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Jenny Carter
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By email: ukfrsperiodicreview@frc.org.uk

Dear Ms Carter,

Periodic review of FRS 102 and other UK and Ireland accounting standards

We welcome the opportunity to provide input into the forthcoming periodic review of FRS 102 and other UK and Ireland accounting standards and offer our suggestions and comments below.

In general, we consider that the UK financial reporting regime is working well and is achieving the intended objectives. We have developed our response in the context of the FRC's overriding objective when developing financial reporting standards and, in particular, the aim to achieve consistency with global accounting standards through the application of an IFRS-based solution unless an alternative solution is clearly better. With this in mind, we support the implementation of the principles of IFRS 15 *Revenue from Contracts with Customers* and IFRS 16 *Leases* into FRS 102, with appropriate simplifications, clarifications and transitional provisions to achieve a proportionate solution.

However, we are not in favour of introducing the impairment model of IFRS 9 *Financial Instruments* for all FRS 102 reporters and instead recommend that a sub-set of FRS 102 preparers with fiduciary responsibilities should, instead, be required to apply IFRS 9 rather than Sections 11 and 12 of FRS 102 (together with the disclosure requirements set out in IFRS 7). We also have some further suggestions regarding other developments in IFRS Standards since the last periodic review was carried out.

As regards the IFRS for SMEs, which is currently undergoing its own review, while we acknowledge that there may be some benefits in following these developments, we consider that FRS 102 has a different user pool and has diverged significantly from the IFRS for SMEs. It would therefore be more beneficial for UK reporters if the "IFRS-based solution" to be found for FRS 102 was aligned as closely as possible to the principles in full IFRS.

In progressing the periodic review, we strongly urge the FRC to work with the UK government and specifically the Department for Business, Energy and Industrial Strategy (BEIS) to achieve broader reform of the UK corporate reporting regime. Of particular relevance to the periodic review is the opportunity to revisit the current regimes for small companies and micro-entities and question whether they are functioning as desired. In our view, the current micro-entity accounts regime is unfit for purpose. There is such limited information in the accounts prepared under the micro-entity regime and FRS 105 that they

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provide almost no value to stakeholders, and therefore the purpose of reporting by micro-entities needs to be addressed before any meaningful review of FRS 105 can take place.

Meanwhile, the small company regime, set out in UK law and Section 1A of FRS 102, remains subject to the tension between the requirement for small entity accounts to give a true and fair view and the legal restriction that only certain disclosures can be mandated. As the UK has left the European Union, there is no longer any requirement to adhere to "maximum harmonisation" and we call on the FRC and BEIS to review and revise the small company regime and, in particular, to lift the ban on introduction of additional disclosure requirements beyond those imposed by law. We acknowledge that FRS 102 also applies in Ireland and note that differential disclosure requirements may be necessary as Ireland remains a member of the European Union and therefore subject to the requirements of the Accounting Directive.

More widely, difficulty continues to exist in reconciling the requirements set out in the Accounting Regulations (SI 2008/409 and SI 2008/410) with those in accounting standards. The extensive measurement and disclosure requirements in the Accounting Regulations use different terminology and do not always fit neatly or consistently with FRS 101 or FRS 102, and the primary statement formats are outdated. Given the existence of clear, comprehensive UK accounting standards, there seems no value to retaining these requirements in company law as well. We therefore call upon the FRC and BEIS to collaborate on a project to remove – or at least, significantly reduce – the accounting requirements contained in the Accounting Regulations and to place the remit for developing accounts presentation and disclosure squarely with the FRC (or its successor).

Given the substantial issues which need to be considered as part of this periodic review, we consider the timeframe for publication of an exposure draft and the proposed effective date of the revised standards to be rather optimistic. We would prefer that the FRC take the time to gather appropriate input and feedback and to consider carefully how to implement new requirements such as those in IFRS 15 and 16 in a proportionate manner while preserving the core principles of those standards. This periodic review is significantly more complex than the previous periodic review, which focused primarily on implementation issues, and will necessarily take more time to complete. We would be happy to assist with the more detailed aspects of implementation.

Our comments on specific areas are set out in the following Appendices:

- Appendix 1: Implementation of IFRS 15 *Revenue from Contracts with Customers*
- Appendix 2: Implementation of IFRS 16 *Leases*
- Appendix 3: Implementation of the impairment model in IFRS 9 *Financial Instruments* and other financial instruments-related issues
- Appendix 4: Interaction between accounting standards and UK company law
- Appendix 5: Implementation of other changes to IFRS Standards
- Appendix 6: Comments on FRS 102
- Appendix 7: Comments on other FRSs

If you have any questions, please contact Robert Carroll on 020 7303 2458 or rcarroll@deloitte.co.uk, or Anne Cowley on 020 7007 5636 or annecowley@deloitte.co.uk.

Yours sincerely

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Appendix 1: Implementation of IFRS 15 Revenue from Contracts with Customers

Revenue is one of the most important metrics in the financial statements and it is essential that accounting standards provide a clear framework for recognising and measuring revenue. We are therefore strongly in favour of implementing the core principles of IFRS 15 into FRS 102 and consider that there is no other option which would be consistent with the FRC's objective to apply an IFRS-based solution unless an alternative is clearly better.

In our view, the existing guidance in Section 23 is no longer fit for purpose. It is too high-level and does not result in reliable, comparable reporting of revenue. To the extent that entities are currently applying appropriate accounting treatment for revenue under FRS 102, we believe that this is either because their revenue streams are so straightforward that largely the same accounting would result regardless of the requirements, or because they are looking to alternative GAAPs such as IFRS for guidance because the limited guidance in FRS 102 is inadequate to guide them to the appropriate accounting treatment. We also do not believe that it would be sufficient to supplement the existing content of Section 23 with additional guidance, not least because Section 23 and IFRS 15 are based on different principles (risks and rewards vs control); the fundamental model for revenue recognition needs to be clear and comprehensive and additional guidance for a flawed model would not achieve that.

IFRS 15 is a lengthy and detailed standard; however, we consider that a simplified version, which brings across the core principles and key underlying guidance while leaving behind some of the more detailed and prescriptive provisions, would be appropriate for FRS 102. We acknowledge that this will result in a longer Section 23, but this is simply necessary; Section 23 as it currently stands does not provide sufficient guidance to achieve consistent application in practice. While there may be an initial implementation cost, we believe that it should be reasonably straightforward to adopt a simplified version of IFRS 15 and therefore should not be as time-consuming or challenging as it was for IFRS reporters, particularly if some of the more prescriptive aspects of IFRS 15 are simplified or removed. In any case, we believe that the benefit of a model which supports and facilitates reliable, relevant revenue reporting in the financial statements (and, consequently, improves comparability not only across FRS 102 reporters but also with IFRS reporters) significantly outweighs any initial implementation cost.

