Saffery Champness
CHARTERED ACCOUNTANTS

71 Queen Victoria Street,
London EC4V 4BE

T: +44 (0)20 7841 4000
F: +44 (0)20 7841 4100
info@saffery.com
www.saffery.com

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Accounting and Reporting Policy team
Financial Reporting Council
8th Floor
125 London Wall
London
EC2Y 5AS
ukfrsperiodicreview@frc.org.uk

Dear Sir/Madam

**FRED 82 - Draft amendments to FRS 102 and other FRSs - Periodic review**

We welcome the opportunity to comment on the proposed amendments to FRS 102 Draft amendments to FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* and other FRSs.

We respond to the specific queries within the consultation document below.

**Question 1: Disclosure**

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

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

Generally, we consider the level of disclosures proposed to be proportionate to the needs of users albeit with the publication of this Exposure Draft we consider this to be a missed opportunity to address certain matters which have been problematic for some users and preparers of FRS 102 financial statements.

In relation to the proposed revenue disclosures, the simplifications from full IFRS are welcome. The disaggregation of revenue appears to be simplified from that in IFRS 15 which is helpful but the addition of "may disaggregate revenue on an alternative basis" is likely to cause difficulties in preparation and disagreement as there are no examples or guidance on when it might be appropriate that 'an alternative basis' would better reflect the nature of the entity's performance. It also seems that the "significant judgements in the application of this standard" section of IFRS 15 has not been included within the proposals yet might be assumed to be included via application of paragraph 8.6 "information about judgements"? Some clarity here would be helpful.

In respect of leasing disclosures these do not seem to be significantly reduced from those within IFRS 16 but seem appropriate to give sufficient information over the extent of leasing arrangements. The disclosures

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included in paragraph 20.87 appear unusual and those included in paragraph 55 of IFRS 16 would be more appropriate than those included within FRED 82. By their definition short term leases have a lease term of less than 12 months so a maturity profile for these leases does not make sense.

In respect of other disclosures, we support the inclusion of the "encouraged" disclosures contained in Appendix E of Section 1A as required disclosures for UK companies. Anything that can be done to achieve clarity for smaller entities is helpful. We have specific comments as follows:

- We would have appreciated some clarity around the disclosure of directors' remuneration which is an area where there is divergence in interpretation of "not under normal market conditions".
- The addition of the sentence requiring paragraph 33.9 and 33.14 disclosures for related party transactions is confusing as there would then appear to be overlap with what is already included in paragraph AC 35.
- The inclusion of share-based payment disclosures is helpful except that paragraph 26.18b seems excessive for small entities.

In addition, we would ask the FRC to consider the issue of disclosures in charity accounts. Under paragraph 3.14 of FRS 102 an entity is required to present comparative information in respect of the preceding period for all amounts presented in the current period's financial statements. Due to the number of additional analyses and breakdowns of charitable income and expenditure there is a risk that current year information may be obscured by the sheer number and size of some of the notes within charity financial statements. We would ask the FRC to consider whether a carve-out may be appropriate for entities applying the Charity SORP from presenting comparative information for certain notes. This is not something that can be remedied within the SORP as the requirement is directly from FRS 102 to present comparatives.

**Question 2: Concepts and pervasive principles**

The 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 Standard 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 21018 Conceptual Framework in a proportionate manner.

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

This FRED, and IASB/ED/2022/1, propose to continue using the extant definition of an asset for the purposes of Section 18 *Intangible Assets other than Goodwill* and the extant definition of a liability for the purposes of Section 21 *Provisions and Contingencies* of FRS 102. This is consistent with the approach taken in IAS 38 *Intangible Assets* and IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* which use the definitions of an asset and a liability from the IASB's 1989 Framework for the Preparation and Presentation of Financial Statements. Do you agree with this approach? If not, why not?

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

We do not have any issues with aligning Section 2 of FRS 102 with the 2018 Conceptual Framework. This is consistent with the proposed amendments to the third edition of the IFRS for SMEs although we note that other than for consistency with IFRS and IFRS for SMEs we had no specific criticism of the existing Concepts and Pervasive Principles section of FRS 102 that needed to be remedied by replacement.

