Draft amendments to FRS 102 and other FRSs: Periodic Review (FRED 82)

Response from ICAS to the Financial Reporting Council

27 April 2023

Introduction

ICAS is a professional body for more than 23,600 world class businesspeople who work in the UK and in more than 80 countries around the world. Our members have all achieved the internationally recognised and respected CA qualification (Chartered Accountant). We are an educator, examiner, regulator, and thought leader.

More than half of our working membership work in business; many leading some of the UK's and the world's great companies. The others work in accountancy practices ranging from the Big Four in the City to the small practitioner in rural areas of the country.

We currently have over 4,400 students striving to become the next generation of CAs under the tutelage of our expert staff and members. We regulate our members and their firms. We represent our members on a wide range of issues in accountancy, finance and business and seek to influence policy in the UK and globally, always acting in the public interest.

ICAS was created by Royal Charter in 1854.

General comments

ICAS welcomes the opportunity to comment on the Financial Reporting Council's draft amendments to FRS 102 and other FRSs, set out in Financial Reporting Exposure Draft (FRED) 82.

In our responses to the individual consultation questions we highlight where our comments are sector specific either from a Public Benefit Entity (PBE) or pension scheme perspective.

If you have any questions about our response, please contact Christine Scott (cscott@icas.com), Head of Charities and Reporting at ICAS.

Responses to consultation questions

Question 1: 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?

Response

In general, we believe that the overall level of disclosure required by the proposed FRS 102 to be proportionate, given that the Standard will be applied by entities of varying sizes. Where we have any comments on specific proposed disclosure requirements, we refer to these in our responses to other consultation questions.

Question 2: Concepts and pervasive principles

The proposed revised Section 2 Concepts and Pervasive Principles of FRS 102 and FRS 105 would broadly align with the IASB's 2018 Conceptual Framework for Financial Reporting.

The IASB's Exposure Draft Third edition of the IFRS for SMEs Accounting Standard (IASB/ED/2022/1) contains similar proposals. The FRC considers it appropriate that FRS 102 and FRS 105 should be based on the same concepts and pervasive principles as IFRS Accounting Standards including the IFRS for SMEs Accounting Standard, given the FRC's aim of developing financial reporting standards that have consistency with global accounting standards.

The FRC has made different decisions from the IASB in some respects in developing proposals to align FRS 102 and FRS 105 with the 2018 Conceptual Framework in a proportionate manner.

Do you agree with the proposal to align FRS 102 and FRS 105 with the 2018 Conceptual Framework? If not, why not?

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?

Response

We agree with the proposal to broadly align FRS 102 and FRS 105 with the IASB's 2018 Conceptual Framework.

We also agree with the proposal to continue to align 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. We support this compromise, which we view as pragmatic, to maintain consistency between FRS 102 and IFRS Accounting Standards.

A recently published ICAS research report 'The production and consumption of information on intangibles: An empirical investigation of preparers and users' however concludes that a need exists to reconsider the definition of an asset in IAS 38 Intangible Assets, which does not correspond to that in the 2018 revised IASB Conceptual Framework.

Further work is therefore still needed on the definition of an asset to create a sustainable conceptual framework which meets the needs of both financial statements' preparers and users. We are not in favour of permitting more classes of intangibles to be recognised on-balance sheet and believe that additional disclosures would better meet the needs of investors and potential investors. However, the IASB rather than the FRC needs to take the lead on this.

Question 3: Fair value

The proposed Section 2A Fair Value Measurement of FRS 102 would align the definition of fair value, and the guidance on fair value measurement, with that in IFRS 13 Fair Value Measurement. Do you agree with this proposal? If not, why not?

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?

Response

We support the new proposed Section 2A Fair Value Measurement and alignment with IFRS 13 Fair Value Measurement.

However, we have three specific points to raise on the content of this section which would result in closer alignment:

- We are not convinced that it is necessary to retain the extant definition of fair value for the purpose of Section 26 Share-based payment. We would prefer where possible for FRS 102 to align with IFRS Accounting Standards.

- We recommend that the requirements of paragraph 17 of IFRS 13 on information that is reasonably available when selecting a market are reflected in Section 2A. Paragraph 17 states that "An entity need not undertake an exhaustive search of all possible markets to identify the principal market or, in the absence of a principal market, the most advantageous market, but it shall take into account all information that is reasonably available. In the absence of evidence to the contrary, the market in which the entity would normally enter into a transaction to sell the asset or to transfer the liability is presumed to be the principal market or, in the absence of a principal market, the most advantageous market."

- We also recommend that non-performance risk is an aspect of risk covered by Section 2A to align FRS 102 specifically with the requirements of paragraphs 42 to 44 of IFRS 13.

Pension scheme perspective
In the new Section 2A there is a proposed change to the material on valuation techniques to align FRS 102 with IFRS 13. We believe this proposed change may have unintended consequences for pension scheme financial statements.

