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Thursday 27 April 2023

Dear FRC colleagues,

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

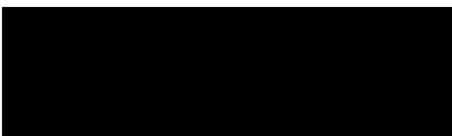
We welcome the opportunity to respond to your consultation on the draft amendments to FRS 102.

The Quoted Companies Alliance *Accounting, Auditing and Financial Reporting Expert Group* has examined the proposals and advised on this response from the viewpoint of small and mid-sized quoted companies. A list of Expert Group members can be found in Appendix A.

Overall, we consider the changes to be reasonable and well considered and the comments we have to make are very much a sense-check rather than objections to the proposals.

If you would like to discuss our response in more detail, please do not hesitate to contact us.

Yours sincerely,



James Ashton
Chief Executive

The Quoted Companies Alliance champions the UK's community of 1000+ small and mid-sized publicly traded businesses and the firms that advise them.

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## Q1 Disclosure

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

**Do you believe that users of financial statements prepared under FRS 102 will generally be able to obtain the information they seek? If not, why not?**

In general, we agree with the proposed changes to leases, revenue and expected credit losses. However, we question the benefit of proposed reforms to small entities applying section 1A of FRS 102, business combinations, and the lack of requirements around uncertain tax treatments.

There was concern among some members that the FRC should adopt a questioning mindset as to whether the existing information presented in the primary statements and/or notes, including those relating to turnover, are sufficient enough in their existing form. The rationale for changes in UK GAAP should be clearly articulated and justified against the needs of UK reporting entities, investors, and stakeholders rather than a desire to mirror revisions in the international financial reporting framework.

In relation to the proposed changes to leases, we broadly agree with this proposal. However, we consider the requirement in 20.87 to provide a 'maturity analysis' for short-term and low value lease commitments as overly burdensome, without merit or justification of the benefit to disclose, and beyond the requirements of IFRS 16 in this area. We also query whether this disclosure would be relevant to short-term leases (i.e. by its nature it is less than 12 months therefore entities will be reporting nil disclosures for the bandings required in 20.87(b) and (c)). It is our view that any issues the FRC perceive in relation to lease commitments could be better addressed through improved narrative disclosure rather than that proposed in 20.87.

As for revenue, whilst we support increased disclosure in this area, we have the following suggestions for improvements in the proposals:

- As it is currently worded, the proposals in 23.121-23.121A regarding the disclosure of revenue disaggregation is likely to lead to limited improvements. We suggest adding a disclosure objective, similar to that in IFRS 15, to the requirement for disaggregation.
- We also suggest adding a specific disclosure requirement to explain and qualify the effects of any significant variable consideration. Reliance on the general disclosure requirements in section 8 of FRS 102 alone to provide this will unlikely result in sufficient relevant information being disclosed by entities.

For expected credit losses, we welcome the introduction of 11.48ZA and 11.48ZB as providing further disclosures on expected credit losses for those entities choosing IFRS 9. We believe this could be enhanced by modifying 11.48ZB to provide examples of the reconciling items that would typically be expected. Additionally, we believe that more, if not all, of the IFRS 7 credit risk disclosures should be required by FRS 102 preparers that apply IFRS 9.

In respect of the proposed amendments to Section 1A, whilst we support the move to require small entities to provide the disclosures that were previously only encouraged to be disclosed, we question the benefit and need to expand the disclosures beyond this. There are revisions proposed to Section 1A that go beyond what was previously in Appendix C of Section 1A (e.g. leases, share-based payment transactions etc). These additional disclosure requirements will likely result in a greater administrative and financial reporting burden to entities that purposely apply Section 1A to reduce the level of disclosures given in their annual financial

statements. The FRC has not explained the rationale for why these disclosures, that are in addition to what was previously covered in Appendix C of Section 1A, are necessary in order for a small entity's financial statements to show a true and fair view.

Finally, guidance has been added for uncertain tax treatments but there are no new disclosure requirements. Our suggestion would be to add a disclosure requirement that offers a brief explanation and qualification of material, both individually and collectively, for uncertain tax treatments.

**Q2 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?**

**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?**

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

On the question of alignment of FRS 102 with the 2018 Conceptual Framework, we agree with the overall proposal. FRS 102 is a principles-based framework and is intended to be broadly consistent with IFRS, so it is sensible that they share the same conceptual underpinnings. However, the FRC should be open to diverging from those underpinnings in the future should it be considered appropriate for UK entities and should publish their conclusions as to why FRS 102 should be aligned with the 2018 Conceptual Framework.