We believe that the FRC should introduce the core principle that an entity recognises revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This principle would then be underpinned by the five-step model for recognising revenue from contracts with customers. The detailed guidance around these core principles can be simplified from "full" IFRS 15 by reducing the number of rules around them and by streamlining some of the terminology used. We propose that this simplified model should then be applicable for all entities applying FRS 102, regardless of size; in other words, there should be no further ongoing recognition and measurement simplifications for small entities. However, it may be appropriate to introduce additional transitional provisions (or allow a later effective date) for small entities to enable them to implement the new model.

Although some high-level suggestions for simplification follow, the full exercise will require detailed consideration of the provisions in IFRS 15 and assessment of which of these must be included, simplified or left out. We would be happy to assist the FRC in this regard.

<u>Step 1 – identify the contract(s) with a customer:</u>
In our view this step is not particularly time-consuming, but one simplification that we recommend would

be to simplify the requirements regarding the accounting where the criteria for a contract are not yet met; applying these requirements has proven challenging in practice for IFRS reporters.

Step 2 – identify the performance obligations:

This step could be simplified by removing the requirements around accounting for a *series* of distinct goods or services. This would then enable removal of the term "performance obligation" such that FRS 102 reporters would only need to identify "distinct" goods and services. The term "performance obligation" is only needed in "full" IFRS 15 because of the requirement to account for a series of distinct goods or services "that are substantially the same and that have the same pattern of transfer to the customer" as a separate performance obligation. Removing that requirement, and instead requiring FRS 102 reporters only to identify distinct goods or services, would greatly simplify the terminology associated with this step. It would also make it easier for entities to account for multi-year service contracts in a way that more closely reflects the pricing model agreed with customers.

In terms of identifying whether a good or service is distinct, we advise bringing in the overarching requirement in IFRS 15:27, and the guidance in IFRS 15:28. However, when determining whether an item is separately identifiable under IFRS 15:27(b), we suggest retaining the requirements of IFRS 15:29(a) and (b) – perhaps with simpler terminology – but removing (c) ("the goods or services are highly interdependent, or highly interrelated") as this has proven challenging to apply in practice. Although simplified guidance in this area might slightly widen the circumstances in which entities may come to different conclusions based on judgements made, we believe this can be captured adequately by disclosure.

Step 3 – determine the transaction price:

We believe that most of the provisions in this step will need to be retained, but some of these could be simplified. For instance, the FRC could set a simpler threshold in FRS 102 for determining when there is a significant financing component, or remove the need to account for a significant financing component where the customer pays in advance.

In particular we consider that the IFRS 15 approach to variable consideration is conceptually far better – and easier to apply in practice – than the current "reliable measurement" approach in Section 23. There is significant judgement in assessing when revenue is sufficiently reliably measurable to warrant recognition under Section 23, whereas the requirement to constrain estimates of variable consideration eliminates some of that judgement. Moreover, we believe that some of the wording in IFRS 15 could be simplified for the purpose of FRS 102 to make this step more user friendly to apply.

We also recommend including the specific requirements around accounting for consideration payable to a customer as set out in IFRS 15:70 (where the accounting depends on whether that payment is in exchange for a distinct good or service). This could be supplemented in FRS 102 by including guidance to explain that for a good or service supplied in this way to be distinct, it needs to be reasonable that the entity would have bought this from the customer even had it not made the associated sale to the customer.

Step 4 – allocate the transaction price to the performance obligations in the contract:

IFRS 15 is very prescriptive in how value is allocated between performance obligations. This could be implemented in FRS 102 in a much simpler way by replacing the detail with an objective to allocate the transaction price between the performance obligations such that each is allocated an amount consistent with its standalone selling price. Where there are discounts, those should be allocated in a way that reflects management's view of the economics of the contract, and not automatically on a pro rata basis.

This step should also allow for the possibility that variable consideration may, in some cases, need to be allocated to individual deliverables, but in others might be related to the contract as a whole. We do not consider that FRS 102 needs to be prescriptive in this regard but should instead allow management to use judgement to arrive at an appropriate answer and, if material, explain how and why that judgement was made.

Step 5 – determine when to recognise revenue:
For the final step, we recommend retaining the core concepts but simplifying the language used. The most important concept at this stage is the decision to recognise revenue "over time" or "at a point in time" and these terms should be retained. However, the criteria for recognition over time could be set out in a more straightforward manner. IFRS 15:35 essentially sets out three criteria for recognition over time which could be rephrased as follows: a) the customer simultaneously receives and consumes benefits (i.e. performance results in an expense for the customer), b) the customer obtains an asset where control is passed as the asset is created or enhanced (i.e. performance results in an asset for the customer) and c) the entity has an enforceable right to payment for performance to date and that performance has not created an asset that the entity could readily redirect to a different customer (i.e. even where physical possession has not transferred, the customer is exposed to the associated risks and rewards because they have to pay for work carried out to date).

The IFRS 15 guidance on recognising revenue over time is quite lengthy and the FRC may wish to cut this down (for instance, the detailed guidance on input and output measures could be abbreviated). In particular, simplifying the requirement for a single measure of progress would reduce the complexity of this topic and make the guidance easier to apply in practice.

We consider that the guidance for recognition "at a point in time" does not need to change significantly for implementation into FRS 102.

Other requirements
The requirements in IFRS 15 for determining whether an entity is acting as an agent or a principal could be made substantially simpler and less judgemental than even the equivalent content currently in Section 23. For instance, the standard could simply state that "an entity is acting as a principal if:

a) it has primary contractual responsibility to the customer for the goods or services that they are buying, such that in the event that the customer is entitled to compensation, they would be entitled to claim it from that entity; or
b) if the goods or services that the customer is obtaining are controlled by the entity as its inventories before they are transferred to the customer.

If neither of these is the case, the entity is acting as an agent."

The requirements in IFRS 15 around costs to obtain and fulfil a contract could also be simplified. We would favour an accounting policy choice over whether to expense costs of obtaining a contract. We would base the requirements for capitalisation on those in IFRS 15, but we recommend avoiding use of the word "incremental" when setting out which costs incurred to obtain a contract may be capitalised. A simpler alternative would be to allow capitalisation of "success fees" only (e.g. sales commission payable to employees). As regards the treatment of costs to fulfil a contract, Section 23 could simply state that an asset may only be recognised to the extent that the costs meet the criteria for capitalisation under another relevant section of FRS 102 (e.g. Sections 13, 17 and 18). If this approach is adopted, we would recommend some small enhancements to the wording in Section 13 to make clear, for example, that costs incurred in developing a report for which revenue will be recognised at a point in time are eligible for recognition as inventories.

Disclosure
We consider it likely that most of the disclosures in IFRS 15 will need to be included in FRS 102 and advise against simplifying these too much; it is important that companies explain how and when they recognise revenue and what judgements have been made in arriving at those conclusions. However, we would suggest permitting disclosure exemptions similar to those in FRS 101 for qualifying entities.

Effective date and transition
In our view the proposed effective date of 1 January 2024 is likely to prove very challenging for reporters applying the principles of IFRS 15 for the first time. They will need time to understand and assess the new requirements and consider how their accounting will change. Even with generous transitional provisions in place (which we would be in favour of, similar to those in IFRS 15), we consider that entities will need at least a further year to prepare and adapt, especially given the other significant changes to FRS 102 which would take effect at the same time (e.g. leases). As noted above, the FRC may wish to extend more generous transitional relief to small entities (such as an even later effective date).