The proposals preserve the current methodology for fair value measurement by permitting the use of the bid price in arriving at a fair value. However, the wording in proposed paragraph 2A.17, underlined below, suggests bid price is now a secondary valuation method. This could lead to the assumption that FRS 102 has a preference for not using bid prices:

"Valuation techniques, or the use of multiple techniques, can often produce a range of reasonable valuations. The selection of the most appropriate fair value within the range requires judgement, considering qualitative and quantitative factors specific to the measurement. <u>The use of bid prices for asset positions and ask prices for liability positions is permitted, but is not required</u>."

Greater clarity could be achieved by replacing paragraph 2A.17 with paragraphs 70 and 71 of IFRS 13. The wording of these paragraphs is as follows, with paragraph 70 retaining the wording underlined above but in a more suitable context:

"Inputs based on bid and ask prices

70. If an asset or a liability measured at fair value has a bid price and an ask price (e.g. an input from a dealer market), the price within the bid-ask spread that is most representative of fair value in the circumstances shall be used to measure fair value regardless of where the input is categorised within the fair value hierarchy (i.e. Level 1, 2 or 3;……..). The use of bid prices for asset positions and ask prices for liability positions is permitted, but is not required.

71. This [Standard] does not preclude the use of mid-market pricing or other pricing conventions that are used by market participants as a practical expedient for fair value measurements within a bid-ask spread."

Question 4: Expected credit loss model

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

In IASB/ED/2022/1 the IASB proposes to retain the incurred loss model for trade receivables and contract assets and introduce an expected credit loss model for other financial assets measured at amortised cost. The FRC's preliminary view is that, in the context of FRS 102, it may be appropriate to require certain entities to apply an expected credit loss model to their financial assets measured at amortised cost but allow other entities to retain the incurred loss model. Do you agree with this view? If not, why not?

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

Response

We support the FRC's decision to defer the introduction of an expected credit loss model into FRS 102.

We believe that if, or when, an expected credit loss model is introduced into FRS 102, it will be appropriate to limit which entities would be required to apply it to other financial assets measured at amortised cost. We believe that for most businesses outside of the banking sector applying an expected credit loss model will not be appropriate to meet the needs of preparers and users.

Question 5: Other financial instruments issues

When it has reached its conclusion as to whether to align FRS 102 with the expected credit loss model, the FRC intends to remove the option in paragraphs 11.2(b) and 12.2(b) of FRS 102 to follow the recognition and measurement requirements of IAS 39 Financial Instruments: Recognition and Measurement.

This intention was communicated in paragraph B11.5 of the Basis of Conclusions to FRS 102 following the Triennial Review 2017. In preparation for the eventual removal of the IAS 39 option, the FRC proposes to prevent an entity from newly adopting this accounting policy. Do you agree with this proposal? If not, why not?

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?

Response

We support the proposal to prohibit newly adopting the recognition and measurement requirements of IAS 39 Financial Instruments: Recognition and Measurement.

We support the removal of temporary amendments in relation to IBOR reform, subject to the FRC being satisfied that these are no longer of any relevance to longer-term hedging contracts.

Question 6: Leases

FRED 82 proposes to revise the lease accounting requirements in FRS 102 to reflect the on-balance sheet model from IFRS 16 Leases, with largely optional simplifications aimed at ensuring the lease accounting requirements in FRS 102 remain cost-effective to apply. An entity electing not to take these proposed simplifications will follow requirements closely aligned to those of IFRS 16, which is expected to promote efficiency within groups.

Do you agree with the proposals to revise Section 20 of FRS 102 to reflect the on-balance sheet lease accounting model from IFRS 16, with simplifications? If not, why not?

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

Response

At a conceptual level, we support the on-balance sheet treatment of operating leases and believe this is the appropriate way forward for entities applying FRS 102.

However, for lessees bringing operating leases on-balance sheet this is not just an accounting exercise. Rather, this is a business issue and will have considerable implications where entities have banking or loan covenants referring to EBITDA (Earnings before interest, taxation, depreciation and amortisation), interest cover, gearing and similar key performance measures. Therefore, there will be some pain for companies in renegotiating contracts.

There is a question over whether covenant negotiations can be completed in time for implementation of the proposed changes by 1 January 2025 and there is a possibility that covenant breaches may arise from the transition. This means that the revised FRS 102 needs to be published as soon as possible and, we believe, no later than the end of September 2023.

The definition of a lease incentive in FRS 102 should be revised to align with IFRS 16 Leases. The current definition within FRS 102 has not been updated and still refers to ‘an operating lease’. The IFRS 16 definition is as follows; “Payments made by a lessor to a lessee associated with a lease, or the reimbursement or assumption by a lessor of costs of a lessee.”

