



April 2023

FRED 83

Draft amendments to FRS 102
*The Financial Reporting Standard
applicable in the UK and Republic
of Ireland* and FRS 101 *Reduced
Disclosure Framework*

International tax reform – Pillar Two model rules

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8th Floor, 125 London Wall, London EC2Y 5AS



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Overview

- (i) The FRC's overriding objective in setting accounting standards is to enable users of accounts to receive high-quality understandable financial reporting proportionate to the size and complexity of the entity and users' information needs.

Draft amendments to FRS 102 and FRS 101

- (ii) In December 2021, the Organisation for Economic Co-operation and Development (OECD) published its Pillar Two model rules. The rules are part of a two-pillar solution to address the tax challenges arising from the digitalisation of the economy. The Pillar Two model rules:
 - (a) aim to ensure that large multinational groups pay a minimum amount of tax on income arising in each jurisdiction in which they operate; and
 - (b) would achieve that aim by applying a system of top-up taxes that results in the total amount of taxes payable on excess profit in each jurisdiction representing at least the minimum rate of 15%.
- (iii) The IASB issued Exposure Draft IASB/ED/2023/1 *International Tax Reform—Pillar Two Model Rules – Proposed amendments to IAS 12* in January 2023. The proposals in that Exposure Draft would introduce a temporary exception to the accounting for deferred taxes arising from the implementation of the Pillar Two model rules, alongside targeted disclosure requirements.
- (iv) The FRC has considered whether similar proposals are required in relation to Section 29 *Income Tax* of FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* and has developed this FRED. The proposals in this FRED are based on those in IASB/ED/2023/1 and would introduce a temporary exception to the accounting for deferred taxes arising from the implementation of the Pillar Two model rules, alongside targeted disclosure requirements.
- (v) The FRC has also considered whether to provide disclosure exemptions for qualifying entities, as defined in FRS 102 or FRS 101 *Reduced Disclosure Framework*. The proposals in this FRED would introduce an exemption for qualifying entities from certain proposed disclosures that are primarily relevant to the consolidated financial statements of a group, provided that equivalent disclosures are included in the consolidated financial statements in which the qualifying entity is included.
- (vi) In deciding whether to proceed with the proposed amendments the FRC will consider:
 - (a) further statements made by the UK and Irish governments about the approaches taken to incorporate the Pillar Two model rules into domestic legislation;
 - (b) the comments it receives on this FRED; and
 - (c) the final amendments issued by the IASB in its project *International Tax Reform—Pillar Two Model Rules*.¹
- (vii) Subject to the above, the FRC plans to finalise any resulting amendments in summer 2023.

¹ <https://www.ifrs.org/projects/work-plan/international-tax-reform-pillar-two-model-rules/>

Invitation to comment

- 1 The FRC is requesting comments on FRED 83 by 24 May 2023.
- 2 The FRC is committed to developing standards based on evidence from consultation with users, preparers and others. Comments are invited in writing on all aspects of the draft amendments. In particular, comments are sought in relation to the questions below.

Question 1

Do you agree that the proposed definition of the term 'Pillar Two legislation' would capture all transactions that are relevant to this topic? If not, please provide examples to support your view.

Question 2

Do you agree with the proposed amendments to FRS 102 that introduce mandatory temporary exceptions to recognising or disclosing information about deferred tax assets and liabilities related to Pillar Two income tax (proposed paragraph 29.2B), and to taking the effects of Pillar Two legislation into account when measuring deferred tax assets and liabilities (proposed paragraph 29.12)? If not, why not?

Question 3

Do you agree with the proposed amendments to FRS 102 that require an entity to disclose:

- (a) the fact that it expects to fall within the scope of Pillar Two legislation (proposed paragraph 29.28);
- (b) the current tax expense related to Pillar Two income taxes (proposed sub-paragraph 29.26(g)); and
- (c) information that will enable users of financial statements to understand a group's potential exposure to paying top-up tax, when Pillar Two legislation has been enacted or substantively enacted but is not yet in effect (proposed paragraph 29.29)?

If not, why not?

