Impact Assessment

Periodic Review of the *Financial Reporting Standards applicable in the UK and Republic of Ireland* 2024

March 2024

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Title: Periodic Review of the Financial Reporting Standards applicable in the UK and Republic of Ireland 2024 **Lead department or agency:** Financial Reporting Council **Other departments or agencies:** N/A			Impact Assessment (IA) **Date: 14/03/2024** **Stage: Final Stage** **Source of intervention: Domestic**
Summary: Intervention and Options			**RPC Opinion: Not applicable**
Cost of Preferred (or more likely) Option (in 2024 prices)			
Total Net Present Social Value	**Business Net Present Value**	**Net cost to business per year**	**Business Impact Target Status**
£-704.5m	£-704.5m	£150.7m	Qualifying provision

What is the problem under consideration? Why is government action or intervention necessary?

The FRC maintains a suite of financial reporting standards applicable in both the UK and the Republic of Ireland. In line with established policy, the standards are subject to review, and potential amendment, at least every five years. Maintaining consistency with international accounting standards is a long-standing policy that has been developed through consultation, and reflects the wider approach taken by the FRC. There have been changes in international standards, which requires the issues of alignment to be considered together with other emerging issues and simplification/clarifications as part of the FRC's review.

What are the policy objectives of the action or intervention and the intended effects?

Periodic reviews of financial reporting standards support the FRC's overriding objective in setting financial reporting standards, which is to enable users of accounts to receive high-quality understandable financial reporting that is proportionate to the size and complexity of both the entity and users' information needs.

In achieving this overriding objective, the FRC aims to provide succinct financial reporting standards that:

- have consistency with global accounting standards through the application of an IFRS-based solution unless an alternative clearly better meets the overriding objective;
- balance improvement, through reflecting up-to-date thinking and developments in the way businesses operate and the transactions they undertake, with stability;
- balance consistent principles for accounting by all UK and Republic of Ireland entities with proportionate and practical solutions, based on size, complexity, public interest and users' information needs;
- promote efficiency within groups; and
- are cost-effective to apply.

The principal effective date for these amendments is accounting periods beginning on or after 1 January 2026, with early application permitted provided all amendments are applied at the same time.

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)
The *do nothing* option is to retain the FRC's financial reporting standards in their current form (Option 1). The FRC has considered four other options, consisting of: • a base level of incremental improvements and clarifications that address various less-significant amendments to international accounting standards, emerging issues, and stakeholder feedback (Option 2); • Option 2 plus realignment of the accounting requirements for revenue to international standards, simplifying where appropriate (Option 3); • Option 3 plus realignment of the lease accounting requirements for all entities except micro-entities to international standards, simplifying where appropriate (Option 4a); and • Option 3 plus realignment of the lease accounting requirements for all entities to international standards, simplifying where appropriate (Option 4b). Option 4a is the implemented option because it provides the greatest positive impact to the FRC's objectives of setting high standards in corporate reporting and sharing best practice through incorporating appropriate international standards into the UK regulatory framework.
Will the policy be reviewed? The FRC's financial reporting standards are reviewed every five years. The FRC's preliminary aim is for the next periodic review amendments to be effective five years later than the current periodic review amendments (ie 1 January 2031) and will set the review date accordingly.

Is this measure likely to impact on international trade and investment?		No		
Are any of these organisations in scope?	**Micro** Yes	**Small** Yes	**Medium** Yes	**Large** Yes
What is the CO_2 equivalent change in greenhouse gas emissions? (Million tonnes CO_2 equivalent)		**Traded:** N/A	**Non-traded:** N/A	

Summary: Analysis & Evidence Policy Option 4a (Implemented option)

Description: Incremental improvements and clarifications and realignment of the accounting requirements for revenue to international standards, simplifying where appropriate; plus realignment of the accounting requirements for leases to international standards, simplifying where appropriate. Applies to all entities applying the FRC's financial reporting standards, except that the changes to the accounting requirements for leases do not apply to micro-entities.

FULL ECONOMIC ASSESSMENT

Price Base	**PV Base**	**Time Period**	**Net Benefit (Present Value (PV)) (£m)**		
Year 2024	**Year** 2026	**Years** 5	**Low:**	**High:**	**Best Estimate: -704.5**

COSTS (£m)	**Total Transition** (Constant Price) Years		**Average Annual** (excl. Transition) (Constant Price)	**Total Cost** (Present Value)
Low				
High				
Best Estimate	454.4	1	62.9	**746.8**

Description and scale of key monetised costs by main affected groups

- One-off familiarisation costs for accountants of entities in scope and their auditors who need to prepare or audit financial information that is prepared in accordance with the FRC's amended financial reporting standards, rather than the extant standards; the costs will be incremental to general re-familiarisation carried out each year.
- One-off transition costs and annual ongoing costs for affected entities, related to both the new revenue and lease accounting requirements. These will be incremental to the costs currently incurred to report under the extant standards.
- One-off transition costs for auditors, related to the design of new audit procedures to address the new revenue and lease accounting requirements, and ongoing annual costs related to the audit of the new requirements. These will be incremental to the costs currently incurred to report under the extant standards.

Other key non-monetised costs by main affected groups

Users of financial statements who are not accountants may need to familiarise themselves with the changes to revenue and lease accounting requirements.

BENEFITS (£m)	**Total Transition** (Constant Price) Years		**Average Annual** (excl. Transition) (Constant Price)	**Total Benefit** (Present Value)
Low				
High				
Best Estimate	-	-	9.1	**42.3**

Description and scale of key monetised benefits by main affected groups		
• The amendments are expected to substantively remove the ongoing costs of supplementary analysis when financial information closely aligned to the international accounting standards is required, and of accountants maintaining an ongoing awareness of differences between domestic and international standards. • However, the majority of the benefits have not been monetised because it is impracticable to do so.		
Other key non-monetised benefits by main affected groups		
• The amendments are expected to contribute to an increase in the quality of financial reporting of affected entities, thereby enabling investors, analysts, and other users of financial statements to better assess the financial position and financial performance of an entity. • The amendments are expected to improve the comparability of financial statements of reporting entities. This is likely to benefit users of financial statements. • The amendments that clarify or simplify requirements, or promote efficiency within groups, could contribute to a reduction in the cost of preparing or auditing financial statements.		
Key assumptions/sensitivities/risks	Discount rate	3.5%
• Calculations are based on assumptions about the number of affected entities, the number of accountants working for affected entities, the time taken to carry out tasks, and the cost of accountants' time. • A key risk to the analysis is that data and evidence on the costs and benefits is limited. In many instances judgement has been used to form assumptions to facilitate the analysis, and estimated values are therefore indicative. • The time period of the assessment is five years because we expect the next review will be in five years' time.		

BUSINESS ASSESSMENT (Option 4a)

Direct impact on business (Equivalent Annual, UK only) £m:			**Score for Business Impact Target (UK qualifying provisions only) £m:**
Costs: 148.8	**Benefits: 8.3**	**Net: -140.5**	N/A

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1. Introduction and background

Introduction

1. This document sets out the Financial Reporting Council's (FRC) assessment of the impacts of amendments to its financial reporting standards that are applicable in both the UK and Republic of Ireland, arising from the second periodic review of those standards.

2. In line with the approach taken in the consultation stage impact assessment, most of the assessment provided in this document relates to direct impacts arising from those amendments.

3. This document provides an assessment of the key impacts associated with our implemented option (Option 4a) as well as the other options considered. In preparing this document, we have considered the responses we received to the consultation stage impact assessment. Significant changes made to the analysis presented in the consultation stage impact assessment are set out in Appendix 2.

Background

4. UK and Irish companies and other entities[1] are required to produce financial statements:

   (a) using UK and Republic of Ireland Generally Accepted Accounting Practice (GAAP), which is effectively a combination of financial reporting standards set by the FRC[2] and the company law of either the UK or Republic of Ireland, respectively; or

   (b) using:

      (i) in the UK, UK-adopted international accounting standards, meaning International Financial Reporting Standards (IFRS) Accounting Standards issued by the International Accounting Standards Board (IASB) and adopted by the UK Endorsement Board (UKEB) for use in the UK; or

      (ii) in the Republic of Ireland, EU-adopted IFRS, meaning IFRS Accounting Standards issued by the IASB and adopted in the European Union in accordance with *EU Regulation 1606/2002*.

5. The FRC issues and maintains a suite of financial reporting standards[3] applicable in the UK and Republic of Ireland, some of which are optional if qualifying criteria are met or only apply in certain circumstances.

[1] These are entities with other legal forms, which include limited liability partnerships, some charities, building societies, credit unions, education institutions, registered providers of social housing, mutual insurers, co-operatives and others.

[2] The FRC is a prescribed body for issuing accounting standards in the UK and Republic of Ireland as set out in:
(a) the *Statutory Auditors (Amendment of Companies Act 2006 and Delegation of Functions etc) Order 2012* (SI 2012/1741) for the UK; and
(b) the *Companies Act 2014 (Accounting Standards) (Prescribed Body) Regulations 2018* (SI No. 84 of 2018) for the Republic of Ireland.

[3] For a description of these reporting standards see FRC (2022) *Overview of the financial reporting framework*, available at https://www.frc.org.uk/library/standards-codes-policy/accounting-and-reporting/uk-accounting-standards/uk-accounting-standards-overview/.

6. FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* is available for use in the preparation of financial statements by all UK and Irish entities, except for the consolidated financial statements of listed entities. As a result, FRS 102 is applied by a very wide range of corporate and other entities, including the largest private companies[4] and some regulated entities, such as financial institutions, charities, and pension schemes.

7. The aim of financial reporting standards is to ensure quality and consistency in the presentation of financial statements so that users of financial statements can analyse the financial position and financial performance of different companies on a clear and comparable basis. Users' needs and expectations from financial reporting constantly evolve to reflect new circumstances and consensus. Therefore, the FRC's financial reporting standards require periodic review and revision to ensure they continue to effectively support the preparation of accounts that give a true and fair[5] view of the assets, liabilities, financial position and profit or loss of an entity. Section 393 of the *Companies Act 2006*[6] in the UK, and sections 291 and 294 of the *Companies Act 2014*[7] in the Republic of Ireland, require that the directors of a company must not approve accounts unless they are satisfied that they give a true and fair view. The *true and fair* requirement has been fundamental to accounting in the UK and Republic of Ireland for many years. It is a requirement of both UK and EU law. The application of financial reporting standards is necessary in order to give a true and fair view. Such financial reporting standards are arrived at after extensive consultation and full due process.

8. The FRC considers whether any changes to its financial reporting standards are required on a periodic basis.[8] The following principles will guide FRC decisions about when to amend a standard. The FRC will only consider making a change where it is satisfied that:

   (a) there is a clearly defined issue relevant to the FRC's purpose and responsibilities;

   (b) the change is the most appropriate way to address the issue;

   (c) one or more of the following conditions is met:

      (i) a change is necessary to comply or align with a legal requirement;

      (ii) a change is required in the light of developments in international standards or in UK regulation;

      (iii) the risks to the public interest of not acting are significant, for example, a risk of systemic and/or market failure;

      (iv) it is possible to eliminate or significantly simplify a current requirement;

      (v) it is necessary to clarify a current requirement;

[4] Some of which are expected to be included in a new definition of Public Interest Entities (PIEs), see Department for Business, Energy and Industrial Strategy (2022) *Restoring trust in audit and corporate governance: government response to consultation on strengthening the UK's audit, corporate reporting and corporate governance systems* available at https://www.gov.uk/government/consultations/restoring-trust-in-audit-and-corporate-governance-proposals-on-reforms.
[5] FRC (2014), *True and Fair Concept,* available at https://www.frc.org.uk/library/standards-codes-policy/accounting-and-reporting/true-and-fair-concept/.
[6] The *Companies Act 2006*, c. 46, available at https://www.legislation.gov.uk/ukpga/2006/46/contents.
[7] The *Companies Act 2014*, available at https://revisedacts.lawreform.ie/eli/2014/act/38/revised/en/html.
[8] FRC (2014), *Principles for the development of Codes, Standards and Guidance*, available at https://www.frc.org.uk/getattachment/d3385cab-f429-4fc7-a5be-36cdc147cb2e/Principles-for-the-development-of-Codes-2014.pdf.

(vi) it is possible to create significant additional benefits in the public interest; or

(vii) a change is necessary to underpin the effectiveness of the FRC's enforcement and disciplinary activities; and

(d) the anticipated benefits of the change outweigh the costs.

9. In determining whether to make such changes the FRC will have regard to the strength of the evidence supporting the change, the likely impact (both intended and unintended) of such changes, and the cumulative impact of a number of changes or other initiatives which could make the adoption of an otherwise satisfactory proposal inappropriate. The FRC consults in accordance with the published *Regulatory Standards & Codes Committee procedures.*[9]

Problem under consideration

10. The FRC began its second periodic review of its financial reporting standards in 2021, in accordance with its usual procedures (see paragraph 8). We identified three key sources of potential amendments to our financial reporting standards as part of this periodic review:

(a) improvements required to existing financial reporting requirements;

(b) changes in IFRS Accounting Standards and the *IFRS for SMEs* Accounting Standard; and

(c) wider developments in corporate reporting.

Improvements required

11. In March 2021, the FRC issued a request for views to inform this periodic review. Stakeholders were invited to provide feedback on how the standards are working in practice, as well as any new issues or transactions that should be addressed.

12. The FRC collected a large number of specific comments from stakeholders regarding possible incremental improvements and clarifications, which were considered in developing the proposals that were set out in a public consultation: FRED 82 *Draft amendments* to *FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland and other FRSs – Periodic Review*[10], published in December 2022. Stakeholder comments received in response to that consultation were considered before the FRC reached a final view.

Changes in international standards

13. The FRC recognises that financial reporting evolves over time, and we seek consistency with global accounting standards through the application of IFRS-based solutions. Therefore, we have considered aligning our financial reporting standards to developments in international standards, which themselves reflect the evolving information needs of users of financial statements. For this periodic review we have specifically considered the following:

(a) Major changes to IFRS Accounting Standards in recent years include the introduction of IFRS 9 *Financial Instruments* and IFRS 15 *Revenue from Contracts with Customers*, both

[9] FRC, *Regulatory Standards and Codes Committee procedures*, available at https://www.frc.org.uk/about-the-frc/procedures-and-policies/regulatory-standards-and-codes-committee-procedure.

[10] www.frc.org.uk/fred82

effective from 1 January 2018, and IFRS 16 *Leases*, effective from 1 January 2019. We have also considered other recent changes to IFRS Accounting Standards.

(b) In September 2022, the IASB published Exposure Draft IASB/ED/2022/1 *Third edition of the IFRS for SMEs Accounting Standard* as part of its second comprehensive review of that standard. The IASB's staff anticipate[11] that its main redeliberations will be completed in the first half of 2024 and the third edition of the *IFRS for SMEs* Accounting Standard will be published in the fourth quarter of 2024. The FRC's standards FRS 102 and FRS 105 *The Financial Reporting Standard applicable to the Micro-entities Regime* were originally based on the *IFRS for SMEs* Accounting Standard, and the IASB's second comprehensive review has considered similar matters to the FRC's periodic review.

Wider developments in corporate reporting

14. The FRC has considered the UK government proposals to expand the definition of a public interest entity (PIE); other current UK government developments, including those contained in the *Economic Crime and Corporate Transparency Act 2023*, and the *Smarter regulation non-financial reporting review: call for evidence*[12]; and changes to Irish company law. No amendments to the FRC's financial reporting standards in relation to these matters have been made at this time.

Amendments proposed in FRED 82 for public consultation

15. In light of stakeholder feedback, matters identified by the FRC and changes in international standards, in December 2022 the FRC issued FRED 82 which included the following proposed amendments to FRS 102:

    (a) introducing a five-step model for revenue recognition based on that in IFRS 15 *Revenue from Contracts with Customers*, including appropriate simplifications;

    (b) introducing an on-balance sheet model for lease accounting based on that in IFRS 16 *Leases*, including appropriate simplifications; and

    (c) making incremental improvements and clarifications, which include:

        (i) greater clarity for small entities in the UK applying Section 1A *Small Entities* regarding which disclosures need to be provided in order to give a true and fair view;

        (ii) a revised Section 2 *Concepts and Pervasive Principles*, updated to reflect the IASB's *Conceptual Framework for Financial Reporting*, issued in 2018; and

        (iii) a new Section 2A *Fair Value Measurement*, replacing the Appendix *Fair value measurement* to Section 2 and updated to reflect the principles of IFRS *13 Fair Value Measurement*.

[11] As set out in its project plan discussed at its meeting on 21 September 2023 (Agenda Paper 30A, paragraph 16), available at https://www.ifrs.org/news-and-events/calendar/2023/september/international-accounting-standards-board/.

[12] https://www.gov.uk/government/calls-for-evidence/smarter-regulation-non-financial-reporting-review-call-for-evidence/smarter-regulation-non-financial-reporting-review-call-for-evidence

16. Proposed amendments to FRS 105 arose predominantly from incorporating those proposed amendments to FRS 102 that were also relevant to FRS 105, subject in some cases to additional simplifications proportionate for micro-entities.

17. The amendments proposed were accompanied by a consultation stage impact assessment that set out the options that the FRC considered in arriving at its implemented option (Option 4a). The changes made to the impact assessment following the consultation are summarised in Appendix 2.

Amendments proposed in FRED 84 for public consultation

18. In September 2023, the FRC issued FRED 84 *Draft amendments to FRS 102 – Supplier finance arrangements*[13], which proposed to introduce new disclosure requirements to provide users of financial statements with additional information about an entity's use of supplier finance arrangements and the effect of such arrangements on the entity's financial position and cash flows.

19. The proposals in FRED 84 were based on amendments issued by the IASB in May 2023, which was after the FRC had already considered changes in international standards for inclusion in FRED 82. The FRC received feedback from stakeholders that this topic should be addressed in FRS 102 sooner rather than later, and therefore decided to finalise the amendments arising from FRED 84 with the amendments arising from FRED 82. The final amendments arising from those set out in FRED 84 have been combined with the finalisation of FRED 82, and this impact assessment addresses all the changes.

Rationale for change

20. The FRC considers that the conditions for proposing changes to its financial reporting standards are met (refer to paragraph 8), as follows:

    (a) *There is a clearly defined issue relevant to the FRC's purpose and responsibilities*: This project is derived from the FRC's status as a prescribed body for issuing accounting standards in the UK and Republic of Ireland and our policy of reviewing our financial reporting standards at least every five years to consider whether any changes are required as financial reporting evolves and entities enter into new transactions. As set out in *FRC Strategy, Plan & Budget 2023-26*, completion of this periodic review is a key priority and deliverable for the FRC for 2023/24.[14]

    (b) *The change is the most appropriate way to address the issue*: Guidance, or other non-regulatory measures, cannot override the extant financial reporting standards; therefore, the necessary changes can only be made by amending our financial reporting standards.

[13] https://www.frc.org.uk/consultations/fred-84/

[14] See FRC (2023) *FRC Plan and Budget 2023-26*, available at https://www.frc.org.uk/about-us/reports-plans-and-budgets/plan-and-budget/.

(c) The amendments considered can be broadly categorised as addressing the need to:

(i) align our financial reporting standards to changes in international accounting standards, reflecting the FRC's long-standing policy of seeking consistency with global accounting standards through the application of an IFRS-based solution; and

(ii) simplify or clarify existing requirements, reflect changes in legal requirements, or create additional benefits in the public interest.

(d) *We expect the anticipated benefits of the change to outweigh the costs*: This impact assessment sets out analysis that supports this conclusion (see Section 4).

Policy objectives

21. In developing financial reporting standards, the overriding objective of the FRC is to enable users of accounts to receive high-quality understandable financial reporting proportionate to the size and complexity of the entity and users' information needs.[15] In achieving this overriding objective, the FRC aims to provide succinct financial reporting standards that:

(a) have consistency with global accounting standards through the application of an IFRS-based solution unless an alternative clearly better meets the overriding objective;

(b) balance improvement, through reflecting up-to-date thinking and developments in the way businesses operate and the transactions they undertake, with stability;

(c) balance consistent principles for accounting by all UK and Republic of Ireland entities with proportionate and practical solutions, based on size, complexity, public interest, and users' information needs;

(d) promote efficiency within groups; and

(e) are cost-effective to apply.

22. The analysis presented in this impact assessment has been used by the FRC to help assess how well the amendments deliver against these aims in comparison to the current financial reporting standards.

Purpose and scope of the impact assessment

23. The analysis in this impact assessment is intended to support our decision on the most appropriate option to implement. In this impact assessment we:

(a) identify the groups affected by the changes considered under each option;

(b) consider and quantify the direct impacts arising from the options that the FRC considered; and

[15] See FRC (2022), *Basis for Conclusions to FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland*, paragraphs A.1 to A.2, available at https://www.frc.org.uk/library/standards-codes-policy/accounting-and-reporting/uk-accounting-standards/frs-102.

