether these fit neatly within existing line items or a new class of asset and liability must be introduced. There is specific guidance on the classification of refund assets (to be classified as inventories) but not across all of the new asset and liability categories.

FRS 101

FRED 82 states that a company that is an FRS 101 reporter must apply the Regulations (SI 2008/410) in preparation of the financial statements rather than the Small Companies Regulations (SI 2008/409). This goes beyond the current requirement that the formats for the profit and loss account and balance sheet must follow Schedule 1 to the Regulations. The current position is consistent with paragraph 3(3) of the Small Companies Regulations which specifically allows a company to defer in part or whole to Schedule 1 to the Regulations. This dispensation does not, however, extend to other Schedules of the Regulations. Moreover, it is not clear that companies in scope of the Small Companies Regime *should* be applying the Regulations since paragraph 2(4) of the Regulations (which sets out their scope) applies to companies that are not subject to the small companies regime whereas paragraph 2(3) of the Small Companies Regulations states that the Small Companies Regulations apply to companies that are subject to the small companies regime.

There are other exemptions that apply to companies that are subject to the small companies regime in the Companies Act 2006 (outside the Small Companies Regulations) that impact the financial statements, for example, disclosure of staff costs and numbers, more limited information on off-balance sheet arrangements and group accounts exemptions and filing exemptions (currently). It is not clear that the FRC could or should prohibit use of the small companies regime.

The effect of this change to FRS 101 would mean, for example, that statutory directors' remuneration would be required as would disclosure in respect of related undertakings (such as subsidiary, associated, and significant undertakings), although these statutory disclosures are not required for a full IFRS reporter that is subject to the small companies regime. Instead, the FRC could consider whether the exemption for key management compensation available for FRS 101 reporters (IAS 24.17, 18A) might be removed (except in the case where the statutory directors' remuneration disclosures are given and the identity of the directors and key management personnel are the same, i.e., a similar approach to FRS 102.33A).

While FRED 82 refers to ‘accounts’; not ‘accounts and reports’, we believe that it should be spelt out that an FRS 101 reporter could still use the small companies exemption from preparation of a strategic report or from providing certain directors’ report disclosures. These exemptions are available for IFRS reporters that are small companies.

Drafting points

Further points of less significance and drafting points are set out in the Appendix to this letter.

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 believe it is best left for preparers to comment on this.

APPENDIX

This section sets out further comments, organised by section of FRS 102, on areas not specifically asked about in the consultation questions, or where we provide further detail in respect of our response.

Section 2 *Concepts and Pervasive Principles*

We have the following drafting points*:*

- Paragraph 2.8 should be headed 'Qualitative characteristics for useful financial information' and then paragraph 2.9 can be headed 'Fundamental qualitative characteristics of useful financial information'.
- Paragraphs 2.104 and 2.105 should refer to 'income statement' consistently (as this is the term used for 'statement of profit and loss' in FRS 102 (see paragraph 2.103 and Section 5 *Statement of Comprehensive Income and Income Statement* generally). In the IFRS Conceptual Framework, the corresponding paragraphs, CF7.15, 7.15, 7.19 use 'statement of profit and loss'.

Section 11 *Basic Financial Instruments* and Section 12 *Other Financial Instruments Issues*

Paragraph 11.13A(c) allows a trade receivable or contract asset where payment is expected within 6 months or less from when the entity transfers the good or service to be measured initially at transaction price. We believe this should include ", at contract inception," before "payment". This relates to the requirement in proposed revised Section 23 to account for interest expense on such transactions – see our comments on Question 7. We further note that this requirement to discount is inconsistent with paragraph 11.14(a)(ii) for "a non-interest-bearing debt instrument which is payable or receivable within one year on normal business terms".

While no change has been made to FRS 102.11.14(c), we do not believe it makes sense for a commitment to make a loan to be measured at cost less impairment. We would recommend deletion of "less impairment".

Paragraphs 11.14A and 12.9A should clarify that these address the accounting for dividend income on investments in equity instruments.

Paragraph 11.48ZA adds new disclosure requirements requiring additional qualitative info on ECL application. However, it appears there is no requirement to provide quantitative details – for example, key inputs into any economic scenarios used. So, while we can see the benefit of adding bespoke disclosure requirements for those applying IFRS 9, as worded, the new requirement does not seem to require much more than a good accounting policy on application of ECL.