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Appendix 2: Implementation of IFRS 16 Leases

We are in favour of introducing the requirements of IFRS 16 for lessees into FRS 102 at this time. Operating leases are by far the most prevalent form of lease entered into by FRS 102 preparers and we do not consider that the current disclosure requirements provide sufficient information or are sufficiently prominent in the financial statements to aid user understanding of the commitments entered into. We also do not see that enhanced disclosure would resolve this.

We consider that the IFRS 16 model provides more relevant and reliable information for users as it makes the financial position of the lessee far clearer than the current 'off-balance sheet' approach for operating leases. We acknowledge that this will be a significant change for FRS 102 preparers and may incur substantial one-off implementation costs, but believe that with certain simplifications and transitional provisions, the benefits of implementation would outweigh the cost. It would also reduce the burden on groups where subsidiaries apply FRS 102 and report consolidated figures for IFRS purposes as the difference in approach would typically remove the need to adjust on consolidation. These entities will already have the IFRS numbers and transition should not pose a significant challenge in such cases. As such, consideration should be given to a transitional provision that would enable subsidiaries reporting under FRS 102 to measure balances by reference to those already recorded in IFRS consolidated accounts in which they are included. Further, by the time any changes from this periodic review take effect, IFRS 16 will have been in place for IFRS reporters for five years, meaning that there will be significant implementation experience to learn from.

We would not propose an exercise to mirror the lessor accounting with the IFRS 16 lessee model at this stage. This was abandoned by the IASB in development of IFRS 16 and we recommend consistency with the IASB's approach. However, we encourage the FRC to review the requirements in IFRS 16 for lessors to identify whether there are any areas which could usefully be expanded upon in FRS 102. One such example is lease modifications; there is currently no detail on how a modification to an operating lease should be dealt with (aside from in the specific instance of COVID-19 related rent concessions). Clear requirements as to the treatment of initial direct costs would also be helpful.

We acknowledge that there are particular challenges posed by IFRS 16 which could prove problematic on adoption. For instance, it can be difficult to assess whether arrangements in the technology space (such as off-site servers as part of cloud computing arrangements) contain or represent a lease. Impairment testing of right of use assets has also been challenging to apply in practice in some cases. Again, lessons learned from implementation by IFRS reporters and developing practice over the period to 2024 may well help here.

There is also a potential challenge in that the scope of FRS 102 includes many small entities which are required to apply the same recognition and measurement principles as the largest FRS 102 reporters. We do not believe that there should be any difference in the basic recognition and measurement approach taken for small entities (although some additional transitional relief may be helpful).

In part this is because we believe the information provided by the IFRS 16 model is equally relevant for the users of small entity accounts as for others (and many small entities will have significant operating leases), but there is also a potential challenge around application of the small company criteria if the accounting is different. One of the three criteria under the Companies Act 2006 for qualification as small is "total assets" and this metric is directly affected by the application of the IFRS 16 model, since it requires the recognition of a right-of-use asset. This means that a company applying the existing requirements in

Section 20 may qualify as small, but if it were to apply the principles of IFRS 16, it may no longer qualify as small due to an increase in total assets. Allowing small entities to continue with the current treatment for operating leases could therefore leave them in the situation where they only qualify as small because they are not applying the full recognition and measurement model required for other entities, which is a rather unpalatable outcome. It would therefore be preferable for all entities applying FRS 102 to adopt the IFRS 16 model.

For all entities, we believe it will be essential to introduce some simplifications in implementing IFRS 16 into FRS 102 if the cost/benefit balance is to be maintained. In addition, we strongly support retention of existing simplifications, such as the exemptions for low-value and short-term leases. In determining whether a lease meets the low-value exemption, we firmly believe that it is important to include a monetary threshold; a principles-based approach would result in inconsistencies in application and risks excessive or inappropriate judgement arising around what constitutes a low-value lease (not unlike the challenges preparers and auditors faced in applying the "undue cost or effort" exemption, which the FRC chose to remove from FRS 102 in the triennial review). Both consistency and ease of application would be enhanced by providing a monetary threshold similar to that in the Basis for Conclusions to IFRS 16.

Other possibilities for simplification may include:

- Considering how best to arrive at the appropriate discount rate to be used. Determination of the incremental borrowing rate has often proved challenging for IFRS preparers. Consideration could be given to whether an option could be inserted for lessees to use a risk free rate for discounting purposes, with the election made by class of asset, potentially with other restrictions on its applicability (e.g. by length of lease or for small entities only). A similar exception is available under US GAAP for private companies.
- Removing the requirement to use a new discount rate in the scenario where there is a modification to a lease but the length of the lease has not been altered.
- Providing greater clarity on how to determine the enforceable lease term and on situations where both parties can terminate without more than an 'insignificant penalty'; this has been particularly problematic under IFRS 16.

As with IFRS 15, we consider that an effective date of 1 January 2024 may be difficult for entities to prepare for and entities may need at least a further year to prepare and adapt, especially given the other significant changes to FRS 102 which would take effect at the same time.

We also recommend clear and straightforward transitional provisions. These may follow the approach taken in IFRS 16 or may be more simplified still (for instance, it may be beneficial to require all entities to apply the cumulative catch-up method rather than full retrospective application, and to limit or simplify the options available under that method). For small entities in particular, it may be helpful to include additional specific transitional provisions which may include a later effective date. Such entities will necessarily need more time to prepare for and apply the principles of IFRS 16 and these proposals would provide that. Provisions for first-time adopters of FRS 102 should also be set out in Section 35.

Any version of IFRS 16 which is implemented into FRS 102 will necessarily need to be simplified and shortened. This will require detailed consideration of the provisions in IFRS 16 and assessment of which must be included and which may be left out. We would be happy to assist the FRC with this exercise.

Appendix 3: Implementation of the impairment model in IFRS 9 Financial Instruments and other financial instruments-related issues

Sections 11, 12 and 22 – general

Broadly speaking, we believe that the current content in Sections 11, 12 and 22 of FRS 102 is functioning as intended. Preparers are now familiar with the basic/non-basic model and the introduction of the broader principle for determining classification, which was inserted during the previous periodic review, has assisted in this regard. The only change we would propose is in respect of the accounting policy choice to apply the recognition and measurement provisions of IAS 39 instead of those of Sections 11 and 12. This option was initially included to assist with transition to FRS 102 for entities previously applying FRS 26, and to bridge the gap until IFRS 9 was complete and in force. However, now that the requirements of both FRS 102 and IFRS 9 are well established and understood, we recommend that this option be restricted such that the accounting policy choice to apply the recognition and measurement provisions of IAS 39 is not available to entities unless they were already applying that option. This would clearly signal the ultimate intention to withdraw the option, whilst allowing those that still need to refer to IAS 39 (e.g. insurers) to do so. In order to further encourage entities to move away from the out-dated requirements of IAS 39, we would propose the development of robust transitional provisions for those wishing to apply the requirements of Sections 11 & 12 in full rather than the recognition and measurement provisions of IFRS 9.