(c) take into account the intended impacts and, as far as possible, any potential risks, unintended consequences and wider implications of the options considered.

24. Our assessment of impacts has been conducted in accordance with the *Better regulation framework: interim guidance*.[16] In developing the impact assessment, we have also drawn on:

    (a) the HM Treasury Green Book (*Green Book*) and Business case model;[17]

    (b) the Regulatory Policy Committee (RPC) – Case Histories;[18] and

    (c) the FRC's approach to impact assessment.[19]

25. We have identified the expected impacts of the measures considered and those groups that will be impacted based on a combination of economic theory, evidence from similar measures implemented in the past, and responses to the consultation stage impact assessment. In many instances judgement has been used to form assumptions to facilitate the analysis.

26. Details of our evidence sources and assumptions used for quantifying the impacts identified, including changes made as a result of feedback from stakeholders responding to the consultation stage impact assessment, can be found in Section 5 and Appendix 2.

27. The analysis presented in this impact assessment focuses mostly on direct impacts arising from the measures considered – we only monetise the direct costs of compliance with our options on the main affected groups.

[16] Department for Business, Energy & Industrial Strategy (2020), *Better regulation framework: interim guidance*, available at https://www.gov.uk/government/publications/better-regulation-framework. The Department for Business and Trade published an updated Better Regulation Framework in September 2023. As there is a transition period required to adjust to the new framework (until the start of September 2024), we have drafted this impact assessment according to the interim guidance published in 2020. We used the same guidance to draft the consultation impact assessment published in December 2022.

[17] HM Treasury (2022), *The Green Book*, available at https://www.gov.uk/government/publications/the-green-book-appraisal-and-evaluation-in-central-government.

[18] RPC case histories provide practical guidance, with case study examples, of how the better regulation framework has been applied by the committee: https://www.gov.uk/government/collections/rpc-case-histories.

[19] FRC Operational Policies, see *Approach to Impact Assessment*: https://www.frc.org.uk/about-the-frc/frc-operational-policies.

2. Options considered

28. The FRC's financial reporting standards set out: the concepts and pervasive principles underlying financial statements; requirements about the presentation and disclosure of financial information; and specific accounting requirements for transactions, other events and conditions.

29. Amendments to the standards may result in significant familiarisation and implementation costs. Therefore, the FRC reviews its financial reporting standards on a periodic basis and has grouped possible amendments together to minimise those costs and develop plausible policy options that could be implemented by UK and Irish companies and other entities. The groupings considered are:

    (a) amendments that introduce incremental improvements and clarifications; and

    (b) incorporating principles from recent IFRS Accounting Standards:

        (i) IFRS 15 *Revenue from Contracts with Customers*; and

        (ii) IFRS 16 *Leases*.

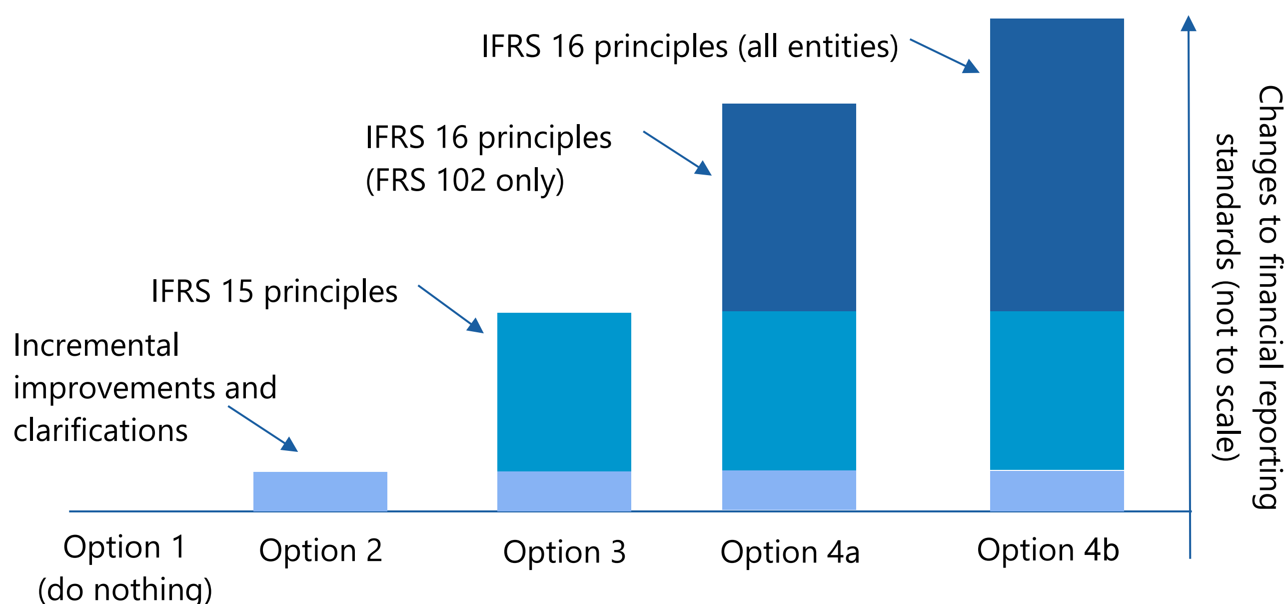
30. The rationale for considering the amendments that incorporate IFRS 15 and IFRS 16 principles separately to other improvements is that those amendments entirely replace sections of the extant standard and would require more than one-off familiarisation costs to implement.

Development of options

31. In developing options, the FRC considered whether a different approach could be taken for small entities and micro-entities (see Section 7, subsection *Impact on small and micro businesses*), and for entities with fewer than 500 employees (see Section 7, subsection *Medium-sized business regulatory exemption assessment).*

32. The groupings of possible amendments are, in part, dependent on each other because the financial reporting standards are single documents that apply as a whole and the requirements of some sections interact with those of other sections. For example, the requirements that incorporate IFRS 16 principles depend, in part, on IFRS 15 principles already being incorporated. This means that the options the FRC developed build on each other, rather than being entirely independent, as illustrated in Figure 2.01.

Figure 2.01 – Illustration of how the options for changes to the FRC's financial reporting standards build upon each other



33. Based on the considerations above, we have appraised in this impact assessment the following options.

Description of Option 1

34. Under Option 1, the FRC's standards would not be amended to realign with international accounting standards or be amended to reflect other incremental improvements or clarifications. The extant versions would remain in force until at least the next periodic review (expected after five years).

35. This option is unchanged from the one set out in the consultation stage impact assessment.

Description of Option 2

36. Under Option 2, the FRC would make minor amendments to the standards that introduce incremental improvements and clarifications, arising from:

(a) minor amendments to IFRS Accounting Standards since the last review (that is, amendments other than IFRS 15, IFRS 16, and the expected credit loss model of financial asset impairment from IFRS 9. This includes the amendments to introduce new disclosure requirements to provide users of financial statements with additional information about an entity's use of supplier finance arrangements and the effect of such arrangements on the entity's financial position and cash flows, which were proposed in FRED 84);

(b) amendments proposed in the Exposure Draft IASB/ED/2022/1 *Third edition of the IFRS for SMEs Accounting Standard*, published by the IASB in September 2022 as part of its second comprehensive review of the *IFRS for SMEs* Accounting Standard, other than amendments relating to IFRS 9 and IFRS 15; and

(c) issues raised by stakeholders or identified by the FRC.

37. Incremental improvements and clarifications would be made throughout the FRC's financial reporting standards. The more substantial changes would include:

    (a) greater clarity for small entities in the UK applying Section 1A regarding which disclosures need to be provided in order to give a true and fair view;

    (b) a revised Section 2 *Concepts and Pervasive Principles*, updated to reflect the IASB's *Conceptual Framework for Financial Reporting*, issued in 2018;

    (c) a new Section 2A *Fair Value Measurement*, replacing the Appendix *Fair value measurement* to Section 2 and updated to reflect the principles of IFRS 13 *Fair Value Measurement*;

    (d) new disclosure requirements in Section 7 *Statement of Cash Flows* to provide users of financial statements with additional information about an entity's use of supplier finance arrangements and the effect of such arrangements on the entity's financial position and cash flows; and

    (e) similar amendments to FRS 105, when relevant.

38. Alignment with IFRS 15 and IFRS 16 principles would be deferred until at least the next periodic review (expected after five years).

39. This option is largely unchanged from the one set out in the consultation stage impact assessment.

Description of Option 3

40. Under Option 3 the FRC would make:

    (a) the same amendments as proposed under Option 2; and

    (b) amendments to FRS 102 and FRS 105 that incorporate revenue recognition principles from IFRS 15, with appropriate simplifications.

41. This option is fundamentally the same as the one set out in the consultation stage impact assessment, which also considered the application of revenue recognition principles from IFRS 15 to both FRS 102 and FRS 105. However, the final amendments have been simplified in some respects, based on stakeholder feedback and further deliberation, from the original proposals, in order to align more closely on some topics with the language and requirements of IFRS 15 rather than IASB/ED/2022/1.

Description of Option 4a

42. Under Option 4a, the FRC would make:

    (a) the same amendments as proposed under Option 3; and

    (b) amendments to FRS 102 that incorporate lease accounting principles from IFRS 16, with appropriate simplifications.

43. Amendments in relation to IFRS 16 principles would not be made to FRS 105, which would retain the extant requirements.

44. This option is fundamentally the same as the one set out in the consultation stage impact assessment, which also considered the application of lease accounting principles from

IFRS 16 to FRS 102. However, we have given due consideration to specific suggestions made by respondents in determining how to finalise the proposals; for example, by making some changes to what was originally proposed to more closely align some topics with the language and requirements of IFRS 16, and by adopting a more permissive approach to the definition of low-value assets, for which an entity is able to take exemptions from some of the requirements.

Description of Option 4b

45. Under Option 4b, the FRC would make:

    (a) the same amendments as proposed under Option 3; and

    (b) amendments to both FRS 102 and FRS 105 that incorporate lease accounting principles from IFRS 16, with appropriate simplifications.

46. This option is fundamentally the same as the one set out in the consultation stage impact assessment, but with changes that are consistent with the changes to Option 4a set out above.

Non-regulatory options

47. In addition to the options above, we have also considered whether there are other ways to achieve improvements to financial reporting that would address the issues identified but do not involve any changes to our financial reporting standards; for example, whether entities could adopt any of the amendments on a voluntary basis, or through other non-regulatory measures.

48. Entities that apply the FRC's financial reporting standards cannot choose to override their requirements except in very limited circumstances; therefore, entities cannot apply the amendments unless the FRC modifies its financial reporting standards. There is no viable non-regulatory option.[20]

Main affected groups

49. We expect the options considered in this impact assessment to affect the following groups:

    (a) Entities currently preparing financial statements in accordance with the FRC's financial reporting standards (*affected entities*). Those entities will need to prepare their financial statements in accordance with the new requirements.

    (b) Individual accountants, who might be directly employed by affected entities in the UK and Republic of Ireland or might work for accounting firms which provide accounting services to the affected entities (*affected accountants*). Those individuals will be required to familiarise themselves with the amendments to the standards in order to apply them in their work, or to maintain a general awareness of accounting practice, with those individuals more closely involved in financial reporting likely to be more

[20] Entities cannot voluntarily adopt amendments that are inconsistent with FRS 102 or FRS 105. IFRS 15 and IFRS 16 could be applied by voluntarily applying IFRS Accounting Standards instead. This is likely to involve significant other changes for alignment with other IFRS Accounting Standards as well.

affected. Many affected accountants will be required to do a certain amount of training and development each year as part of the continuing professional development (CPD) requirements of professional accountancy bodies, which could include familiarisation with the amendments to the standards considered in this impact assessment.

(c) Auditors of financial statements of affected entities.[21] In addition to familiarisation by individual auditors (who are also expected to be affected accountants), those firms or individuals may need to design new audit procedures that address new accounting requirements. This could lead to additional audit work and result in additional audit costs to the affected entities. We consider this to be a direct impact of the measures considered, which will fall on those entities required to apply the amended standards.

(d) Users of financial statements, who will benefit from improvements to the quality and comparability of the financial reporting of the affected entities.

50. Most of the costs of the measures considered in this impact assessment are likely to fall on affected entities, either directly as a result of needing to implement systems and processes that enable them to apply the amended standards, or indirectly as a result of the direct costs that fall on affected accountants and auditors being passed on to the entities that employ them, or contract them to provide audit services.

51. Benefits will mainly accrue to users of financial statements. Users of financial statements include existing and potential investors, lenders, and other creditors. As further described in Section 4, most of the benefits are likely to be intangible and difficult to monetise.

[21] Section 475 of the *Companies Act 2006* requires that a company's annual accounts for a financial year must be audited unless the company is exempt. In general, a company may be exempt if it is a small standalone company; a small member of a small group; a company of any size with a parent guarantee in a UK group; or a dormant company. Therefore, some affected entities are subject to audit, which will be carried out by audit firms registered with a Recognised Supervisory Body.

3. Implemented option

Implemented option and rationale

52. The FRC has decided to implement Option 4a: incremental improvements and clarifications; realignment of the accounting requirements for revenue to international standards, simplifying where appropriate; plus realignment of the accounting requirements for leases (in FRS 102 only) to international standards, simplifying where appropriate.

53. We concluded that Option 1, the *do nothing* option, would not be an effective option. The FRC's overriding objective in setting accounting standards is to enable users of accounts to receive high-quality understandable financial reporting proportionate to the size and complexity of the entity and users' information needs. If reporting requirements are not kept up-to-date as reporting practice evolves, business transactions change, and users' needs change, entities will incur costs (as set out in Section 5) in delivering information through other means. Under Option 1, the benefits set out in Section 4 (the increase in the quality and comparability of financial statements) would not be realised because the misalignment between domestic and international financial reporting standards, which was introduced by the IASB issuing IFRS 15 and IFRS 16, would persist.

54. Of the four regulatory options considered, we have decided to implement Option 4a because it provides, through the benefits set out in Section 4, the greatest positive impact to the FRC's objectives of setting high standards in corporate reporting and sharing best practice through incorporating appropriate international standards into the UK regulatory framework. Although our standards were originally based on the *IFRS for SMEs* Accounting Standard, and Option 3 is the option most closely aligned to the proposed third edition of that standard, the requirements in FRS 102 are modified from that standard in terms of the scope of entities eligible to apply it, the accounting treatments provided, and the required disclosures;[22] we consider that also aligning FRS 102 with IFRS 16 principles is appropriate because of the increased quality and comparability of financial reporting that will arise (see Section 4).

Implementation and transitional arrangements

55. The FRC is a prescribed body in the UK and Republic of Ireland for issuing accounting standards. We will implement the measures by issuing amendments to FRS 102 and other existing financial reporting standards. The amendments will form part of the financial reporting standards, which must be followed by entities that are required, or choose, to apply them.

56. Financial statements include comparative information from prior periods. In general, the FRC's financial reporting standards require full retrospective application to comparative

[22] For details, refer to *Significant differences between FRS 102 and the IFRS for SMEs Standard*, available at https://www.frc.org.uk/library/standards-codes-policy/accounting-and-reporting/uk-accounting-standards/uk-accounting-standards-overview/significant-differences-between-frs-102-and-the-ifrs-for-smes-standard/.

information, as if the new accounting requirements had always been applied. However, some specific sections of the standards have special transitional provisions that allow or require a simpler approach. Such provisions have been included for the more substantial changes (accounting requirements for revenue and for leasing) and special transitional provisions and practical expedients are available that are expected to simplify transition to the new requirements. These have been taken into account in the analysis of impacts.

Effective date

57. We intend that there will be sufficient time between the publication of the amendments and their effective date to allow for effective implementation. The amendments will apply to financial statements prepared in relation to accounting periods beginning on or after 1 January 2026, except for the new disclosure requirements about supplier finance arrangements that apply for accounting periods beginning on or after 1 January 2025. Early application is permitted provided that all the amendments are applied at the same time.

Ongoing operation and enforcement

58. The new arrangements will not alter the existing approach to operation and enforcement:

    (a) Directors (and their equivalents, for example trustees of a charity) are responsible for preparing financial statements in accordance with the applicable financial reporting framework.

    (b) Some entities, including the majority of entities of any significant size, require an independent audit, or other examination, of their financial statements.

    (c) Some entities, including public companies and large private companies, are within the scope of the FRC's corporate reporting review activities.

Monitoring and evaluation plan

59. The FRC has established principles for the development of Codes, Standards and Guidance.[23] The FRC's financial reporting standards are kept under regular review and reconsidered at least once every five years.

60. The FRC will monitor the outcomes of these amendments to its financial reporting standards in accordance with its principles, including by continuing to seek stakeholders' views in this area. Stakeholder feedback will inform the next periodic review of the FRC's financial reporting standards. If our monitoring indicates it is necessary, the next periodic review could include further changes to the amendments made in this periodic review to ensure the financial reporting standards deliver our intended policy objectives.

[23] FRC, *Principles for the development of Codes, Standards and Guidance*, available at https://www.frc.org.uk/about-the-frc/procedures-and-policies/regulatory-standards-and-codes-committee-procedure.

4. Benefits

61. As set out in paragraph 8, the FRC will only make a change to financial reporting standards when it is satisfied that the anticipated benefits of the change outweigh the costs.

62. The FRC anticipates that the benefits of the implemented option (Option 4a) will outweigh the costs set out in Section 5. However, because of the nature of the anticipated benefits, it has generally been impracticable to quantify them. They are described as non-monetised benefits in this section, with one exception: the savings that are expected to result from the reduction in the misalignment of UK and international standards are presented within Section 5. The FRC considers that presenting those cost savings relative to the estimated cost of doing nothing (Option 1) together with the other costs of each option is clearer than presenting them separately within this section of the Impact Assessment.

Scope

63. Directors of companies are required by legislation to prepare financial statements that give a true and fair view of:

    (a) the assets, liabilities and financial position of the company and, where relevant, the group at the end of the reporting period; and

    (b) the profit or loss of the company and, where relevant, the group for the reporting period.

    In the case of a micro-entity, financial statements drawn up in accordance with the micro-entity provisions of company law are presumed to give a true and fair view.

64. The FRC's financial reporting standards exist to provide a framework for the preparation of financial statements that give a true and fair view, by entities that are not required, and do not choose, to apply IFRS Accounting Standards.

65. The benefits of the extant requirements to prepare financial statements to give a true and fair view, and of the existence of financial reporting standards to support that preparation, are not within the remit of this impact assessment.

Established frameworks and principles

66. The FRC's established principles for the development of standards, codes and guidance provide for a periodic review of the financial reporting standards at least every five years, and the FRC aims for the financial reporting standards to be relatively stable in between those periodic reviews.

67. The FRC has a long-standing policy of seeking consistency with global accounting standards through the application of an IFRS-based solution. This policy has been developed through consultation in the past and reflects the wider approach of the FRC.

68. The whole essence of accounting standards is to provide for recognition, measurement, presentation and disclosure for specific aspects of financial reporting in a way that reflects economic reality and hence provides a true and fair view.

69. *True and fair* is not a static concept. The information needs of users of financial statements change over time. New kinds of transactions emerge, which need to be accounted for. In addition, small problems or ambiguities in the extant financial reporting standards may be identified over time. In this context, making periodic amendments, including incremental improvements and clarifications, to the FRC's financial reporting standards provides a mechanism to respond to both users' and preparers' changing needs. Such changes are beneficial because they provide consistent accounting requirements for new transactions and make existing requirements easier to apply consistently.

70. *True and fair* is not a concept that is unique to the UK and Republic of Ireland frameworks or the FRC's financial reporting standards. Whilst we also consider the benefits of stability by making periodic rather than continuous changes to our financial reporting standards, we generally aim to provide accounting standards that have consistency with global accounting standards through the application of an IFRS-based solution. This is beneficial because it supports the international competitiveness of affected entities and affected accountants by creating a level playing field. Because IFRS Accounting Standards change frequently, whereas the FRC aims to provide stability in between periodic reviews, as part of a periodic review there will necessarily be a number of changes in IFRS Accounting Standards which need to be considered.

71. Overall, this approach to periodic amendments to financial reporting standards also means that:

    (a) it will be easier for affected entities to know what is required to prepare financial statements that give a true and fair view and for auditors to audit those financial statements; and

    (b) users of financial statements will be provided with the right information to make investment decisions and can more confidently compare the financial statements of entities applying the FRC's financial reporting standards to other financial statements without worrying about a need to adjust for consistency.

    This could support a lower cost of capital and help to drive economic growth.