We also support the process of simplification of the discussion when compared to the IASB's framework given the nature and format of FRS 102. We consider the length and level of complexity of the proposed section to be proportionate with the rest of the standard.

Regarding the continuing use of the extant definition of an asset, we ask the FRC to reconsider the application of different meanings for the term 'asset' depending on the area it is being assessed. The extant term is not often clearly understood nor consistently applied when reported by many preparers.

Finally, as a minor point of consistency and clarity, 2.104 refers to the 'statement of profit or loss' rather than the 'income statement'. Additionally, 2.103 assumes a two-statement approach has been adopted which might not necessarily be the case in some instances.

### Q3 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?**

**Do you agree with the proposed consequential amendment to Section 26 Share-based Payment of FRS 102 to retain the extant definition of fair value for the purposes of that section? If not, why not?**

Yes - we support alignment with IFRS 13.

When financial liabilities are measured at fair value, IFRS 9 generally requires the part of the fair value movement that relates to changes in own credit risk to be presented in other comprehensive income rather than profit or loss. The IASB required this in response to stakeholders' concerns that it would create inappropriate volatility and, in general, the effects of own credit risk are not realised as they are not reflected in any settlement amount. We view the proposed changes to FRS 102 as creating a GAAP difference with IFRS and its not clear if this is intended. FRS 101 preparers are encouraged to apply a true and fair override of the Companies Act 2006 in order to present the own credit risk impact in OCI.

Paragraph 2A.5 in the extant FRS 102 states that *"There are many situations in which the variability in the range of reasonable fair value estimates of assets that do not have a quoted market price is likely not to be significant. Normally it is possible to estimate the fair value of an asset that an entity has acquired from an outside party."*

There is no statement as strong as this in the revised guidance. We believe this paragraph has in practice been useful when challenging entities that have claimed not to be able to fair value an item (for example equity holdings in other unquoted entities). Therefore, our suggestion is that this is retained.

Regarding 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 – we disagree with this proposal.

We believe that the term 'Fair Value' should be replaced with the term 'Market Value'. The use of 'Market Value' would relate to a value that could be readily obtained from a sale. In cases where a Market Value does not exist, attempts to identify a useful Fair Value should be avoided.

### Q4 Expected credit loss model

**The FRC intends to defer its conclusion as to whether to align FRS 102 with the expected credit loss model of financial asset impairment from IFRS 9 Financial Instruments pending the issue of the IASB's third edition of the IFRS for SMEs Accounting Standard. Any proposals to align with the expected credit loss model will therefore be presented in a later FRED. Do you agree with this approach? If not, why not?**

**In IASB/ED/2022/1 the IASB proposes to retain the incurred loss model for trade receivables and contract assets, and introduce an expected credit loss model for other financial assets measured at amortised cost. The FRC's preliminary view is that, in the context of FRS 102, it may be appropriate to require certain**

**entities to apply an expected credit loss model to their financial assets measured at amortised cost, but allow other entities to retain the incurred loss model. Do you agree with this view? If not, why not?**

**Based on stakeholder feedback received to date, the FRC does not intend to use the existing definition of a financial institution to define the scope of which entities should apply an expected credit loss model. The FRC's preliminary view is that it may be appropriate to define the scope based on an entity's activities (such as entering into regulated or unregulated credit agreements as lender, or finance leases as lessor), or on whether the entity meets the definition of a public interest entity. Do you have any comments on which entities should be required to apply an expected credit loss model?**

No – we do not agree with the FRC's approach to defer its conclusion as to whether to align FRS 102 with the expected credit loss model of IFRS 9 pending the issuance of IASB's third edition of the IFRS for SMEs Accounting Standard.

There is already significant and justifiable divergence between FRS 102 and the IFRS for SMEs, which is set to increase in respect of the proposals regarding leases.

More importantly, the significantly different scope of FRS 102 compared with the IFRS for SMEs are particularly relevant when considering impairment models for financial instruments. ECL is of most relevance to entities providing debt and lease capital to third parties as part of their core business – entities that will be predominantly excluded from the scope of the IFRS for SMEs but will fall within the scope of FRS 102.

