

17 April 2023

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

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**

We welcome the opportunity to comment on FRED 82.

Mercia is one of the leading providers of training and support services to the UK and Ireland accountancy profession. Over 7,000 firms attend our training events, rely on our technical products and promote themselves using our marketing services.

Mercia's technical team has considered the proposals in FRED 82. The attached appendix to this letter includes our comments on the specific questions raised in the exposure draft.

If you wish to discuss any matters raised, please contact Jenny Faulkner on [REDACTED]

Yours faithfully

[REDACTED]

Jenny Faulkner

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## Appendix

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

#### Question 1: Disclosure

*Do you have any comments on the proposed overall level of disclosure required by FRS 102?*

We consider that the proposed overall level of disclosure required by FRS 102 is appropriate and will generally not be too cumbersome for entities to comply with.

*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?*

Yes, we do believe that generally users of financial statements prepared under FRS 102 will be able to obtain the information they seek. Depending on their information needs, users of financial statements prepared in accordance with FRS 102 Section 1A may struggle to obtain such information. We recognise, however, that an appropriate balance is required for small entities, and feel that with the proposed amendments to the disclosure requirements of Section 1A, this balance is broadly achieved.

#### 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?*

We agree with the proposal to align FRS 102 and FRS 105 with the 2018 Conceptual Framework.

*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?*

Given the particular nature of Section 18 Intangible Assets other than Goodwill and Section 21 Provisions and Contingencies, we agree with the approach to retain the extant definitions of an asset and liability respectively for these sections, and support the inclusion of the proposed paragraphs 18.4A and 21.4A which highlight the use of the alternative definitions.

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

We note a minor inconsistency between the proposed paragraph 2.32 which references the intention of the entity and the extant paragraph 3.8 which references the intention of management, and that this inconsistency is also apparent within IASB/ED/2022/1.

### **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 agree with this proposal.

*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?*

We agree with the proposed consequential amendment.

### **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?*

We agree with this approach.

*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?*

We broadly agree with this view and consider that the introduction of an expected credit loss model for some entities may be unduly cumbersome, with the benefits of doing so being outweighed by the costs.

*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 would agree that it would be more appropriate to define the scope of which entities should apply an expected credit loss model based on an entity's activities rather than whether or not it meets the definition of a financial institution. This should result in more relevant information for users of the financial statements.

We agree with the examples provided of entering regulated or unregulated credit agreements as lender, or finance leases as lessor.

We would encourage consideration of whether the expected loss model should be applied to all financial assets measured at amortised cost in such entities or just to those financial assets measured at amortised cost which are related to the activities which would bring the entity within scope of the expected credit loss model.

#### **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 this proposal.

*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 would support the deletion of these temporary amendments and would not consider it unreasonable to delete these temporary amendments for periods commencing on or after 1 January 2025, although would also be comfortable with deletion at a later date.

#### **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?*

We understand the rationale for the proposals to revise Section 20 of FRS 102, and we agree that the model will result in more relevant lease accounting which would improve comparability across entities applying FRS 102, as well as with entities applying IFRS, and provide improved information to users of financial statements. The proposals will, however, undoubtedly result in greater compliance costs, particularly for lessees needing to bring most leases on-balance sheet – this is likely to have a disproportionate impact on smaller entities (including, for example, charities which are prohibited from applying FRS 105) and those less familiar with the extant requirements of IFRS 16. There is also a threat to auditor independence since many smaller entities are likely to push their auditors to undertake transition and subsequent calculations for them.

If the changes are to be implemented, we would be in agreement with most of the simplifications and

practical expedients proposed, However, we have some concerns regarding the practical expedient proposed in paragraph 20.34. We agree with the overall aim of the practical expedient, however, consider that the threshold of 'at least half of the total consideration for a contract' is too low. If an exact proportion is to be used (as opposed to a more judgemental measure), we would consider a threshold of 75% to be more appropriate. We consider such a threshold to provide a more appropriate balance between application of the underlying requirements of the section and efficiency. If it is not considered appropriate to increase this threshold, we would nevertheless recommend the wording is amended such that 'more than half' replaces 'at least half'. This would avoid potential unintended results in the very rare cases where there are two lease components for which the consideration was equal.