We support the practical expedient at paragraph 1.41 of draft FRS 102 which permits IFRS 16 to be applied directly in a group situation. We recommend that reference is made to the practical expedient within Section 20 Leases.

The proposals approach efficiency within groups differently for lease accounting and for accounting for revenue from contracts with customers. Paragraph B20.6 of the basis for conclusions explains the approach for lease accounting and paragraph B23.8 explains the approach for revenue accounting. We are keen for there to be no requirement, and no ambiguity as to whether there is a requirement, in either case for financial statements’ preparers to conduct an exercise to demonstrate the method used is equivalent to FRS 102 compliance. We comment further on this point in our response to question 7.

PBE/charity sector perspective: The on-balance sheet treatment of leases
Charities are not entitled to apply FRS 105. This means that charities which would meet the size criteria for treatment as a micro-entity (if they were not charities) will be required to bring leases currently classified as operating leases on-balance sheet. As a result many charities will be subject to more onerous (and therefore costly) requirements than the FRC considers appropriate for micro entities, particularly where no in-house accountancy expertise is available. Given the lower audit thresholds in place for UK charities, the changes could also push some charities from the charity independent examination regime into the charity audit regime, adding an additional regulatory and cost burden to charities relative to companies of a similar size.

We therefore believe it would be appropriate for the FRC to consider providing concessions from complying with the lease accounting changes for charities and other PBEs based on their size, for example, for those charities and PBEs which meet the micro-entity size criteria.

We recognise this would add complexity to FRS 102 but we believe that such a concession is appropriate from a cost benefit perspective. For example, the next edition of the Charities SORP would be able to provide guidance on the operation of such a concession.

PBE/charity sector perspective: Initial measurement of the lease liability
There is a hierarchy of interest rates which an entity can apply to the measurement of a lease liability with an additional rate which PBEs can apply, the rate available on deposits.

We are aware based on current experience that it is possible for some charities to identify the interest rate implicit in the lease but for many charities this will not be the case, with this in mind we would welcome clarification within FRS 102 about how much work needs to be undertaken by entities before they are permitted to rule out this measure.

The next rung of the hierarchy in FRS 102 is a straight accounting policy choice between the lessee's incremental borrowing rate and the lessee's obtainable borrowing rate (with the rate available on deposits permitted as a proxy for PBEs only). The next rung is the gilt rate which can only be used in exceptional circumstances.

It would be helpful to have clarity within FRS 102 about whether the rate available on deposits is expected to be the default rate applied by charities and other PBEs, where it is not possible for the entity to identify the rate implicit in the lease. This would be of assistance to SORP-making bodies revising PBE SORPs for the changes to FRS 102.

PBE/charity sector perspective: Leases provided at below market rent
We acknowledge that the requirement for leases provided at below market rent impacts on entities which are not PBEs but we are largely addressing this issue from a PBE perspective given the likelihood that charities may be disproportionately impacted.

The proposed requirements for accounting for leases at below market rent are complex and are an additional compliance and cost burden for the entities affected. Some PBEs, particularly smaller ones which are likely to be charities, would probably need to engage an external valuer to obtain a market rent which could be considered reliable.

Identifying the market rent is likely to be more challenging in some particular circumstances, for example, where there are no comparable properties (for example, the asset is a heritage asset) and/or the entity is only using a building as it is surplus to the lessor's requirements (for example, when the lessor is a local authority).

For public benefit entities, we appreciate that in seeking to measure a non-exchange transaction the entity must "take into consideration whether the resource can be reliably measured and whether the benefits of recognising the resource outweigh the costs" (PBE34.67).

FRS 102 expands on this point further at PBE34.70 which states: "In some cases it may be impracticable to estimate the value of the resource with sufficient reliability when the resource is received or receivable; for example, in the case of high volume, low value second-hand goods donated for resale. In such cases, the income shall be recognised in the period when the resource is sold or distributed."

The glossary states that "Applying a requirement is impracticable when the entity cannot apply it after making every reasonable effort to do so."

However, PBE.34.69A appears to create a rebuttable presumption that "Resources that can usually be measured reliably include donations of cash or goods or facilities such as the free use of office accommodation or event space…."

While there is a desire to separate out the accounting for donated facilities from the accounting for leases at below market rent, the requirements in Section 34 on accounting for non-exchange transactions means that similar principles apply, although the requirement is for donated facilities to be measured at 'value to the entity', which can be but is not necessarily market value.

However, we think it will be difficult for PBEs to judge when it is and when it is not impracticable to measure the non-exchange element of a lease at below market rent. For example, the non-exchange element will not be sold or distributed and there is an assumption that donations of facilities can be reliably measured. It is important that there is consistency in the way PBEs are required to recognise property related transactions where there is a non-exchange element and at the moment, we believe there could be greater clarity around when it is and when it is not practicable to recognise the non-exchange element of a lease provided at below market rent.