As such, we do not believe that the conclusions reached in the third edition of the IFRS for SMEs are important in the FRC being able to conclude on whether to align FRS 102 with the expected credit loss model of financial asset impairment from IFRS 9 Financial Instruments. For the reasons established above, the FRC should be in a position to conclude on this now as part of this exposure draft. The FRC should also seek to minimise the volume of revisions to FRS 102, especially for fundamental changes in the recognition, measurement, and disclosure requirements of items within the financial statements.

We do, however, agree that it is appropriate for certain entities to apply an ECL model while other entities retain the incurred loss model. We consider that it would be reasonable for FRS 102 preparers for whom assessment, management and pricing of credit risk is incidental to their core business, to continue with an incurred loss model.

We also agree that it is appropriate to define the scope of entities who should apply ECL by reference to the entity's activities rather than the instrument type.

**Q5 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?**

**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?**

Yes – we agree with the proposal to prevent an entity from newly adopting the IAS 39 option.

We also agree that relevant requirements should be removed once there is evidence that all benchmark rates to which the requirements might be relevant.

**Q6 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?**

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

It is the view of our members that on-balance sheet lease accounting results in a more meaningful presentation of an entity's financial position as lease commitments do meet the definition of liabilities, and therefore provides support for the proposed changes to FRS 102.

On the issue of scoping, it is not clear what is meant by 20.1(f) and 'non-typical contractual terms'. Clarity in this area will be important given it is relevant to the scope of section 20.

Regarding discount rate, we agree with the simplification to allow the use of obtainable borrowing rate when the incremental borrowing rate cannot he readily obtained. However, we are concerned about the use of a gilt rate in cases where neither the OBR nor IBR can be readily determined: such a rate is entirely independent of the entity. Further, it is not clear if it would ever be relevant due to the expectation that, as a minimum, the obtainable borrowing rate can be readily determinable.

While we expect the use of a gilt rate would most likely be rare, we are concerned that it could be overused. In addition, we are concerned that it could lead to assets and liabilities being systematically overstated.

We consider the changes proposed to modifications as sensible. However, we note that the wording in 20.72 *'if the value of each lease payment for the remainder of the lease term is unaffected by the change in lease term'* is unclear. It is uncertain whether 'lease term' is in reference to the original or new lease term. If it is in reference to the original lease term, then it would appear to exclude the shortening of a lease. If it is referring to the new lease term, then it would appear to exclude the lengthening of the lease term.

On the area of multiple components, we disagree with the practical expedient in 20.34 and believe this could lead to some misleading treatments in certain circumstances.

When assessing sale and leaseback, we found that 20.128(a) was not clear as to whether it is intended to apply on an entity wide, or lease by lease basis. There is a question as to whether reference to 20.48 in 20.128(a)(ii) should be to paragraphs 20.49-20.51 instead.

Regarding variations arising from a change in index, we agree in principle that the simplification is reasonable. However, we are uncertain as to whether it will work as intended in practice.

Specifically, in paragraphs 20.67 and 20.74 there appears to be a conflict between the requirement to remeasure the liability to reflect revised in-substance fixed lease payments and the option to re-measure for changes related to an index or rate.

In the UK, most property leases have lease payments that are either upwards only RPI linked or subject to regular upward only market rent reviews. An interpretation question is whether an upwards only change in payments linked to an index or a rate (particularly when the reference rate is known before it takes effect) is, in substance, a fixed lease payment once the reference rate is known. For example, if a payment due on 1 Jan will be increased by reference to the RPI for Sept in the prior year – is the payment in-substance fixed from the date that the Sept RPI rate is known, or does it fall under the change in index/rate provisions meaning it is only considered when the cash flows change on 1 Jan?

Under IFRS 16, a consensus view is that the amount is in-substance fixed once all variability is resolved – this is partly supported by reference to IFRS 16.B42. A similar interpretation could be drawn from FRS 102.20.55.

Due to this potential interpretation issue, we believe the wording should be clarified to state that the in-substance fixed provisions do not apply is such circumstances.

Finally, we agree with the proposals relevant to low value exemption.

**Q7 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?**

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

Yes – we are supportive of the overall principle of implementing the five-step model into FRS 102, along with most of the application guidance from IFRS 15.