Question 4

Do you agree with the proposal to exempt qualifying entities, as defined in FRS 102 or FRS 101, from the disclosures that would otherwise be required by proposed paragraph 29.29 of FRS 102 and proposed² paragraph 88C of IAS 12 *Income Taxes* respectively? If not, why not?

Question 5

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

² Proposed in *IASB/ED/2023/1 International Tax Reform—Pillar Two Model Rules – Proposed amendments to IAS 12*, available at <https://www.ifrs.org/projects/work-plan/international-tax-reform-pillar-two-model-rules/exposure-draft-and-comment-letters/>.

Question 6

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

- 3 Information on how to submit comments and the FRC's policy in relation to responses is set out on page 20.

Draft amendments to FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*

International tax reform – Pillar Two model rules

Draft amendments to Section 1 Scope

1 The following paragraphs set out the draft amendments to Section 1 *Scope* (inserted text is underlined).

2 Sub-paragraph 1.12(dA) is inserted as follows:

1.12 A qualifying entity (for the purposes of this FRS) may take advantage of the following disclosure exemptions:

...

(dA) The requirements of paragraph 29.29, provided that disclosures equivalent to those required by this FRS are included in the consolidated financial statements in which the qualifying entity is included.

...

3 A sub-heading and paragraphs 1.34 and 1.35 are inserted as follows:

International tax reform – Pillar Two model rules

1.34 In [July 2023] amendments were made to this FRS that introduce a temporary exception to the accounting for deferred taxes arising from **Pillar Two legislation**, and require related targeted disclosures. An entity shall apply:

(a) paragraph 29.2B [immediately upon issue of these amendments]; and

(b) paragraphs 29.12A, 29.26(g), 29.28 and 29.29 for accounting periods beginning on or after [1 January 2023].

1.35 Early application is permitted. If an entity applies these amendments early it shall disclose that fact, unless it is a small entity in the Republic of Ireland, in which case it is encouraged to disclose that fact.

Draft amendments to Section 29 *Income Tax*

4 The following paragraphs set out the draft amendments to Section 29 *Income Tax* (deleted text is struck through, inserted text is underlined).

5 Paragraph 29.2B is inserted as follows:

29.2B As an exception to the requirements in this section, an entity shall neither recognise nor disclose information about deferred tax assets and liabilities related to **Pillar Two income tax**.

6 Paragraph 29.12A is inserted as follows:

29.12A As an exception to the requirements in this section, an entity shall not take into account the effects of **Pillar Two legislation** when measuring deferred tax assets and liabilities.

7 Paragraph 29.26 is amended as follows:

29.26 An entity shall disclose separately the major components of tax expense (income). Such components of tax expense (income) may include:

- (a) current tax expense (income);
- (b) any adjustments recognised in the period for current tax of prior periods;
- (c) the amount of deferred tax expense (income) relating to the origination and reversal of timing differences;
- (d) the amount of deferred tax expense (income) relating to changes in tax rates or the imposition of new taxes;
- (e) adjustments to deferred tax expense (income) arising from a change in the tax status of the entity or its shareholders; ~~and~~
- (f) the amount of tax expense (income) relating to changes in accounting policies and material errors (see Section 10 *Accounting Policies, Estimates and Errors*); and
- (g) current tax expense (income) relating to Pillar Two income taxes.

8 A sub-heading and paragraphs 29.28 to 29.30 are inserted as follows:

International tax reform – Pillar Two model rules

29.28 If an entity expects to be within the scope of Pillar Two legislation it shall disclose that fact.

29.29 If an entity expects to be within the scope of Pillar Two legislation then, when such legislation has been enacted or substantively enacted by the reporting date but is not yet in effect for the entity, the entity shall disclose, for the current period only:

- (a) [Not used]
- (b) the jurisdictions in which the entity's **average effective tax rate** for the current period is below 15%. The entity shall also disclose the tax expense (income) and profit or loss before taxation for these jurisdictions in aggregate, as well as the resulting weighted average effective tax rate.

- (c) if assessments that the entity has made in preparing to comply with Pillar Two legislation indicate that there are jurisdictions:
- (i) identified in applying paragraph 29.29(b) but in relation to which the entity might not be exposed to paying Pillar Two income taxes;
or
 - (ii) not identified in applying paragraph 29.29(b) but in relation to which the entity might be exposed to paying Pillar Two income taxes,
- that fact and the relevant jurisdictions.

