FRS 102 Periodic review

To whom it may concern,

Thank you for the opportunity to comment on the proposals within FRED 82.

To begin, I want to clarify that the opinions and observations that follow are solely my own and are not associated with any of my current or past employers.

My main areas of interest are how these updates will affect the requirements for SMEs in making the annual accounts understandable and valuable to end users and how accountants will practically achieve the processes required to meet the new disclosure requirements.

I have had prior experience auditing IFRS 16 and IFRS 15 with large companies. Questions that I have either no comments on or don't have relevant experience I have not included. In particular, I have not responded to the detailed areas of fair value and expected credit loss.

Question 1: Disclosure
Do you have any comments on the proposed overall level of disclosure required by FRS 102?

Overall the level of disclosure seems to be at the right level.

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

Yes

Question 2: Concepts and pervasive principles

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

Yes, it makes sense to update the conceptual framework to keep it relevant and aligned.

Question 4: Expected credit loss model

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

Yes agreed. The credit loss model per IFRS 9 requires significant work and estimates that would be beyond the ability of lots of SMEs and would not provide substantial benefits to the business or stakeholders.

Question 6: Leases

FRED 82 proposes to revise the lease accounting requirements in FRS 102 to reflect the on-balance sheet model from IFRS 16 Leases, with largely-optional simplifications aimed at ensuring the lease accounting requirements in FRS 102 remain cost-effective to apply. An entity electing not to take these proposed simplifications will follow requirements closely aligned to those of IFRS 16, which is expected to promote efficiency within groups. Do you agree with the proposals to revise Section 20 of FRS 102 to reflect the on-balance sheet lease accounting model from IFRS 16, with simplifications? If not, why not? Have you identified any further simplifications or additional guidance that you consider would be necessary or beneficial?

I agree that this is suitable for Medium and Large entities that will benefit from having their accounts in line with IFRS. However, I don't think it is suitable or proportionate for small entities applying FRS102 1A even with simplifications. Small businesses often have extremely limited accounting resources and would hence be very reliant upon external accounting firms for help in this area. It is likely that this will simply be done as a year-end compliance exercise and fail to deliver value to the business but will come as an additional expense. Hence, I think that applying these requirements to 1A entities presents a significant barrier to entry for small businesses, which are a key pillar of the UK economy.

Right-of-use assets and liabilities are not easily understood by users of the accounts as they do not directly represent a physical asset. I think this could lead to accounts that are harder to understand by members of the public. In this sense, these proposals are likely to lead to less valuable accounts.

Cost-effective measures for SMEs that want to implement the on-balance sheet model will most likely depend on accounting and bookkeeping software being able to automate these entries. Manually computing discounted cashflows of the leases and subsequent unwinding can be a complicated calculation and as the figures have no relation to day-to-day business any errors may not be immediately apparent.

The simplifications allowing the obtainable borrowing rate or Gilt rate to be used is greatly appreciated key as many small firms may not have a suitable on-hand figure for their incremental borrowing rate. This may benefit from further information clarifying what figure should be used when the lease term does not match a specific gilt. For example, should a 7-year lease use the 5yr Gilt rate, 10-year Gilt rate or some average of the two?

I understand that the FRD wants to avoid different measurement basis in FRS 102 for those applying 1A but I think that this proposal is likely to cost SMEs proportionally more and will have a negative impact on the understandability of the accounts. If the current proposals are kept I think it would be beneficial to have a later effective date for small businesses to allow time for accounting and bookkeeping software to take the majority of the extra burden.

Question 7: Revenue

FRED 82 proposes to revise the revenue recognition requirements in FRS 102 and FRS 105 to reflect the revenue recognition model from IFRS 15 Revenue from Contracts with Customers. The revised requirements are based on the five-step model for revenue recognition in IFRS 15, with simplifications aimed at ensuring the requirements for revenue in FRS 102 and FRS 105 remain cost-effective to apply. Consequential amendments are also proposed to FRS 103 and its accompanying Implementation Guidance for alignment with the principles of the proposed revised Section 23 of FRS 102.
Do you agree with the proposals to revise Section 23 of FRS 102 and Section 18 of FRS 105 to reflect the revenue recognition model from IFRS 15, with simplifications? If not, why not? Have you identified any further simplifications or additional guidance that you consider would be necessary or beneficial?

I agree.

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?

Agree in principle for medium and large businesses but that small businesses should have a later effective date to allow them to adopt technology that will make the transition easier.

I am not sure that early adoption will be practical as the FRS102 IXBRL taxonomy will also need to be updated to include the relevant tags for the new disclosure requirements so that the accounts can be filled with Companies House and HMRC electronically.

FRED 82 proposes transitional provisions (see paragraphs 1.35 to 1.60 of FRS 102 and paragraph 1.11 of FRS 105). In respect of leases, FRED 82 proposes to permit an entity to use, as its opening balances, carrying amounts previously determined in accordance with IFRS 16. This is expected to provide a simplification for entities that have previously reported amounts in accordance with IFRS 16 for consolidation purposes, promoting efficiency within groups. Do you agree with this proposal? If not, why not?

Agreed and would go further to suggest that balances calculated under IFRS 16 would also be acceptable going forwards so that entities in IFRS groups can keep the figures aligned and prevent any drift due to differences in accounting standards either intended or accidental.

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

I think this would be suitable for entities applying for full FRS102.

Question 9: Other comments

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

I appreciate the changes in making the Going concern disclosures clearer for small companies.

I also recently discovered an inconsistency between FRS102 and the Companies Act that I think would benefit from being cleared up. The particular disclosure requirement is:

3.24

An entity shall disclose the following in the notes:
the legal form of the entity, its country of incorporation and the address of its registered office (or principal place of business, if different from the registered office); and

However, Companies Act 396 (d) has a requirement to always disclose: ‘the address of the company’s registered office’

It seems FRS102 conflicts with the Companies Act as 3.24 implies that the registered office address is not required if the principal place of business address is given however the Companies Act always requires the registered address. I would appreciate it if FRS102 could be updated in line with the Companies Act to clear up this inconsistency.