The benefits of the amendments made in this periodic review

72. The options (other than the counterfactual Option 1) assessed in this impact assessment are expected to result in the following non-monetised benefits:

    (a) increasing the quality of financial reporting of affected entities, thereby enabling investors, lenders, analysts, and other users of financial statements to better assess the financial position and financial performance of an entity, which could support economic growth and international competitiveness through a reduction in the cost of capital;

    (b) improving the comparability of financial statements of affected entities with those of other reporting entities, particularly in maintaining consistency with international accounting standards, which is a long-standing policy that has been developed through consultation and reflects the wider approach taken by the FRC; and

    (c) in some areas, reducing the cost to affected entities of preparing financial statements or of having those financial statements audited, because some of the amendments simplify some

existing requirements. The amendments have also been designed to promote efficiency within groups of entities.

73. The amount of benefit will increase as the scale of amendments made increases (ie Option 4a will result in more benefit than Option 3, which will result in more benefit than Option 2). These potential benefits are outlined in more detail below.

Increasing the quality of financial reporting

74. We expect increases in the quality of financial reporting to arise mainly from the changes to revenue and lease accounting; however, the other incremental improvements and clarifications should also increase the quality of financial reporting by reducing the risk of error or divergent practice when applying the FRC's financial reporting standards.

75. The amendments will result in accounting outcomes that better reflect the substance of an entity's transactions. This is expected to contribute to an increase in the quality of financial information and transparency about the nature of entities' business, their financial position and performance, which could also translate into higher investor and stakeholder confidence in financial information (and higher allocative efficiency of their investments as a result), supporting economic growth. A wider benefit is the potential for a reduction in the cost of capital for affected entities, because of greater transparency.

76. Providing a more faithful representation of an entity's financial position, including greater transparency about its assets and liabilities, is also expected to provide benefits to users of financial statements that are not investors; for example, those that provide resources to charities that apply FRS 102. This improved information may also result in better understanding of transactions and, therefore, better decision-making, within the entity concerned.

Quality benefits arising from incremental improvements and clarifications

77. The incremental improvements and clarifications relevant to all options (except the counterfactual Option 1) are expected to increase the quality of financial reporting by reducing the risk of error or divergent practice when applying the FRC's financial reporting standards. In addition to various other incremental improvements and clarifications throughout the standards, these amendments include:

    (a) A new Section 2A in FRS 102, replacing the Appendix to Section 2, providing new guidance on fair value measurement that is consistent with IFRS Accounting Standards. Fair value measurement is fundamental to accounting for a number of types of transactions and balances but can be subject to significant judgement. Providing additional guidance is expected to help preparers to arrive consistently at appropriate conclusions.

    (b) A revised Section 2 in FRS 102 and FRS 105, updating the concepts and pervasive principles underlying financial reporting to be consistent with those underlying IFRS Accounting Standards. In certain cases, an entity may need to apply these concepts and pervasive principles to develop an accounting policy for a transaction or balance not otherwise addressed by financial reporting standards. The concepts and pervasive principles will also underlie the ongoing development of those financial reporting standards. Keeping these concepts and pervasive principles up-to-date and aligned

with international standards should help to maximise the relevance of accounting policies developed in such cases, and support the future development of the FRC's financial reporting standards in line with international norms.

(c) Revisions to Section 1A of FRS 102 specific to small entities in the UK, reducing the judgement required to determine which disclosures should be made in order to meet the legal requirement to give a true and fair view. This is expected to make it easier for preparers to identify the disclosures that need to be made, and in turn may also result in an increase in the overall quality and consistency of UK small entity financial statements.

Quality benefits arising from IFRS 15 principles

78. Revenue is often the largest number in an entity's financial statements and is often used as a shorthand for the size of an entity. The extant accounting requirements for revenue in FRS 102 and FRS 105 are less prescriptive than the new requirements under Options 3, 4a and 4b and leave significant room for interpretation and judgement to be applied. We believe that this can lead to diversity in practice and make it challenging to determine the appropriate accounting for new types of contracts with customers, particularly in light of the diversity of contracts with customers that exist in the modern economy.

79. The new requirements for both FRS 102 and FRS 105 are based on the principles of the latest international accounting standard on revenue from contracts with customers, IFRS 15. These principles provide a single model for determining the appropriate recognition of revenue from contracts with customers, based on identifying the performance obligations in the contract and the pattern of fulfilment of those performance obligations. The model can be applied to all contracts with customers and should make it easier for entities to account for their revenue transactions correctly and consistently, supporting growth, and will provide more useful information to users of financial statements about the nature, amount and timing of revenue and cash flows arising from an entity's contracts with customers. We expect the new requirements to result in improvements to the quality of financial reporting, and in users receiving more reliable financial information.

80. Providing an updated revenue recognition model for micro-entities applying FRS 105 will support those entities to grow because higher-quality and principles-based revenue recognition may be helpful in seeking debt or equity financing, and will be likely to continue to be appropriate as they grow into small entities.

Quality benefits arising from IFRS 16 principles

81. Many entities use leasing to access assets required to carry out their business (for example, by renting property or machinery). Leasing is also a source of finance, giving access to an asset without incurring a large upfront cash flow to purchase it. Leasing an asset is economically analogous to a purchase financed by borrowing, but the extant accounting requirements do not reflect this.

82. The extant accounting requirements for leases in FRS 102 and FRS 105 require lessees to classify each lease as an operating lease or a finance lease, which may require significant judgement. Operating leases are accounted for off-balance sheet, meaning that no liability is

recognised for future lease payments and no asset is recognised for the right to use the underlying asset. Having substantial amounts of leases off-balance sheet means that users do not get complete information about the assets controlled or the liabilities owed by an entity.

83. The new requirements for FRS 102 remove the distinction, for lessees, between operating leases and finance leases. Most leases previously classified as operating leases will be accounted for on-balance sheet, with both a lease liability and a right-of-use asset recognised. The inclusion of operating leases in the balance sheets of affected entities is expected to improve the quality of financial reporting for entities that currently have material off-balance sheet leases, supporting growth by providing users of financial information with greater transparency over the true indebtedness of the business and more relevant information about affected entities' assets and liabilities because there is no longer a fundamental distinction in how leasing and other forms of secured borrowing are reported.

84. In its effects analysis for IFRS 16,[24] the IASB concluded that *recognising assets and liabilities in essence for all leases provides a more faithful representation of the financial position of a company and greater transparency about the company's financial leverage and capital employed. This is expected to enable investors and analysts*[25] *to better assess the financial position and financial performance of a company*.

85. The IASB noted that affected entities might further benefit from applying IFRS 16:

    (a) *some companies might benefit from more precise measurement – a company's reported financial position is expected to be more accurate applying IFRS 16 as compared to the financial position adjusted by investors and analysts. This is expected to result in a more level playing field for all companies.*[26]

    (b) *some companies might identify improvements in how they finance and operate their business.*[27]

86. We therefore expect the new requirements to result in improvements to the quality of financial reporting under FRS 102, and in users receiving more relevant financial information for decision making.

Improving the comparability of financial statements

87. We expect improvements in the comparability of financial statements to arise from all options (except the counterfactual Option 1). Comparability enables users of financial statements to understand an entity's financial position and financial performance in comparison to other entities, which could translate into higher utility of that financial

[24] IASB (January 2016), *IFRS 16 Leases: Effects Analysis*, page 22, available at https://www.ifrs.org/content/dam/ifrs/project/leases/ifrs/published-documents/ifrs16-effects-analysis.pdf.

[25] For example, credit rating agency analysts may use operating leases to compare entities to better understand their credit risk. More information between lenders and borrowers can reduce the pricing risk of a loan, thus reducing the cost of borrowing. IASB (January 2016), IFRS 16 Leases: Effects Analysis, page 26, available at https://www.ifrs.org/content/dam/ifrs/project/leases/ifrs/published-documents/ifrs16-effects-analysis.pdf.

[26] IASB (January 2016), *IFRS 16 Leases: Effects Analysis*, More level playing field, page 22, available at https://www.ifrs.org/content/dam/ifrs/project/leases/ifrs/published-documents/ifrs16-effects-analysis.pdf.

[27] IASB (January 2016), *IFRS 16 Leases: Effects Analysis*, Improved Decision making, page 26, available at https://www.ifrs.org/content/dam/ifrs/project/leases/ifrs/published-documents/ifrs16-effects-analysis.pdf.

information to investors and other stakeholders. Maintaining consistency with international accounting standards is a long-standing policy that has been developed through consultation, and reflects the wider approach taken by the FRC. FRS 102 and FRS 105 were originally based on the *IFRS for SMEs* Accounting Standard, first issued in 2009. However, IFRS Accounting Standards have evolved over the years which, where this evolution has not been reflected in FRS 102 and FRS 105, has resulted in divergence in a number of areas in which the FRC's financial reporting standards and IFRS Accounting Standards were previously aligned. These areas of misalignment include concepts and pervasive principles, fair value measurement, revenue from contracts with customers and accounting for leases, all of which are addressed by the implemented option. Re-establishing consistency by aligning now will:

(a) enhance the comparability of financial statements prepared in accordance with the FRC's financial reporting standards with financial statements prepared in accordance with IFRS Accounting Standards, enhancing the efficiency of decision-making about the allocation of capital; and

(b) aid preparers and auditors of financial statements, by reducing inconsistency between the frameworks in which they work, lowering the overall cost of education and training.

Comparability benefits arising from incremental improvements and clarifications

88. A number of incremental improvements and clarifications are relevant to all options (except the counterfactual Option 1). In general, these are expected to reduce diversity in practice and improve the quality of financial reporting (as described above). This in turn should improve the comparability and consistency of financial statements prepared under the FRC's financial reporting standards.

89. Certain incremental improvements and clarifications are derived from international accounting standards in areas in which there is already broad consistency between the FRC's financial reporting standards and international accounting standards, but for which minor amendments have been made to the international accounting standards or where the international accounting standards contain more specific requirements than are currently included in the FRC's accounting standards (for example, share-based payments). These amendments could therefore increase consistency and comparability between entities applying the FRC's financial reporting standards and entities applying international accounting standards.

90. Certain incremental improvements and clarifications update the FRC's financial reporting standards to align with recent developments in international accounting standards, such as IFRS 13 *Fair Value Measurement* (new Section 2A of FRS 102) and the 2018 *Conceptual Framework for Financial Reporting* (revised Section 2 of FRS 102 and FRS 105). These amendments are therefore expected to maintain, or increase, comparability between entities applying the FRC's financial reporting standards and entities applying international accounting standards, and support the international competitiveness of affected entities and affected accountants by facilitating a level playing field.

Comparability benefits arising from IFRS 15 principles

91. FRS 102 was previously aligned with international accounting standards for revenue recognition, but diverged when a new IFRS Accounting Standard, IFRS 15, became effective in 2018. This misalignment may have affected competitiveness by reducing the comparability of financial statements prepared using the FRC's financial reporting standards to those prepared using IFRS Accounting Standards.

92. Under Option 3 (and Options 4a and 4b), revenue recognition under the FRC's financial reporting standards is aligned with the principles of IFRS 15, and hence realigned with international norms. These principles provide a single comprehensive framework for revenue recognition and remove certain inconsistencies and weaknesses in the previous revenue recognition requirements that could lead to different entities taking different approaches.

93. Implementing these new principles is expected to promote consistency and comparability between entities applying the FRC's financial reporting standards and entities applying international accounting standards (for example, by reducing the need for users of financial statements to translate an entity's revenue recognition under FRS 102 into IFRS 15 terms), as well as consistency and comparability between different entities applying the FRC's financial reporting standards.

Comparability benefits arising from IFRS 16 principles

94. FRS 102 was previously aligned with the international accounting standards for lease accounting, but diverged when a new IFRS Accounting Standard, IFRS 16, became effective in 2019. This misalignment may have affected competitiveness by reducing the comparability of financial statements prepared using the FRC's financial reporting standards to those prepared using IFRS Accounting Standards.

95. Under Options 4a and 4b, lease accounting under the FRC's financial reporting standards is aligned with the principles of IFRS 16, and hence realigned with international norms. The new model provides a more faithful representation of an entity's assets and liabilities and resolves a discrepancy in which leveraged purchases and leases, although economically similar, looked very different, with operating leases left off-balance sheet.

96. This may facilitate a more effective assessment of an entity's financial position and credit risk.[28] It is also expected to improve comparability between entities that obtain assets via leases and entities that obtain assets by borrowing to buy them.[29] This may contribute towards fairer competition in private capital markets as the implementation of IFRS 16 principles will facilitate comparison between prospective borrowers.[30]

[28] Europe Economics (2017), *Ex ante Impact Assessment of IFRS 16*, paragraph 1.4.3, available at https://www.efrag.org/Assets/Download?assetUrl=%2Fsites%2Fwebpublishing%2FProject%20Documents%2F269%2FIFRS%2016%20-%20Europe%20Economics%20-%20Ex%20ante%20Impact%20Assessment%20%2822%20February%202017%29.pdf.

[29] IASB (January 2016), *IFRS 16 Leases, Effect Analysis*, Leasing and borrowing to buy assets, page 28, available at https://www.ifrs.org/content/dam/ifrs/project/leases/ifrs/published-documents/ifrs16-effects-analysis.pdf.

[30] See Europe Economics (2017), *Ex ante Impact Assessment of IFRS 16,* 5.4.3 Private capital market effects, pages 50–51, available at https://www.efrag.org/Assets/Download?assetUrl=%2Fsites%2Fwebpublishing%2FProject%20Documents%2F269%2FIFRS%2016%20-%20Europe%20Economics%20-%20Ex%20ante%20Impact%20Assessment%20%2822%20February%202017%29.pdf.

Reducing the cost of preparing or auditing financial statements

97. We expect a small reduction in the cost of preparing some elements of financial statements. The incremental improvements and clarifications introduced will clarify and simplify some existing requirements, leading to a reduction in the amount of judgement required to interpret and implement the requirements of the financial reporting standards. For example, the amendments to Section 1A of FRS 102 should provide greater certainty to UK small entities regarding which disclosures are required to give a true and fair view, and the new Section 2A of FRS 102 provides greater guidance regarding fair value measurement. We expect that these amendments may lower the cost to affected entities of preparing financial statements.

98. Increased consistency arising from these incremental improvements and clarifications could also lead to a reduction in the cost of auditing the financial information, by reducing diversity in practice and judgement which would otherwise need to be considered by auditors.

99. We also expect our proposals to promote efficiency within groups in some circumstances. When an entity applies FRS 102 in its individual or separate financial statements but is part of a group whose consolidated financial statements are prepared under IFRS Accounting Standards, it must prepare financial information under two different frameworks. At present, the differences between IFRS Accounting Standards and FRS 102 in respect of revenue and, in particular, leasing mean that the financial information prepared under the two frameworks may be significantly different, which may lead to significant additional effort. The amendments under Options 3, 4a and 4b have been designed to promote efficiency within groups by aligning with the core principles of IFRS 15 and IFRS 16 and making simplifications from the requirements of IFRS 15 and IFRS 16 optional in some cases. An entity choosing not to apply these simplifications would therefore be able to minimise the costs of preparing financial information, and having it audited, under both IFRS Accounting Standards and the FRC's financial reporting standards, reducing overall costs for the group.

5. Monetised and non-monetised costs of each option

100. In this section we quantify the direct costs to affected entities of complying with the changes considered in Option 2, Option 3, Option 4a and Option 4b compared to Option 1 (our counterfactual option). We also consider non-monetised impacts.

101. We assess changes over a five-year appraisal period. The length of the appraisal period reflects the frequency of periodic reviews of the FRC's financial reporting standards (see Section 3, subsection *Monitoring and evaluation plan*). The analysis presented is for both the UK and the Republic of Ireland because the FRC's financial reporting standards apply in both jurisdictions.

Determining the counterfactual for assessing impacts

102. In this impact assessment we assess the relative impact of our options against a counterfactual.

103. We make some assumptions about the counterfactual in order to measure the impact of the options considered relative to what otherwise would have happened. This allows us to compare the relative impacts associated with different options.

104. We have determined that the relevant counterfactual would be the continuation of the existing financial reporting standards – Option 1 as described in Section 2.

105. In accordance with the Green Book,[31] we quantify the costs of each option compared to the counterfactual (that is, we subtract from the total cost of each option the cost of Option 1). Monetised costs are presented in 2024 prices.

Assumptions and estimates that are applicable to more than one option

Estimated number of affected entities in the UK

106. In order to monetise the direct cost of compliance arising from our options, we need to estimate the number of entities that would need to comply with the amended financial reporting standards.

107. We have used data from Companies House to derive the number of entities in scope in the UK under each of the options considered.

108. Companies House publishes statistics of the annual accounts filed each year. In the year to 31 March 2023, 3,764,562 annual accounts were filed by private limited companies, public

[31] See paragraph 4.8 of the Green Book for further details. HM Treasury (2022), *The Green Book*, available at https://www.gov.uk/government/publications/the-green-book-appraisal-and-evaluation-in-central-government.

limited companies (PLCs) and Limited Liability Partnerships (LLPs).[32] This number is lower than the number of entities on the total register maintained by Companies House[33] for a variety of reasons. For example, the total register includes companies in the course of removal and liquidation, and companies that would not be required to file accounts in a given year due to being recently incorporated.

109. The total number of annual accounts filed is used in this impact assessment as a proxy for the number of entities that will be preparing financial statements in a given year in the UK and would need to comply with the amended financial reporting standards.

110. Adjustments have been made to these initial statistics to reflect known differences in scope, as follows:

(a) The statistics directly record the number of dormant entities, which are removed from further analysis because, by definition, they have no transactions and therefore do not need to apply the requirements of the FRC's financial reporting standards.

(b) Additional Companies House statistics[34] indicate that the total register includes around 127,000 entities of other corporate body types (that is, not private limited companies, PLCs or LLPs). Most of these corporate types are not relevant for our analysis: for example, in most cases, overseas companies registered at Companies House prepare accounts under the law of the country where the company is incorporated. However, the charitable incorporated organisations (CIO)[35] form is relevant because many charities, including CIOs, prepare accounts in accordance with FRS 102. This means that 31,542 CIOs have been added to the analysis. Whilst some very large charities exist, the vast majority of CIOs by number are assumed to be small. No other additions for any other corporate body types have been made, on the basis they are not likely to be significant to the overall number of entities preparing accounts in accordance with the FRC's financial reporting standards. Unincorporated charities are likely to be the largest such group (see (c) below) and we are not aware of any other groups that are significant by number.

(c) Certain entities that are required to prepare accounts in accordance with the FRC's financial reporting standards are not required to submit accounts to Companies House and are therefore not included in Companies House statistics. This population includes some unincorporated charities, which are required to submit records to charity regulators[36] but not to Companies House. There are around 215,300 charities

[32] Companies House (2023), *Companies House management information tables 2022 to 2023,* available at https://www.gov.uk/government/statistical-data-sets/companies-house-management-information-april-2022-to-march-2023.

[33] The total register comprises all companies to which the *Companies Act 2006* relates, which are registered with Companies House regardless of trading status. This includes both dormant and actively trading companies. It includes all companies required to file documents at Companies House. It excludes dissolved companies but includes those in liquidation, in the course of dissolution, and those in the course of receivership.

[34] Companies House (2023), *Companies register activities: 2022 to 2023* Table 1, available at https://www.gov.uk/government/statistics/companies-register-activities-statistical-release-2022-to-2023/companies-register-activities-2022-to-2023/.

[35] Note that the CIO corporate form has existed since 2013; many charities choose to remain incorporated as charitable companies limited by guarantee, and are already included in the "private limited" category of the initial statistics.

[36] The Charity Commission for England and Wales, the Scottish Charity Regulator (OSCR), or The Charity Commission for Northern Ireland.

in the UK, including charitable companies, CIOs, and charities that are unincorporated[37]. Most CIOs and unincorporated charities with gross incomes of £250,000 or less can prepare *receipts and payments* accounts, rather than accounts in accordance with FRS 102. We estimate that around 175,500 charities in the UK would be eligible to prepare receipts and payments accounts.[38] We have assumed that the remaining 39,800 charities are already included because the Companies House statistics already include incorporated charities (for example, private companies limited by guarantee and CIOs). Accordingly, no further adjustment has been made to reflect unincorporated charities preparing FRS 102 accounts, on the basis that they are not likely to significantly affect the overall estimate of the number of entities preparing accounts in accordance with the FRC's financial reporting standards.