Implementation of the IFRS 9 impairment model

We do not support the incorporation of the IFRS 9 expected credit loss (ECL) impairment model into the requirements Sections 11 and 12 of FRS 102, either in full or as a ‘cut down’ version. The model in IFRS 9 was developed in response to the economic downturn and ‘credit crunch’ several years ago and is most relevant for financial institutions which hold significant assets in a fiduciary capacity. The approach currently set out in Section 11 of FRS 102 is well understood and relatively straightforward for both users and preparers of FRS 102 accounts to understand and explain. The breadth of entities applying FRS 102 is substantial and includes many small entities which are subject to the same recognition and measurement requirements as large and medium-sized entities. We believe that the expected credit loss model would prove unduly complex and onerous to apply and would not necessarily result in more relevant, reliable or understandable information for users. In other words, the cost/benefit test is not met and there is a clearly better alternative – namely the targeted application of the IFRS 9 requirements by the most relevant entities whilst allowing the majority of FRS 102 reporters to continue with the existing incurred loss model. To the extent that there are perceived weaknesses in the application of the existing requirements, we recommend that the FRC considers issuing targeted material to assist preparers in improving their reporting in this respect. Certainly if preparers find the current model challenging to apply, we do not expect that it will improve matters to require them to implement the more conceptually complex ECL model.

Instead, we propose that, for a subset of entities, FRS 102 should include one of the following requirements: a) apply the ECL model of IFRS 9 or b) the full recognition and measurement requirements of IFRS 9. We would suggest that this subset should include banks, building societies and other similar entities that hold significant assets in a fiduciary capacity, including those with a significant commercial lending business. This approach promotes consistency for that subset of financial institutions where the benefits are greatest and most relevant. We would not be in favour of requiring all financial institutions to apply the ECL model as this could result in unnecessary difficulties, particularly in group situations where a corporate treasury company meets the FRS 102 definition of a financial institution. We propose that the FRC follows the simplest approach of requiring such entities to apply the recognition and measurement provisions of IFRS 9 in full. The interaction of the impairment requirements of IFRS 9 and the remaining recognition and measurement provisions of Sections 11 and 12 (or IAS 39) is likely to be complex, and the identification and resolution of any potential issues may be time consuming.

We would advise against an approach which involves incorporating the IFRS 9 impairment requirements directly into FRS 102. Such an exercise would prove very challenging in practice as the ECL model is detailed and cannot easily be simplified or shortened and would risk omitting crucial pieces of the model which are necessary for it to function as intended.

In addition, the FRC should consider revisiting whether this group of entities should be required to make the disclosures related to the IFRS 9 ECL model under IFRS 7; again, this is due to the level of detail in the ECL model and the entity-specific way in which it is applied.

ESG-linked instruments

We would also suggest that the FRC considers whether or not amendments are needed to address the increasing use of environmental, social and governance (ESG)-linked instruments, where returns may vary depending on movement in an ESG metric (such as carbon emissions). We acknowledge that the FRC may wish to wait until the IASB has set out further guidance on these instruments, but this is an area of increasing concern and may warrant earlier attention as part of this periodic review; by 2024 such instruments may well be in common use. Certainly if not as part of the periodic review, then the accounting for such instruments should be addressed as a narrow scope amendment as soon as feasible. Currently the requirements in FRS 102 are likely to force such instruments into the scope of Section 12 and require them to be accounted for at fair value. This is unlikely to encourage their uptake and use and we would recommend that the FRC consider whether there is a way to bring such instruments into the scope of Section 11 and allow amortised cost accounting.

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Appendix 4: Interaction between accounting standards and UK company law

It has become increasingly difficult to reconcile the requirements set out in the Accounting Regulations (SI 2008/409 and SI 2008/410) with those in accounting standards. This became particularly evident in application of FRS 101, as companies sought to present IFRS accounting concepts in a way that did not conflict with the legal formats. Although this problem was addressed to some extent via the option, introduced by SI 2015/980, to adapt the formats of the primary statements, this option was only introduced for companies applying Schedule 1. Banks and insurance companies, which are subject to Schedules 2 and 3 to the Regulations, continue to see issues as the formats in these Schedules simply do not work with IFRS. This was acknowledged in a recent amendment to FRS 101 which prohibited insurance entities from application of IFRS 17 because to do so would create unresolvable conflict with the law.

There are also challenges in practice in applying the formats in the Accounting Regulations. For example, we consistently observe difficulty in determining what should be included as a "fixed asset" versus a "current asset", particularly in the context of intercompany balances. Confusion around these terms has increased as preparers have become increasingly familiar with the more straightforward IFRS distinction between "non-current" and "current". Further, the extensive measurement and disclosure requirements in the Accounting Regulations use different terminology and do not always fit neatly or consistently with FRS 101 or FRS 102. This creates an unnecessary additional burden on preparers to ensure that they have understood and complied with both sets of requirements. Given the existence of clear, comprehensive UK accounting standards, there seems no value to retaining the confusing and outdated requirements in company law as well.

Several issues also continue to exist in the context of small entities and the "maximum harmonisation" approach that was taken with reference to the implementation of the EU Accounting Directive in the UK, again via SI 2015/980. These issues have typically arisen as a result of the tension between the requirement for small entity accounts to give a true and fair view and the restriction that only certain disclosures can be mandated by law or accounting standards. This has proven particularly challenging in areas such as disclosure of related party balances and transactions, where the legal disclosures are limited and yet detailed related party disclosures are typically considered to be qualitatively material and necessary to give a true and fair view. The status of "encouraged" disclosures is also confusing; although we agree that these are disclosures which should be given for a true and fair view, it is difficult to mandate that entities make those disclosures and depending on the entity, there may be many other disclosures which should be given for a true and fair view.

We therefore call upon the FRC and BEIS to collaborate on a project to remove – or at least, significantly reduce – the accounting requirements contained in the Accounting Regulations and to remedy the issues around small entity disclosures.

We acknowledge that the government may wish to set out some basic parameters for the preparation of UK company accounts and specify certain requirements as a matter of public policy. This may include, for instance, the requirements contained in Schedules 5 and 8 (directors' remuneration), Schedule 7 (directors' report) and the requirements which govern information to be included in the "front half" of the annual report. However, the requirements contained in Schedules 1, 2, 3 and 6 (and potentially Schedule 4 also) could be removed from the law and captured by accounting standards under the FRC's (or its successor's) remit. This would result in a simpler regime under FRS 102 and remove the only remaining source of complexity in applying FRS 101.

We also recommend the removal of the “maximum harmonisation” restriction on disclosures for small companies; a fuller disclosure regime is required to enable small company accounts to give a true and fair view. The FRC and BEIS should develop a more user-friendly, appropriate regime for small entities (and more widely, as noted further below). This could either take the form of a separate section with disclosure requirements for small entities (as we have now) or be achieved by identifying those disclosures in the main body of the standard which do/do not apply to small entities. As a minimum this should include the existing “encouraged” disclosures but in our view this would still not necessarily be sufficient to give a true and fair view.