Draft amendments to Appendix I *Glossary*

- 9 The following paragraphs set out the draft amendments to Appendix I *Glossary* (inserted text is underlined).
- 10 The following glossary terms and definitions are inserted in alphabetical order as follows:

<u>average effective tax rate</u>	<u>Tax expense</u> divided by profit or loss before taxation.
<u>Pillar Two income taxes</u>	<u>Income taxes</u> arising from <u>Pillar Two legislation</u> .
<u>Pillar Two legislation</u>	<u>Tax law that implements the Pillar Two model rules published by the Organisation for Economic Co-operation and Development (OECD), including tax law that implements qualified domestic minimum top-up taxes described in those rules.</u>

Draft amendments to FRS 101 *Reduced Disclosure Framework*

International tax reform – Pillar Two model rules

Draft amendments to FRS 101 *Reduced Disclosure Framework*

11 The following paragraphs set out the draft amendments to FRS 101 (inserted text is underlined).

12 Sub-paragraph 8(iZA) is inserted immediately after sub-paragraph 8(i) as follows:

8 A qualifying entity may take advantage of the following disclosure exemptions, from when the relevant standard is applied:

...

(iZA) The requirements of paragraph 88C of IAS 12 *Income Taxes*, provided that equivalent disclosures are included in the consolidated financial statements in which the entity is included.

...

13 A sub-heading and paragraph 17 are inserted as follows:

International tax reform – Pillar Two model rules

17 In [July 2023] amendments were made to this FRS to insert sub-paragraph 8(iZA) as a consequence of amendments made to IAS 12 that would require an entity to provide specific information to users of financial statements in periods in which Pillar Two legislation is enacted or substantively enacted, but not yet in effect.

Basis for Conclusions

FRED 83 Draft amendments to FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland and FRS 101 Reduced Disclosure Framework – International tax reform – Pillar Two model rules

This Basis for Conclusions accompanies, but is not part of, this FRED and summarises the main issues considered by the FRC in developing FRED 83 Draft amendments to FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland and FRS 101 Reduced Disclosure Framework – International tax reform – Pillar Two model rules.

When these proposals are finalised, the Basis for Conclusions accompanying FRS 102 and FRS 101 will be updated.

Objective

- 1 In developing financial reporting standards, the overriding objective of the FRC is to enable users of accounts to receive high-quality understandable financial reporting proportionate to the size and complexity of the entity and users' information needs.
- 2 In achieving this objective, the FRC aims to provide succinct financial reporting standards that:
 - (a) have consistency with global accounting standards through the application of an IFRS-based solution unless an alternative clearly better meets the overriding objective;
 - (b) balance improvement, through reflecting up-to-date thinking and developments in the way businesses operate and the transactions they undertake, with stability;
 - (c) balance consistent principles for accounting by all UK and Republic of Ireland entities with proportionate and practical solutions, based on size, complexity, public interest and users' information needs;
 - (d) promote efficiency within groups; and
 - (e) are cost-effective to apply.

Background

- 3 In December 2021, the Organisation for Economic Co-operation and Development (OECD) published its Pillar Two model rules.³ The rules are part of a two-pillar solution to address the tax challenges arising from the digitalisation of the economy.
- 4 The Pillar Two model rules:
 - (a) aim to ensure that large multinational groups pay a minimum amount of tax on income arising in each jurisdiction in which they operate; and
 - (b) would achieve that aim by applying a system of top-up taxes that results in the total amount of taxes payable on excess profit in each jurisdiction representing at least the minimum rate of 15%.
- 5 In general, the rules are intended to apply to multinational groups with revenue of over €750 million, subject to certain exclusions.

³ OECD (2021), *Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two): Inclusive Framework on BEPS*, OECD Publishing, Paris, <https://doi.org/10.1787/782bac33-en>.

- 6 In this FRED, 'Pillar Two legislation' is tax law that implements the Pillar Two model rules, including tax law that implements qualified domestic minimum top-up taxes described in those rules. The term would also include an implementation that applies the Pillar Two model rules more broadly than defined by the OECD, for example by applying the system of top-up taxes described in those rules to groups operating in only one jurisdiction.