The above comments notwithstanding and as referred to in our overall comments on the impact on the new leasing requirements on charities, we believe it would be helpful simplification for charities which meet the size criteria for micro entities if the lease accounting changes proposed to FRS 102 could be disapplied in full, mirroring the FRS 105 position.

There is also a possible technical difficulty in the proposed treatment of the non-exchange element of leases provided at below market rent which arises from the basis for conclusions (paragraph B34.4) and flows through to paragraphs 20.36 and 20.50e of FRS 102. PBEs are being directed to Section 34 on Specialised Activities to address the accounting requirements and not to Section 24 Government Grants when the lessor is a government body. We are not sure if this is intentional or whether the wording is ambiguous. However, it appears that the basis for conclusions contains the implicit assumption that a government body would offer a below market rent lease to an entity which is not a PBE but not to an entity which is a PBE. This does not appear to be an appropriate assumption to make within an accounting standard. Also, we believe it is the nature of the transaction and not the nature of the entity which should impact on the treatment in this situation. If a lease is provided to a PBE by a government body at below the market rent it would make sense to apply Section 24 as would be the case for any other government grant, subject to the requirements of any separate specialist SORP.

Assuming it would be appropriate for a PBE to refer to Section 24 in the event that the lease is provided by a government body, this is also problematic. This is due to Section 24 applying the accrual model to accounting for right-of-use assets while the Charities SORP specifically prohibits charities from using the accrual model Therefore, the Charities SORP would need to make an exception by permitting the accrual model for right-of-use assets. It would also make sense to provide a concession where it is impracticable to measure the grant element due to it being impracticable to identify the market rent.

Another observation is that the accrual model in Section 24 requires the related grant to be recognised as income but a non-exchange transaction accounted for in accordance with Section 34 is described as a 'contribution to the cost of the right-of-use asset'. In the basis for conclusions (B34.4) the difference between the actual rental charge and the market rent, whether it is categorised as a government grant or non-exchange transaction is described as a 'contribution to the cost'. While there may be no intention for the grant or non-exchange element to be netted off, this could be interpreted as such so some clarification wording would be helpful. Also, consistent wording on this point should be used in both Section 24 and Section 34.

PBE/charity sector perspective: Heritage assets held by the lessee as right-of-use assets
We recommend the following amendments to proposed FRS 102, shown as underlined, to clarify the treatment of heritage assets to be recognised as right-of-use assets:

PBE 34.51 An entity shall recognise and measure heritage assets in accordance with Section 17, or Section 18 or Section 20, as appropriate (i.e., using the cost model or revaluation model), subject to the requirements set out in paragraphs 34.52 to 34.53 below. <u>For heritage assets recognised as right-of-use assets in accordance with Section 20 the cost model shall be used.</u>

PBE 34.53 Where heritage assets have previously been capitalised <u>or leased</u>, or are recently purchased <u>or leased</u>, information on the cost or value of the asset will be available. Where this information is not available, and cannot be obtained at a cost which is commensurate with the benefits to users of the financial statements, the assets shall not be recognised in the statement of financial position, but must be disclosed in accordance with the requirements below.

<u>PBE 34.53A For heritage assets classified as right-of-use assets and containing a government grant or a non-exchange transaction, for example, where lease payments are significantly below market rent, an entity shall apply paragraph 20.36.</u>

It would also be helpful if FRS 102 could include guidance within this section of FRS 102 for entities with right-of-use heritage assets to assist them in determining whether an asset contains a government grant or non-exchange transaction. We believe guidance is required as determining whether or not the rent is significantly below the market rent for unique assets is unlikely to be straight forward, given the likely absence of an active market.

Question 7: Revenue

FRED 82 proposes to revise the revenue recognition requirements in FRS 102 and FRS 105 to reflect the revenue recognition model from IFRS 15 Revenue from Contracts with Customers. The revised requirements are based on the five-step model for revenue recognition in IFRS 15, with simplifications aimed at ensuring the requirements for revenue in FRS 102 and FRS 105 remain cost-effective to apply. Consequential amendments are also proposed to FRS 103 and its accompanying Implementation Guidance for alignment with the principles of the proposed revised Section 23 of FRS 102.

Do you agree with the proposals to revise Section 23 of FRS 102 and Section 18 of FRS 105 to reflect the revenue recognition model from IFRS 15, with simplifications? If not, why not?

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

Response

We support the five step model. Its introduction means that financial statements will better reflect economic reality which is good governance. It should also promote greater comparability of the revenue of different entities.

The same concerns arise for preparers as they do with the implementation of changes to accounting for leases. Where covenants (and to a rarer degree earnout agreements) refer to EBITDA (or another measure of profit) some entities will recognise revenue from contracts with customers sooner than currently and some later.