(d) IFRS Accounting Standards must be applied in preparing the consolidated financial statements of companies listed on a regulated exchange. For other financial statements, companies may choose to apply IFRS Accounting Standards rather than the FRC's financial reporting standards. In addition, the FRC's financial reporting standard FRS 101 *Reduced Disclosure Framework* permits an entity that might otherwise have applied FRS 102 to apply IFRS recognition and measurement requirements (with reduced disclosure). The UK Endorsement Board[39] estimates that 15,500 companies are required, or choose, to apply IFRS Accounting Standards[40] (either directly or by applying FRS 101) and therefore these have been removed from this analysis.

111. After the adjustments above, we estimate that there are 3,139,876 affected entities in the UK applying FRS 102 or FRS 105. Further assumptions have been made using the Companies House statistics to allocate those entities as micro-entities (applying either FRS 102 or FRS 105) or small, medium-sized, or large entities (applying FRS 102):

(a) The Companies House statistics directly record the number of entities registering annual accounts prepared under the micro-entity framework (FRS 105).

(b) Annual accounts recorded in the statistics as types *small*, *abbreviated small*, and *audited abridged* are presumed to pertain to either micro-entities (that have chosen

[37] 183,755 registered with the Charity Commission for England and Wales: Charity Commission, *Sector overview*, accessed on 19 September 2023 and available at https://register-of-charities.charitycommission.gov.uk/sector-data/sector-overview.
25,332 registered with the Scottish Charity Regulator (OSCR): OSCR (2023), *Sector Overview Report, Q2 2023 Report, updated 30 June 2023,* available at https://www.oscr.org.uk/about-charities/overview-of-scottish-charities/data-and-research/sector-overview/.
7,863 registered with The Charity Commission for Northern Ireland: Charity Commission, *Charity Search*, accessed on 19 September 2023 and available at https://www.charitycommissionni.org.uk/charity-search.
Note that some charities may be registered with more than one regulator.
[38] 148,347 registered with the Charity Commission for England and Wales: search of the register on 19 September 2023.
20,942 registered with the Scottish Charity Regulator (OSCR): search of the register on 19 September 2023.
6,184 (income less then £100,000) registered with The Charity Commission for Northern Ireland: search of the register on 19 September 2023.
[39] The UK Endorsement Board endorses new or amended IFRS Accounting Standards issued by the IASB for use by UK companies. See https://www.endorsement-board.uk/about-us for further details.
[40] UKEB (2023), *Final Comment Letter Post-Implementation Review IFRS 15,* available at https://www.endorsement-board.uk/post-implementation-review-of-ifrs-15-revenue-from-contracts-with-customers.

not to apply FRS 105) or small entities because those account types are only available to entities of that size.

(c) Annual accounts recorded in the statistics as types *full* or *abbreviated medium* are presumed to pertain to small, medium-sized, or large entities.

(d) Annual accounts recorded in the statistics as type *group* are presumed to pertain to either medium-sized or large entities because small entities have no requirement to prepare group accounts.

112. Where, after the allocations above, some groupings still relate to more than one size category we have used statistics on the estimated number of businesses in the UK private sector by employment size-band in Table 1 of *Business population estimates 2022*[41] to apportion those groupings into the size categories.

113. Table 5.01 sets out the final estimated number of affected entities by size band.

Table 5.01: Estimated number of affected entities using FRS 102 and FRS 105 in the UK

Entity size	Total	Entities applying FRS 102	Entities applying FRS 105
Micro	2,792,977	1,226,882	1,566,095
Small	309,642	309,642	-
Medium	30,701	30,701	-
Large	6,556	6,556	-
Total	**3,139,876**	**1,573,781**	**1,566,095**

Source: FRC calculations based on Companies House and Department for Business and Trade data.

[41] Department for Business and Trade (October 2022), *Business population estimates 2022*, available at https://www.gov.uk/government/statistics/business-population-estimates-2022.

Estimated number of affected accountants in the UK

114. As of 31 December 2022, there were 397,587 registered members of accountancy bodies[42] included in the FRC's Key Facts and Trends (KFAT) publication in the UK and Republic of Ireland.[43] In addition, there were also 4,140 registered members of CPA Ireland, which are not included in KFAT, in the UK and Republic of Ireland.[44] The Irish Auditing and Accounting Supervisory Authority (IAASA) states that 43,321 accountants registered with some[45] of those accountancy bodies are located in the Republic of Ireland.[46] The remaining accountancy bodies included in KFAT (ICAEW and ICAS) are not Recognised Accountancy Bodies in the Republic of Ireland, so we assume that the number of accountants registered with those bodies located in the Republic of Ireland is negligible, and the figure we use to remove affected accountants in the Republic of Ireland from the total in KFAT is the IAASA figure of 43,321. Because of a discrepancy of 472 between KFAT and the IAASA data, we subtract this figure from the total. We therefore estimate that the total number of accountants who are potentially affected by our measures in the UK is 357,934.

115. We have assumed that 50% of accountants in the UK have an interest in financial reporting matters. This takes into account that: approximately 11% of registered members are retired;[47] that a further 85,953 accountants (24%) are registered with the Chartered Institute of Management Accountants (CIMA), and so are likely to be engaged primarily in management accounting rather than financial accounting; and that a proportion of other accountants will also not be primarily engaged in financial reporting.

116. This results in an overall estimate of 178,967 accountants that will be affected by changes to the FRC's financial reporting standards (*affected accountants*) in the UK.

Estimated number of affected audit firms in the UK

117. As of 31 December 2022, there were 4,310 audit firms registered with a UK Recognised Supervisory Body[48] to carry out statutory audit work in the UK and Republic of Ireland.[49] ACCA and CAI are also Recognised Accountancy Bodies in the Republic of Ireland and some audit firms registered with those bodies may only carry out audit work in the Republic of

[42] The six UK Chartered Accountancy bodies (Association of Chartered Certified Accountants (ACCA), Institute of Chartered Accountants in Ireland (ICAI/CAI), Chartered Institute of Public Finance and Accountancy (CIPFA), Chartered Institute of Management Accountants (CIMA), Institute of Chartered Accountants in England and Wales (ICAEW) and Institute of Chartered Accountants of Scotland (ICAS)) and the Association of International Accountants (AIA).
[43] FRC (August 2023), *Key Facts and Trends in the Accountancy Profession 2023*, available at https://www.frc.org.uk/auditors/professional-oversight/key-facts-and-trends-in-the-accountancy-profession.
[44] IAASA (April 2023), *2022 Profile of the Profession*, Table A.1, available at https://iaasa.ie/publications/profile-of-the-profession-2022/.
[45] ACCA, CPA Ireland, CAI, AIA, CIMA, and CIPFA.
[46] IAASA (April 2023), *2022 Profile of the Profession*, Table A.1, available at https://iaasa.ie/publications/profile-of-the-profession-2022/.
[47] FRC (August 2023), *Key Facts and Trends in the Accountancy Profession 2023*, Figure 50, available at https://www.frc.org.uk/auditors/professional-oversight/key-facts-and-trends-in-the-accountancy-profession.
[48] To be a Recognised Supervisory Body, the body must satisfy the recognition criteria as set out in Schedule 10 of the *Companies Act 2006*. Individuals and audit firms that wish to be appointed as a statutory auditor in the UK must be registered with an RSB.
[49] FRC (August 2023), *Key Facts and Trends in the Accountancy Profession 2023*, available at https://www.frc.org.uk/auditors/professional-oversight/key-facts-and-trends-in-the-accountancy-profession.

Ireland. This could mean the total is an overestimate of affected audit firms in the UK However, the effect of this is assumed not to be significant to the overall estimate.

118. Of the 4,310 audit firms, 123 firms have 11 or more principals (*larger auditors*). The remaining 4,187 audit firms have ten principals or fewer (*smaller auditors*).

Estimated number of affected entities, affected accountants, and affected audit firms in the Republic of Ireland

119. In calculating the direct costs of compliance in the Republic of Ireland we have made the following assumptions:

(a) **Estimated number of accountants affected**: As referred to in paragraph 114, IAASA disaggregates the number of accountants registered with ACCA, CPA Ireland, CAI, AIA, CIMA, and CIPFA into those located in the UK and those located in the Republic of Ireland[50] and the number located in the Republic of Ireland is 43,321. As with the UK estimate, we have assumed that 50% of accountants have an interest in financial reporting matters, resulting in 21,661 affected accountants.

(b) **Estimated number of auditors affected**: IAASA statistics show that there were 1,059 statutory audit firms with offices in the Republic of Ireland approved to audit in the Republic of Ireland at 31 December 2022.[51] This figure may double-count some firms that are also included in the estimated number of affected audit firms in the UK because audit firms registered with ACCA and CAI with an office in the Republic of Ireland may also be registered to carry out statutory audit work in the UK; however, the effect of this is assumed not to be significant to the overall estimate.

(c) **Estimated number of entities affected**: The Companies Registration Office (CRO) in the Republic of Ireland, indicated that there were 240,223 annual returns (which typically include financial statements) received by the CRO in 2022.[52] This number is used to estimate the total number of entities that would need to comply with the amended financial reporting standards in the Republic of Ireland.[53] To derive the proportion of entities in each size category we have used data from the CRO as well as data published in the *Business Demography 2021 statistics* issued by the Central Statistics Office (CSO) of the Republic of Ireland. The CSO indicated that there were 365,766 enterprises in the Republic of Ireland in 2021. Of those number of enterprises, 338,100 were defined as micro-entities, 22,714 as small, 4,089 as medium and 863 as large sized.[54] We apply the proportion of entities in each size category from the CSO data to the number of annual returns received by the CRO in 2022. To estimate the number of micro-entities using FRS 102 and FRS 105, we use the same proportions as

[50] IAASA (April 2023), *2022 Profile of the Profession*, Table A.1, available at https://iaasa.ie/publications/profile-of-the-profession-2022/.

[51] IAASA (April 2023), *2022 Profile of the Profession*, Table E.3, available at https://iaasa.ie/publications/profile-of-the-profession-2022/.

[52] The Companies Registrations Office, *Companies Registration Office Report 2022,* page 10, available at https://www.cro.ie/Portals/0/Forms/2022%20CRO%20Annual%20Report.pdf.

[53] https://www.cso.ie/en/releasesandpublications/ep/p-bd/businessdemography2021/

[54] From the CSO, we calculated the group sizes as follows, micro-entities: under 10 employees; small entities: 10-19 employees and 20-49 employees, medium entities: 50-249 employees, large entities: 250 or more employees.

applied in the UK for micro-entities. Table 5.02 sets out the final estimated number of affected entities in the Republic of Ireland by size band.

Table 5.02: Estimated number of affected entities using FRS 102 and FRS 105 in the Republic of Ireland

Entity size	Total	Entities applying FRS 102	Entities applying FRS 105
Micro	222,053	97,542	124,511
Small	14,918	14,918	-
Medium	2,686	2,686	-
Large	567	567	-
Total	**240,224**	**115,713**	**124,511**

Source: FRC calculations based on Central Registrations Office and Central Statistics Office data.

Hourly rate for accountants in the UK and the Republic of Ireland

120. In estimating the direct costs of compliance with the changes considered, we use hourly rates for an accountant. We estimate the hourly rate for accountants in the UK and the Republic of Ireland using the 2022 ONS Annual Survey of Hours and Earnings (ASHE).[55] From the survey we use the 75th percentile for the hourly wage rate for chartered and certified accountants to take into account that some aspects of our proposals will require input from more senior staff, consultants, or experienced technical accountants. This figure is then converted to 2024 prices using the GDP deflators at market prices guide.[56] We then calculate a non-wage labour costs uplift of 18.8%[57] to reflect the total costs of an hour of an accountant's time incurred by affected entities in the UK. As a result of our calculations, we estimate the hourly rate for an accountant is £36.33 in the UK. We use the same estimate for the Republic of Ireland.[58]

[55] ONS, *ASHE data 2022*, Table 14.5a, Chartered and certified accountants, 75th percentile, available at https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/earningsandworkinghours/datasets/occupation4digitsoc2010ashetable14.

[56] https://www.gov.uk/government/statistics/gdp-deflators-at-market-prices-and-money-gdp-december-2023-quarterly-national-accounts

[57] The non-wage labour cost uplift is calculated using statistics on the value of labour costs. ONS (2020), Index of Labour costs per Hour, UK: July to September 2020 available at https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/earningsandworkinghours/bulletins/indexoflabourcostsperhourilch/julytoseptember2020.

[58] There is no official data on hourly wages for accountants published by the Central Statistics Office (CSO) in the Republic of Ireland. Therefore, we use data for the hourly wages of an accountant by the Office for National Statistics (ONS) for the UK and apply it to accountants in the Republic of Ireland.

Option 1: Do nothing

Overview of Option 1

121. Under this option (the counterfactual) the FRC's financial reporting standards are not amended to realign with international accounting standards or amended to reflect other incremental improvements or clarifications. The extant versions remain in force until at least the next periodic review (expected after five years).

Expected impacts on main affected groups: Option 1

122. This option is expected to affect:

   (a) entities currently preparing financial statements in accordance with FRS 102 and FRS 105. As we discuss further below, the cost associated with this option is likely to fall on those entities applying FRS 102 because entities using FRS 105 are less likely to incur any additional costs arising from the misalignment between domestic and international standards; and

   (b) some individual accountants who might be directly employed by affected entities in the UK and Republic of Ireland or might work for accounting firms which provide accounting services to the entities affected. Those individuals may need to maintain awareness of the misalignment between domestic and international standards, which may increase over time if domestic standards are not updated.

Assessment of monetised cost of option

123. Although under this option there are no changes to the financial reporting standards until the next periodic review and entities in scope are not required by the FRC to change the way they currently prepare their financial statements, some of those entities are likely to experience some additional ongoing costs arising from the misalignment between domestic and international accounting standards. For example:

   (a) Some entities, or users of the financial statements of those entities, may need to create supplementary analysis that is consistent with IFRS 15 or IFRS 16 principles. This is only likely to affect entities who have, or are seeking, international investment, entities requested to prepare such information by their bank, and subsidiary companies preparing IFRS-based information for their parent companies. The cost is likely to be primarily related to the time taken to adjust existing financial information to be in accordance with IFRS Accounting Standards each time a report is required. Those entities that have more complex accounting transactions are likely to require more adjustment; some entities may not require significant adjustment if the accounting outcomes are the same under both frameworks, but some analysis would need to be carried out to confirm that this is the case.

   (b) Some affected accountants would be required to maintain awareness of both accounting frameworks. We have assumed that most accountants that prepare and audit financial statements do so under only one framework and therefore that only a proportion (assumed to be 20%) of affected accountants would be required to maintain awareness of both frameworks. The cost to each individual accountant

would be likely to include ongoing training and re-familiarisation costs. Depending on the entities the accountant works for, advises or audits, more or less time would be required for familiarisation. Some accountants may develop training materials that allow others to familiarise themselves more efficiently with the requirements.

124. In Tables 5.03 and 5.04, we have quantified the ongoing costs to the affected entities of providing supplementary analysis and of maintaining awareness of multiple financial reporting frameworks.

125. We assess these costs over a five-year appraisal period, which starts from 1 January 2026 (the principal effective date of the amendments to the standards) and ends on 31 December 2030. The length of the appraisal period reflects the frequency of periodic reviews of the FRC's financial reporting standards.

Ongoing costs of Option 1

Ongoing costs to affected entities of misalignment between domestic and international accounting standards

126. In estimating the costs of supplementary analysis, we have assumed that only a small number of entities may need to create supplementary analysis that is consistent with IFRS 15 or IFRS 16. We have assumed this will affect 2% of the total number of entities applying FRS 102.[59]

127. We expect supplementary costs to apply as time is spent by company staff to prepare supplementary analysis that is consistent with IFRS 15 or IFRS 16 principles. We therefore use our estimate of an hourly rate for an accountant, calculated using the ONS ASHE Survey data, as explained in Section 3. We have assumed that this would take five hours on average per entity per year. The estimated total cost for the UK and Republic of Ireland is approximately £6.1 million per year.

[59] Entities using FRS 105 for preparing their financial statements are less likely to have international reporting requirements or users that are interested in making international comparisons. An entity that is included in consolidated financial statements is not eligible to use FRS 105. Therefore, we have assumed that these entities do not prepare supplementary analysis.

Table 5.03: Estimated annual ongoing costs of supplementary analysis (2024 prices. Figures have not been discounted)

	Number of entities applying FRS 102	Annual requirement for supplementary analysis	Affected entities	Average hours per entity	Total hours of analysis	Cost per hour (£)	Total annual ongoing cost (£m)
UK	1,573,781	2%	31,476	5	157,380	36.33	5.7
Republic of Ireland	115,713	2%	2,314	5	11,570	36.33	0.4
Total	**1,689,494**		**33,790**		**168,950**		**6.1**

Source: FRC calculations.
Note: Totals may not add up due to rounding.

128. In addition to supplementary analysis, we have assumed that 20% of affected accountants would be required to maintain awareness of multiple accounting frameworks. This is likely to be a fifth of affected accountants because we have assumed that most accountants that prepare and audit financial statements do so under only one framework.

129. We have assumed that to maintain awareness of multiple accounting frameworks would take two hours of time on average per year per affected accountant, which would be likely to include ongoing training and re-familiarisation. The estimated total annual ongoing cost is approximately £2.9 million for the UK and Republic of Ireland.

Table 5.04: Estimated annual ongoing costs of maintaining awareness of multiple accounting frameworks under Option 1 (2024 prices. Figures have not been discounted)

	Affected accountants	Average hours per accountant	Total hours of analysis	Cost per hour (£)	Total annual ongoing cost (£m)
UK	35,793	2	71,586	36.33	2.6
Republic of Ireland	4,332	2	8,664	36.33	0.3
Total	**40,125**		**80,250**		**2.9**

Source: FRC calculations
Note: Totals may not add up due to rounding.

Total costs of Option 1

130. Our total estimate of the annual cost of misalignment between domestic and international accounting standards under Option 1 is £9.1 million for the UK and Republic of Ireland (see Table 5.05).

Table 5.05: Estimated total annual ongoing costs of Option 1 (2024 prices. Figures have not been discounted)

	UK (£m)	Republic of Ireland (£m)	Total (£m)
Costs of supplementary analysis	5.7	0.4	6.1
Costs of awareness of multiple standards	2.6	0.3	2.9
Total	**8.3**	**0.7**	**9.1**

Source: FRC calculations
Note: Totals may not add up due to rounding.

131. In Table 5.06 we present the net present value[60] for Option 1 over a five-year appraisal period, which is £42.3 million for the UK and Republic of Ireland, resulting in an annual equivalent cost[61] to entities in scope of approximately £8.3 million per year in the UK.

Table 5.06: Total cost of Option 1 for the UK and Republic of Ireland over a five-year appraisal period (2024 prices, Net present value (NPV) and Equivalent Annual Net Direct Cost to Business (EANDCB)[62]

	NPV, 5-yr period (£m)	EANDCB (excluding Republic of Ireland) (£m)
Option 1	42.3	8.3

Source: FRC calculations
Notes: Equivalent Annual Net Direct Cost to Business is calculated only for the UK.

[60] The net present value represents putting the interventions with different time spans and benefit–cost profiles on to a common present value basis by applying a discount rate. HM Treasury (2022), *The Green Book (2022),* page 46, available at https://www.gov.uk/government/publications/the-green-book-appraisal-and-evaluation-in-central-government.
[61] Annual equivalent cost represents the total annual cost to entities in scope for Option 1. This is calculated according to the methodology in Section 2.4 of the Better Regulation Framework (2020). The equivalent annual net direct cost to business is calculated by dividing the net present value to Businesses by the annuity rate.
[62] We calculate the EANDCB for the UK only. This is because the EANDCB is a specific requirement under the Better Regulation Framework.

Option 2

Overview of Option 2

132. Under Option 2, the FRC would make amendments to financial reporting standards that address incremental improvements and clarifications, as described in Section 2. Alignment with IFRS 15 and IFRS 16 principles would be deferred until at least the next periodic review (expected after five years).

Expected impacts on main affected groups: Option 2

133. This option is expected to affect:

    (a) entities currently preparing financial statements in accordance with FRS 102 and FRS 105. Some of those entities would be required to carry out additional analysis to prepare their accounts for the first time in accordance with the new requirements and would incur one-off costs; some entities may incur ongoing additional costs arising from the remaining misalignment between domestic and international standards; those entities with more complex transactions are likely to be more affected and entities with less complex transactions are likely to incur less cost;

    (b) individual accountants who might be directly employed by affected entities in the UK and Republic of Ireland or might work for accounting firms which provide accounting services to the entities affected. Those individuals would be required to familiarise themselves with the amendments to the standards in order to apply them in their work, or to maintain a general awareness of accounting practice, with those individuals more closely involved in financial reporting likely to be more affected; and

    (c) auditors, or those that otherwise examine financial statements prepared in accordance with the FRC's issued standards. Those firms or individuals may need to design new audit procedures that address the new accounting requirements. We have assumed that once affected accountants are familiar with the amendments, as set out in (b), the additional audit cost, both one-off and ongoing, is not significant to the total estimate.