Proposed amendments to FRS 102

- 7 The FRC anticipates that some entities applying FRS 102 will be within the scope of Pillar Two legislation. The FRC is proposing to amend FRS 102 because it is concerned about the potential implications for income tax accounting resulting from jurisdictions implementing the Pillar Two model rules.
- 8 The FRC aims to provide succinct financial reporting standards that, amongst other things, have consistency with global accounting standards through the application of an IFRS-based solution unless an alternative clearly better meets the overriding objective.
- 9 The IASB issued IASB/ED/2023/1 *International Tax Reform—Pillar Two Model Rules – Proposed amendments to IAS 12* in January 2023.⁴ The proposals in that Exposure Draft would amend IAS 12 *Income Taxes* to introduce a temporary exception to the accounting for deferred taxes arising from the implementation of the Pillar Two model rules, alongside targeted disclosure requirements. IASB/ED/2023/1 was open for comment until 10 March 2023. The IASB plans to finalise any resulting amendments in the second quarter of 2023.
- 10 The IASB's proposed amendments would, in part, be applicable immediately and applied retrospectively. In order to make similar relief available to entities applying FRS 102 within a consistent timeframe, the FRC decided to consult on the basis of the IASB's proposals, rather than waiting for the final amendments. As a result, when considering respondents' feedback to this FRED, the FRC will also consider how the IASB finalised its proposals and may make further changes to the proposals to reflect the final amendments issued by the IASB.
- 11 The FRC's proposals are therefore based on the IASB's proposals in IASB/ED/2023/1, but amended where the FRC considers that an alternative clearly better meets the overriding objective.

Temporary exception for deferred tax

- 12 Amendments are proposed to insert paragraphs 29.2B and 29.12A, which respectively provide mandatory temporary exceptions to recognising or disclosing information about deferred tax assets and liabilities related to Pillar Two income tax, and to taking the effects of Pillar Two legislation into account when measuring deferred tax assets and liabilities. The exceptions are necessary because of the risk that entities would otherwise apply the principles and requirements in Section 29 inconsistently to account for deferred taxes related to Pillar Two income tax.
- 13 The FRC intends to remove the temporary exceptions when the concerns set out in paragraph 12 no longer apply, or when an accounting treatment for Pillar Two income taxes is established that better meets the FRC's overriding objective.

⁴ <https://www.ifrs.org/projects/work-plan/international-tax-reform-pillar-two-model-rules/exposure-draft-and-comment-letters/>

- 14 In determining whether to remove the temporary exception the FRC is likely to consider:
- (a) amendments issued by the IASB to modify or remove the temporary exception from IFRS Accounting Standards, or to introduce similar requirements to the *IFRS for SMEs Accounting Standard*; and
 - (b) further engagement with stakeholders.

Disclosures

- 15 An amendment is proposed to insert paragraphs 29.26(g), 29.28 and 29.29, which will require an entity:
- (a) to disclose separately the current tax expense related to Pillar Two income taxes. This will help users of financial statements understand the magnitude of Pillar Two income taxes relative to an entity's overall tax expense;
 - (b) that expects to fall within the scope of Pillar Two legislation to disclose that fact. This will enable users of financial statements to understand if the temporary exception for deferred tax has been applied and if an entity's future cash flows may be affected by transactions arising from Pillar Two legislation; and
 - (c) that expects to fall within the scope of Pillar Two legislation to, when such legislation has been enacted or substantively enacted by the reporting date but is not yet in effect for the entity, make disclosures that will enable users of financial statements to understand the entity's potential exposure to paying top-up tax.

Disclosure exemption for qualifying entities

- 16 An amendment is proposed to insert sub-paragraph 1.12(dA), which would allow qualifying entities, as defined in the Glossary to FRS 102, not to make the disclosures required by proposed paragraph 29.29, provided that equivalent disclosures are made in the consolidated financial statements in which the entity is included.
- 17 In general, the system of top-up taxes introduced by the Pillar Two model rules is determined on a jurisdiction-by-jurisdiction basis and reflects all of a group's operations in each jurisdiction. The most useful information for users of financial statements about exposure to paying top-up taxes would therefore be provided in the consolidated financial statements of the group in which the entity is consolidated.