Section 14 *Investments in Associates*

Paragraph 14.8(d) should likely refer to the investor accounting for a financial instrument that, in substance, forms part of the investor's net investment, under Section 11 or Section 12 before applying paragraph 14.8(d) (impairment) or paragraph 14.8(h) (losses in excess of investment). It could be helpful to reflect IAS 28.14A and clarify that in applying Sections 11 or 12, no account is taken of any adjustments to the carrying amounts of those interests arising from applying Section 14. Section 14 also does not specify the order of allocating any losses (see IAS 28.38) nor address reversals of impairment.

Section 17 *Property, Plant and Equipment* and Section 18 *Intangible Assets other than Goodwill*

Similar paragraphs to paragraph 16.2A covering the judgement of whether a purchase of investment property is a business combination or not have been added to Sections 17 and 18. While these likely do little harm, there is no counterpart in IFRS Accounting Standards for the additions to the latter two sections.

Section 19 *Business Combinations and Goodwill*

Guidance on 'acquirer'

Paragraph 19.10 introduces new guidance for identifying the acquirer in new paragraphs 19A.1 to 19A.6. This guidance is referred to when "applying the requirements of paragraphs 9.5 to 9.6A does not clearly indicate which of the combining entities is the acquirer". FRS 102.9.5-9.6, in particular, describe the determination of control through voting rights. In cases where it is difficult to identify the accounting acquirer in a business combination, it is often straightforward to determine the *legal* acquirer through the analysis of the factors described in FRS 102.9.5-9.6A. In such cases, these paragraphs might clearly indicate an acquirer but if new paragraphs 19A.1-19A.6 were referred to, a different interpretation might be drawn. This could be confusing for preparers, and we recommend that the factors in new paragraphs19A.1-19A.6 are considered *in addition to* FRS 102.9.5-9.6A rather than *only* when the latter paragraphs do not clearly indicate an acquirer.

Disclosures

The following paragraphs introduce new requirements similar to those of IFRS 3 *Business Combinations*, but with certain details omitted from the proposed requirement. We believe the omitted information could be useful to readers, as follows:

- Paragraph 19.25(dA) introduces a requirement to disclose details of contingent consideration similar to IFRS 3.B64(g). However, the proposed disclosure does not require 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.
- Paragraph 19.25(i) introduces a requirement to disclose details of contingent liabilities similar to IFRS 3.B64(j). However, the proposed disclosure does not require the reasons why the liability cannot be measured reliably, if a contingent liability is not recognised because its fair value cannot be measured reliably.
- Paragraph 19.25B introduces a requirement to disclose the fact that initial accounting for a business combination is incomplete and the line items for which provisional amounts have been recognised similar to IFRS 3.B67(a). However, the proposed disclosure does not require the reasons why the initial accounting for the business combination is incomplete or the nature and amount of any measurement period adjustments recognised during the reporting period.
- Particularly given the introduction of guidance on employee remuneration, we believe that it would be appropriate to require disclosure of transactions recognised separately from the business combination (and how accounted), based on IFRS 3.B64(l).

Drafting points

Paragraph 19A.1 introduces guidance similar to IFRS 3.B14, although the verb 'incur' has been replaced with 'assume' in reference to liabilities. We note that 'assuming liabilities' is more normally associated with the liabilities acquired in a business combination and 'incurring liabilities' is more normally associated with the payment of consideration. Since paragraph19A.1 is describing the payment of consideration, the original wording in IFRS 3.B14, using 'incur', is more natural.

Section 20 *Leases*

In addition to our comments on Question 6, we have the following drafting points:

- The definition of interest rate implicit in the lease in extant FRS 102 refers to 'minimum lease payments', which is no longer a defined term in FRED 82.
- In addition, the Glossary definition of interest rate implicit in the lease indicates a specific period only (as italicised) – "The discount rate that, *at the inception of the lease*…" This appears inconsistent with the use of the interest rate implicit in the lease at lease modification or reassessment (paragraph 20.71). We suggest that the definition be aligned with the definition in IFRS 16 Appendix A.
- For consistency with IFRS 16.B9, and paragraph 20.22, we suggest the FRC should consider changing paragraph 20.18 to read "A contract conveys the right to control the use of an identified asset when, throughout the period of use, the customer has both the right to obtain substantially all the economic benefits from the use of the identified asset, and the right to direct the use of the identified asset".
- Paragraphs 20.29 and 20.30 should be included under a separate sub-heading – 'Separating components of a contract'. The paragraphs are relevant to both lessee and lessor so should not be included under the Lessee subheading.
- We believe that paragraph 20.125 should also include references to investment property and agriculture, consistent with IFRS 16.96.
- We believe that paragraph 20.131 should specify that the financial liability may be accounted for applying IFRS 9, if that is the policy choice selected by the entity to account for its financial instruments.