Assessment of monetised cost of Option 2

134. Under this option the FRC would be making incremental improvements and clarifications to its financial reporting standards. This would result in a small reduction in the ongoing cost of misalignment between domestic and international accounting standards that we quantified under Option 1. This small reduction in cost has been monetised as a benefit in comparison to Option 1.

135. However, because of the incremental improvements made there would be some additional, one-off familiarisation and analysis costs which would be incurred by the entities in scope in the first year of implementation. We do not expect any additional ongoing costs from this option.

One-off costs of Option 2

One-off costs for familiarisation with new requirements

136. Because of the changes proposed under Option 2, some individual accountants would be required to familiarise themselves with the new requirements. Those affected would primarily be accountants in financial reporting roles, for example those preparing and auditing financial statements, and those that rely on such financial statements. Those affected would incur a one-off familiarisation cost. Depending on the entities the accountant works for, advises or audits, more or less time would be required for familiarisation. Some accountants would develop training materials that allow others to familiarise themselves more effectively with the requirements.

137. We assume that training would take two hours of time on average per affected accountant. The estimated total cost is approximately £14.6 million for the UK and Republic of Ireland. As a simplifying assumption, we assume this cost would be incurred in the first year of implementation and that no additional re-familiarisation costs would be incurred over the five-year appraisal period because affected accountants would have been required to re-familiarise themselves with the extant requirements in any case.

Table 5.07: Estimated one-off familiarisation costs under Option 2 compared to Option 1 (2024 prices. Figures have not been discounted)

	Affected accountants	Average hours per accountant	Total hours	Cost per hour (£)	Total costs (£m)
UK	178,967	2	357,934	36.33	13.0
Republic of Ireland	21,661	2	43,322	36.33	1.6
Total	**200,628**		**401,256**		**14.6**

Source: FRC calculations
Note: Totals may not add up due to rounding.

One-off costs to entities in scope for new systems and processes

138. In addition to familiarisation costs, we also expect that some entities would be required to carry out additional analysis to prepare their accounts for the first time in accordance with the new requirements. This would result in additional one-off costs, with those entities with more complex transactions likely to be more affected and those entities with less complex transactions likely to incur lower costs. We assume that the time required for additional analysis will vary from zero to five hours on average per entity, increasing with entity size as a proxy for accounting complexity. For micro-entities on average we assume it would be very close to zero, and therefore effectively zero. Tables 5.08 and 5.09 show one-off analysis costs for the UK and Republic of Ireland.

Table 5.08: Estimated one-off analysis costs under Option 2 compared to Option 1 for the UK (2024 prices. Figures have not been discounted)

Entity size	Number of entities	Hours of analysis per entity	Total hours of analysis	Cost per hour (£)	Total costs (£m)
Micro	2,792,977	0	0	36.33	0.0
Small	309,642	1	309,642	36.33	11.2
Medium	30,701	2	61,402	36.33	2.2
Large	6,556	5	32,780	36.33	1.2
Total	**3,139,876**		**403,824**		**14.7**

Source: FRC calculations
Note: Totals may not add up due to rounding.

Table 5.09: Estimated one-off analysis costs under Option 2 compared to Option 1 for the Republic of Ireland (2024 prices. Figures have not been discounted)

Entity size	Number of entities	Hours of analysis per entity	Total hours of analysis	Cost per hour (£)	Total costs (£m)
Micro	222,053	0	0	36.33	0.0
Small	14,918	1	14,918	36.33	0.5
Medium	2,686	2	5,372	36.33	0.2
Large	567	5	2,835	36.33	0.1
Total	**240,224**		**23,125**		**0.8**

Source: FRC calculations
Note: Totals may not add up due to rounding.

Ongoing costs of Option 2

Ongoing costs to affected entities of misalignment between domestic and international accounting standards

139. The cost of supplementary analysis would still be incurred by affected entities as there would be no changes to the FRC's financial reporting standards to incorporate IFRS 15 and IFRS 16 principles: therefore, this cost is unchanged compared to Option 1.

140. The reduction in misalignment under Option 2 would affect the annual ongoing cost of maintaining awareness of multiple financial reporting frameworks. As the main sources of

misalignment between domestic and international standards are due to IFRS 15 and IFRS 16 principles, the more minor amendments proposed in Option 2 would reduce misalignment only marginally: we have assumed that this cost would be reduced by 10% compared to Option 1.

Table 5.10: Estimated annual ongoing costs of maintaining awareness of multiple accounting frameworks under Option 2 (2024 prices. Figures have not been discounted)

	Total cost from Option 1 (£m)	Reduction from Option 1 (%)	Total annual ongoing cost (£m)
UK	2.6	10%	2.3
Republic of Ireland	0.3	10%	0.3
Total	**2.9**		**2.6**

Source: FRC calculations
Note: Totals may not add up due to rounding.

Total costs of Option 2

141. In Tables 5.11 and 5.12 we present the total one-off costs and annual reduction in costs which form part of the benefits of Option 2 (the only part we are able to monetise) compared to the counterfactual (Option 1).

Table 5.11: Estimated total additional one-off costs under Option 2 compared to Option 1 (2024 prices. Figures have not been discounted)

	UK(£m)	Republic of Ireland (£m)	Total (£m)
Changes to systems and processes	14.7	0.8	15.5
Familiarisation costs	13.0	1.6	14.6
Total	**27.7**	**2.4**	**30.1**

Source: FRC calculations
Note: Totals may not add up due to rounding.

Table 5.12: Estimated total annual reduction of costs under Option 2 compared to Option 1 (2024 prices. Figures have not been discounted)

	UK (£m)	Republic of Ireland (£m)	Total (£m)
Costs of supplementary analysis	0.0	0.0	0.0
Costs of awareness of multiple standards	0.3	0.0	0.3
Total	**0.3**	**0.0**	**0.3**

Source: FRC calculations
Note: Totals may not add up due to rounding.

142. In Table 5.13 we present the total costs of Option 2 compared to the counterfactual (Option 1). The net present value[63] for Option 2 over a five-year appraisal period is £28.7 million for the UK and Republic of Ireland, resulting in an annual equivalent cost[64] to entities in scope of £5.7 million per year in the UK.

Table 5.13: Total cost of Option 2 over Option 1 for the UK and Republic of Ireland over a five-year appraisal period (2024 prices, Net present value (NPV) and Equivalent Annual Net Direct Cost to Business (EANDCB)

	NPV, 5-yr period (£m)	EANDCB (excluding Republic of Ireland) (£m)
Option 2	28.7	5.7

Source: FRC calculations
Notes: Equivalent Annual Net Direct Cost to Business is calculated only for the UK. Totals may not add up due to rounding.

[63] The net present value represents putting the interventions with different time spans and benefit–cost profiles on to a common present value basis by applying a discount rate. HM Treasury (2022), *The Green Book*, page 46, available at https://www.gov.uk/government/publications/the-green-book-appraisal-and-evaluation-in-central-government.
[64] Annual equivalent cost represents the total annual cost to entities in scope for Option 2. This is calculated according to the methodology in Section 2.4 of the Better Regulation Framework (2020). The equivalent annual net direct cost to business is calculated by dividing the net present value to Businesses by the annuity rate.

Option 3

Overview of Option 3

143. Under Option 3 the FRC would:

   (a) make amendments to its financial reporting standards that address incremental improvements and clarifications. Those are the same changes as proposed in Option 2; and

   (b) make amendments to FRS 102 and FRS 105 that incorporate principles from IFRS 15 for revenue recognition, with appropriate simplifications.

144. Under Option 3, alignment with principles from IFRS 16 for lease accounting would be deferred until at least the next periodic review (expected after five years).

Expected impacts on main affected groups: Option 3

145. This option is expected to affect:

   (a) entities currently preparing financial statements in accordance with FRS 102 and FRS 105. Those entities may need to implement and operate, on an ongoing basis, systems and processes (for example new accounting software or methods to collect data) that enable them to apply the amended standards; some entities may incur additional costs arising from the remaining misalignment between domestic and international standards;

   (b) affected accountants, who would be required to familiarise themselves with the amendments to the standards in order to apply them in their work, or to maintain a general awareness of accounting practice; and

   (c) auditors, or those that otherwise examine financial statements prepared in accordance with the FRC's issued standards. Those firms or individuals may need to design and conduct new audit procedures that address the new accounting requirements. However, on an ongoing basis it is not expected that those new processes will result in an incremental cost compared to the existing processes.

Assessment of monetised cost of option

146. Under this option the FRC would be making:

   (a) incremental improvements and clarifications to its financial reporting standards (as in Option 2); and

   (b) major changes to align domestic standards to IFRS 15 principles for revenue recognition.

147. These changes mean that the cost of misalignment between domestic and international accounting standards that we quantified under Option 1 is significantly reduced. However, the other costs associated with Option 2 would also be incurred under this option.

148. Because of the changes to revenue accounting principles, we expect affected entities to incur one-off costs for familiarisation and analysis as well as one-off and, in some cases, ongoing

costs arising from new systems and processes. Those entities with more complex transactions are likely to be more affected and those entities with less complex transactions are likely to incur a relatively smaller one-off and annual ongoing costs, or no costs at all.

149. We also expect auditors to incur costs in designing and developing new audit procedures to address new revenue recognition principles. Auditors would then need to implement those procedures in each individual audit, which would result in one-off costs.

One-off costs of Option 3

One-off costs for familiarisation with new requirements

150. Affected accountants would be required to familiarise themselves with the new accounting requirements proposed under Option 3 (comprising the incremental improvements and clarifications under Option 2, as well as the proposed new revenue recognition requirements under Option 3). Those accountants who are auditors would also need to familiarise themselves with the new audit procedures. It is assumed that this would take two hours of time, on average, per affected accountant in addition to the familiarisation time we assumed under Option 2, so four hours in total. We note that the assumption of two additional hours of familiarisation time is an average across all affected accountants. The time taken is likely to be lower for those accountants who already use IFRS Accounting Standards, given that the proposals are closely aligned to IFRS 15 but with some simplifications. However, these accountants would still need to familiarise themselves with the simplifications. Accountants who do not use IFRS Accounting Standards and are not already familiar with IFRS 15 are likely to require more time for familiarisation. Some accountants may develop training materials that allow others to familiarise themselves more efficiently with the requirements.

151. Total familiarisation costs are shown in Table 5.14 and amount to approximately £29.2 million for the UK and Republic of Ireland. As a simplifying assumption, the FRC assumes these costs will be incurred in the first year of reporting in alignment with the new standards.

Table 5.14: Estimated one-off familiarisation costs under Option 3 (2024 prices. Figures have not been discounted)

	Affected accountants	Additional average hours per accountant	Total hours	Cost per hour (£)	Total additional costs (£m)	Costs from Option 2 (£m)	Total costs (£m)
UK	178,967	2	357,934	36.33	13.0	13.0	26.0
Republic of Ireland	21,661	2	43,322	36.33	1.6	1.6	3.1
Total	**200,628**		**401,256**		**14.6**	**14.6**	**29.2**

Source: FRC calculations
Note: Totals may not add up due to rounding.

One-off costs to entities in scope for new systems and processes

152. Entities in scope are expected to face the same costs we quantified under Option 2 (see Tables 5.08 and 5.09) in relation to additional analysis for preparing their accounts for the first time in accordance with the incremental improvements and clarifications.

153. In addition to the costs associated with Option 2, entities will be required to apply a new approach to determining the appropriate recognition of revenue from contracts with customers in their financial statements and we expect that this will result in one-off costs related to changes to systems and processes to enable compliance.

154. Not all entities will have revenue from contracts with customers. For example, entities that generate revenue from investments, or some entities within a group structure that do not directly transact with customers, may not. In determining the proportion of entities that have revenue from contracts with customers (the prevalence of revenue), we have reviewed data available through several data services. We consider that there are limitations to the reliability and completeness of this data because the data services may not classify transactions as *revenue* in the same way as the scope of our amendments under IFRS 15 principles and because complete financial information is not available for all entities (for example, small companies can choose to remove certain parts of their accounts (such as the profit and loss account and the directors' report) before they are made public at Companies House). Further, we did not receive any evidence on this assumption from consultation responses. For these reasons, we had to estimate the prevalence of revenue.

155. As shown in Table 5.15, we have assumed that the prevalence of revenue from contracts with customers ranges from 70% to 97% (with larger entities more likely to have revenue from contracts with customers), and that the average time taken to transition to new systems and processes ranges from 1.5 hours to 20 hours per entity (with larger entities more likely to require more time to implement the requirements).

Table 5.15: Assumptions on prevalence of revenue from contracts with customers and time taken to make changes to systems and processes to enable compliance with new revenue recognition requirements, by size of entities in scope

Entity size	Prevalence of revenue	Average hours per entity
Micro (FRS 105)	70%	1.5
Micro (FRS 102)	70%	1.5
Small	80%	5.0
Medium	95%	10.0
Large	97%	20.0

Source: FRC assumptions

156. In Tables 5.16 and 5.17 we show the total one-off costs related to changes to systems and processes to enable compliance with the proposed new revenue recognition principles in the

UK and Republic of Ireland, by size of entity. Entities are likely to need to develop some new processes, and, depending on the volume and complexity of their contracts with customers, some entities may need to invest in upgraded systems to support their revenue accounting.

Table 5.16: Estimated one-off costs for new systems and processes to enable compliance with new revenue recognition principles for entities in the UK (2024 prices. Figures have not been discounted)

Entity size	Number of entities	Prevalence of revenue	Affected entities	Hours of analysis per entity	Total hours of analysis	Cost per hour (£)	Total costs (£m)
Micro (FRS 105)	1,566,095	70%	1,096,267	1.5	1,644,401	36.33	59.7
Micro (FRS 102)	1,226,882	70%	858,817	1.5	1,288,226	36.33	46.8
Small	309,642	80%	247,714	5.0	1,238,570	36.33	45.0
Medium	30,701	95%	29,166	10.0	291,660	36.33	10.6
Large	6,556	97%	6,359	20.0	127,180	36.33	4.6
Total	**3,139,876**		**2,238,323**		**4,590,037**		**166.8**

Source: FRC calculations
Note: Totals may not add up due to rounding.

Table 5.17: Estimated one-off costs for new systems and processes to enable compliance with new revenue recognition principles for entities in the Republic of Ireland (2024 prices. Figures have not been discounted)

Entity size	Number of entities	Prevalence of revenue	Affected entities	Hours of analysis per entity	Total hours of analysis	Cost per hour (£)	Total costs (£m)
Micro (FRS 105)	124,511	70%	87,158	1.5	130,737	36.33	4.7
Micro (FRS 102)	97,542	70%	68,279	1.5	102,419	36.33	3.7
Small	14,918	80%	11,934	5.0	59,670	36.33	2.2
Medium	2,686	95%	2,552	10.0	25,520	36.33	0.9
Large	567	97%	550	20.0	11,000	36.33	0.4
Total	**240,224**		**170,473**		**329,346**		**12.0**

Source: FRC calculations
Notes: Cost per hour assumed to be the same in the UK and Republic of Ireland. Totals may not add up due to rounding.

157. These costs would be lower if an entity has one standard contract with all customers, and higher if the entity has many different types of customer contracts with different contractual terms. The costs are also likely to be higher if the entity has contracts that span a longer period (such as construction contracts or licensing), and lower if the entity's contracts are short (such as immediate retail sales).

158. The new requirements would require additional effort to put in place new accounting policy choices, to assess existing contract types against the new revenue recognition model, to adjust (as required) the revenue recognition approach for each contract type, and to establish an approach for new disclosure requirements. Some entities may choose to adjust the wording of their contracts to change or simplify the way in which they will be accounted for. The new disclosure requirements would require entities to provide more information about how they earn revenue from contracts with customers and how they recognise that revenue in the statements of financial performance.

One-off costs for new procedures for auditors

159. Auditors may need to design new audit procedures that address the new accounting requirements for revenue. We do not expect auditors to incur an ongoing cost for the new revenue recognition requirements as the amendments should lead to a better understanding of revenue and how it has been determined.

160. Auditors who already audit entities applying IFRS Accounting Standards should already have audit procedures in place that will be suitable for the audit of revenue accounting under

revised FRS 102, with minor modification (given that IFRS 15 has been effective since 1 January 2018), but auditors without experience of IFRS Accounting Standards will need to develop audit procedures, or source procedures developed by others that they can apply to their work.

161. We expect that some auditors will develop the new procedures in-house, or significantly customise standardised audit methodologies for their own use and some auditors will purchase standardised audit methodologies from third-party providers.

162. Our analysis suggests that the cost of this will not be significant, taking larger audit firms 80 hours on average to develop new, or adapt existing, procedures and with smaller audit firms incurring a £70 cost on average, generally from a third-party provider. The total estimated one-off cost is £0.7 million in the UK and £0.1 million in the Republic of Ireland. As a simplifying assumption, we assume this will all be incurred in the first year of implementation.

One-off costs of audit per audited entity

163. In addition to one-off costs for new audit procedures, auditors will need to audit the transition of entities to the new revenue accounting requirements.

164. The new requirements for revenue recognition are different to the existing ones and will require the auditor to carry out additional work in the year which audited entities transition, resulting in one-off costs.

165. These costs will only be incurred by medium-sized and large entities, which are required to obtain an audit of their financial statements.

166. Our analysis shows that the cost of this will not be significant, based on an assumption that audit costs would be 5% of the total costs for new systems and processes incurred by affected entities. The total estimated one-off cost is £0.8 million in the UK and £0.1 million in the Republic of Ireland. As a simplifying assumption, we assume this will all be incurred in the first year of implementation.

Ongoing costs of Option 3

Ongoing costs to entities in scope for misalignment between domestic and international accounting standards

167. A reduction in misalignment will result in both a reduction in the annual ongoing cost of supplementary analysis as well as to the annual ongoing cost of maintaining awareness of multiple financial reporting frameworks. We assume that these costs would reduce by 50% compared to Option 1 because under Option 3 there would not be any changes to incorporate IFRS 16 principles, so there would still be some misalignment between domestic and international accounting standards.

Table 5.18: Estimated annual ongoing costs of misalignment between domestic and international accounting standards under Option 3 (2024 prices. Figures have not been discounted)

	Total cost from Option 1 (£m)	Reduction from Option 1 (%)	Total annual ongoing cost (£m)
UK	8.3	50%	4.2
Republic of Ireland	0.7	50%	0.4
Total	**9.1**		**4.5**

Source: FRC calculations
Note: Totals may not add up due to rounding.

Ongoing costs to entities in scope for new systems and processes

168. We expect some affected entities to incur some ongoing costs associated with the new approach to revenue recognition. These costs are not expected to be large because entities are already required to account for revenue and, once one-off costs have been incurred, the new requirements should not be substantially more onerous than the extant requirements, particularly when an entity's contracts with customers are not complex.

169. As shown in Table 5.19, we have assumed the average additional time taken to operate systems and processes ranges from zero hours to five hours per entity, with larger entities more likely to require more time to implement the requirements, and micro-sized entities assumed to, on average, not incur any additional ongoing cost.

Table 5.19: Assumptions on the additional time taken to operate systems and processes to enable compliance with new revenue recognition requirements, by size of entities in scope

Entity size	Hours per entity
Micro (FRS 105)	0
Micro (FRS 102)	0
Small	1
Medium	2
Large	5

Source: FRC calculations

170. The estimated ongoing cost to entities to operate new systems and processes associated with new revenue recognition requirements is approximately £12.3 million per year in the UK and £0.7 million per year in the Republic of Ireland. Tables 5.20 and 5.21 show costs by entity size, for the UK and Republic of Ireland.

Table 5.20: Estimated additional ongoing costs to operate systems and processes to enable compliance with new revenue recognition principles for entities in the UK (2024 prices. Figures have not been discounted)

Entity size	Number of entities	Prevalence of revenue	Affected entities	Hours of analysis per entity	Total hours	Cost per hour (£)	Total costs (£m)
Micro (FRS 105)	1,566,095	70%	1,096,267	0	0	36.33	0.0
Micro (FRS 102)	1,226,882	70%	858,817	0	0	36.33	0.0
Small	309,642	80%	247,714	1	247,714	36.33	9.0
Medium	30,701	95%	29,166	2	58,332	36.33	2.1
Large	6,556	97%	6,359	5	31,795	36.33	1.2
Total	**3,139,876**		**2,238,323**		**337,841**		**12.3**

Source: FRC calculations
Note: Totals may not add up due to rounding.