Banks and other financial statements' users need to be informed about the transitional provisions as entities have the option of full retrospective application or modified retrospective application.

On a point of detail, the term 'performance obligation' in IFRS 15 Revenue from Contracts with Customers is well understood and used in the GAAP guides published by the larger accountancy firms. Therefore, we do not support the use of the term 'promise' in UK accounting standards. We recommend that the term 'performance obligation' is used as this will ensure all UK GAAP preparers have access to guidance prepared using consistent terminology on the recognition of revenue from contacts with customers from other sources.

We recommend that the practical expedient which is available for group entities to apply IFRS 16 is made available in the same circumstances to the application of IFRS 15. We believe this approach to be more appropriate than the current approach articulated at FRED82.B23.8 where the revised FRS 102 permits an approach which is analogous to IFRS 15.

Additionally, it would be helpful if such a practical expedient were to be made available for this to be referred to in Section 23 on Revenue from Contracts with Customers.

Question 8: Effective date and transitional provisions

The proposed effective date for the amendments set out in FRED 82 is accounting periods beginning on or after 1 January 2025, with early application permitted provided all amendments are applied at the same time. Do you agree with this proposal? If not, why not?

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.

Response

For the proposed effective date to be feasible, we believe that the revised edition of FRS 102 will need to be published no later than the end of September 2023. This is to ensure that entities have sufficient time to prepare for the implementation of the changes, including the preparation of comparative and other information needed to comply with transitional provisions.

Having said that, we would also welcome the FRC giving consideration to a short implementation delay perhaps to periods commencing on or after 1 April 2025 to enable the accountancy profession to better serve its clients. This short delay would avoid a six month overlap, from April 2026 to September 2026, where financial statements' preparers would be working on both 31 December 2025 and 31 March 2026 year-ends, until the filing deadline for 31 December 2025 year-ends had passed.

Another alternative could be to have a 12 month delay in implementation for entities applying Section 1A of FRS 102 and FRS 105, again this would ease the demands placed on the accountancy profession and on business of implementing the revised standards. A similar approach was taken when FRS 102 was first implemented and use of the FRSSE was permitted for an additional year.

We agree that the proposed changes should be implemented as a package where FRS 102 or FRS 105 is adopted early. We also support in FRS 102, the option for IFRS 16 figures to be used to promote efficiency within groups and would welcome the same approach being applied to IFRS 15 figures.

We believe that investors and potential investors in SMEs would benefit from having full comparative information relating to the implementation of changes arising from alignment with IFRS Accounting Standards, but are pragmatic in supporting transitional arrangements which are also available under IFRS Accounting Standards to ease the burden on business.

Ideally, we would prefer to see full comparatives provided by entities on adoption of the five step model for revenue from contracts with customers. However, we accept the pragmatic approach proposed in FRS 102 and the supporting rationale that the costs of providing full comparatives may be disproportionate to the benefits. We recognise that this situation will filter out quickly but additional disclosures may be needed in the year of transition for entities where there is distortion to their recognition of revenue in the year of transition.

Question 9: Other comments

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

Response

Overall comments
We note and welcome the FRC's efforts to ensure that the revised FRS 102 will be proportionate while still providing users with useful and relevant information. On balance we are supportive and our view is influenced by the wide range of entities which apply FRS 102. However, we appreciate that some may question whether the extent of these compromises as a whole represents a reasonable departure from IFRS Accounting Standards from the perspective of information which may be material to financial statements' users.

Some of our members have suggested an alternative to the current arrangements through having a single reporting standard for small and micro entities. We believe this could be achieved through replacing Section 1A with an enhanced FRS 105, which would apply to entities below the statutory audit threshold for companies. We appreciate that this would require changes to the accounting regulations, which is beyond the powers of the FRC. FRS 102 could then become a standard primarily designed to fit the needs of the financial statements' users of entities above the Companies Act 2006 audit threshold. This would help to remove some of the tension that exists between trying to create a proportionate financial reporting standard that is intended to serve the needs of exceptionally large entities as well as smaller entities. We appreciate that this is something that would only be achievable in the medium term.

Going concern
We welcome the strengthened requirement on going concern related disclosures in proposed new paragraph 3.8A. However, we do have a concern that the confirmation statement wording could become boilerplate. To ensure that this is not the case and to demonstrate that management's going concern assessment meets the requirements of paragraph 3.8, we would welcome a requirement for a description of the available information and the specific time horizon about the future which was considered.

FRS 102 Section 1A
We welcome the inclusion of the previously encouraged disclosures as mandatory in the UK.

Section 1A is used by financial statements' preparers for many small entities and we would welcome the production of a standalone Section 1A without cross-references to FRS 102. Previous cross-references related to similar requirements in full FRS 102. However, the proposed new Section 1A includes cross-references to FRS 102 where compliance with full FRS 102 is a requirement, for example, in relation to going concern, leases, revenue from contracts, deferred tax and related party transactions. A standalone Section 1A would also be of assistance to auditors.