Section 21 *Provisions, contingent liabilities and contingent assets*

We agree with the inclusion of guidance based on the recent Amendments to IAS 37 – *'Onerous Contracts – Cost of Fulfilling a Contract'* within paragraph 21A.2. However, to avoid diversity in practice, we believe this should be supplemented with the examples of costs relating directly to fulfilling contracts as set out in IAS 37.68A. A key purpose of the IASB's Amendments to IAS 37 was to reduce diversity of practice over the measurement of onerous contracts.

Section 23 *Revenue*

In addition to our comments on Question 7, we noted the following areas where we believe further guidance should be issued (e.g., educational material/staff guidance notes):

- IFRS 15.3 (first part) requires an entity to consider the terms of the contract and all relevant facts and circumstances. This paragraph helps in analysing what terms of the contracts are, i.e., 'relevant facts and circumstances' may include law or regulation applicable to the customer contract. This helped during the COVID-19 pandemic to identify whether certain changes are accounting modifications or should have been treated as variable consideration.

- IFRS 15.10 and IFRS 15.12 give guidance in determining whether a revenue contract exists or not. This is not included in proposed revised Section 23 (albeit the FRS 102 Glossary defines what is a 'contract').
- Guidance on the following matters related to non-cash consideration:
  - The measurement date for determining the fair value of non-cash consideration (noting that IFRS 15 is unclear when the fair value must be measured);
  - The subsequent accounting and constraint requirements on the changes/variability of fair value of non-cash consideration (see IFRS 15.68); and
  - The accounting treatment of goods/services contributed by a customer in an entity's fulfilment of the contract (see IFRS 15.69).
- Accounting treatment when the fair value of distinct goods/services obtained from the customer exceeds the consideration payable to a customer to acquire such distinct goods/services (see IFRS 15.71).
- Guidance on where a change in transaction price occurs after a modification (see IFRS 15.90).
- Accounting when an entity is not able to reasonably measure its progress towards complete satisfaction of a performance obligation (see IFRS 15.44, 45).
- Guidance on bill-and-hold arrangements
- Paragraphs 23.86 and 23.87 are based on IFRS 15.B84-B85 but we believe the guidance on trial periods in IFRS 15.B86 is quite useful and should be brought into avoid confusion.
- It would be helpful to include examples of the type of costs to fulfil a contract that might or might not be capitalised under proposed revised Section 23, which would not have already been capitalised under Section 13 *Inventories*, Section 17 or Section 18. Example 37 of IFRS 15 gives an example of costs capitalised relating to a service contract to manage a data centre which might be helpful.

Below are drafting suggestions:

- It will be clearer if the word ''simultaneously" in paragraph 23.78(a) is added back to read as "simultaneously receives and consumes", which is consistent with IFRS 15.35(a).
- We consider paragraph 23.71A should refer to "shall" not "may" consistent with paragraph 23.70.
- We believe that paragraph 23.79(b) should refer to "*substantive* contractual restrictions" rather than "*substantial* contractual restrictions", consistent with IFRS 15.B7. The terms have subtly different meanings.
- We note that the consideration of time value of money when comparing the selling price with the repurchase price appears only in the requirements for a forward/call option (paragraph 23.87C) while the explanation of the accounting when the option is not exercised (paragraph 23.78H) only appears in the requirements for a put option. We expect that these two requirements are applicable and should be incorporated into the accounting requirements for both forward/call option and put option (consistent with IFRS 15.B67, B69 and IFRS 15.B75-B76).
- In line with our comment in Question 7 above relating to guidance on licensing, paragraph 23.97 should be changed to read as follows:

  "A licence provides a customer with a right to access an entity's intellectual property if ~~the entity expects to undertake activities that either~~:
  (a) ~~will~~ **the entity is required or is expected to undertake activities that** significantly affect the benefit the customer obtains from the intellectual property by changing the substance of the intellectual property; ~~or~~ **and**
  (b) ~~could significantly affect the benefit the customer obtains from the intellectual property by~~ **the rights granted by the licence** directly ~~exposing~~ **expose** the customer to any positive or negative effects of those activities **in (a)**."

