

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

April 2023

## About Charity Finance Group

Charity Finance Group (CFG) is the charity that works to improve the financial leadership of charitable organisations, promote best practice, inspire change and help organisations to make the most of their funds so they can deliver the biggest possible impact for the communities and beneficiaries they serve. CFG has over 1450 members and collectively they manage over £21 billion in charitable funds – around a third of the entire charity sector's income.

We have a Technical Accounting Forum that includes individuals who work in charities, are trustees of charities and professional advisors / auditors. The Forum is chaired by Pesh Framjee our Special Advisor. We have arranged and participated in round tables on FRED82 and our comments below are informed by these and other consultations.

## Question 2: Concepts and pervasive principles

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

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

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

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

FRS 105 only applies to incorporated entities and charities are specifically excluded from applying FRS 105. Broadly we would agree with the proposal to align FRS 102 and FRS 105 with the 2018 conceptual framework, although there are several important caveats that we have discussed in answer to the next question.

***This FRED, and IASB/ED/2022/1, propose to continue using the extant definition of an asset for the purposes of Section 18 Intangible Assets other than Goodwill and the extant definition of a liability for the purposes of Section 21 Provisions and Contingencies of FRS 102. This is consistent with the approach taken in IAS 38 Intangible Assets and IAS 37 Provisions, Contingent Liabilities and Contingent Assets which use the definitions of an asset and a liability from the IASB's 1989 Framework for the Preparation and Presentation of Financial Statements.***

***Do you agree with this approach? If not, why not?***

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

Section 2.36 proposes the definition of an asset as 'a present economic resource controlled by the entity as a result of past events.' With an economic resource defined in 2.37 as 'a right that has the potential to produce economic benefits.' Similarly, a liability is defined in relation to an economic resource as 'a present obligation of the entity to transfer an economic resource as a result of past events.' Sections 2.38 and 2.46 include a list of the different forms this might take, including rights that may or may not correspond to another party, but is always expressed in terms of financial benefit.

However, for the charity sector there may not always be a financial benefit. In many instances it could be the benefit to the activities of the charity. It is with this in mind that we would seek an amendment to include a reference to the service potential created as an example of economic benefit which would offer a more complete and appropriate approach for charities. This is not without precedent as this would mirror language used in the FRS 102 Charities SORP which defines economic benefit as follows "Economic benefits refers to the value derived from an asset in terms of cash flows generated, its cash flow generating capacity, or the service potential created, or costs saved or avoided by having control over the asset."<sup>1</sup>

## Question 6: Leases

***FRED 82 proposes to revise the lease accounting requirements in FRS 102 to reflect the on-balance sheet model from IFRS 16 Leases, with largely-optional simplifications aimed at ensuring the lease accounting requirements in FRS 102 remain cost-effective to apply. An***

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<sup>1</sup> [0a4311bd-da96-a551-dccb-d841156ac3bc \(charitycorp.org\)](https://www.charitycorp.org/0a4311bd-da96-a551-dccb-d841156ac3bc)

***entity electing not to take these proposed simplifications will follow requirements closely aligned to those of IFRS 16, which is expected to promote efficiency within groups.***

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

Fred 82 proposes a number of significant changes for lessees based on the on-balance sheet model from IFRS16 'leases' with some simplifications. This would have a significant impact on charities who have a large number of leases, including those with a substantial charity retail footprint.

A notable simplification under FRED 82 from IFRS16 is to simplify this to the lessee's 'obtainable borrowing rate'. From FRED82- 20.36 "A lease component may contain a government grant or, for a public benefit entity, a non-exchange transaction if, for example, the lease payments are significantly below market rents. An entity shall apply Section 24 Government Grants or, for a public benefit entity, paragraphs PBE34.64 to PBE34.74 Incoming Resources from Non-Exchange Transactions of Section 34 Specialised Activities to account for the difference between the lease payment." We have concerns that in many instances it would be difficult for charities to determine the uplift of the market rate.