With regard to the new cross-references to FRS 102, we question whether some of the additional disclosure requirements are excessive given the overriding requirement for financial statements to give a true and fair view:

- Share-based payments (1AC.31.B). For example, all of the additional share-based payment disclosures can't be material or relevant, especially, the weighted average exercise prices.
- Provisions and contingencies (1AC.31CB)
- Related party transactions (1AC.35)
- Deferred tax (1AC.36A)

The rationale for these additional disclosures has not been addressed in commentary relating to the consultation questions or in the basis for conclusions.

We also believe that Section 1A could be more helpful if it distinguished between what disclosures are required by company law (and the LLP equivalent) from those required by Section 1A. Paragraph 1A.17A, which contains minor proposed amendments, says disclosures need not be provided " if the information resulting from that disclosure is not material, except when required by the Act regardless of materiality."

Another improvement which would assist financial statements' preparers and auditors is a recasting of Section 1AC so that it follows the order of the financial statements rather than the order of the legislation, as referred to above, and distinguishes between legal requirements, accounting requirements and also guidance.

We believe that there is merit in a future revision of Section 1A considering whether there are any recognition and measurement simplifications that could be introduced. One example is the simplification of requirements around share-based payments. The volatility in share price can make share-based payment charges unduly material, but they have no cost to the business.

This is consistent with our comments above about enhancing FRS 105 with a view to it replacing Section 1A in the medium-term.

FRS 105
We anticipate that when the Economic Crime and Corporate Transparency Bill is enacted micro entities will be required to file their income statement. In addition, to these enhanced filing requirements, we believe the value of micro-entity financial statements to users could be enhanced further by requiring micro entities to make additional disclosures which in our view are fundamental to users' understanding of an entity's final performance and financial position. We envisage additional fundamental disclosures would include the following, where applicable:

- Material uncertainty about the entity's ability to continue as a going concern, including ceasing trading, or if the entity has not applied the going concern basis of preparation.
- Prior period adjustments. It is fundamental for users to be informed if any brought forward figures do not agree to prior year figures in the signed financial statements.
- Exceptional items. Significant one-off transactions ought to be identified to avoid misleading users about the underlying performance of the entity and /or trends in performance.
- Related party transactions. There is currently a lack of disclosure about related party transactions which would impact the economic decisions of users of the financial statements such as material sales and/ or purchases between related parties. We believe there is a need for the proportionate disclosure of related party transactions.

We make these comments notwithstanding our view that it would be helpful in the medium term for FRS 105 to be even further enhanced to replace Section 1A.

PBE/charity sector perspective: Tiering
Most UK charities would meet the size criteria for applying either FRS 105 or Section 1A of FRS 102. However, they are prohibited from applying FRS 105 by law and there is no clear route for them to take advantage of the Section 1A concessions and still prepare financial statements which give a true and fair view.

While we recognise that the nature of charities means that they should have a greater degree of accountability to the public and transparency about their activities than, say, private companies, we believe that there is scope to offer concessions to charities, particularly in relation to the disclosure requirements and presentation requirements (i.e. the comparative information requirements) of FRS 102. However, we also believe that there is scope for recognition and measurement concessions for charities which meet the size criteria for a small or micro-entity, for example, in relation to donations in-kind. Disclosure concessions could enable charities to focus on what is important and a package of concessions could reduce the cost burden on charities which are small entities and have the potential to improve the quality of charity financial statements by focussing on what is important.

As things stand, the Charities SORP can only offer sized-based concessions from requirements set out in the Charities SORP. The scope for such concessions is in relation to narrative disclosures and the presentation of numerical information. Some presentation concessions are already offered within the SORP.

We therefore recommend that the FRC considers consulting on this matter as part of a future periodic review of UK GAAP. Such a review would require consideration of the related accounting regulations which must be complied with by UK charities so the relevant government bodies would need to be involved.

PBE/charity sector perspective: Comparatives

Due to the interaction of FRS 102 with other requirements placed on charities by accounting regulations and the Charities SORP, charities must provide more extensive comparatives than non-charitable organisations. The inclusion of comparatives has been a significant factor in contributing to charity financial statements prepared under FRS 102 being longer and more cluttered compared to other types of entity. While some additional comparative information may be of value, this is an area which is considered unduly burdensome by charities.

We would welcome a concession in FRS 102 which would enable comparatives prepared by PBEs as a result of SORP requirements or charity specific accounting regulations (if feasible in law) to be at the discretion of the sector specific SORP. If it is not feasible to introduce such a measure in the next edition of FRS 102, we would welcome consideration in a future periodic review.