Effective date

- 18 Amendments are proposed to insert paragraphs 1.34 and 1.35 to address the effective date of the proposed amendments. The temporary exception for deferred tax would apply immediately, and retrospectively in accordance with paragraph 10.11 of FRS 102. The disclosure requirements would apply for annual reporting periods beginning on or after 1 January 2023 because entities would need time to prepare the required information, but an entity would be permitted to early adopt.
- 19 In finalising these amendments and the amendments proposed by FRED 82 *Draft amendments to FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland and other FRSS – Periodic Review* the FRC will ensure the paragraph numbers in Section 1 are unique.

Differences from IASB/ED/2023/1

- 20 In developing FRED 83, the FRC has departed from the proposals in IASB/ED/2023/1 to reflect:
- (a) non-substantive matters necessary to reflect the drafting of FRS 102, for example changing paragraph references and moving defined terms to the Glossary; and
 - (b) substantive changes, as follows:
 - (i) Adding an exception to considering the effects of Pillar Two legislation when measuring recognised deferred tax assets and liabilities, in addition to the exception in IASB/ED/2023/1 to recognising or disclosing information about deferred tax assets and liabilities related to Pillar Two income taxes. This change was made because Pillar Two legislation may affect the measurement of recognised deferred tax assets or liabilities and an exception should be provided because of the risk that entities might otherwise inconsistently apply the principles and requirements in Section 29 (see paragraph 12).
 - (ii) Deleting the requirement to disclose that the exception to recognising and disclosing information about deferred tax assets and liabilities related to Pillar Two income tax has been applied. This change was made because the exception is mandatory in any case.
 - (iii) Adding a requirement that, if an entity expects to be within the scope of Pillar Two legislation, it shall disclose that fact. This change was made because the majority of entities applying FRS 102 are not expected to be within the scope of Pillar Two legislation and those that expect to be should therefore make that fact clear to the users of their financial statements (see paragraph 15).
 - (iv) Omitting the specific requirement for an entity to disclose information about Pillar Two legislation enacted or substantively enacted in jurisdictions in which the entity operates.
 - (v) Clarifying and more tightly defining the circumstances in which detailed disclosures are made about the jurisdictions in which the entity's average effective tax rate for the current period is below 15%, to apply clearly only to entities expected to be within the scope of Pillar Two legislation (see paragraph 15).
 - (vi) Permitting early application. This change was made to allow an entity to make the disclosures earlier than it is required to do so, reflecting the likelihood of a longer post-reporting date preparation period being available to entities preparing financial statements in accordance with FRS 102 (see paragraph 18).
 - (vii) Adding an exemption for qualifying entities from certain proposed disclosures that are primarily relevant to the consolidated financial statements of a group, provided that equivalent disclosures are included in the consolidated financial statements in which the qualifying entity is included (see paragraphs 16 and 17).

Proposed amendments to FRS 101

- 21 The FRC is proposing to amend FRS 101 to provide an exemption from certain of the proposed new disclosure requirements in IAS 12, in line with the exemption proposed for qualifying entities under FRS 102 and for the same reason (see paragraphs 16 and 17). An amendment is proposed to insert sub-paragraph 8(iZA), which would allow qualifying entities not to disclose the information required by paragraph 88C of IAS 12.

Consultation stage impact assessment

Introduction

- 1 The FRC is committed to a proportionate approach to the use of its powers, making effective use of impact assessments and having regard to the impact of regulation on small enterprises.