  The first sentence of paragraph 23.98 should then be changed to read as – "**The activities referred to in paragraph 23.97(a)** may be included in the terms of a contract or arise from those activities that the customer reasonably expects the entity will undertake."

- A subheading “Costs to obtain a contract” is missing from above paragraph 23.102 (it is included in the equivalent paragraph for FRS 105).
- Paragraph 23.127(a) should clarify that it requires disclosures of *both* costs to obtain and to fulfil the contract (rather than using the word ‘or’).

<u>Section 24 *Government Grants*</u>

There appears to be a drafting error in paragraph 24.5A. For example, where a grant relates to assets, there will be deferred income to release. Consequently, the recognition of a liability for repayment would not necessarily be recognised in income (or at least this would not be the whole accounting impact). See IAS 20.32.

In addition, we note that paragraph 24.5E has been amended to explain when a grant relating to revenue for immediate financial support is recognised. While we do not disagree this is a valid interpretation of paragraph 24.5E, this is a difference to the wording in IAS 20.20 (which may not be desirable) and there is potential for some entities to amend their accounting. For example, an entity may receive immediate financial support but still need to incur future related costs (even though the grant itself does not depend on future related costs being incurred).

<u>Section 26 *Share-based payment*</u>

Areas where we would welcome improvements or additional guidance are as follows:

Cancellation and settlement

We welcome the proposed additional guidance on settlement accounting in paragraph 26.13A. However, we would also welcome guidance on accounting for a new award when it is issued as a replacement of a cancelled award. Currently, there is no guidance and the proposed inclusion of paragraph 26.1B clarifies that replacement awards in a business combination fall within Section 26, which highlights the gap in the accounting requirements. We suggest an amendment to FRS 102.26.13 below and a further paragraph to be inserted after paragraph 26.13A, based on wording similar to IFRS 2.28(c). This will ensure a consistent approach with all elements of IFRS 2.28:

“26.13 An entity shall account for a cancellation or settlement of an equity-settled share-based payment transaction as an acceleration of vesting, <u>subject to paragraph 26.13B</u>, and therefore shall recognise immediately the amount that otherwise would have been recognised for services received over the remainder of the vesting period.

<u>26.13B If new equity instruments are granted to the employee and, on the date when those new equity instruments are granted, the entity identifies the new equity instruments granted as replacement equity instruments for the cancelled equity instruments, the entity shall account for the granting of replacement equity instruments in the same way as a modification of the original grant of equity instruments, in accordance with paragraph 26.12. The incremental fair value granted is the difference between the fair value of the replacement equity instruments and the net fair value of the cancelled equity instruments, at the date the replacement equity instruments are granted. The net fair value of the cancelled equity instruments is their fair value, immediately before the cancellation, less the amount of any payment made to the employee on cancellation of the equity instruments that is accounted for as a deduction from equity in accordance with paragraph 26.13A. If the entity does not identify new equity instruments granted as replacement equity instruments for the cancelled equity instruments, the entity shall account for those new equity instruments as a new grant of equity instruments</u>.”

Share-based payment transactions with cash alternatives

We welcome the proposals to provide guidance on cancellation and settlement of equity-settlement share-based payment transactions in paragraph 26.13A. However, what is less clear, is the accounting when the counterparty has a choice of settlement and on settlement the alternative method is chosen. The accounting model in Section 26 is different to IFRS 2 (no split accounting is required in FRS 102) where the counterparty has a choice of settlement, therefore FRS 102.10.6 cannot be applied to help formulate an accounting policy. Additional guidance would be welcomed in this area.

Our suggestions, based on IFRS principles, to update the guidance include the following:

- Counterparty choice – accounted for as equity-settled but on settlement the counterparty chooses to receive cash. As there is no guidance in Section 26, an acceptable approach might be to apply the proposed guidance in paragraph 26.13A, therefore we would suggest paragraph 26.13A(a) be amended to read, "…(a) the entity <u>or counterparty</u> has a choice of settlement;…". Currently the examples provided in paragraph 26.13A all relate to the entity's actions.
- Counterparty choice – accounted for as cash-settled but on settlement the counterparty chooses to receive equity-instruments. Paragraph 26.13A addresses settlement of equity-settled awards, on that basis it would be beneficial if the FRC clarify if all that is required is the cash-settled liability is remeasured at settlement date and reclassified to equity.

