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Dear Sirs

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

We welcome the opportunity to respond to FRED 82 and our responses are set out below.

HAT Group of Accountants provide technical, training and compliance support to accountancy practices throughout the UK. The practices we support range from several of the Accountancy Age 'Top 50 + 50' through to sole practitioners. The vast majority of entities dealt with by the accountancy firms supported by HAT are small or medium sized.

Based on our discussions with accountancy firms during the first quarter of 2023, it is clear that there is a lot of resistance to some of the proposed changes set out in FRED 82, principally around leases and the Section 1A disclosures.

The outcomes of these discussions have helped informed some of our responses.

Should you wish to discuss any of the points raised, please do not hesitate to contact us.

Yours faithfully

S P Kettlewell

Simon Kettlewell
Director
On behalf of HAT Group of Accountants

Question 1: Disclosure

The disclosures proposed in FRS 102 'full' are considered appropriate.

However, our main concern relates to the increased disclosure requirements included in Section 1A. For many small entities, the inclusion of share-based payments, provisions and deferred tax disclosures feels excessive. This increased level of disclosure would only leave a minimal reduction in the number of notes when compared with the financial statements for a medium-sized entity prepared under FRS 102 'full'.

Whilst it is acknowledged that additional disclosures have been encouraged under extant Section 1A in order to assist with giving a true and fair view, the key point is that these were optional. It is unclear why the FRC considers that all of the additional proposed disclosures (in excess of those that were previously included in Appendix E of Section 1A) are required. Further, small entities will soon be required to include additional information in their financial statements filed at Companies House as a result of the Economic Crime and Corporate Transparency Bill, including the profit and loss account. The provision of the profit and loss account alongside the additional disclosures suggested by FRED 82 will result in a lot more information being available on public record. It is questionable whether such information should be publicly available.

Question 2: Concepts and pervasive principles

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

We agree with the proposal to retain 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.

We have no other comments.

Question 3: Fair Value

Any additional guidance that can be provided within the Standard to help both preparers and accountants/ auditors is welcome. It tends to be the case that larger (audit) firms are more comfortable with the Fair Value requirements, due to technical resources and detailed experience of dealing with IFRS. Many small entities and their accountants/advisors lack this knowledge and/or experience, so any further detail in the Standard to assist in determining fair value can only be a good thing. Therefore, we agree with the proposal to align Section 2A *Fair Value Measurement* of FRS 102 with IFRS 13.

We also agree that the extant definition of fair value in Section 26 *Share-based Payment* should be retained.

Question 4: Expected credit loss model

We believe that it is the correct decision to not introduce the Expected Credit Loss (ECL) model into FRS 102 at this point in time.

Due to the complexity of the ECL model, careful consideration must be given to which entities the model would apply to. It is noted that the FRC considers it may be appropriate to define the scope based on an entity's activities, but that scope needs to very specific and not unduly apply to relatively simple entities. Only complex entities should be required to implement the ECL model and therefore we would be supportive of this being limited to Public Interest Entities.

Question 5: Other financial instruments issues

We believe that the proposals are appropriate.

Question 6: Leases

It is acknowledged that consistency with IFRS 16 is desired for UK entities that are part of large groups where consolidated accounts are prepared under IFRS. However, FRS 101 (or indeed full IFRS) exists as an option to enable such consistency.

For smaller, privately held stand-alone entities, such consistency is not desired. The model in extant section 20 of FRS 102 results in disclosure of the contractual lease obligations and therefore arguably provides users of the financial statements with appropriate information. This approach has existed in UK GAAP for a number of years and is understood by users of such financial statements. The inclusion of right of use assets and lease liabilities may actually serve to provide less useful information to users, by adding complexity for those users who may not be familiar with the requirements under IFRS.

Whilst it is acknowledged that there may not be a desire to revert to a UK GAAP framework that includes a standard applicable for smaller entities akin to the old Financial Reporting Standard for Small Entities (FRSSE) it should be noted that such differences in measurement and recognition for micro entities under FRS 105 already exist and will become greater under these proposals. Therefore, we consider that the following options could be considered:

- The IFRS 16 requirements are only mandatory for entities that are large or those that are part of a large group preparing consolidated financial statements under IFRS;
- The IFRS 16 requirements are not required for entities qualifying as small based on the numerical criteria set out in the Companies Act 2006, so as to enable entities that are ineligible per section 384 but would otherwise qualify as small to be excluded from the requirements.

Whilst it is accepted that exceptions from adopting the IFRS 16 model are available for leases of low-value assets and short-term leases under proposed FRS 102, the primary exception (which is welcome) is that micro-entities adopting FRS 105 will not be required to apply the IFRS 16 leasing model. However, the provisions set out in Section 384B of Companies Act 2006 prevent the use of the micro entity regime by charities and those entities included in consolidated group accounts. Therefore, very small charities and some very small subsidiary entities will be required to implement the IFRS 16 requirements where there is likely to be minimal benefit and disproportionate cost of implementation.