Draft amendments to FRS 102 and FRS 101

- 2 The proposals in this FRED are made in response to the expected enactment of tax law that implements the Pillar Two model rules into domestic legislation.
- 3 The proposals in this FRED will affect entities applying FRS 102 and FRS 101 that are within the scope of Pillar Two legislation. The high-level scope of the Pillar Two model rules is relatively clear, but the final approach taken may differ in practice in different jurisdictions. In the final stage impact assessment, we may reflect information included in impact assessments, or similar analyses, produced alongside top-up tax legislation.
- 4 At this stage, we expect that entities in scope will include those that are a member of a corporate group with revenue in its consolidated financial statements exceeding €750 million in at least two of the four preceding fiscal years, except for government entities, international organisations, non-profit organisations, pension funds, investment funds or real estate funds. Only some such entities will apply FRS 102 or FRS 101 and be affected by the proposals in this FRED; some entities may instead, for example, apply adopted IFRS Accounting Standards.
- 5 OECD statistics⁵ indicate that there are 387 Multinational Enterprises (MNEs) which have headquarters in the UK, and 61 MNEs which have headquarters in the Republic of Ireland, with consolidated revenues of at least €750 million. The UK government estimates the number of MNEs with consolidated revenues of at least €750 million which have operations in the UK but are headquartered outside the UK is 4,000.⁶ MNEs operate through more than one entity, each of which is required to prepare financial statements. However, even taking this into account we expect the proposals in this FRED would affect only a small proportion of the entities that apply FRS 102, which we estimate to be 1,767,465 entities in total.⁷
- 6 The proposals in this FRED provide a temporary exception to certain aspects of recognition and measurement of deferred taxes, and require certain disclosures relating to Pillar Two income tax. They are not expected to affect an entity's exposure to tax.
- 7 Because of the issues set out in paragraph 12 of the Basis for Conclusions it is difficult to assess the impact that the proposals will have. However, in general, we expect the proposals in this FRED will:
 - (a) allow in-scope entities to avoid costs that they would otherwise have incurred in recognising and disclosing information about deferred tax assets and liabilities related to top-up taxes; and

⁵ The fourth edition of the *Corporate Tax Statistics* database available at <https://www.oecd.org/tax/beps/corporate-tax-statistics-database.htm>.

⁶ *Written question, 31 January 2023, UIN 136517* available at <https://questions-statements.parliament.uk/written-questions/detail/2023-01-31/136517>.

⁷ Tables 1 and 2 of the *Consultation Stage Impact Assessment* accompanying FRED 82 *Draft amendments to FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland and other FRSs*, available at <https://www.frc.org.uk/fred82>.

- (b) introduce limited additional costs, which would be less than the costs avoided, because the new disclosure requirements in:
 - (i) proposed paragraphs 29.26(g), 29.28, and 29.29(b) are readily determinable from the analysis a group will carry out to comply with Pillar Two legislation;
 - (ii) proposed paragraph 29.29(c) would be required only if an entity has already made such assessments; and
 - (iii) proposed paragraph 29.29 would not apply to qualifying entities, as defined in FRS 102, provided that equivalent disclosures are included in the consolidated financial statements in which the qualifying entity is included and a similar exemption would be available to qualifying entities as defined in FRS 101.

Conclusion

- 8 Overall, the FRC believes that the proposed amendments will have a positive impact on financial reporting that is expected to exceed the costs of applying the new requirements.

This draft is issued by the FRC for comment. It should be noted that the draft may be modified in the light of comments received before being issued in final form.

For ease of handling, we prefer comments to be sent by e-mail to:

ukfrs@frc.org.uk

Comments may also be sent in hard copy to:

Accounting and Reporting Policy team
Financial Reporting Council
8th Floor
125 London Wall
London
EC2Y 5AS

Comments should be despatched so as to be received no later than 24 May 2023. If you have sent a copy of your response electronically, there is no need to send an additional hard copy.

The FRC's usual policy is to publish on its website all responses to formal consultations issued by the FRC unless the respondent explicitly requests otherwise. An automatic confidentiality statement in an e-mail message will not be regarded as a request for non-disclosure. Please be aware that we cannot guarantee confidentiality of consultation responses in all circumstances.

The FRC may not edit (but may redact) personal information (such as telephone numbers or postal or e-mail addresses) from submissions; therefore, only information that you wish to be published should be submitted.

We will process your personal data in accordance with applicable UK data protection laws. Please see our privacy policy.⁸

The FRC aims to publish responses within 10 working days of receipt.

The FRC will publish a summary of the consultation responses, either as part of, or alongside, its final decision.

⁸ <https://www.frc.org.uk/about-the-frc/procedures-and-policies/privacy-the-frc>



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ISBN 978-0-7545-5970-2



9 780754 559702