Share-based payment transactions with net settlement features

FRED 82 proposes to provide guidance to address share-based payment transactions with net settlement features for withholding tax obligations. We note a similar proposal is included in the ED for the Third Edition of the IFRS for SMEs that appears more aligned to IFRS 2 *Share-based Payment*. The wording proposed in FRED 82, while appearing to result in similar accounting to IFRS 2 and the IFRS for SMEs Exposure Draft, could be read that Section 26 is not as restrictive on the use of the exemption, since wording similar to IFRS 2.33H(a) on when the exception does not apply has not been included.

The Glossary definition defines "Net settlement feature" as [emphasis added]:
"**<u>A term</u>** of a share-based payment arrangement that permits or requires the entity to withhold the number of equity instruments equal to the monetary value of the employee's tax obligation from the total number of equity instruments that otherwise would have been issued to the employee upon exercise (or vesting) of the share-based payment. **<u>Such terms may exist</u>** when tax laws or regulations oblige an entity to withhold an amount for an employee's tax obligation associated with a share-based payment and transfer that amount, normally in cash, to the tax authority on the employee's behalf."

Reference to "term" in the opening sentence could refer to *any term* in the scheme arrangement included to cover the employees tax obligation, and when referring to "such terms may exist…", this could mean there are "such terms" other than obligated by tax laws or regulations that could be captured.

If the FRC are intending to restrict the application of the exemption to be consistent with IFRS 2 without including all relevant paragraphs from IFRS 2, we suggest removal of "Such terms may exist" in the Glossary and replace with "Such terms only exist".

Group plans

While FRED 82 does not include amendments in this area, we would like to highlight a potential improvement to the alternative method for accounting for group plans. FRS 102.26.16 provides an alternative method to measure the share-based payment expense "on the basis of a reasonable allocation of the expense for the group" referring to paragraphs 26.7 to 26.15C, that do not cover the recognition paragraphs of the section. The concern here is that it is common for UK entities to have share-based payment awards over a US parent's shares which are accounted for in US GAAP consolidated financial statements but there are known differences in accounting for "graded vesting" awards under US GAAP to IFRS/FRS 102. Consequently, it is unclear whether an FRS 102 reporter that is a group entity would be able to use this alternative method and make a reasonable allocation of the expense reported in the group's US GAAP consolidated financial statements.

The IFRS for SMEs includes the relevant recognition paragraphs, therefore for consistency, we believe paragraph 26.16 should be amended to include reference to paragraphs 26.3-26.6. We note the reference to paragraphs 26.3 to 26.6 within FRS 102.26.16 was removed as part of the Triennial Review Amendments 2017 but are uncertain of the background behind this.

We note that the FRC in paragraph 18 of the Impact Assessment and Feedback Statement on the Amendments to FRS 100 *Application of Financial Reporting Requirements – The Interpretation of Equivalence* states:
"…Paragraph AG28 of FRED 80 provided additional detail, clarifying that it is necessary to consider whether "the basis on which the group share-based payment expense has been calculated is in accordance with the basic requirements of the measurement basis of FRS 102 or IFRS 2". The implication is that it is not sufficient to determine that the framework is equivalent; the method of calculation of the share-based payment expense must itself be equivalent. It is conceivable that even when a framework has been determined to be equivalent, the manner of calculation of the share-based payment expense might not be. To aid preparers, a reference is added in paragraph AG28 to "the requirement to measure the goods or services received on a fair value basis" as an example of the basic requirements of the measurement basis of FRS 102 or IFRS 2."

If the intention of the FRC is that recognition of the group expense on a different basis to that applied in FRS 102/IFRS 2 would result in the alternative approach not being applied, that fact should be clarified possibly in the basis of conclusions to FRS 102. However, our preference would be that paragraph 26.16 be aligned to also include reference to paragraphs 26.3-26.6.

Drafting points

We have the following drafting points:

- *Recognition when there are vesting conditions* – we would welcome clarification on the accounting after vesting for equity-settled awards based on IFRS 2.23, in-light of cash-settled share-based payment accounting having been clarified in FRED 82 (new paragraphs 26.14A to 26.14C inserted).