PBE/charity sector perspective: Employer accounting for pensions

There are gaps in the FRS 102 requirements on how an employer must account for its relationship with a pension scheme, including a multi-employer pension scheme. While the following comments reflect the experience of our members working in or advising charities, these issues are not entirely exclusive to charities or to the broader PBE sector. The relevant sections of FRS 102 are Section 28 Employee Benefits and Section 21 Provisions and Contingencies.

The gaps we have identified are as follows:

- Accounting requirements when Defined Benefit (DB) accounting ceases to be appropriate.

The reverse scenario was addressed by the FRC when amendments to FRS 102 were made due to the housing sector needing clarification as to how an entity receiving DB accounting information for the first time should account for this.

Due to current economic conditions more charities participating in multi-employer schemes have been exiting these schemes, so accounting requirements on this topic have become increasingly necessary.

- Accounting for a DB pension asset

In the current economic climate we are aware of charities participating in standalone and multi-employer schemes which have a DB accounting asset which meets the recognition criteria in FRS 102. The requirements in FRS 102 on how to account for a DB pension asset are not expansive and charities and their advisers are having to refer to IFRS Accounting Standards for guidance, specifically IAS 19 Employee Benefits and IFRIC 14 (The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction).

We recommend that FRS 102 is revised to include more detail on how entities should account for a DB pension asset.

- DB accounting information not available and a deficit recovery plan or cessation debt has not been agreed.

In circumstances where an entity cannot recognise a net DB liability due to the information not being available from the scheme and the entity does not have an agreed deficit recovery plan in place at the balance sheet date, it is not clear whether the entity should recognise, on its balance sheet, any liabilities in respect of a funding deficit with the scheme or disclose a contingent liability instead.

A similar scenario exists, at the balance sheet date, where a cessation debt has been triggered (i.e. an employer has ceased to have any active (contributing) members in the scheme) but has not yet reached agreement with the scheme on how much the employer will need to pay to discharge its cessation debt.

- Disclosure of third party guarantees by charities (and other not-for-profit entities)

Charities participating in multi-employer schemes may have third party guarantees from government. Some of these may have been in place for many years and charities don't often understand the nature of these guarantees. Where a charity has a more recent third-party guarantee, the terms of the guarantee are likely to be clearer and better understood. In both these broad scenarios the nature of the guarantee could have an impact on the going concern status of the charity. Therefore, having a requirement to disclose the nature of any guarantees may assist charity trustees in preparing their going concern assessment.

Pension scheme perspective: Investment risk disclosures
Proposed new wording has been added to paragraph 34.43 which sets out requirements for pension schemes on making investment risk disclosures. Paragraph 34.43 is set out below with the new wording underlined:

"A retirement benefit plan shall disclose information that enables users of its financial statements to evaluate the nature and extent of credit risk and market risk arising from financial instruments to which the retirement benefit plan is exposed at the end of the reporting period <u>and which may impact the ability of the plan to pay the promised retirement benefits to members</u>."

The reference to 'promised retirement benefits' is relevant to Defined Benefit schemes but not to Defined Contribution schemes and Master Trust schemes. We therefore recommend that the wording, which appears to be clarification wording, is amended so that it is relevant to all pension schemes preparing their financial statements in accordance with FRS 102 and the Pensions SORP. This could be achieved by removing the word 'promised'.

Pension scheme perspective: Other potential changes for consideration
Pension scheme financial statements are stewardship financial statements primarily intended to record and report on scheme net assets and financial transactions. They do not record the scheme's pension liabilities.

With the nature of pension scheme financial statements in mind, we believe there is scope to review aspects of the approach to pension scheme financial statements under FRS 102 with a view to either amending the requirements placed on pension schemes or reaffirming that the requirements apply by explaining why these are being retained.

We understand that the FRC has not been minded to consider these issues within this periodic review, nevertheless, we believe that there is merit in consulting on the following two significant issues as part of a future review of FRS 102:

- Investment risk disclosures. The implementation of FRS 102 by pension schemes requires schemes to make extensive investment risk disclosures. Given the nature of pension scheme financial statements, there is a question-mark as to how meaningful these additional disclosures are. In our experience, trustees do not perceive the disclosures as adding value but from an employer’s perspective these can help the employer to understand the risks the scheme is exposed to.

Audit work on investment risk disclosures and communicating with pension scheme trustees about why the disclosures are there adds cost to the audit, so it is important that these are helpful to the main users of pension scheme financial statements. For smaller pension schemes, which do not have advisers, dealing with issues around the investment risk disclosures is especially burdensome.

At present, there is no requirement for pension scheme financial statements to make disclosures about liquidity risk. However, we are mindful of recent events where many schemes experienced significant liquidity issues due to unprecedented collateral calls. We would therefore envisage that any review of the investment risk disclosures made by pension schemes should consider whether it would be appropriate for them to make tailored liquidity risk disclosures.