Any significant changes in this regard should be timed to coincide with the effective date of the revised UK accounting standards; this would avoid two sets of changes in rapid succession. We cannot overstate the importance of BEIS and the FRC working together to simplify and rationalise the current outdated system.

We acknowledge that such fundamental changes are likely to incur significant one-off costs (for instance, updating of software packages). However, change always comes with a cost and in this situation we believe that the long-term benefits of a simpler, streamlined UK reporting regime would far outweigh the initial costs of implementation and would align with the FRC’s overriding objective and principles in standard setting.

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Appendix 5: Implementation of other changes to IFRS and consideration of IFRS for SMEs developments

General approach

We understand that the general approach of the FRC is to implement changes arising from IFRS only when those changes have taken effect and there is some implementation experience from IFRS reporters. In general, we support this approach and have therefore not proposed that the FRC should implement any standards or amendments that are not yet effective.

That said, in cases where changes to IFRS would provide useful clarity or promote more relevant reporting, we do not think that the FRC should need to wait until the next periodic review to propose similar amendments to FRS 102; these should be evaluated on a case-by-case basis. An example might be *Onerous Contracts – Cost of Fulfilling a Contract (Amendments to* IAS 37 *Provisions, Contingent Liabilities and Contingent Assets)* which provides clarification rather than a substantive change to the existing requirements of IAS 37; although this is not effective until 1 January 2022 it could be helpful to include similar requirements in Section 21 of FRS 102 in this periodic review, as that section is broadly consistent with the requirements of IAS 37.

Other changes to IFRS

IFRIC 23 *Uncertainty over Income Tax Treatments*: As noted in Appendix 6, we recommend incorporating the principles of IFRIC 23 into Section 29 Income Tax. These principles are often applied in practice by FRS 102 preparers but there may be some divergence in practice as there is no requirement to apply this treatment. IFRIC 23 provides a logical and sensible set of principles for dealing with income tax uncertainty and we believe these should be included in FRS 102.

IFRS 13 *Fair Value Measurement*: Although this is not a new standard since the last periodic review of FRS 102, there is now significantly more implementation experience from IFRS adopters. FRS 102 contains relatively little guidance on determining fair value and it may be worth reconsidering whether the time is now right to introduce the principles of IFRS 13. This could aid with transition between IFRS (or FRS 101) and FRS 102 as determination of fair value would be on the same bases.

IFRS 10, 11 and 12: We do not recommend reopening consideration of implementing IFRS 10, 11 and 12 into FRS 102. The established principles and requirements in Sections 9, 14 and 15 are well understood and we consider that they produce sufficiently reliable and relevant information for users. The cost of implementing IFRS 10 and 11 in particular would be significant. In the case of IFRS 10, the assessment is unlikely to change the outcome for the majority of reporters and in the case of IFRS 11, the classification of a joint arrangement as a joint operation or a joint venture can be challenging and complex.

Equity Method in Separate Financial Statements (Amendments to IAS 27*)*: We note that the law now permits the use of the equity method in separate financial statements. The FRC may wish to consider whether it would be appropriate to amend Section 9 of FRS 102 to permit this accounting treatment.

Classification and Measurement of Share-based Payment Transactions (Amendments to IFRS 2*)*: As noted in Appendix 6, we believe it would be useful to bring in some of these amendments made to IFRS 2, particularly regarding the accounting for certain aspects of cash-settled share-based payments.

Definition of a Business (Amendments to IFRS 3*)*: As noted in Appendix 6, we believe that it would be useful to include some additional guidance in FRS 102 regarding the definition of a business, drawing on these amendments, although we would not suggest bringing in all of the guidance in these amendments (e.g. we believe the optional concentration test does not need to be included in FRS 102).

Definition of Material (Amendments to IAS 1 *and* IAS 8*)*: We consider that it would be helpful to include the expanded definition of the term "material" in FRS 102. The underlying concept is intended to be consistent across both frameworks and the amendments to IFRS are intended to make that underlying concept easier to understand. Accordingly, we consider that the additional guidance on determining whether information is material would be useful to users and preparers of FRS 102 accounts.

Plan Amendment, Curtailment or Settlement (Amendments to IAS 19*)*: As noted in Appendix 6, we believe that additional guidance on measuring the gain or loss arising on amendment, curtailment or settlement of a defined benefit plan would be helpful, as well as guidance on the treatment of past service costs; these are areas on which FRS 102 is currently silent. These amendments should be considered in developing any such guidance.

<u>IFRS for SMEs developments</u>
We acknowledge that FRS 102 was first derived from the IFRS for SMEs, but do not believe that it is necessary for the FRC to follow closely any changes made to the IFRS for SMEs in developing FRS 102 further. In meeting its overriding objective, the FRC notes that its financial reporting standards should have consistency with global accounting standards through the application of an IFRS-based solution unless an alternative clearly better meets the overriding objective.

While the IFRS for SMEs is arguably an IFRS-based solution, the scope of FRS 102 is quite different from that of the IFRS for SMEs as it includes entities with public accountability. The requirements in FRS 102 have already diverged significantly from the IFRS for SMEs in key areas such as income tax and financial instruments and we do not see it as particularly relevant or beneficial to attempt to keep FRS 102 close to the IFRS for SMEs.

In our view it is preferable by far to aim for consistency with full IFRS, where appropriate and proportionate, as IFRS is a valid accounting framework in the UK and is therefore more relevant for UK preparers. We acknowledge that the IFRS for SMEs is currently undergoing its own review process for improvements and agree that it may be worthwhile keeping track of developments there, but this should not delay or prevent the FRC from developing its own amendments to FRS 102.

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Appendix 6: Comments on FRS 102

In this appendix we provide some wider comments on existing requirements in FRS 102 and offer areas for further consideration as part of the periodic review. These are by no means exhaustive but focus on sections of FRS 102 which we believe would benefit from more significant review and revision.

Section 1A Small Entities

In addition to our comments in Appendix 4 regarding the legal position, the FRC may also wish to reconsider the broader policy decision to maintain the same recognition and measurement principles for all entities applying FRS 102, particularly as more complex aspects of IFRS are introduced. While we would not advocate for a return to a separate "small entities" standard such as the FRSSE of old, there may be some areas of simplification which would make application of FRS 102 less onerous and costly without sacrificing relevance, reliability or comparability. For example, a simpler model for share-based payments or financial instruments could provide substantial relief and represent a better cost/benefit balance, with appropriate disclosure to ensure transparency. As noted in Appendix 1 and 2, we also suggest introducing specific, generous transitional provisions for small entities should the requirements of IFRS 15 and 16 be brought into FRS 102, or even a later effective date for such entities.