  Suggested wording to include after paragraph 26.10 before paragraph 26.11:
  "Having recognised the goods or services received and a corresponding increase in equity, the entity shall make no subsequent adjustment to total equity after vesting date. For example, the entity shall not subsequently reverse the amount recognised for services received from an employee if the vested equity instruments are later forfeited or, in the case of share options, the options are not exercised. However, this requirement does not preclude the entity from recognising a transfer within equity, i.e., a transfer from one component of equity to another."

- *Cancellation and settlement* – we understand that a "condition that is not a vesting condition" are those referred to in IFRS 2 as "non-vesting conditions". Current guidance includes the accounting for when an entity cancels an equity-settled share-based payment arrangement (FRS 102.26.13), but we would welcome guidance to specifically address a situation when an entity or counterparty fail to meet a condition that is not a vesting condition during the vesting period, which we believe should also be treated as a cancellation. This would align the accounting with IFRS 2.28A.

Suggested wording to include after our proposed paragraph 26.13B (see proposed amendment above):

"If an entity or counterparty can choose whether to meet a condition that is not a vesting condition, the entity shall treat the entity's or counterparty's failure to meet that condition during the vesting period as a cancellation."

- Section 26 provides a hierarchy to measure fair value and does not mandate but allows the use of an option pricing model, based on FRS 102.26.11(c) which states [emphasis added] "If an observable market price is not available and obtaining a reliable measurement of fair value under (b) is impracticable, indirectly measure the fair value of share options or share appreciation rights *using an alternative valuation methodology* such as an option pricing model….". It appears the FRC no longer assess not mandating the use of an option pricing as a significant difference to the IFRS for SMEs (not listed on the following page Accountants I Accounting and Reporting Policy I UK Accounting Standards I Financial Reporting Council (frc.org.uk)), therefore the FRC could consider removing the italicised wording above, on the basis it is not clear what alternative methodologies would be used.

Section 27 *Impairment of Assets*

We note that the guidance on fair value less costs to sell has been removed, presumably because fair value is dealt with in new Section 2A. However, there is no guidance on 'costs to sell' comparable with the definition of 'costs of disposal' in IAS 36.6.

Section 28 *Employee Benefits*

We note that because paragraph 28.21A combines both curtailments and settlements, it does not clearly state that the gain or loss on settlement is net of any settlement price paid (see IAS 19.109). See suggested drafting.

> 28.21A - If a defined benefit plan has been curtailed (ie benefits or group of covered employees are reduced) ~~or settled (the relevant part of the employer's obligation is completely discharged)~~ in the current period, the defined benefit obligation shall be decreased ~~or eliminated~~, and the entity shall recognise the resulting gain or loss in profit or loss in the current reporting period. If a defined benefit plan has been settled (the relevant part of the employer's obligation is completely discharged), the difference between the defined benefit obligation eliminated and the settlement price is recognised as a gain or loss in profit or loss in the current reporting period.

In addition, IAS 19.101A clarifies that the asset ceiling is to be ignored when calculating a past service cost (e.g., when a plan amendment or a curtailment occurs) or the gain or loss on settlement. Instead, the effect of the asset ceiling is considered after the plan amendment, curtailment or settlement and any change recognised in other comprehensive income. We believe it would be helpful to include similar guidance in Section 26 to clarify the accounting. Although Section 26 does not have detailed guidance on how to determine whether a defined benefit surplus is recoverable, the requirements of IAS 19.101A impact presentation in profit or loss, or other comprehensive income and do not depend on the exact mechanics of determining the asset ceiling.

Section 34 *Specialised Activities*

Agricultural activities

FRS 102.34.9A defines 'cost', with the definition similar to that in Section 17, with some differences in wording. In paragraph 34.9A(c), it is not clear why "for purposes other than to produce inventories during that period" had been deleted.

Under IFRS Accounting Standards, bearer plants are accounted as property, plant and equipment under IAS *16 Property, Plant and Equipment* [IAS 16.3] and the cost model in that standard would be applied. For other biological assets accounted for using the cost model (because fair value cannot be determined reliably), an entity considers IAS 2 *Inventories* or IAS 16. Indeed, for some assets, such as consumable biological assets that will be harvested (fish, livestock), IAS 2 might be a more appropriate determinant of cost. Therefore, the FRC could instead refer to the definitions of cost included in Section 13 or Section 17, depending on the nature of the biological asset (rather than introducing a new cost definition based on the requirements of Section 17).