We would therefore welcome specific consideration by the FRC as to whether a more tailored approach to the investment risk disclosure requirements for pension schemes could be developed within FRS 102. This could not only improve the way that these are perceived but would result in clearer requirements for financial statements’ preparers and a more consistent approach to the disclosures. It is also our experience that investment risk disclosures, particularly in relation to pooled investment vehicles, are not only inconsistent but of variable quality. For smaller schemes which are more likely to find the disclosures burdensome, and which are likely to invest in pooled vehicles, tailored requirements may be particularly helpful.

- Accounting for liability driven investments. Pension schemes are required to take the same approach to liability driven investments as companies. Therefore, consistent with our comments on investment risk disclosure requirements, we would welcome consideration being given to having more tailored requirements for pension schemes.

  Prior to the implementation of FRS 102, insurance policies (annuity buy-ins) were not recognised in pension scheme financial statements, although there was a requirement to recognise longevity swaps at fair value.

  We recognise that requirements under FRS 102, which mean that pension schemes must recognise insurance policies have led to improvements in the governance and record keeping around these assets. Therefore, with this in mind, we believe that deliberations around accounting for liability driven investments should consider whether narrative disclosures within the notes to the financial statements would suffice without the need to recognise liability driven investments in the financial statements.

  Disclosures could focus on explaining what holding these assets means for the scheme rather than focusing on valuations.

  Where there has been an insurance buy-in and the insurer is paying scheme benefits directly to the scheme member or other beneficiary, the pension scheme must recognise the pension payment and related investment income in its financial statements. However, the scheme has no role in administering those benefits and therefore does not implement any internal controls around those payments or the receipt of any related investment income. A disclosure approach under FRS 102 would remove the need for these transactions to be recognised in scheme financial statements but would have the advantage of communicating to users of the financial statements why the buy-in was entered into.

  Valuations obtained for liability driven investments are not used for any other purpose and therefore, similarly, the trustees do not operate internal controls around the valuation of these assets. Asset values and the value of related liabilities do not necessarily make a complete match which results in additional audit effort.

  Where liabilities have been bought out by insurance companies but there has not been a full buy-out, valuation information is viewed by insurers as proprietary so scheme financial statements with buy-ins are relatively difficult to audit. It is also questionable whether the numbers matter. We recognise that some full buyouts are delayed due to guaranteed minimum pension (GMP) issues, so financial statements for schemes with buy-ins covering all scheme liabilities will continue to be prepared until these issues are resolved.

Where liability matching is involved, actuaries undertake the valuations and auditors have to audit them, which involves engaging another actuary (an auditor's expert) to provide a view. In engaging an actuary, the auditor must comply with ISA (UK) 620 Using the work of an auditor's expert.

The interaction between financial reporting requirements and audit requirements (specifically the audit of accounting estimates) takes a disproportionate amount of time for the auditor resulting in additional costs to the scheme due to the risks associated with auditing asset values relating to pension scheme liabilities which themselves are not recorded in pension scheme financial statements.

Formatting
This is a minor point but one that would assist financial statements' preparers and auditors share information about UK GAAP. The use of the † symbol doesn't copy from the PDF into email or Word. Therefore, we suggest using a standard symbol such as '^'.

Question 10: Consultation stage impact assessment

Do you have any comments on the consultation stage impact assessment, including those relating to assumptions, sources of relevant data, and the costs and benefits that have been identified and assessed? Please provide evidence to support your views.

In particular, feedback is invited on the assumptions used for quantifying costs under each of the proposed options (Section 3 of the consultation stage impact assessment); any evidence which might help the FRC quantify the benefits identified or any benefit which might arise from the options proposed which the FRC has not identified (Section 4 of the consultation stage impact assessment); and appropriate data sources to use to refine the assumption of the prevalence of leases by entity size (Table 23 of the consultation stage impact assessment).

Response

We believe the costs set out in the impact assessment are likely to underestimate the cost to entities of implementing the revised FRS 102 based on discussions with practitioners and businesses. However, we are not in a position to provide evidence to support our view on the potential costs of implementing the changes.

The impact of implementing the changes in Section 23 Revenue from Contracts with Customers may be difficult to quantify and will be more straightforward for some entities than others. For example, an entity with a standard process and contract for every sale will find it more straightforward to implement the five step model than an entity with non-standard processes and contracts.

Financial statements' preparers who are aware of the implications for the proposed changes to Section 23 will be trying to put customers on standard contracts to take advantage of the portfolio approach which is allowed.

As a general point, communicating the changes to financial statements' preparers and their advisers will be essential to ensure that business issues are addressed prior to implementation, for example, the renegotiation of covenants referring to EBITDA or other measures of profit.

Overall, we believe that the impact of implementing the changes is likely to be significant but change is desirable to maintain consistency with IFRS Accounting Standards.

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