Fred PBE20.53 also states 'Public benefit entities may choose to replace the lessee's obtainable borrowing rate with the rate of interest otherwise obtainable on their deposits held with financial institutions'. We would support this change helps to make things simpler for the preparers of accounts and also for auditors of accounts.

We are concerned that under FRED82, charities would need to bring all leases on to the balance sheet, including those with an element of non-exchange transaction, which includes those under market value or with minimal cost where there is otherwise no 'market' such as in the case of some peppercorn rents. We seek further clarity on this matter in the updated draft.

Where such changes proposed apply to all charities that have to show 'fair and true accounts', a lot of smaller charities would be required to make changes with minimal financial impact. We believe that this would place a disproportionate regulatory burden on smaller organisations, already struggling. We believe there should be an exemption for smaller charities, as there is for commercial companies under FRS 105.

## **Question 7: Revenue**

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

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

FRED 82 provides definitions of a contract, a promise, and of a customer:

Promise (in a contract with a customer) “An obligation to transfer a good or service (or bundle of goods or services) that is distinct”

Contract: “An agreement between two or more parties that creates enforceable rights and obligations.”

Customer: “A party that has contracted with an entity to obtain goods or services that are an output of the entity’s ordinary activities in exchange for consideration.”

Due to the nature of some PBE contracts, we note that they may prima facie not meet the ‘enforceable rights and obligations’ threshold due to ‘escape clauses’. For example, many PBE contracts state that the meeting of the obligation is dependent on funds being available. Further clarity is needed on ‘enforceable rights and obligations’ section to address our concern.

In considering the definition of a customer we note that in the charity sector goods or services don’t always pass to a customer they pass to a third-party community organisation or NGO. For instance, you might have a funder who is the person who funds the organisation and the charity supplies goods to a third party. Income would still be required to be recognised. Clarification in the application of the definition of ‘customer’ to such circumstances is needed.

There are many instances for PBEs where it can be difficult to determine the distinction between a grant or a contract when applying the wording as drafted. So, it would be very helpful for FRED 82 to provide clarification on the distinction between a grant and a contract.

- **Concerns with allocating the transaction price to the promises in the contract.**

Charities will have to allocate which element of the price relates to which element of the performance obligations/ promises in the contract.

There are many examples where this would create difficulties for the charity sector, with an air ambulance charity being an illustrative example – the charity would not be able to identify the different elements because the information remains confidential to the supplier/provider and is not shared by the entity to whom they contract to provide helicopters, related insurance and the helicopter maintenance.

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

We believe some aspects of FRED 82 will need further clarification. Either via the FRS or the charities SORP. While FRED 82 requires a contract to have commercial substance, there is no definition of commercial substance, The risk, timing or amount of the entity’s future cash flows is expected to change as a result of the contract.

## Question 8: Effective date and transitional provisions

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

The proposed effective date for the amendments set out in FRED 82 is accounting periods beginning on or after 1 January 2025, with early application permitted provided that all amendments are applied at the same time. The timeframes involved will mean that to digest and incorporate changes to the SORP wording, before consulting the sector on the subsequent SORP draft, make further amends as required and finalise the text will leave very little time to train and support the sector. Given the practicality of completing the implementation of these changes into the SORP for it then to be consulted upon and then training undertaken to support charities. An additional 12 months would allow the sector to prepare appropriately.

## Question 9: Other comments

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

Many in the charity sector have expressed concerns about the number of comparatives included in their accounts, which do not provide useful information to the readers of charity accounts, and in many instances may detract from them, making it more difficult for the typical reader to discern the information most pertinent to them. These include but are not limited to, full comparatives when using fund accounting which is a peculiarity for charities. We would welcome further opportunities to discuss with the FRC removing disclosures which are specific to charities, and the ability of the charities SORP making bodies to create specific rules for charity specific disclosures and comparatives.