Table 5.21: Estimated additional ongoing costs to operate systems and processes to enable compliance with new revenue recognition principles for entities in the Republic of Ireland (2024 prices. Figures have not been discounted)

Entity size	Number of entities	Prevalence of revenue	Affected entities	Hours of analysis per entity	Total hours	Cost per hour (£)	Total costs (£m)
Micro (FRS 105)	124,511	70%	87,158	0	0	36.33	0.0
Micro (FRS 102)	97,542	70%	68,279	0	0	36.33	0.0
Small	14,918	80%	11,934	1	11,934	36.33	0.4
Medium	2,686	95%	2,552	2	5,104	36.33	0.2
Large	567	97%	550	5	2,750	36.33	0.1
Total	**240,224**		**170,473**		**19,788**		**0.7**

Source: FRC calculations
Note: Totals may not add up due to rounding.

Total costs of Option 3

171. In Tables 5.22 and 5.23 we present the total one-off and additional annual ongoing costs of Option 3 compared to the counterfactual (Option 1). Table 5.24 presents the annual reduction in the costs of misalignment, which form part of the benefit of Option 3 (the only part we are able to monetise) compared to the counterfactual.

Table 5.22: Estimated one-off costs under Option 3 compared to Option 1 (2024 prices. Figures have not been discounted)

	UK (£m)	Republic of Ireland (£m)	Total (£m)
New systems and processes to enable compliance with new revenue recognition principles	166.8	12.0	178.7
Changes to systems and processes (from Option 2)	14.7	0.8	15.5
New procedures for auditors	0.7	0.1	0.8
Familiarisation costs	26.0	3.1	29.2
Audit of transition to new revenue recognition principles	0.8	0.1	0.8
Total	**208.8**	**16.1**	**225.0**

Source: FRC calculations
Note: Totals may not add up due to rounding.

Table 5.23: Estimated total additional annual ongoing costs under Option 3 compared to Option 1 (2024 prices. Figures have not been discounted)

	UK (£m)	Republic of Ireland (£m)	Total (£m)
New systems and processes to enable compliance with new revenue recognition principles	12.3	0.7	13.0
Total	**12.3**	**0.7**	**13.0**

Source: FRC calculations
Note: Totals may not add up due to rounding.

Table 5.24: Estimated total annual reduction of costs under Option 3 compared to Option 1 (2024 prices. Figures have not been discounted)

	UK (£m)	Republic of Ireland (£m)	Total (£m)
Costs of supplementary analysis	2.9	0.2	3.1
Costs of awareness of multiple standards	1.3	0.2	1.5
Total	**4.2**	**0.4**	**4.5**

Source: FRC calculations
Note: Totals may not add up due to rounding.

172. We also calculate the net present value[65] for Option 3 compared to the counterfactual (Option 1) over a five-year appraisal period, which is £264.5 million for the UK and Republic of Ireland, resulting in an annual equivalent cost to entities in scope of £52.8 million per year in the UK.

Table 5.25: Total cost of Option 3 over Option 1 over a five-year appraisal period (2024 prices, NPV and EANDCB)

	NPV, 5-yr period (£m)	EANDCB (excluding Republic of Ireland) (£m)
Option 3	264.5	52.8

Notes: Equivalent Annual Net Direct Cost to Business is calculated only for the UK. Totals may not add up due to rounding.

Source: FRC calculations

[65] The net present value represents putting the interventions with different time spans and benefit–cost profiles on to a common present value basis by applying a discount rate. HM Treasury (2022), *The Green Book*, page 46, available at https://www.gov.uk/government/publications/the-green-book-appraisal-and-evaluation-in-central-government.

Option 4a (Implemented option)

Overview of Option 4a

173. Under the implemented option, Option 4a, the FRC will:

   (a) make amendments to its financial reporting standards that address incremental improvements and clarifications. Those are the same changes as proposed in Option 2;

   (b) make amendments to FRS 102 and FRS 105 that incorporate principles from IFRS 15 for revenue recognition, with appropriate simplifications. Those are the same changes as proposed in Option 3; and

   (c) make amendments to FRS 102 that incorporate principles from IFRS 16 for lease accounting, with appropriate simplifications. Those amendments will not apply to entities using FRS 105, which will retain the extant requirements.

Expected impacts on main affected groups: Option 4a

174. This option is expected to affect:

   (a) entities currently preparing financial statements in accordance with FRS 102 and FRS 105, except that the changes relating to IFRS 16 principles will only apply to entities preparing financial statements in accordance with FRS 102. Those entities may need to implement and operate, on an ongoing basis, systems and processes (for example new accounting software or methods to collect data) that enable them to apply the amended standards;

   (b) affected accountants, who will be required to familiarise themselves with the amendments to the standards in order to apply them in their work, or to maintain a general awareness of accounting practice;

   (c) auditors, or those that otherwise examine financial statements prepared in accordance with the FRC's issued standards. Those firms or individuals may need to design new audit procedures that address the new accounting requirements, which will result in a one-off additional cost. In addition, auditors will need to plan and implement those audit procedures in each individual audit to address the new lease requirements. We expect the one-off cost incurred in the first year of implementation to be higher than the ongoing cost.

Assessment of monetised cost of option

175. Under Option 4a the FRC will be making:

   (a) incremental improvements and clarifications to its financial reporting standards (as in Option 2);

   (b) major changes to align domestic standards to IFRS 15 principles (as in Option 3); and

   (c) major changes to align domestic standards to IFRS 16 principles (except for micro-entities applying FRS 105).

176. Under this option, the FRC's financial reporting standards will be broadly aligned to recent developments in international accounting standards in respect of most accounting requirements[66] and, therefore, we assume that all ongoing costs from misalignment that were included in Option 1 will be avoided. This has been monetised as a benefit as compared to Option 1. However, the other costs associated with Option 3 would also be incurred under this option.

177. We expect affected entities to incur one-off and ongoing costs arising from the adoption of IFRS 16-aligned lease accounting. Entities applying FRS 102 will need to account for some of their leases in a different way. The changes predominantly affect lessee (rather than lessor) accounting requirements for leases that would previously have been classified as operating leases, and which do not qualify for recognition exemptions available for short-term leases and leases of low value assets. Entities will need to make accounting policy choices about how to account for those leases, obtain required information about each lease, make judgements and estimates, and calculate both initial and subsequent accounting entries for each lease. As well as on transition for existing leases, these judgements will need to be made on an ongoing basis as the entity enters into new leases. This means that there will be both one-off transition costs and additional ongoing costs compared with accounting under the existing requirements. Entities will be likely to need to develop some new processes and, depending on the volume and complexity of their leases, some entities may need to invest in upgraded IT systems to support their lease accounting.

178. Further, changes related to lease accounting that require the recognition of right-of-use assets are expected to increase an entity's total assets. Since total assets is one of the three quantitative criteria relevant to determining an entity's size under company law, some entities currently classified as small could be reclassified as medium-sized (triggering, amongst other changes, a requirement for audit), and some entities currently classified as medium-sized could be reclassified as large.

179. Auditors may also need to design new audit procedures, which will result in a one-off additional cost. As well as developing new audit procedures to address the new accounting requirements for leases, auditors will need to plan and implement those audit procedures on each individual audit, which will result in an additional ongoing cost.

180. Below we describe how we have quantified one-off and ongoing costs we expect entities to incur.

One-off costs of Option 4a

One-off costs for familiarisation with new requirements

181. Affected accountants will be required to familiarise themselves with the new accounting requirements proposed under Option 4a. Those accountants who are auditors will also need to familiarise themselves with new audit procedures. It is assumed that this will take two

[66] There would still be some misalignment in relation to requirements for insurance contracts and some other matters relating to financial instruments for which the FRC is awaiting further implementation experience before considering alignment.

hours of time on average per affected accountant in addition to the familiarisation time we assumed under Option 3, so six hours in total.

182. We note that the assumption of two additional hours of familiarisation time is an average across all affected accountants. The time taken is likely to be lower for those accountants who already use IFRS Accounting Standards, given that the proposals are closely aligned to IFRS 16 but with some simplifications. However, these accountants will still need to familiarise themselves with the simplifications. Accountants who do not use IFRS Accounting Standards are likely to require more time for familiarisation. Some accountants may develop training materials that allow others to familiarise themselves more efficiently with the requirements.

183. Total familiarisation costs are shown in Table 5.26 and amount to approximately £43.7 million for the UK and Republic of Ireland. As a simplifying assumption, we assume these costs will be incurred in the first year of reporting in alignment with the new standards.

Table 5.26: Estimated one-off familiarisation costs under Option 4a compared to Option 1 (2024 prices. Figures have not been discounted)

	Affected accountants	Additional average hours per accountant	Total hours	Cost per hour (£)	Total additional costs (£m)	Costs from Option 3 (£m)	Total costs (£m)
UK	178,967	2	357,934	36.33	13.0	26.0	39.0
Republic of Ireland	21,661	2	43,322	36.33	1.6	3.1	4.7
Total	**200,628**		**401,256**		**14.6**	**29.2**	**43.7**

Source: FRC calculations
Note: Totals may not add up due to rounding.

One-off costs to entities in scope for new systems and processes

184. Under Option 4a, entities in scope will incur the one-off costs quantified under Option 2, the additional one-off costs associated with changes to IFRS 15-aligned revenue recognition quantified under Option 3 (see Tables 5.16 and 5.17), and additional one-off costs due to the adoption of IFRS 16-aligned lease accounting.

185. Entities applying FRS 102 will need to account for their leases in a different way. We expect the prevalence of leases (proportion of entities with one or more leases) to vary depending on the size of the entities in scope. We have assumed it ranges from 21% to 80%, with larger entities more likely to have leases. The assumptions for micro-entities and small and medium-sized entities have been informed by the findings of the *Longitudinal Small Business*

Survey 2022: businesses with employees[67] conducted by the Department for Business and Trade in 2022. The survey indicates that 21%, 38% and 52% of micro, small, and medium-sized employers, respectively, use leasing or hire purchase as a form of financing. A report by Oxford Economics[68] on the use of leasing amongst SMEs in Europe contains similar findings. For large entities, we considered the European Commission's *Survey on the Access to Finance of Enterprises (SAFE) 2022*.[69] This survey found that 38% of large entities (from a survey of 5,520 firms) specified that leasing or hire purchase was not relevant to their firm, either in the past or being considered for use in the future. We have used this data (implying that leasing is relevant to 62% of large-sized entities) to inform our assumption for the prevalence of leases for large entities in the impact assessment[70] and have considered some caveats of the data. Firstly, the survey does not include entities from the UK[71] and evidence from Leaseurope[72] may suggest that leasing in the UK is more prominent than other similar-sized economies in Europe. Secondly, in the consultation stage impact assessment, we had assumed that the prevalence of leases for large entities was 100% and we did not receive any responses to the contrary. Considering the evidence and applying judgement, we have assumed that the prevalence of leases for large entities is 80%.

186. We have also assumed that the cost of implementing changes to systems and processes for entities in scope will vary according to their size. For micro-entities and small and medium-sized entities with one or more leases, we have assumed it will require five, 10, and 20 hours respectively of professional time. The cost for large entities is assumed to be £16,750 per entity on average, based on the figure calculated by Europe Economics in their *Ex ante Impact Assessment of IFRS 16*.[73] The estimated cost for large entities is significantly larger than that for micro-entities and small and medium-sized companies because it is assumed that, on average, large entities will need to invest in new IT systems to deal with the new accounting requirements and smaller entities will not. The Europe Economics report, upon which our estimate for large entities is based, noted that IT and changes to accounting systems accounted for around 90% of the estimated total one-off compliance costs for those entities.

[67] Department for Business and Trade (August 2023), *Longitudinal Small Business Survey: SME Employers (businesses with 1-249 employees) – UK, 2022*, Table 59, available at https://www.gov.uk/government/statistics/small-business-survey-2022-businesses-with-employees.
[68] Oxford Economics (2015), *The Use of Leasing Amongst European SMEs*, Figure 7, page 18, available at https://leasingsolutions.bnpparibas.com/wp-content/uploads/sites/4/2016/01/leaseeurope_report.2966.pdf.
[69] European Commission (2022), *Data and surveys – SAFE, Results 2022 – Results by business characteristics*, Table 28, available at https://single-market-economy.ec.europa.eu/access-finance/data-and-surveys-safe_en.
[70] By applying the calculation 1 – 0.38, to give us an estimated prevalence of leases of 62% for large entities.
[71] The European Commission's SAFE report includes data for the Republic of Ireland, however this data is not disaggregated for different business sizes. Therefore, we have assumed the prevalence of leases for large-sized entities in the Republic of Ireland is the same as assumed for the UK.
[72] Leaseurope (2021), *Key Facts and Figures*, available at https://www.leaseurope.org/_flysystem/s3?file=Statistics/Facts%20and%20Figures/LeaseuropeF%26F_21.pdf.
[73] This is based on the one-off average cost per company calculated by Europe Economics for entities with <€500m turnover. See Europe Economics (2017), *Ex ante Impact Assessment for IFRS 16*, Table 1.1, available at https://www.efrag.org/Assets/Download?assetUrl=%2Fsites%2Fwebpublishing%2FProject%20Documents%2F269%2FIFRS%2016%20-%20Europe%20Economics%20-%20Ex%20ante%20Impact%20Assessment%20%2822%20February%202017%29.pdf. We take the top band, convert it using an exchange rate of £1 = €1.14 and inflate it using the Bank of England Inflation Calculator.

Table 5.27: Assumptions on prevalence of leases (proportion of entities with one or more leases) and implementation costs by size of entities in scope (2024 prices. Figures have not been discounted)

Entity size	Prevalence of leases	Assumed average one-off costs per entity with one or more leases (£)
Micro	21%	182
Small	38%	363
Medium	52%	727
Large	80%	17,640

Source: FRC calculations

187. In Tables 5.28 and 5.29 we show the total estimated one-off costs relating to changes to systems and processes to enable compliance with IFRS 16 principles in the UK and Republic of Ireland by size of the entity. Total one-off costs are estimated to be approximately £208.5 million in the UK and Republic of Ireland. As a simplifying assumption, we assume these costs will be incurred in the first year of implementation.

Table 5.28: Estimated one-off costs for new systems and processes to enable compliance with new lease accounting principles for entities in the UK (2024 prices. Figures have not been discounted)

Entity size	Number of entities	Prevalence of leases	Affected entities	Assumed average initial costs per entity (£)	Total initial costs (£m)
Micro (FRS 105)	Not in scope				
Micro (FRS 102)	1,226,882	21%	257,645	182	46.8
Small	309,642	38%	117,664	363	42.7
Medium	30,701	52%	15,965	727	11.6
Large	6,556	80%	5,245	17,640	92.5
Total	**1,573,781**		**396,519**		**193.7**

Source: FRC calculations
Note: Totals may not add up due to rounding.

Table 5.29: Estimated one-off costs for new systems and processes to enable compliance with new lease accounting principles for entities in the Republic of Ireland (2024 prices. Figures have not been discounted)

Entity size	Number of entities	Prevalence of leases	Affected entities	Assumed average initial costs per entity (£)	Total initial costs (£m)
Micro (FRS 105)	Not in scope				
Micro (FRS 102)	97,542	21%	20,484	182	3.7
Small	14,918	38%	5,669	363	2.1
Medium	2,686	52%	1,397	727	1.0
Large	567	80%	454	17,640	8.0
Total	**115,713**		**28,004**		**14.8**

Source: FRC calculations
Note: Totals may not add up due to rounding.

One-off costs for new procedures for auditors

188. The one-off costs to develop new audit procedures to address new revenue recognition principles included within Option 3 are also relevant for Option 4a. In addition, auditors may also need to develop new audit procedures that address the new accounting requirements for leases.

189. We have assumed that the costs incurred to develop new audit procedures that address the new accounting requirements for leases will be the same as for revenue recognition. This is because the activities involved in developing new audit procedures, including the way in which this is approached by larger audit firms and by other groupings or third-party providers, are expected to be largely the same. The total estimated cost is £1.3 million in the UK and £0.2 million in the Republic of Ireland. As a simplifying assumption, we assume this will all be incurred in the first year of implementation.

One-off costs of audit per audited entity

190. Auditors will need to audit entities' transition to the new lease accounting approach. This may lead to an increase to the cost of audit of each entity that has leases.

191. The new accounting requirements for leases are different to the existing requirements and may require the auditor to carry out additional audit work in the year in which audited entities transition, resulting in one-off costs.

192. Micro-entities and small companies are not required to obtain an audit, therefore we have assumed that these costs will only be incurred in respect of entities that are medium-sized and large.

193. We have assumed that the additional cost of auditing financial information related to leases in the first year of implementation is 5% of the additional cost incurred by entities in preparing it. The total estimated one-off cost is £6.0 million in the UK and £0.5 million in the Republic of Ireland. As a simplifying assumption, we assume this will all be incurred in the first year of implementation.

Ongoing costs of Option 4a

Ongoing costs to entities in scope for misalignment between domestic and international accounting standards

194. As discussed above, because domestic reporting standards will be broadly aligned to recent developments in international standards the ongoing cost of misalignment (both the cost of supplementary analysis and of awareness of multiple standards) is assumed to be zero, being a 100% reduction compared to Option 1.

Ongoing costs to entities in scope for new systems and processes

195. Under Option 4a, we expect entities in scope to incur ongoing costs associated with the change to an IFRS 16-like approach to lease accounting, as any new leases are entered into. We have assumed that the ongoing cost for new systems and processes to entities will vary according to their size, as a proxy for how many leases an entity has. As shown in Table 5.30, we have assumed the additional time taken to operate systems and processes ranges from one hour for micro-entities to five hours for medium-sized entities. For large entities, rather than assuming the number of hours we have assumed ongoing cost to be £2,760 per entity per year based on the figure calculated by Europe Economics in the *Ex ante Impact Assessment of IFRS 16*.[74]

[74] This is based on the ongoing average cost per company calculated by Europe Economics for entities with <€500m turnover. See Europe Economics (2017), Ex ante Impact Assessment for IFRS 16, Table 1.1, available at https://www.efrag.org/Assets/Download?assetUrl=%2Fsites%2Fwebpublishing%2FProject%20Documents%2F269%2FIFRS%2016%20-%20Europe%20Economics%20-%20Ex%20ante%20Impact%20Assessment%20%2822%20February%202017%29.pdf. We take the mid-point of the range and convert it using an exchange rate of £1 = €1.14 and inflate it using the Bank of England Inflation Calculator.

Table 5.30: Assumptions on the additional time taken to operate systems and processes to enable compliance with new lease accounting requirements, by entities in scope (2024 prices)

Entity size	Average hours per entity (if applicable)	Cost per hour (£)	Average ongoing additional costs per entity per year (£)
Micro (FRS 102)	1	36.33	36
Small	2	36.33	73
Medium	5	36.33	182
Large	N/A	N/A	2,760

Source: FRC calculations

196. The estimated additional annual ongoing costs to entities to operate new systems and processes associated with new lease accounting principles is approximately £35.3 million in the UK and £2.7 million in the Republic of Ireland. Tables 5.31 and 5.32 show costs by entity size, for the UK and the Republic of Ireland.

Table 5.31: Estimated additional annual ongoing costs to operate new systems and processes to enable compliance with new lease accounting principles for entities in the UK (2024 prices. Figures have not been discounted)

Entity size	Number of entities	Prevalence of leases	Affected entities	Average ongoing additional costs per entity per year (£)	Total annual ongoing costs (£m)
Micro (FRS 105)	Not in scope				
Micro (FRS 102)	1,226,882	21%	257,645	36	9.4
Small	309,642	38%	117,664	73	8.5
Medium	30,701	52%	15,965	182	2.9
Large	6,556	80%	5,245	2,760	14.5
Total	**1,573,781**		**396,519**		**35.3**

Source: FRC calculations

Table 5.32: Estimated additional annual ongoing costs to operate new systems and processes to enable compliance with new lease accounting principles for entities in the Republic of Ireland (2024 prices. Figures have not been discounted)

Entity size	Number of entities	Prevalence of leases	Affected entities	Average ongoing additional costs per entity per year (£)	Total annual ongoing costs (£m)
Micro (FRS 105)	Not in scope				
Micro (FRS 102)	97,542	21%	20,484	36	0.7
Small	14,918	38%	5,669	73	0.4
Medium	2,686	52%	1,397	182	0.3
Large	567	80%	454	2,760	1.3
Total	**115,713**		**28,004**		**2.7**

Source: FRC calculations
Note: Totals may not add up due to rounding.

Ongoing costs of audit per audited entity

197. Auditors will need to audit entities' ongoing compliance with the new lease accounting approach. This may lead to an increase to the ongoing cost of audit of each entity that has leases, compared to the cost of auditing under the old requirements.

198. The new accounting requirements for revenue recognition and leases are different from the existing requirements and may require the auditor to carry out additional audit work when auditing ongoing compliance.