Regarding 23.38 in relation to principal vs. agent, we find this paragraph differs to IFRS 15. We are unclear as to the benefits of creating a potential GAAP difference by changing the relevant importance of indicators. Specifically, factors relating to primary responsibility and inventory risk would lead to a principal conclusion

under FRS 102 whereas they are the only indicators in IFRS 15. Further, IFRS 15 considers price risk which is not mentioned in FRS 102.

We disagree with setting the threshold for considering the time value of money at six months when IFRS 15 is 12 months. We believe this will create an unnecessary GAAP difference and appears to go against the general approach of making FRS 102 either consistent with, or otherwise less onerous than, IFRS.

A minor point but the proposed changes refer to "promises" rather than "performance obligations" as in IFRS 15. While the terms are likely intended to be interchangeable, the principle of "performance obligations" is well understood by those familiar with IFRS and could be retained in FRS 102 for consistency.

The very useful appendix to section 23 of FRS 102 has been deleted. While this is likely to have been removed to prevent the standard from being excessively long, we do recommend that the FRC finds other means of providing practical application guidance for preparers in this complex area. This would acknowledge that users of FRS 102 are ordinarily less well resourced than IFRS preparers and will benefit from enhanced guidance.

**Q8 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?**

**FRED 82 proposes transitional provisions (see paragraphs 1.35 to 1.60 of FRS 102 and paragraph 1.11 of FRS 105).**

**In respect of leases, FRED 82 proposes to permit an entity to use, as its opening balances, carrying amounts previously determined in accordance with IFRS 16. This is expected to provide a simplification for entities that have previously reported amounts in accordance with IFRS 16 for consolidation purposes, promoting efficiency within groups. Do you agree with this proposal? If not, why not?**

**Otherwise, FRED 82 proposes to require the calculation of lease liabilities and right-of-use assets on a modified retrospective basis at the date of initial application. Do you agree with this proposal? If not, why not?**

**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?**

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

**Have you identified any additional transitional provisions that you consider would be necessary or beneficial? Please provide details and the reasons why.**

We consider that the proposed effective date of periods commencing on or after 1 Jan 2025 is too early for all of the amendments proposed to be adopted. It is our view that deferral to 1 Jan 2026 would be more appropriate in order to enable all preparers, especially small entities and those with a large number of leases, to effectively prepare and implement the revisions, especially those relating to leases and revenue. Experience of IFRS 15 and IFRS 16 transitions showed that many preparers needed significant amounts of time to implement systems to identify and recognise all in scope transactions. For instance, charities of any size are likely to struggle with the proposed effective date as many will have a large number of retail units that are leased. Commercial retailers will also likely find the 1 Jan 2025 date challenging to comply with.

Alternatively, the FRC should consider whether it would be feasible and practicable to adopt a 'two-stage implementation approach' to the revisions to FRS 102 whereby the lease and revenue amendments apply a year later to the proposed effective date of 1 Jan 2025. We do however recognise that such an approach could likely cause confusion to preparers, especially the consequential impact on disclosures and balances referenced elsewhere in the standard. It is for that reason that our view remains as deferring the implementation date by one year.

**Q9 Other comments**

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

We urge the FRC to work with government to revisit the Companies Act formats for the balance sheet, particularly the need for debtors due in more than one year to be presented as current.

The changes to Section 8 and the disclosure of accounting policies, although not headline grabbing are welcome as they should help to make financial statements shorter, yet more bespoke and relevant to entities and therefore to users. Any attempt to bring clarity to financial reporting is welcomed.

**Q10 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).**

Based on our members' experience with the implementation of IFRS 16 and IFRS 15, we would consider the implementation costs are significantly understated.

**<u>Appendix A</u>**

**The Quoted Companies Alliance *Accounting, Auditing and Financial Reporting Expert Group***

| | |
|---|---|
| Rochelle Duffy (Chair) | PKF Littlejohn LLP |
| Tom Stock (Deputy Chair) | Haysmacintyre LLP |
| Richard Amos | Skillcast Group PLC |
| Edward Beale | Western Selection PLC |
| Matthew Brazier | Invesco Asset Management Limited |
| Simon Cooper | KPMG LLP |
| Anna Hicks | Saffery Champness LLP |
| Mark Hodgkins | Trackwise Designs PLC |
| Michael Hunt | ReNeuron Group PLC |
| Clive Lovett | Kinovo PLC |
| Sandra McGowan | BDO LLP |
| Giles Mullins | Grant Thornton UK LLP |
| James Nayler | Mazars LLP |
| Matthew Stallabrass | Crowe UK LLP |