We assume that the replacement is either in full or not at all but do make the following comments about specific matters.

There are some matters which we see as useful additions to the *Concepts and Pervasive Principles* section:

- The introduction of explanation around materiality and how information may be obscured. This will assist conversations with preparers around more qualitative information within the financial statements.
- Paragraph 2.61 specifically states that items cannot be recognised within the statement of financial position if they do not meet the definition of an asset even if they result from applying the notion of the “matching concept” for measuring profit or loss. This is helpful clarity as there can often be confusion in this area.

There are other matters where guidance has been removed or for which the addition is unclear:

- In referring to the qualitative characteristics, the existing guidance refers to the consistency of accounting policies which is a helpful addition that would be lost under the proposed revisions.
- The definition of an asset seems to be appropriate, and the examples are helpful however it would be useful to understand the circumstances envisaged by paragraph 2.39 b (the creation of a right where another party has no practical ability to act in a manner inconsistent with its customary practices, published policies or specific statements).
- The definition of income has been amended but has now lost the explanation that income encompasses both revenue and gains which was useful to achieve clarity in this area.
- The recognition criteria currently in FRS 102 is much clearer than under the proposals. Having the two criteria of probability of benefit and reliable measurement is well understood and practical. The proposed replacement is unnecessarily complicated.
- The derecognition guidance seems overly complex and we would question whether paragraphs 2.70 and 2.71 are required.
- The explicit reference to the accruals basis has been removed despite this being a helpful statement to distinguish from cash accounting.

We agree with the proposal 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 to ensure consistency with IFRS.

**Question 3: Fair value**

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

Do you agree with the proposed consequential amendment to Section 26 *Share-based Payment* of FRS 102 to retain the extant definition of fair value for the purposes of that section? If not, why not?

We agree with the alignment of FRS 102 with guidance in IFRS 13 *Fair Value Measurement*. This is an area where smaller companies struggle so explicit guidance about valuation techniques is welcome.

We agree with the consequential amendment to Section 26 to retain the extant definition of fair value for the purposes of that section. This is well understood and applied.

**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 be presented in a later FRED. Do you agree with this approach? If not, why not?

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

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

We agree that now is not the time to introduce the expected credit loss model of IFRS 9 *Financial Instruments* in addition to the amendments proposed within this FRED. The other proposed changes are significant enough and the quality of adoption may be reduced if the credit loss model is also introduced at the same time. It should be noted that all three amendments (revenue, credit loss model and leases) were not introduced into IFRS at the same time allowing preparers time to focus their efforts on incremental adoption. This also helped the financial statements be more understandable to users as they were not dealing with multiple adjustments for different changes.

We would support deferral until the next periodic review of FRS 102 rather than bringing the model in via another FRED before that point. This will give time for the revenue and leasing changes to settle and give more time for the IASB's post implementation review of IFRS 9. We consider that changes should only be implemented if they are to benefit the users of the accounts and it is not clear what benefits this would bring to users of FRS 102 accounts. The IFRS post implementation review of IFRS 9 plans to ask questions about the costs and benefits of applying the approach to particular transactions, such as inter-company loans. It will also consider the simplified approach for trade receivables, contract assets and lease receivables hence we believe any decision should be deferred at least until this has completed but preferably until the next periodic review.

We disagree with introducing two different models for measuring impairment of financial assets because we support a straightforward, simple approach for this standard and consider that the incurred loss model is appropriate for most entities preparing financial statements under FRS 102. The approach suggested seems overly complex and we would be concerned about:

- the impact of requiring an expected credit loss model for intercompany loans and receivables which may be difficult to apply in practice; and
- having different requirements for different types of receivables.

This would be confusing and reduce the understandability and comparability of financial statements hence we disagree with introducing a mixed model for impairment of financial assets and consequently the definition of which entities should apply an expected credit loss model is not relevant. However, we do not consider that whether an entity meets the definition of a public interest entity would be relevant to this decision; it should be based upon the complexity of the financial instrument and the activities of the entity.