199. Micro-entities and small companies are not required to obtain an audit, therefore we have assumed that these costs will only be incurred in respect of entities that are medium-sized and large.

200. We have assumed that the additional cost of auditing financial information related to leases on an ongoing basis is 5% of the additional cost incurred by entities in preparing it. Our analysis shows that the cost of this will not be significant, with a total estimated one-off cost of £0.9 million in the UK and £0.1 million in the Republic of Ireland.

Ongoing costs to entities that breach the small company threshold

201. The changes to lease accounting could lead to some companies that currently qualify for the small companies regime breaching the relevant size threshold once their right-of-use assets are included on their balance sheets. This is because the recognition of additional right-of-use assets will increase a company's *balance sheet total*, which is one of the criteria that is relevant in the entity size threshold assessment. If a company is no longer classified as small, it will no longer qualify for an audit exemption, and will therefore incur additional costs if it has not previously obtained an audit.

202. This additional cost is a direct cost due to the breach in thresholds not being avoidable when right-of-use assets are included in affected small entities' balance sheets.

203. To estimate the proportion of small entities that will be impacted, we searched for companies that already exceeded one of the two other headline small entity criteria[75] and tested whether adding an average value of leases[76] for small-sized entities to the balance sheet would cause that company to also breach the *balance sheet total* criterion. The estimation arrived at after applying the test is an approximation for several reasons (for example there are other criteria beyond the three headline criteria) but we believe it to be a reasonable approach. As a result of the test, we have estimated that approximately 3% of small companies could breach the threshold when the average value of leases was added to their balance sheet. Companies breaching a threshold must do so for two years before they are reclassified as a medium-sized entity, therefore this ongoing cost will be incurred in years three to five of our analysis. We have assumed that the average incremental cost of being audited is £4,978, based on savings reported when the small company audit exemption was introduced.[77]

204. We use the same assumptions for the Republic of Ireland to calculate the ongoing cost for small entities that may breach the threshold for audit exemption. We show total ongoing costs for the UK and the Republic of Ireland in Table 5.33.

[75] Turnover of £10.2 million or less or 50 employees or fewer. The other criterion is £5.1 million or less balance sheet total.
[76] The average value of leases was calculated using a data subscription to which the FRC has access.
[77] The Department for Business, Energy and Industrial Strategy (BEIS) stated in *The Impact of Exempting Small Companies from Statutory Audit* in 2017 that the average saving reported by those taking up audit exemptions was £3,960 per company per annum. This cost was inflated using the Bank of England inflation calculator to obtain the value in 2024 prices. This gave us an estimate of £4,978. For more information see: *The Impact of Exempting Small Companies from Statutory Audit*, page 65, available at https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/583972/audit-exemption-small-companies-impact.pdf.

Table 5.33: Estimated additional annual ongoing cost (year 3-5) for entities that require an audit when breaching the small entity threshold in the UK and the Republic of Ireland (2024 prices. Figures have not been discounted)

Entity size	Number of affected entities	Estimated proportion of entities breaching threshold	Estimated number of small entities breaching threshold	Cost of an annual audit (£)	Total annual ongoing costs (£m)
UK	117,664	3%	3,530	£4,978	17.6
Republic of Ireland	5,669	3%	170	£4,978	0.8
Total	**123,333**		**3,700**		**18.4**

Source: FRC calculations
Note: Totals may not add up due to rounding.

Total cost of Option 4a

205. In Tables 5.34 and 5.35 we present the total one-off and additional annual ongoing costs of Option 4a compared to the counterfactual (Option 1). Table 5.36 presents the annual reduction in the costs of misalignment that form part of the benefit of Option 4a (the only part we have been able to monetise) compared to the counterfactual.

Table 5.34: Estimated one-off costs under Option 4a compared to Option 1 (2024 prices. Figures have not been discounted)

	UK (£m)	Republic of Ireland (£m)	Total (£m)
New systems and processes to enable compliance with IFRS 15 principles	166.8	12.0	178.7
New systems and processes to enable compliance with IFRS 16 principles	193.7	14.8	208.5
Changes to systems and processes (from option 2)	14.7	0.8	15.5
New processes for auditors	1.3	0.2	1.5
Audit of transition to new revenue and lease accounting principles	6.0	0.5	6.5
Familiarisation costs	39.0	4.7	43.7
Total	**421.4**	**33.1**	**454.4**

Source: FRC calculations
Note: Totals may not add up due to rounding.

Table 5.35: Estimated total additional annual ongoing costs under Option 4a compared to Option 1 (2024 prices. Figures have not been discounted)

	UK (£m)	Republic of Ireland (£m)	Total (£m)
New systems and processes to enable compliance with new revenue recognition principles	12.3	0.7	13.0
New systems and processes to enable compliance with new lease accounting principles	35.3	2.7	37.9
Audit of financial information prepared using new revenue and lease accounting principles	0.9	0.1	0.9
Audit cost for entities that breach small company threshold (Year 3, 4 and 5)	17.6	0.8	18.4
Total (Year 1 and 2)	**48.4**	**3.5**	**51.9**
Total (Year 3, 4, 5)	**66.0**	**4.3**	**70.3**

Source: FRC calculations
Note: Totals may not add up due to rounding.

Table 5.36: Estimated total annual reduction of costs under Option 4a compared to Option 1 (2024 prices. Figures have not been discounted)

	UK (£m)	Republic of Ireland (£m)	Total (£m)
Costs of supplementary analysis	5.7	0.4	6.1
Costs of awareness of multiple standards	2.6	0.3	2.9
Total	**8.3**	**0.7**	**9.1**

Source: FRC calculations
Note: Totals may not add up due to rounding.

206. We also calculate the net present value[78] for Option 4a compared to the counterfactual (Option 1), over a five-year appraisal period, which is £704.5 million for the UK and Republic of Ireland. This results in an annual equivalent cost to entities in scope of £140.5 million per year in the UK.

Table 5.37: Total cost of Option 4a over Option 1 over a five-year appraisal period (2024 prices, NPV and EANDCB)

	NPV, 5-yr period (£m)	EANDCB (excluding Republic of Ireland) (£m)
Option 4a	704.5	140.5

Source: FRC calculations
Notes: Equivalent Annual Net Direct Cost to Business is calculated only for the UK. Totals may not add up due to rounding.

[78] The net present value represents putting the interventions with different time spans and benefit–cost profiles on to a common present value basis and applying a discount rate. HM Treasury (2022), *The Green Book (2022)*, page 46, https://www.gov.uk/government/publications/the-green-book-appraisal-and-evaluation-in-central-government.

Option 4b

Overview of Option 4b

207. Under Option 4b, the FRC would make the same amendments as under Option 4a but amendments to incorporate IFRS 16 principles for lease accounting, with appropriate simplifications, would also be made to FRS 105.

Expected impacts on main affected groups: Option 4b

208. In addition to the affected entities of Option 4a, this option would also have further effects for entities currently preparing financial statements in accordance with FRS 105. Those entities would be required to implement and operate, on an ongoing basis, systems and processes (for example new accounting software or methods to collect data) that enable them to apply the amended standards.

Assessment of monetised cost of option

209. Under Option 4b, the FRC would be making:

    (a) incremental improvements and clarifications to its financial reporting standards (as in Option 2);

    (b) major changes to align domestic standards to IFRS 15 principles (as in Option 3); and

    (c) major changes to align domestic standards to IFRS 16 principles.

210. All costs estimated under Option 4a would also apply to this option. However, under Option 4b the proposed amendments that incorporate IFRS 16 lease accounting principles, with appropriate simplifications, would also apply to micro-entities using FRS 105, leading to additional costs for those micro-entities. As micro-entity accounts do not need to be audited there is no additional cost of audit for this option in comparison to Option 4a.

One-off costs of Option 4b: changes from Option 4a

211. In Tables 5.38 and 5.39 we estimate the total one-off costs for new systems and processes by entity size under Option 4b. Compared to Option 4a, the total cost is higher by £59.7 million in the UK and £4.7 million in the Republic of Ireland due to the additional row *Micro (FRS 105)* in each table.

Table 5.38: Estimated one-off costs for new systems and processes to enable compliance with new lease accounting principles for entities in the UK under Option 4b (2024 prices. Figures have not been discounted)

Entity size	Number of entities	Prevalence of leases	Affected entities	Assumed average initial costs per entity (£)	Total initial costs (£m)
Micro (FRS 105)	1,566,095	21%	328,880	182	59.7
Micro (FRS 102)	1,226,882	21%	257,645	182	46.8
Small	309,642	38%	117,664	363	42.7
Medium	30,701	52%	15,965	727	11.6
Large	6,556	80%	5,245	17,640	92.5
Total	**3,139,876**		**725,399**		**253.4**

Source: FRC calculations
Note: Totals may not add up due to rounding.

Table 5.39: Estimated one-off costs for new systems and processes to enable compliance with new lease accounting principles for entities in the Republic of Ireland under Option 4b (2024 prices. Figures have not been discounted)

Entity size	Number of entities	Prevalence of leases	Affected entities	Assumed average initial costs per entity (£)	Total initial costs (£m)
Micro (FRS 105)	124,511	21%	26,147	182	4.7
Micro (FRS 102)	97,542	21%	20,484	182	3.7
Small	14,918	38%	5,669	363	2.1
Medium	2,686	52%	1,397	727	1.0
Large	567	80%	454	17,640	8.0
Total	**240,224**		**54,151**		**19.6**

Source: FRC calculations
Note: Totals may not add up due to rounding.

212. All the other one-off costs of Option 4a are included in Option 4b without amendment.

Ongoing costs of Option 4b: changes from Option 4a

213. In Tables 5.40 and 5.41 we estimate the additional annual ongoing costs to operate new systems and processes to enable compliance with new lease accounting principles under Option 4b. Compared to Option 4a, the total cost is higher by £11.9 million in the UK and £0.9 million in the Republic of Ireland due to the additional row *Micro (FRS 105)* in each table.

Table 5.40: Estimated additional annual ongoing costs to operate new systems and processes to enable compliance with new lease accounting principles for entities in the UK under Option 4b (2024 prices. Figures have not been discounted)

Entity size	Number of entities	Prevalence of leases	Affected entities	Average ongoing additional costs per entity per year (£)	Total annual ongoing costs (£m)
Micro (FRS 105)	1,566,095	21%	328,880	36	11.9
Micro (FRS 102)	1,226,882	21%	257,645	36	9.4
Small	309,642	38%	117,664	73	8.5
Medium	30,701	52%	15,965	182	2.9
Large	6,556	80%	5,245	2,760	14.5
Total	**3,139,876**		**725,399**		**47.2**

Source: FRC calculations
Note: Totals may not add up due to rounding.

Table 5.41: Estimated additional annual ongoing costs to operate new systems and processes to enable compliance with new lease accounting principles for entities in the Republic of Ireland under Option 4b (2024 prices. Figures have not been discounted)

Entity size	Number of entities	Prevalence of leases	Affected entities	Average ongoing additional costs per entity per year (£)	Total annual ongoing costs (£m)
Micro (FRS 105)	124,511	21%	26,147	36	0.9
Micro (FRS 102)	97,542	21%	20,484	36	0.7
Small	14,918	38%	5,669	73	0.4
Medium	2,686	52%	1,397	182	0.3
Large	567	80%	454	2,760	1.3
Total	**240,224**		**54,151**		**3.6**

Source: FRC calculations
Note: Totals may not add up due to rounding.

214. All the other ongoing costs of Option 4a are included in Option 4b without amendment.

Total costs of Option 4b

215. In Table 5.42 we show the net monetised costs of Options 4a and 4b and differences between the two.

Table 5.42: Estimated one-off and additional annual ongoing net monetised costs under Options 4a and 4b (2024 prices. Figures have not been discounted)

	Option 4b (£m)	Option 4a (£m)	Difference (£m)
One-off net costs	518.9	454.4	64.5
Annual ongoing net costs	60.7	42.8	17.9

Source: FRC calculations
Note: Totals may not add up due to rounding.

216. We also calculate the net present value[79] for Option 4b compared to Option 1, over a five-year appraisal period, which is £852.6 million for the UK and Republic of Ireland, resulting in an annual equivalent cost to entities in scope of £169.5 million per year in the UK.

Table 5.43: Total cost of Option 4b over Option 1 over a five-year appraisal period (2024 prices, NPV and EANDCB)

	NPV, 5-yr period (£m)	EANDCB (excluding Republic of Ireland) (£m)
Option 4b	852.6	169.5

Source: FRC calculations
Note: Totals may not add up due to rounding.

[79] The net present value represents putting the interventions with different time spans and benefit–cost profiles on to a common present value basis and applying a discount rate. HM Treasury (2022), *The Green Book (2022)*, page 46, https://www.gov.uk/government/publications/the-green-book-appraisal-and-evaluation-in-central-government.

Non-monetised costs of options considered

217. In addition to the monetised costs of each option presented, we have also identified a number of key cost impacts which we have not monetised.

218. Under Options 1 and 2, and to a lesser extent Option 3, the costs of a relative decrease in the quality of financial information prepared in accordance with the FRC's financial reporting standards compared to international frameworks have not been quantified. Potentially, this could contribute to decreased investor and stakeholder confidence in the financial information provided by entities (and lower allocative efficiency of their investments as a result).

219. Under Options 3, 4a and 4b, users of financial statements who are not accountants may need to familiarise themselves with the changes to revenue and lease accounting requirements. In some cases, the amount or timing of transactions recognised could change without any alteration in the underlying economics. This could require analysis to understand and compare the new financial information to previous information. The improved disclosure requirements, and transitional requirements, introduced by the amendments should provide meaningful information to users to enable this analysis. Given that the proposals will align information presented in financial statements more closely with financial information already presented in accordance with IFRS Accounting Standards, these costs will be limited to users who are not already familiar with IFRS Accounting Standards. We assume that detailed analysis of financial statements would be carried out by accountants, whose familiarisation costs are already included above, therefore any additional costs to other users are not expected to be substantive overall.

220. Under Options 4a and 4b, we have monetised the ongoing costs to entities that would breach the small company threshold and no longer qualify for an audit exemption. By doing so, we have considered direct impacts in relation to the financial statements, but not other impacts. We acknowledge that there could be other impacts that arise once right-of-use assets are included on entity balance sheets as a result of changes to Section 20 of FRS 102: for example, when regulations apply differently based on size criteria that reference an entity's financial statements, an entity's costs of compliance may increase.

Summary of costs of options considered

221. In Table 5.44 we show the net present value[80] of all options considered in this consultation stage impact assessment against the counterfactual, Option 1.

222. Option 4b is the most expensive option. We also note that there is a relatively large increase in total costs in present value terms between Options 3 and 4a.

Table 5.44: Net present value of each option compared to Option 1 – UK and Republic of Ireland (2024 prices, discounted values)

	Option 2 (£m)	Option 3 (£m)	Option 4a (£m)	Option 4b (£m)
One-off costs	30.1	225.0	454.4	518.9
Annual ongoing costs	-1.4	39.6	250.0	333.6
Total	**28.7**	**264.5**	**704.5**	**852.6**

Source: FRC calculations
Note: Totals may not add up due to rounding.

223. In Table 5.45 we show the Equivalent annual net direct cost to business (EANDCB) (calculated only for the UK) of all options considered in this consultation stage impact assessment against the counterfactual, Option 1.

224. The EANDCB increases as we move from Option 2 to Option 4b, with the largest increase occurring between Option 3 and Option 4a.

Table 5.45: Equivalent annual net direct cost to business in the UK (EANDCB) (2024 prices, discounted values)

	Option 2 (£m)	Option 3 (£m)	Option 4a (£m)	Option 4b (£m)
EANDCB (excluding Republic of Ireland)	5.7	52.8	140.5	169.5

Source: FRC calculations
Note: Totals may not add up due to rounding.

225. Although in absolute terms the costs of adopting the amended financial reporting standards are large, particularly the costs relating to the adoption of IFRS 16 principles for leases (Options 4a and 4b), these new reporting standards would apply to a very large number of entities as shown in Tables 5.46 and 5.47.

[80] The net present value represents putting the interventions with different time spans and benefit–cost profiles on to a common present value basis and applying a discount rate. HM Treasury (2022), *The Green Book (2022)*, page 46, https://www.gov.uk/government/publications/the-green-book-appraisal-and-evaluation-in-central-government.

Table 5.46: Number of entities in scope under each option considered in the UK

Components of each option	Option 2	Option 3	Option 4a	Option 4b
Incremental improvements	3,139,876	3,139,876	3,139,876	3,139,876
IFRS 15 principles	-	3,139,876	3,139,876	3,139,876
IFRS 16 principles	-	-	1,573,781	3,139,876

Source: FRC calculations

Table 5.47: Number of entities in scope under each option considered in the Republic of Ireland

Components of each option	Option 2	Option 3	Option 4a	Option 4b
Incremental improvements	240,224	240,224	240,224	240,224
IFRS 15 principles	-	240,224	240,224	240,224
IFRS 16 principles	-	-	115,713	240,224

Source: FRC calculations

6. Key risks and uncertainties

226. In this section we describe some of the key risks and uncertainties relating to the analysis presented in this impact assessment:

(a) Our estimates of the direct cost of compliance under the options considered are based on key assumptions about the number of affected entities, the number of affected accountants and the number of affected auditors. We based those assumptions on the latest official data from public sources at the time of drafting, such as: Companies House, the Department for Business and Trade, the FRC, the Central Statistics Office, the Companies Registration Office, Irish Auditing & Accounting Supervisory Authority (IAASA), the UK Endorsement Board, the Charity Commission for England and Wales, the Office of the Scottish Charity Regulator (OSCR), and the Charity Commission for Northern Ireland.

(b) Our estimates of the direct cost of compliance are also affected by assumptions relating to the time taken to carry out specific tasks. Because of limited published evidence relevant to the proposed amendments to financial reporting and no additional information from consultation responses, in many instances judgement has been used to form assumptions to facilitate the analysis of one-off and ongoing costs. Our cost estimates are particularly sensitive to changes in the estimates of the time taken to make changes to systems and processes to enable compliance with the new revenue accounting principles (Option 3) and new lease accounting principles (Options 4a and 4b), and to operate those systems and processes on an ongoing basis.

(c) For Option 3, we did not find reliable data sources for estimating the prevalence of revenue from contracts with customers by entity size in the UK and Republic of Ireland. Therefore, we have had to rely on judgement to form assumptions. Our cost estimates for this option are particularly sensitive to this assumption.

(d) For Options 4a and 4b, we found up-to-date data sources for estimating the prevalence of leases by entity size, which have been used to update the assumptions that were included in the consultation stage impact assessment. However, we have still had to rely on some judgement to form the assumption for the prevalence of leases for large entities because the data source used to inform the prevalence of leases for large entities does not include the UK (see paragraph 185). Our cost estimates for this option are particularly sensitive to these assumptions.

(e) We have not been able to monetise the great majority of the benefits which we expect to arise from the amendments considered in this impact assessment. While we think we have identified most of the benefits which might arise from our options, most of these benefits are difficult to monetise and will depend to a large extent on the specific circumstances of each entity affected, particularly for amendments relating to the new lease accounting requirements.

7. Wider impacts

Economic impacts

Competition impact test

227. The Competition and Markets Authority (CMA) publishes guidance[81] to help policymakers assess the impact their proposals might have on competition. Based on this guidance, we consider that the measures included in this impact assessment will affect markets where products and services are supplied by private and public organisations, including the provision of audit and accountancy services in the UK and Republic of Ireland.

228. The CMA also recommends undertaking an initial competition screening, based on the five questions below, to see whether an in-depth assessment of the impact on competition is warranted:

   (a) Will the measure directly or indirectly limit the number or range of suppliers?

   (b) Will the measure limit the ability of suppliers to compete?

   (c) Will the measure limit suppliers' incentives to compete?

   (d) Will the measure affect consumers' ability to engage with the market and make choices that align with their preferences?

   (e) Will the measure affect suppliers' ability and/or incentive to introduce new technologies, products or business models?

229. Our assessment is that the answer to all of the questions above is *no*. Therefore, we consider that an in-depth assessment is not needed because our measures will have no substantive impact on competition. We also note that no concerns about competition were raised by respondents to FRED 82.

[81] Table 1 of *Competition Assessment Guidelines*, available at https://www.gov.uk/government/publications/competition-impact-assessment-guidelines-for-policymakers.