It is noted in paragraph 56 of the Consultation Stage impact assessment that there are 2.85 million entities in the UK that qualify as micro entities, but almost half of those do not use FRS 105. Since 2016, many entities have been discouraged from reporting under FRS 105 due to the lack of information provided in the financial statements. The Government press release regarding audit reform (here: https://bit.ly/3N4Z9JZ) includes the following comment: *"In particular, the government will update the definition of micro-enterprises. This threshold, the relic of an EU directive, could be forcing too many of Britain's smallest businesses to spend time and money preparing accounts to a level of detail only needed for larger companies, distracting them from focusing on growth and creating jobs".*

Many entities that qualify as micro-entities may see the proposed changes set out in FRED 82 as the trigger to adopt FRS 105 (ultimately to avoid the IFRS 16 leasing model) but they may find that the relevant legislation is subject to change by Government not long afterwards, which could lead to additional cost implications.

It is accepted that the FRC do not set the size criteria thresholds as set out in the Companies Act. However, in light of previously announced deregulation for smaller entities, the potential reform of the micro-entity regime as well as the forthcoming changes in the Economic Crime and Corporate Transparency Bill, it feels as though discussions should be held with Government with a view to developing a cohesive approach to reporting for small and micro entities.

In addition, it is not clear whether consideration has been given to the fact that some small entities will be subject to audit as a result of bringing right of use (ROU) assets on to the balance sheet for the first time. Consider an example: an entity has turnover of £12m, gross assets of £4.2m and 35 employees for the year ended 31 December 2024. This will qualify as a small company. However, it has a 15 year lease on a property with rentals of £250k per year. The inclusion of the ROU assets for the 31 December 2025 year would take gross assets over £5.1m and with turnover in excess of £10.2m, this entity would breach the small company thresholds. In the subsequent period, the entity would be medium-sized and an audit would be required.

It is clear from the above that the implications of the proposed leasing model for many small entities could be substantial.

As mentioned above, larger entities and larger audit firms are appropriately resourced and skilled to deal with the implementation of the IFRS 16 requirements. However, many smaller entities and their advisors do not have these skills and resources.

Many small entities affected by the reporting requirements do not possess the accounting skills or software packages to deal with the implementation of the leasing requirements and therefore additional expenditure will be required on training, implementing new systems, taking advice from accountancy firms etc. At the smaller end of the market, entities will expect their accountants (who are often the auditors) to assist with the transition to the new requirements.

Many of these small entities that are currently audited (either voluntarily or due to the size of the group to which the entity belongs, for instance) will ask their auditor to assist with the new requirements. This will result in ethical conflicts and additional cost for smaller entities. See further comments under Question 10 below.

Another point to note is the length of the proposed Section 20. At 131 paragraphs, this is longer than IFRS 16. If it is the case that the IFRS 16 model is to be introduced, simplifications should be made wherever possible.

Finally, if the IFRS 16 model is to be introduced, a monetary threshold for “low value assets” should be provided, similar to that in IFRS 16. We consider this will provide much greater clarity than the guidance in the existing draft of the Standard, removing uncertainty and improving consistency. A threshold of £5,000 would appear appropriate.

Question 7: Revenue

We are generally in agreement with the proposals regarding Revenue, as additional guidance to assist with complex revenue transactions is most welcome. Many smaller entities have fairly simple revenue transactions which should be unaffected by the changes although it is accepted that additional disclosures may be required.

Question 8: Effective date and transition

For large entities or those entities reporting IFRS-compliant numbers for group reporting purposes, the effective date does not seem unreasonable. However, this is on the assumption that the Standard is published prior to the end of 2023.

Of more concern is how smaller entities will be able to respond. Implementing new systems, engaging experts, identifying all leases that need to be accounted for in accordance with the new model, reviewing contracts with customers, training of staff, obtaining updated financial reporting products etc. will all take a significant amount of time and money. Set against the current economic circumstances and resourcing issues faced by all firms of accountants, the effective date is likely to be very challenging for smaller entities.

We agree with the proposed transitional provisions relating to revenue and leases, assuming that the proposals are introduced. However, consistency in application of the transitional arrangements across FRS 102 and FRS 105 would be preferred.

Question 9: Other comments

There appears to be some inconsistency in the application of the requirements, in particular regarding the introduction of the IFRS 15 requirements but exclusion of the IFRS 16 requirements for micro-entities. It would seem more appropriate if both models were excluded from FRS 105.

Question 10: Consultation Stage impact assessment

As noted in paragraph 56 of the Consultation Stage impact assessment, there are only 6,597 large entities and 30,696 medium-sized entities in the UK reporting under FRS 102. The changes set out in FRED 82 appear to be primarily aimed at these entities, rather than considering the implications for the more than 3 million small and micro entities in the UK. We would urge the FRC to carefully consider the impact of these changes for smaller entities set against a backdrop of economic uncertainty and substantial challenges on a number of fronts.

Further, paragraph 63 of the Consultation Stage impact assessment identifies that 4,611 of the 4,745 registered audit firms in the UK "*are assumed to have less working familiarity with the audit of financial statements prepared under IFRS Accounting Standards, and so to require more time than larger auditors to develop new audit processes in accordance with the new requirements.*"

Almost all (if not all) of these 'smaller' audit firms that we have spoken with recently are suffering from enormous resourcing challenges, set against ever increasing regulations (with recent examples being ISQM 1 and 2, ISA 315 and ISA 240). Therefore, these firms will find it difficult to schedule in the required training, updating of systems, assisting entities with transition etc.

These factors combined will mean that the costs of implementation are likely to be substantially higher than the estimated costs set out in the impact assessment.