Section 14 Investments in Associates

We suggest that Section 14 should address the accounting treatment for contingent consideration on the purchase of an associate. It is currently unclear whether the treatment should be the same as that prescribed in Section 19 for a business combination or whether it should be in accordance with Section 12 for a non-basic financial instrument. In practice, this means that there is currently an accounting policy choice.

Paragraph 8 of Section 14 states that, under the equity method of accounting, an equity investment is initially recognised at the transaction price (including transaction costs). Section 14 does not include any further definition or requirements about how the transaction price should be determined. Nor is the term "transaction price" defined in the Glossary. Paragraph 8(c) requires any difference (whether positive or negative) between the cost of acquisition and the investor's share of the fair values of the net identifiable assets of the associate to be accounted in accordance with paragraphs 19.22 to 19.24. This cross reference to Section 19 does not extend to the paragraphs dealing with the measurement of the cost of acquisition. This may be a drafting oversight and it could be intended that the measurement basis should be consistent with Section 19. In the absence of a definition of transaction price for the purposes of Section 14, this would not create a conflict between the sections.

Alternatively, it appears that such contingent consideration could be accounted for under Section 12. FRS 102.12.3(g) contains a scope exclusion for contingent consideration in a business combination and cross refers to Section 19. However, on a literal reading, this does not extend to contingent consideration for the purchase of an interest in an associate accounted for in accordance with Section 14. Again, this may be an unintentional drafting oversight.

Either way, we recommend clarifying Section 14 to set out the appropriate accounting treatment; if Section 19 is updated (see below) to align with IFRS 3 in this respect, we believe that the treatment of contingent consideration under Section 14 should be the same.

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Section 19 Business Combinations and Goodwill

Section 19 is broadly based on IFRS 3 (2004) and does not incorporate the changes made as a result of the 2008 revision. The FRC may wish to consider whether it remains appropriate to take the 2004 approach or whether it would be helpful (and promote consistency) to amend Section 19 to align more closely with the provisions in IFRS 3 (2008). This could affect areas such as the approach to business combinations (taking the acquisition method rather than the purchase method), measurement of contingent consideration and constraint of the measurement period within which provisional fair values may be adjusted. Some specific further points follow:

- The definition of a business as set out in the Glossary to FRS 102 is not straightforward to apply; it would be helpful to include specific guidance in FRS 102 on the meaning of inputs, processes and outputs, similar to that in IFRS 3. Such guidance might include defining inputs, processes and outputs and giving examples of these, as well as setting out situations where outputs may not be required in order to meet the definition (for instance, if a business is in a start-up/development phase).
- Reverse acquisitions are not explicitly mentioned in FRS 102, but they may occur as a result of applying the guidance on identifying an acquirer. We believe it could be helpful to include the principles of reverse acquisition accounting in FRS 102.
- For an acquisition completed in stages, paragraph 19.11A requires the actual cost to be used in computing goodwill. The need to use the true and fair override in some cases is explained in paragraph A4.18 to A4.21 in FRS 102. However, it seems odd that it would be necessary to depart from FRS 102 as well as the legal requirements. It would be helpful if the exception could be incorporated into the requirements of FRS 102; alternatively, the IFRS 3 approach may be preferable.
- When contingent consideration (whether in shares or cash) is payable to vendors who are also directors or employees of the acquiree, it is necessary to consider to what extent it represents purchase consideration and to what extent it represents a remuneration expense. This is particularly important when the payments are linked to continuing service, which creates a rebuttable presumption that the payments are in respect of remuneration. FRS 102 currently contains no requirements in respect of this situation, whereas IFRS 3 contains an inflexible rule that any arrangement in which the payments are automatically forfeited if employment terminates is remuneration for post-combination services. It may, as a minimum, be helpful if FRS 102 contained a rebuttable presumption that payments linked to service constitute remuneration, rather than contingent consideration, with some additional factors to consider in rebutting that presumption.
- In measuring contingent consideration, we consider that it would be much more straightforward to adopt the IFRS 3 (2008) approach and measure at fair value at the acquisition date. This removes the need to assess probability and reliability of measurement and also takes away the need to revisit those assessments on an ongoing basis. Subsequent measurement could then also be in line with IFRS 3 (2008), with remeasurement to fair value at each reporting date, and adjustment against goodwill or profit or loss consistent with the requirements of IFRS 3:58.
- We believe it would be helpful to introduce a requirement that if provisional fair values are used, that fact should be disclosed. Likewise, if a non-controlling interest arises on acquisition, this fact and the amount recorded in respect of NCI on acquisition should also be disclosed.

Challenges in practice continue to exist around applying merger accounting. Consistent with our comments in Appendix 4, we believe that the FRC and BEIS should collaborate to review the legal requirements for applying merger accounting (in Schedule 6 to the Accounting Regulations) and those contained in FRS 102. It is increasingly common for companies to need to apply the true and fair override in company law to enable them to apply merger accounting because the interaction of the conditions for applying merger accounting in FRS 102 with the requirement in the legal framework for there to be common control results in very few transactions meeting all the conditions.

Section 24 Government Grants

This section of FRS 102 has seen significantly increased use in recent years as a result of COVID-19 and is likely to continue to gain in relevance as businesses move to respond to the climate emergency; the UK government may introduce grants to assist businesses in dealing with the transition risks associated with climate change and to encourage them to develop greener policies, practices and objectives. This section of FRS 102 therefore warrants close examination and consideration as part of the periodic review. Some specific points follow:

- We are broadly in favour of retaining the two models set out in Section 24 as both have their merits; the performance model aligns to practice in certain sectors (e.g. charities) while the accruals model promotes consistency with IFRS.
- We advise that the FRC carry out a review of IAS 20 and consider whether there is any additional guidance which might usefully be transferred into FRS 102. For example:
    - The Glossary to FRS 102 does not define the terms “government assistance”, “grants relating to assets” or “grants relating to income”. IAS 20 also contains additional interpretation of the definition of a “government grant”. All of these are defined terms in IAS 20.
    - Guidance on application of FRS 102.24.3A as regards “reasonable assurance” would also be helpful in practice.
    - FRS 102.24.5A is silent on how a liability to repay a grant should be accounted for; we consider it appropriate to account in a way consistent with IFRS Standards. IAS 20 requires that a government grant that becomes repayable should be accounted for as a change in accounting estimate in accordance with IAS 8, with specific requirements in IAS 20:32 for grants related to income and grants related to assets. It may be helpful to include similar explicit requirements in FRS 102, although in the case of a grant related to an asset, it would only be appropriate under FRS 102 to reduce the deferred income balance (since it is not permitted to offset the grant against the carrying value of the asset under FRS 102).
- It would be helpful to include some additional guidance on presentation in the income statement, particularly as regards the release of deferred grants related to assets. In line with Section 2 of FRS 102 and with the Accounting Regulations, it is not permitted to set off items of income and expenditure or assets and liabilities. The latter is made clear in Section 24 as to how it should be approached, but there is no specific guidance on where in profit or loss this could appear. For instance, where an entity has included the depreciation of a fixed asset in its cost of inventory, would it be acceptable to release the related grant to profit or loss to match the timing of sale of that inventory, and does it need to be presented as a separate income line item rather than as a reduction to cost of sales? Or is it simply required to release the grant on a straight line basis over the useful life of the asset and present as some form of “other operating income”? Additional guidance in this regard would improve comparability.
- The phrase “recognised in income” appears in paragraph 24.5B in the context of recognition under the performance model, and in paragraphs 24.5D-F in respect of the accruals model. It is

not clear why this expression has been retained from the IFRS for SMEs. The more commonly used expression is "in profit or loss" and the use of "recognised in income" represents an inconsistency with the rest of the standard. If there is no intended difference we recommend replacing with the phrase "in profit or loss" to avoid misunderstanding.