Small and micro businesses assessment (SaMBA)

Background to differential treatment for different-sized entities in financial reporting standards

230. The requirement that the directors of a company must not approve accounts unless they are satisfied that they give a true and fair view is set out in company law and applies equally to all sizes of entity; the FRC cannot change or supersede that requirement. The established approach in the FRC's financial reporting standards for differential application based on business size is derived from the approach taken in company law:[82]

    (a) micro-entities may adopt FRS 105 *The Financial Reporting Standard applicable to the Micro-entities Regime*. Compliance with that framework is presumed in law to result in true and fair financial statements, therefore reducing the need for judgement;

    (b) micro-entities and small entities may choose to adopt the small entities regime and apply Section 1A of FRS 102, which is part of FRS 102 but provides tailored presentation and disclosure requirements and one minor recognition and measurement difference; and

    (c) medium-sized and large entities, and smaller entities not choosing (a) or (b), apply FRS 102 in full.

231. The thresholds for qualifying for different FRC financial reporting standards in the UK are based on those set out in the *Companies Act 2006* and *The Large and Medium-sized Limited Liability Partnerships (Accounts) Regulations 2008* (SI 2008/1913) (and whose thresholds are applied to other legal forms of entity as if they are a company incorporated under company law). An entity must satisfy two of the three headline thresholds set out in Table 7.01, but there are also various exclusions, and different thresholds for parent companies, that may affect whether an entity qualifies for a specific tier.

Table 7.01: UK thresholds for company size

	Turnover	Balance sheet total	Number of employees
Micro	Not more than £632,000	Not more than £316,000	Not more than 10
Small	Not more than £10.2 million	Not more than £5.1 million	Not more than 50
Medium	Not more than £36 million	Not more than £18 million	Not more than 250
Large			Not Micro, Small or Medium

Source: *Companies Act 2006* sections and 382 and 465

[82] Sections 381 to 384B (Companies subject to the small companies' regime) and sections 465 to 467 (Companies qualifying as medium-sized) of the *Companies Act 2006*.

232. The FRC uses the thresholds set out in law because requirements regarding the form and content of annual accounts are set out in company law (and equivalent law for LLPs and other entities). The proposals in this impact assessment do not modify the law, and the FRC is not empowered to do so.

233. As set out in Section 5, Table 5.01 there are currently 3.1 million affected entities that are small and micro businesses in the UK (98.8% of the total). The UK government is currently conducting a review[83] to consider whether current company size thresholds (micro, small, medium and large) that determine certain non-financial reporting requirements, and the preparation and filing of accounts with Companies House, remain appropriate. Any changes in these thresholds would be expected to change the proportion of entities in each category.

Overarching approach

234. If financial information is to be useful, it must be relevant and faithfully represent what it purports to represent. The usefulness of financial information is enhanced if it is comparable, verifiable, timely and understandable. In general, these characteristics are independent of the size of the business the financial information relates to and this is reflected in the general approach taken in the FRC's standards:

(a) The same recognition and measurement requirements (that is, how specific transaction types are accounted for) typically apply to small entities applying Section 1A of FRS 102 and larger entities applying FRS 102 in full. This is because we believe that there should in principle be no difference in the accounting for transactions of the same substance, whether they are entered into by small entities or by larger entities. This will support growth and competitiveness by removing a barrier to comparability between small and larger companies and preventing them from having to change accounting policies as they grow.

(b) The recognition and measurement requirements of FRS 105 are simplified versions of those in FRS 102, adapted when necessary to reflect the legal requirements of the micro-entities regime and simplified further to reflect the size and nature of micro-entities.

(c) The presentation and disclosure requirements (that is, the form of the financial statements and the level of description about the transactions entered into) of Section 1A are reduced compared to full FRS 102.

(d) The presentation and disclosure requirements for micro-entities are set out in company law and FRS 105 reflects the legal requirements, which are significantly simpler than those of FRS 102.

235. As set out in Table 7.01, measures of business size typically include thresholds of *turnover* and *balance sheet total*. Most changes to the financial reporting standards will affect one of those measures and this is partly why the FRC does not typically provide different approaches for smaller entities (other than for micro-entities, which are subject to a distinct

[83] https://www.gov.uk/government/calls-for-evidence/smarter-regulation-non-financial-reporting-review-call-for-evidence

legal framework): because doing so may provide scope for a business to avoid other regulatory requirements through accounting choices.

Background to a SaMBA

236. The *Better regulation framework: interim guidance*[84] requires departments and regulators to consider the scope of proposed measures and their impacts, including any disproportionate effects on small and micro businesses and how these can be mitigated.

237. The FRC is not exempting small and micro businesses from the measures assessed in this impact assessment, because, as set out above, the legal framework requires those entities to prepare financial statements that meet certain requirements. The expected benefits (Section 4) would not be realised if small and micro businesses were exempted or allowed to implement the measures to a different timetable, because the realisation of the benefits depends on being able to compare an entity to other entities, which is most effective when entities are applying the same financial reporting standards. However:

    (a) financial reporting standards are applied to the financial transactions that an entity undertakes. Therefore, when an entity undertakes fewer transactions, or no transactions of a particular nature, that entity will naturally be less impacted by these changes compared to an entity that undertakes many transactions; and

    (b) aspects of the measures apply differently to small and micro businesses to ensure that they will not be disproportionately impacted. Our specific considerations relating to small and micro businesses are set out below. These considerations take into account the legal context, explained in the *Background to differential treatment for different sized entities* section above.

Small businesses

Recognition and measurement

238. At present, the only recognition and measurement exemption for small entities applying Section 1A of FRS 102 relates to directors' loans, with small entities otherwise following the same requirements as entities applying FRS 102 in full. The FRC considered whether any further recognition and measurement exemptions or simplifications should be granted to small entities. The FRC concluded that no additional recognition and measurement exemptions or simplifications should be applied.

Presentation and disclosure

239. The financial statements of a small entity are required to provide a true and fair view, as are the financial statements of larger entities. Company law specifically requires certain disclosures, which are fewer than those applicable to larger entities, but otherwise leaves preparers to apply judgement to determine what must be disclosed in order to provide a true and fair view.

[84] Department for Business, Energy & Industrial Strategy (2018), *Better regulation framework: interim guidance*, available at https://www.gov.uk/government/publications/better-regulation-framework.

240. The FRC was previously prevented from specifically requiring further disclosures of small entities due to the EU Accounting Directive. Following the UK's exit from the European Union the FRC has made amendments (as part of the incremental improvements in Option 2) to require additional specific disclosures of UK small entities. This is expected to reduce the amount of judgement required by preparers of UK small entity financial statements in determining which disclosures are needed in order to give a true and fair view, and therefore make it easier to apply the FRC's financial reporting standards.

Micro businesses

Recognition and measurement

241. FRS 105 currently applies the recognition and measurement requirements of FRS 102, adapted when necessary to reflect the legal requirements of the micro-entities regime and simplified further to reflect the size and nature of micro-entities.

242. We have considered whether the amendments to FRS 102 are relevant to FRS 105 and, if so, whether they should be reflected in FRS 105:

    (a) We considered whether to align accounting for leases to IFRS 16 principles in FRS 102 only (Option 4a), or in both FRS 102 and FRS 105 (Option 4b). We decided not to introduce the requirements into FRS 105. This has reduced the impact on micro businesses compared to other businesses, by enabling them to avoid the costs of that approach.

    (b) Other amendments to recognition and measurement requirements of FRS 102, to the extent that the accounting requirements are relevant, have been included, and simplified further when possible, for the purposes of FRS 105. In particular, the five-step model for revenue recognition that we have introduced into FRS 105 is significantly simplified compared to the requirements in FRS 102, which will reduce the impact on micro businesses compared to other businesses.

Presentation and disclosure

243. The presentation and disclosure requirements for micro-entities are set out in company law so the FRC is unable to alter them.

Overall benefits for small and micro businesses

244. In general, we think that the nature of the benefits that will accrue to small and micro businesses will not be significantly different to those of the measures as a whole (as set out in Section 4) because small and micro businesses make up 98.8% of the total number of affected entities. However, aspects of the proposals may have specific beneficial implications for smaller businesses, for example:

    (a) the changes made to Section 1A specifically affect small entities, by reducing the judgement required to determine which disclosures should be made in order to meet the legal requirement to give a true and fair view. This is expected to make it easier for preparers to identify the disclosures that need to be made, and in turn may also result

in an increase in the overall quality and consistency of UK small entity financial statements; and

(b) providing revenue accounting principles for small entities and micro-entities and lease accounting principles for small entities that are consistent with those provided for larger entities is expected to support growth, because smaller entities will not need to change their accounting approach as they grow, and may be able to more easily seek debt or equity financing from investors that are familiar with accounting information consistent with that produced by larger entities.

In addition, some aspects of the proposals are not relevant for smaller businesses, for example:

(c) many small companies can take an audit exemption, so in many cases the potential reduction to the cost of auditing financial statements that is set out in Section 4 as a potential benefit of the proposals will not be relevant; and

(d) some requirements, including the new lease accounting principles that are based on IFRS 16, have not been incorporated into FRS 105. This means that micro-entities that apply that standard will not benefit from the associated quality and comparability improvements.

Overall costs falling on small and micro businesses

245. In Tables 7.02 and 7.03 we calculate the direct cost of complying with the amendments under our options for small and micro businesses in the UK.

246. The figures presented are based on the following assumptions:

(a) Tables 5.01 and 5.02 set out the estimated number of entities affected in the UK and Republic of Ireland respectively. In total, 98.8% (3,339,590 entities) are small- or micro-sized. The statistics used to compile the estimates in Section 5 split entities into size categories and it is assumed that those size categories map to the definitions of small and micro businesses for the purpose of a SaMBA.

(b) 18.8% of affected accountants work for small or micro businesses. This figure is derived from Table A of *Business population estimates for the UK and regions 2022*[85] which indicates that out of 22,656,000 employees working for businesses in the UK private sector that are employers, 38.6% of those work for businesses that employ fewer than 49 people. We think that small and micro businesses are more likely to engage an external accountant that works for an accounting firm that is medium-sized or large than to directly employ an affected accountant, and therefore we assume that the proportion of affected accountants working directly for small and micro businesses is half that of overall UK employees.

247. The above assumptions have been used to apportion the monetised costs calculated in Section 5 between small and micro businesses and other businesses. Tables 7.02 and 7.03

[85] Department for Business, Energy & Industrial Strategy (2022), *Business population estimates for the UK and regions 2022*, available at https://www.gov.uk/government/statistics/business-population-estimates-2022/business-population-estimates-for-the-uk-and-regions-2022-statistical-release-html.

show estimates of the total equivalent net annual direct cost to business of each option, and the portion applicable to small and micro businesses.

Table 7.02: Equivalent annual net direct cost to small and micro businesses in the UK (2024 prices, discounted values)

UK	EANDCB (£m)	Of which affecting small and micro businesses (£m)	Percentage (%)
Option 1	8.3	6.1	73%
Option 2	5.7	2.9	51%
Option 3	52.8	41.9	79%
Option 4a	140.5	67.5	48%
Option 4b	169.5	92.3	54%

Source: FRC calculations
Note: Totals may not add up due to rounding.

Table 7.03: Equivalent annual net direct cost to small and micro businesses in the Republic of Ireland (2024 prices, discounted values)

Republic of Ireland	EANDCB (£m)	Of which affecting small and micro businesses (£m)	Percentage (%)
Option 1	0.7	0.5	64%
Option 2	0.5	0.2	36%
Option 3	3.8	2.5	65%
Option 4a	10.3	4.5	44%
Option 4b	12.9	6.5	50%

Source: FRC calculations
Note: Totals may not add up due to rounding.

248. As the tables above show, we expect approximately 48% of the costs in the UK of the amendments from Option 4a (the implemented option) to be borne by small and micro businesses, which make up approximately 99% of the total number of businesses affected. For the Republic of Ireland, the estimated proportion of the costs of the amendments falling on small and micro businesses is 44%. Due to the large number of small and micro-entities which will be affected by the amendments (3,102,619 in the UK and 236,971 in the Republic of Ireland), we do not expect those entities to be significantly disproportionately affected by the FRS 102 and FRS 105 amendments. Those entities with more numerous and/or complex transactions are likely to be more affected than entities with fewer and/or less complex

transactions; those entities that are less affected are likely to incur lower one-off and annual ongoing costs.

Medium-sized business regulatory exemption assessment

249. On 10 October 2022, the UK government issued new guidance asking government departments and regulators to consider the case for exemption of *medium-sized businesses* (defined for these purposes as those with 50 to 499 employees) from the requirements of new regulatory measures.[86] Departments and regulators should now consider the case for exemption of medium-sized businesses in addition to that for small and micro businesses via the completion of an impact assessment. The starting assumption of a medium-sized business regulatory exemption assessment is to also exempt medium-sized businesses.[87]

250. As set out above, the thresholds for applying different FRC financial reporting standards are derived from those set out in company law. The definition of *medium-sized businesses* for the purpose of this medium-sized business regulatory exemption assessment is not the same as *companies qualifying as medium-sized* within the meaning of the *Companies Act 2006* (see Table 7.01).

251. There is no existing mechanism to apply the FRC's financial reporting standards differently to entities that are *medium-sized businesses* as defined (that is, with 50 to 499 employees). Under the *Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008* (SI 2008/410), medium-sized and large companies (within the *Companies Act 2006* definitions) are grouped together. As a result, medium-sized entities are required to prepare financial statements that give a true and fair view, and so prepare financial statements in accordance with the FRC's financial reporting standards. Excluding those entities from improvements to those standards, and to the resulting financial reporting, is impracticable.

252. The FRC's assessment is therefore that there is no practicable mechanism to exempt businesses with fewer than 500 employees from the measures set out in this impact assessment.

Other wider impacts

253. Local Authorities will be impacted to the extent they have subsidiary companies that apply the FRC's financial reporting standards. These impacts are included in the estimated costs and benefits of each option above.

[86] Department for Business, Energy & Industrial Strategy (October 2022), *Medium sized business regulatory exemption assessment: supplementary guidance*, available at https://www.gov.uk/government/publications/better-regulation-framework/medium-sized-business-regulatory-exemption-assessment-supplementary-guidance--2.

[87] The policy applies to:

(a) New regulatory proposals starting the development process from 3 October 2022; and

(b) Regulations that are undergoing regulatory review from 3 October 2022 – the question of amendments to the threshold for existing exemptions should be considered, and for regulations with no exemptions, the introduction of exemptions should be considered as set out above.

The policy does not apply to any proposals which have already gone through, or are currently going through, the *Better Regulation Framework* and RPC scrutiny process as at 3 October 2022.

254. No known other wider impacts from the measures[88] assessed in this impact assessment have been reported or observed. No concerns were raised about these issues by respondents to FRED 82.

Potential trade implication of measures

255. The measures considered in this impact assessment present no foreseeable impact to international trade and investment. No concerns were raised about this issue by respondents to FRED 82.

[88] Other wider impacts include: environmental concerns, direct health and well-being concerns, human rights concerns, requirements for changes to the justice system and rural proofing concerns.

Appendix 1: Note on the Republic of Ireland

256. The FRC is a prescribed body for issuing accounting standards in the Republic of Ireland, as set out in the *Companies Act 2014 (Accounting Standards) (Prescribed Body) Regulations 2018* (SI No. 84 of 2018).

257. The FRC's financial reporting standards apply in both the UK and the Republic of Ireland. Throughout the standards the requirements are tailored such that they can be applied by entities in each legal jurisdiction. For example, they:

    (a) include appendices that explain how references to UK legislation in the standard correspond to Republic of Ireland legislation;

    (b) include requirements written separately in an Irish context, where UK and Irish law are different and entities in each jurisdiction take differing approaches; and

    (c) reflect that the source of adopted IFRS is different in the two jurisdictions (UK-adopted international accounting standards in the UK and EU-adopted IFRS in the Republic of Ireland).

258. The analysis set out in this impact assessment refers to the UK and the Republic of Ireland. We considered the impact of our proposals on the entities affected and, in line with our own policies, we have assessed the impact in both the UK and the Republic of Ireland.

259. We have not prepared a separate impact assessment for the Republic of Ireland. Wherever possible we have provided a separate assessment of costs for the UK and the Republic of Ireland. The benefits are expected to be similar in both the UK and the Republic of Ireland. The only area where our assessment is different for the UK and the Republic of Ireland is in relation to the equivalent annual net direct cost to business. This is a UK requirement under the *Better Regulation Framework* and therefore we exclude costs for the Republic of Ireland when quantifying it in Section 5.

260. Generally, we have assumed that our proposals have a similar impact on similar-sized entities of a similar type, irrespective of whether they are incorporated in the UK or Republic of Ireland. We have also assumed that there will be similar, proportional, impacts on individual affected accountants and audit firms in each jurisdiction because the regulatory environment is very similar.

261. Because of the smaller number of entities in scope in the Republic of Ireland compared to the UK, the net present value cost over the five-year appraisal period is lower for the Republic of Ireland.

262. Table A1.01 sets out the estimated total costs of each of the options for the Republic of Ireland, compared to the UK. For Option 4a, the cost for the Republic of Ireland is 6.8% of the total cost.

Table A1.01: Net present value cost of each option – UK and Republic of Ireland (2024 prices, discounted figures)

	Option 1 (£m)	Option 2 (£m)	Option 3 (£m)	Option 4a (£m)	Option 4b (£m)
UK	38.9	26.5	246.8	656.4	792.2
Republic of Ireland	3.4	2.3	17.8	48.1	60.4
Total	**42.3**	**28.7**	**264.5**	**704.5**	**852.6**
% Republic of Ireland	8.1%	7.9%	6.7%	6.8%	7.1%

Source: FRC calculations
Note: Totals may not add up due to rounding.

263. Table A1.02 sets out the estimated net present value for the Republic of Ireland converted to euros.

Table A1.02: Net present value cost of each option converted to euros – Republic of Ireland (2024 prices, discounted figures)

	Option 1 (€m)	Option 2 (€m)	Option 3 (€m)	Option 4a (€m)	Option 4b (€m)
Republic of Ireland	4.0	2.6	20.5	55.5	69.6

Source: FRC calculations based on Bank of England data[89]
Note: Totals may not add up due to rounding.

[89] The exchange rate is provided by the Bank of England exchange rate database. The quarterly average spot exchange rate on 31 December 2023 was £1 = €1.1537.

Appendix 2: Changes made to the impact assessment following the consultation

264. As part of FRED 82, the FRC published a consultation stage impact assessment.[90] Respondents to FRED 82 were asked to comment on the assumptions, sources of relevant data, and the costs and benefits that had been identified and assessed in the consultation stage impact assessment. In particular, feedback was invited on: the assumptions used for quantifying costs under each of the proposed options; any evidence that might help the FRC quantify the benefits identified or any benefit that might arise from the options proposed which the FRC had not identified; and appropriate data sources to use to refine the assumption of the prevalence of leases by entity size.

265. We have made several changes to this impact assessment following consultation. Some of the changes are the result of more recent data being published. Other changes are in response to feedback from consultation, which is discussed in the associated Feedback Statement, or additional research we have undertaken.

266. Table A2.01 below shows a bridge of the net present value (NPV) cost and estimated annual net direct costs to business (EANDCB) of our implemented option from consultation stage to the final impact assessment. The changes relate to:

    (a) **Update of data inputs**: we have updated the basis for our assumptions about the number of affected entities and their size, the number of affected accountants and auditors, and the average hourly cost of accountants' time to the most recently available data.

    (b) **Changes to assumptions**: we have updated some of our assumptions to reflect stakeholder feedback and other data sources. In particular, as a result of newly-released data from a recent DBT survey[91] on the use of leasing for micro-entities, small and medium-sized entities, we have revised downward our estimate of the prevalence of leasing. In addition, we have revised downward the estimate of the prevalence of leasing for large entities, reflecting new statistics published by the European Commission. We have also revised downward our assumptions on the time taken to develop new audit procedures.

    (c) **Changes to direct cost of compliance**: in response to stakeholder feedback, we have added estimates for the ongoing costs associated with the changes to revenue accounting principles, and for the costs incurred to audit entities that are reclassified to a larger size category as a result of leases being brought on balance sheet and, therefore, can no longer access the small company audit exemption.

[90] See FRC (2022), FRED 82 Consultation stage impact assessment, available at https://www.frc.org.uk/fred82.
[91] *Longitudinal Small Business Survey 2022*, available at https://www.gov.uk/government/statistics/small-business-survey-2022-businesses-with-employees.

Table A2.01: NPV cost and EANDCB for Option 4a at consultation and final impact assessment

Changes to the impact assessment	NPV cost, 5-yr period, (£m)	EANDCB (excluding Republic of Ireland), (£m)
Consultation Impact Assessment	**636.9**	**123.1**
Update of data inputs	+ 51.4	+ 11.4
Changes to assumptions	- 87.6	- 16.7
Changes to direct costs of compliance	+ 103.8	+ 22.7
Final Impact Assessment	**704.5**	**140.5**

Source: FRC calculations
Note: Totals may not add up due to rounding.

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