Service concession arrangements – accounting by the grantor

FRS 102 currently addresses the accounting by the grantor for service concession arrangements (this is not addressed in IFRS Accounting Standards) and these are unchanged in FRED 82. We have considered whether proposed revised Section 20 impacts the accounting by the grantor for service concessions.

IPSAS 32 *Service Concession Arrangements: Grantor,* issued by the International Public Sector Accounting Standards Board (IPSASB), addresses the grantor's accounting in such arrangements. Its approach is consistent with that used for the operator's accounting in IFRIC 12 *Service Concession Arrangements*, in that an infrastructure asset is recognised by the grantor, together with an obligation comprising either a financial liability to the operator or, where an unconditional obligation to pay cash to the operator is not a feature of the arrangement, a deferred revenue balance. In principle, a service concession does not contain a lease and so we question why the accounting should analogise to a lease model. This is because the grantor controls the infrastructure (not the operator) by controlling or regulating what services the operator provides with the infrastructure, to whom and at what price, together with the residual interest (FRS 102.34.12A). The grantor is, therefore, giving to the operator a right of access, not a right of use, over the infrastructure so that the operator can fulfil the terms of the concession arrangement. If FRS 102 is to address the accounting for service concession arrangements by grantors, we would recommend that the IPSAS may provide a basis for an appropriate IFRS-based solution and would suggest the FRC outreach to public sector bodies with service concessions before amending the standard in order to avoid any unintended consequences of application.

Related drafting point

Paragraph 34.12C of FRS 102 (which is unchanged in FRED 82) states: "Accordingly, the contractual terms of certain contracts or arrangements may meet both the scope requirements of paragraphs 34.12 and 34.12A, and Section 20 *Leases*. Where this is the case, the requirements of this section shall prevail". We would suggest that this text is now deleted. Proposed revised Section 20 now applies a control model, as does IFRIC 12, so an arrangement cannot be in scope of both sections. As explained above, a service concession does not contain a lease because the grantor controls the infrastructure. The grantor is, therefore, giving to the operator a right of access, not a right of use, over the infrastructure so that the operator can fulfil the terms of the concession arrangement. In addition, the proposed revised Section 20 excludes from its scope service concession arrangements in scope of Section 34.

Section 35 *Transition to this FRS*

Paragraph 35.10(a) (as amended) states that if an intangible asset is recognised that meets the conditions in FRS 102.18.8(a) and only one of FRS 102.18.8(b) and (c), then that does not constitute an accounting policy choice for post-transition business combinations. This allows an FRS 102 reporter transitioning from IFRS Accounting Standards to continue its previous recognition of intangibles for pre-transition business combinations (even if for subsequent business combinations, its policy choice is that all three conditions must be met). However, it is not clear whether derecognition of acquired intangibles that do not meet all three conditions, with an adjustment to retained earnings, is precluded (when applying FRS 102.35.7-8) if that is to be the policy going forward. It would be helpful if the FRC could clarify that point.

Paragraphs 35.10(o) (as amended) and new paragraph 35.10(w) clarify that if the entity adopts a policy of expensing borrowing costs and/or development costs, it should not include previously capitalised borrowing and/or development costs (under its previous reporting framework) as part of the cost of an asset. We agree with this inference but would suggest the word "should" is changed to "shall". We note that this is included in the list of optional exemptions but is in fact a mandatory consequence of applying the general rules in FRS 102.35.7-8). However, it is a logical place to include such guidance.

However, we note that new paragraph 35.10(z), if used, may have the effect of allowing the IFRS or FRS 101 cost to be grandfathered in any event. We believe this should read "A first-time adopter previously applying FRS 101 or IFRS may elect to measure the cost of an (i)……; (ii)……; or. (iii) … on the date of transition to this FRS at its cost as determined under the previous financial reporting framework ~~as its deemed cost at that date~~."

This might make it clearer that the exemption relates to the cost/deemed cost rather than the previous GAAP carrying amount (which might be cost/deemed cost under IFRS/FRS 101 less impairment). Generally, in Section 35, references to 'deemed cost' are based on fair value or previous revaluations or previous GAAP carrying amounts, and represent the initial cost under FRS 102 (so that past impairments are no longer tracked under the cost model).