- We believe that the disclosure requirements in respect of government grants should be increased, commensurate with the higher profile and frequency of such arrangements. In particular we note:
  - There are no required disclosures for entities applying the accruals model for grants related to assets. We recommend inclusion of a requirement to provide a reconciliation of movements in such grants in the year to promote transparency on balance sheet and profit/loss movements.
  - We recommend inclusion of a requirement to disclose cash flows for grants relating to assets. Following IAS 20, in order to show the gross investment in assets an entity would expect to show cash flows relating to grants as separate items in the statement of cash flows within investing activities.

Section 26 Share-based Payment

A significant number of FRS 102 preparers have share-based payments and these arrangements can often be complex. Increased complexity often arises in group scenarios, where one entity (typically the parent) issues share awards to employees of its subsidiaries. The use of EBTs and ESOP trusts in the UK is also extremely common and these can be challenging to account for. Because of this and the brevity of Section 26, accounting for share-based payments often proves challenging without reference to IFRS 2 *Share-based Payment* for further guidance and direction. We therefore advise a review of Section 26 with reference to the additional detail in IFRS 2 to consider whether additional guidance could be incorporated into FRS 102. Some particular areas might include:

- Scope – it would be useful to bring in something covering the same points as IFRS 2:5 and 2:6. Section 22 effectively covers the IFRS 2:6 point but the IFRS 2:5 content which scopes out certain arrangements such as net assets acquired in a business combination and contributions to a joint venture is not set out clearly in FRS 102.
- Accounting requirements addressing situations where vesting is linked to a change in control clause or initial public offering, and other circumstances when the method of settlement depends on the occurrence of an event outside the control of either party to the transaction. It is frequently the case for FRS 102 reporters that vesting will occur either on completion of an IPO or on any of a number of 'exit events' (e.g. a trade sale of the company's shares or of its trade and assets) through which the company's current owners realise the value of their investment. We acknowledge that this is also an area which IFRS 2 does not cover extensively but it is not uncommon in practice and may be worth considering.
- Accounting by groups – this is frequently an area of difficulty for preparers and divergence arises in practice as there are few clear requirements in Section 26. While we believe that some aspects of Section 26 are helpful in this regard, such as the ability to apportion a group charge on a reasonable basis, there is substantial guidance on accounting for group share-based payment arrangements in Appendix B to IFRS 2 (B45-B61 inclusive) and we suggest that the FRC could review this content and consider whether it, or any of the principles, could helpfully be brought into Section 26.
- Section 26 does not address the following:

- modifications which change the vesting period. It may be helpful to bring in the guidance from IFRS 2 which explains how these should be treated, depending on whether they are beneficial to employees or not.
- the impact of vesting and non-vesting conditions on cash-settled share-based payments. This is not unusual in practice and it would be helpful to include guidance based on IFRS 2:33A-D.
- modifications to cash-settled share-based payments that result in the share-based payment becoming equity-settled. Again, it would be useful to include guidance based on IFRS 2:B44A.
- subsequent accounting for arrangements where the entity has a choice of settlement method; it may be helpful to bring across guidance from IFRS 2:43.
- accounting for National Insurance contributions on share-based payments. This was previously dealt with under UITF Abstract 25 and this accounting is likely to be the approach that continues to be taken by FRS 102 reporters.

Section 28 Employee Benefits
In general the requirements in Section 28 are functioning as intended, are broadly well understood and consistent with IAS 19. However, there are some particular areas where we believe additional guidance could be added.

Section 28 could usefully address the following:

- the unit of account to be used in evaluating the period over which a benefit is expected to be settled (e.g. whether the assessment should be performed at the individual employee level or for the workforce as a whole). IAS 19 advises an assessment of whether any employees are expected to receive settlement after 12 months, in which case all benefits due under the particular scheme would be regarded as other long-term benefits;
- measurement of the gain or loss arising on amendment, curtailment or settlement of a defined benefit plan, as well as guidance on the treatment of past service costs; as noted in Appendix 5, *Plan Amendment, Curtailment or Settlement (Amendments to* IAS 19*)* should be considered in developing any such guidance.
- the situation where a surplus exists in a multi-employer plan; guidance could be included consistent with IAS 19, which suggests that where an entity in a multi-employer plan is party to a contractual arrangement on how a surplus would be distributed it should recognise an asset. Paragraph 11A could also be clearer on how it should be applied in the case of a surplus.
- the meaning of “high quality corporate bonds” as used in paragraph 17; where the same term is used under IAS 19, it is generally taken to refer to corporate bonds with one of the two highest ratings from a recognised rating agency in jurisdictions in which such an agency exists. Under old UK GAAP the standard explicitly required the AA corporate bond rate or equivalent to be used as a 'high quality corporate bond' rate. The approach to discounting could also be set out, consistent with IAS 19.
- administration costs; consistent with IAS 19, these could be addressed by including a requirement to deduct costs relating to the management of the plan assets in determining the return on plan

assets, and to recognise other administration costs in profit or loss when the administration services are provided.

Section 34 Specialised Activities

We have some specific comments around the requirements for biological assets set out in this section of the standard.

Firstly, it is not possible to change from the fair value model to the cost model in accounting for biological assets but it is possible to move from the cost model to the fair value model. When an entity elects to apply a policy to revalue assets in accordance with either Section 17 or 18, FRS 102.10.10A permits that change in accounting policy to be accounted for prospectively from the date of the change. However, FRS 102.10.10A is a specific exception to the general requirement, in FRS 102.10.11 and FRS 102.10.12, to apply changes in accounting policy retrospectively and therefore does not appear to apply for biological assets. It may be helpful to extend the scope of FRS 102.10.10A to permit a prospective change for biological assets as well. In passing, we note that a prospective approach may also be appropriate in the context of a change in accounting policy from cost to fair value in accounting for investments in subsidiaries, associates and joint ventures in the individual financial statements of an investor.

Section 34 is silent on the classification of biological assets as current or fixed. In our view they could be either depending on whether they are held for continuing use in the business. For example, a breeding mare is likely to meet the definition of a fixed asset, while a foal which is to be sold relatively rapidly may be viewed as a current asset (inventory). It would be helpful if the standard could be clear on this point as there appears to be divergence in practice, in particular if the “fixed assets” vs “current assets” distinction is maintained.