*Have you identified any further simplifications or additional guidance that you consider would be necessary or beneficial?*

We would suggest that further guidance on what constitutes a lease for which the underlying asset is of low value would be necessary. Whilst the examples in the proposed paragraphs 20.11 and 20.12 are useful, we consider that reference to a monetary amount may be beneficial in order for this assessment to be made on an absolute basis, as required by the proposed amendments. We acknowledge that the inclusion of a monetary amount in the standard itself presents its own difficulties, but it is perhaps appropriate to make such a reference in the basis for conclusions, similar to the approach adopted for IFRS 16, which makes reference to a monetary amount of US \$5,000 or less in BC100.

We would consider it beneficial for the term 'readily determinable' to be defined to avoid divergence in practice on interpretation when considering whether the interest rate implicit in the lease must be applied or whether the lessee's incremental borrowing rate or obtainable borrowing rate could instead be used.

## **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?*

We broadly agree with the proposals.

We would recommend that the proposed paragraph 18.13 in FRS 105 is amended as it currently appears to require the entity to identify each distinct good or service, rather than each promise to transfer a distinct good or service, although accept that the proposed wording mirrors that proposed by IASB/ED/2022/1 paragraph 23.37. We would also recommend inclusion of the reference to a distinct bundle of goods or services as per the proposed paragraph 23.16 in FRS 102.

*Have you identified any further simplifications or additional guidance that you consider would be necessary or beneficial?*

We would recommend that the guidance on the term 'distinct' is retained in FRS 105 as we consider

leaving interpretation to the term's ordinary meaning is likely to result in divergence in practice.

### **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 agree with this proposal, on the assumption that finalised amendments are published prior to the end of 2023. This should give preparers and software providers sufficient opportunity to update and apply the new requirements, especially as software providers will already be familiar with the requirements of the related IFRSs. Such a timescale should also facilitate consideration of comments on IASB/ED/2022/1 even if the finalised third edition of the IFRS for SMEs has not been issued prior to finalisation of these amendments.

*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?*

We agree with this proposal.

*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 this proposal.

*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 proposal not to permit the revised Section 23 of FRS 102 to be applied on a prospective basis, and agree that this would cause issues with comparability between current and future reporting periods.

For the same reason however, we do not agree with the proposal to require micro-entities to apply the revised Section 18 of FRS 105 on a prospective basis. Whilst this may reduce the burden of transition, for some entities with long-term contracts, this could cause years of potential comparability issues in their financial statements. We would therefore recommend that the same approach to transition is adopted in FRS 105 as is proposed for FRS 102.

*Do you have any other comments on the transitional provisions proposed in FRED 82?*

We have no further 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 have not identified any additional transitional provisions that we consider would be necessary or beneficial.

### **Question 9: Other comments**

*Do you have any other comments on the proposed amendments set out in FRED 82?*

We are broadly supportive of the proposed changes to incorporate the disclosures within the extant Appendix E Additional disclosure encouraged for small entities in the UK into Appendix C, with the effect that these disclosures become mandatory for small entities. We believe that this will help remove unnecessary judgement, whilst providing better information for users of the financial statements. However, we note that these additional requirements are being introduced against a backdrop of deregulation for small companies and therefore this could be seen as contrary to such policy aims.

We question the necessity for the introduction of the proposed paragraph 1AC.36A requiring certain disclosures relating to deferred tax. For most small entities this is unlikely to add much value.

We welcome the proposed additional guidance on settlement of an equity settled share-based payment transactions and measurement of cash-settled share-based payment transactions in Section 26 Share-based payment.

We note that there is a reasonable amount of inconsistency in the rationale for the proposed changes. For example, FRED 82 does not propose to introduce the expected credit loss model for financial instruments, instead the intention is to reconsider the matter in due course, taking into account the IASB's third edition of the IFRS for SMEs when finalised. However, FRED 82 proposes to introduce significant changes to leasing in FRS 102 when IASB/ED/2022/1 doesn't propose to introduce such changes to the IFRS for SMEs at this time. Whilst the basis for conclusions highlights this decision is, at least in part, due to stakeholder feedback received by the FRC, it's unclear whether the views of smaller entities have been considered in taking this decision, especially as the proposed changes to leasing would likely have a much more significant practical impact for smaller entities than the introduction of the expected credit loss model.

### **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 have no specific comments on the consultation stage impact assessment.