Although “class of assets” is a defined term in the Glossary, the part of Section 34 dealing with agriculture does not reference this term and refers to “class of biological assets” in normal text (i.e. not bold). It would be helpful either to define the term “class of biological assets” clearly or use the defined term “class of assets” for avoidance of doubt.

We understand that there may be diversity regarding what falls to be included in cost in the context of the cost of foals bred to be racehorses. FRS 102 is silent as to the cost of a biological asset. It would be helpful to define this – perhaps bringing in the requirements in Schedule 1 to the Accounting Regulations regarding purchase price or production cost, or analogising to Section 13 for biological assets that are inventories or Section 17 for biological assets that are considered to be analogous to property, plant and equipment.

Section 35 Transition to this FRS

This section was originally written with first-time adopters moving from old UK GAAP in mind. This is clearly no longer relevant and therefore the transitional provisions and exceptions in this section will require a substantial rewrite. This should also take into account the fact that some first-time adopters will be coming from FRS 105 while others will be coming from IFRS (or FRS 101), so concessions may need to depend on what previous framework was applied.

In terms of transition from FRS 105 to FRS 102, we would suggest considering concessions around accounting for financial instruments, share-based payment and deferred tax, which will all be new and relatively complex in comparison to FRS 105.

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Regarding transition from IFRS or FRS 101, the concessions available will depend on the extent to which FRS 102 changes under the periodic review. For instance, if IFRS 15 and 16 are brought into FRS 102 then there may be no real need for transitional provisions in this regard (except perhaps to allow entities to carry across their figures from IFRS when transitioning to FRS 102, if practicable). Other areas for consideration could include:

- Financial instruments: the model under FRS 102 is fundamentally different to that in IFRS 9 and some consideration may be needed as to whether there is scope for including transitional options here.
- Business combinations: we recommend retaining the existing exemption and adding guidance on what to do where intangible assets have been separated out under IFRS 3 which would not fall to be separated under Section 19.
- Deemed cost: we support retention of this exemption but only for assets that qualify for recognition under FRS 102 (e.g. some intangible assets previously recognised may not). We also suggest introducing an option to use "previous GAAP" carrying amount when transitioning from IFRS or FRS 101, other than for investment properties.
- Individual and separate financial statements: it may be possible to allow the use of fair value as deemed cost if it is acceptable under the Accounting Regulations to do so.
- Dormant companies: this exemption should be clarified to state that it applies to dormant LLPs as well.
- Small entities: the provisions at paragraphs 10(u) and (v) are now obsolete and should be removed. We do not consider that these are necessary in the case of entities transitioning from FRS 105.
- Disclosures:
    - It may be helpful to introduce an explicit exemption from certain of the disclosure requirements in Section 10 regarding changes in accounting policies, as these are overridden by the specific transition requirements in Section 35.
    - There is no requirement to disclose which of the transitional provisions have been applied; we recommend introducing this.
    - It may be worth considering whether adjustments that do not affect profit or loss or equity should be disclosed.
    - We recommend that disclosure should be required about errors that do not affect profit or loss or equity, especially if they affect the comparative balance sheet.

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Appendix 7: Comments on other FRSs

FRS 100 *Application of Financial Reporting Requirements*
In our view FRS 100 is functioning as intended. The most pressing issue is to address the Application Guidance on Equivalence, which is out of date following the UK's withdrawal from the EU. This is an integral part of the standard and we strongly urge the FRC to update this content as soon as possible and well in advance of the periodic review effective date.

FRS 101 *Reduced Disclosure Framework*
We consider that FRS 101 is working well for UK companies, particularly those that report up to a parent preparing IFRS consolidated accounts. The model, which starts with the full IFRS set of disclosures and then removes certain of those, is now well understood and represents a logical approach. We do, however, question whether conditions about equivalent disclosures in consolidated accounts are still needed; application of the reduced disclosure framework may be more straightforward if this requirement were to be removed.

We are aware that the IASB has recently issued an exposure draft ED/2021/7 S*ubsidiaries without Public Accountability: Disclosures*. This is intended to offer a reduced set of disclosures to certain subsidiaries. While this appears conceptually similar to FRS 101, the approach taken is very different; rather than starting from full IFRS and removing requirements, the ED proposes to start from the disclosures required by the IFRS for SMEs and add requirements. In our view it would not be appropriate for the UK to move from the current FRS 101 approach to adopt that taken in the IASB's ED. The scope and requirements in the ED are quite different from those of FRS 101 and the proposed new standard does not work as neatly for group reporting purposes as some of the disclosures will be different from those in full IFRS.

In our view the only attraction of the ED is that, if adopted in the UK, accounts prepared under it would represent "IAS accounts" under company law; this would remove a great deal of the complexity that currently exists in applying FRS 101 regarding primary formats and terminology. However, as discussed above, we believe that the right approach here is instead for the FRC and BEIS to work together to update and/or remove the accounting requirements contained in the Accounting Regulations as this would resolve numerous challenges across the UK corporate reporting regime, including those around application of FRS 101.

FRS 103 *Insurance Contracts*
We do not recommend any changes to FRS 103 at this time, beyond any consequential amendments required to remain consistent with FRS 102. The appropriate time to revisit this standard will be when IFRS 17 *Insurance Contracts* has taken effect for IFRS preparers and has had sufficient time to 'bed in' such that lessons can be learned from implementation.

FRS 104 *Interim Financial Reporting*
We do not recommend any changes to FRS 104 at this time, beyond any consequential amendments required to remain consistent with FRS 102. The scope of entities applying this standard is relatively small and there have been no changes to IAS 34, on which this standard is based, since the last triennial review.

FRS 105 *The Financial Reporting Standard applicable to the Micro-entities Regime*
The periodic review offers both BEIS and the FRC the opportunity to revisit the current micro-entity regime and question whether it is functioning as desired. In our view, which we also set out in our response to the BEIS consultation *Corporate Transparency and Register Reform – improving the quality*

and value of financial information on the UK companies register, the current micro-entity accounts regime is unfit for purpose. The limited information contained in the accounts is not sufficient to enable users to make informed decisions, meaning that stakeholders (typically shareholders, lenders and HMRC) require more detailed information to be provided to meet their needs. The value of a set of accounts which have to be presumed true and fair seems to be minimal.

We therefore propose two possibilities:

1. Remove the micro-entity regime, reverting such entities to the small companies regime which requires accounts to give a true and fair view. This would increase transparency but may prove overly onerous; given the typical stakeholders of a micro-entity, the cost of preparing such information may exceed the benefit of so doing.

2. Remove the requirement for micro-entities to prepare and file statutory accounts. Shareholders and lenders should have the right (via a shareholder agreement or loan agreement, as relevant) to receive financial information as needed and HMRC would continue to receive the detailed information required for tax purposes. If this were to be implemented, we recommend that the micro-entity regime should only be available where all members have consented to its use.

Either of these options would mean the removal of FRS 105 in its entirety as it would no longer be needed as a framework for preparing statutory accounts. Again, we encourage the FRC and BEIS to work together and consult on the future of the micro-entity regime; the outcome of such consultation will determine the future of FRS 105.