**Question 5: Other financial instruments issues**

When it has reached its conclusion as to whether to align FRS 102 with the expected credit loss model, the FRC intends to remove the option in paragraphs 11.2 (b) and 12.2 (b) of FRS 102 to follow the recognition and measurement requirements of IAS 39 *Financial Instruments: Recognition and Measurement*. This intention was communicated in paragraph B11.5 of the Basis of Conclusions to FRS 102 following the Triennial Review 2017. In preparation for the eventual removal of the IAS 39 option, the FRC proposes to prevent an entity from newly adopting this accounting policy. Do you agree with this proposal? If not, why not?

Temporary amendments were made to FRS 102 in December 2019 and December 2020 in relation to interest rate benchmark reform (IBOR reform). The FRC intends to consider, alongside the future consideration of the expected credit loss model, whether these temporary amendments have now served their purpose and could be removed. Do you support the deletion of these temporary amendments? If so, when do you think they should be deleted? If not, why not?

In our experience few entities are newly electing to follow the recognition and measurement requirements of IAS 39 and we agree with the removal of this option as it does not make sense to allow an option to adopt a standard which has been replaced. However, we note this could be an issue for groups where some entities are already adopting the provisions of IAS 39 but new entities to that group would be prevented from doing so and lead to inconsistency in the group.

We consider that it is likely that by the time the amendments proposed in this consultation document become effective, the issue of IBOR reform should be resolved meaning the temporary relief will not be required. However, we do not believe that there should be a rush to delete these sections and it might be sensible to leave these amendments in until a final decision is made about the impairment provisions of IFRS 9.

**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?

Overall, we support the alignment of FRS 102 with IFRS 16 in the longer term as the proposed changes will improve comparability between companies and aid the preparation of financial statements for groups of companies where components apply IFRS. However, we note that feedback that would have been obtained through a post implementation review of IFRS 16 will not be incorporated and could result in further changes in the future. This could be avoided if changes to lease accounting requirements were introduced at a later date.

We would raise some specific issues:

- The proposed leasing changes relate to FRS 102 only and have not been extended to FRS 105, which was a decision taken based on the significant cost of implementation for small entities applying FRS 105. Section 384B(f) of the Companies Act 2006 prohibits charities from applying FRS 105 and instead they are required to follow FRS 102 and the corresponding Statement of Recommended Practice (SORP) for Charities. We therefore highlight that the significant cost implication cited as the reason for excluding the changes to lease accounting from FRS 105 will apply to small charities and may create an unnecessary burden for them where, similar to entities applying FRS 105, the cost of implementing these changes may exceed the benefits derived.

- We question the merit of giving lessees the option not to separate non-lease components from lease components within contracts as this could distort the accounting treatment, for example where contracts include provision of significant services in addition to the lease of the underlying asset or assets.

- The optional remeasurement conferred by paragraph 20.74 for changes in lease payments caused by variables such as rent reviews could lead to inconsistency with no apparent practical benefits of permitting this policy choice. We would welcome a more consistent approach.

- We note that there is no carve-out for leases between group entities whereby a subsidiary may be required to bring right of use assets onto the balance sheet for them to be removed on consolidation. This could have been a helpful expedient for some entities which would have improved efficiency within groups.

We are particularly concerned that the modified retrospective approach to transition is mandated rather than also allowing the option of fully retrospective transition. Allowing a policy choice in this area would be consistent with IFRS 16 and provide the same flexibility in terms of initial presentation, as appropriate to the users of the financial statements. The modified retrospective approach limits comparability with previous periods and other benefits associated with restatement of comparative information. For certain companies that are significantly impacted by this revision it could create confusion as opposed to improving comparability for various stakeholder groups especially when borrowing covenants including debt and gross margin ratios are impacted.

We welcome some of the practical expedients proposed:

- The portfolio application and the option to combine lease components where one constituent lease accounts for at least half of the total consideration may be particularly useful to entities with significant operating lease commitments, without compromising the information available to the users of the financial statements.

- The examples to help determine whether underlying assets are considered low value or not will be particularly useful for users and auditors alike to avoid inappropriate judgements being made.

- The determination of the lease term is an area which is likely to involve significant management judgement and is complex, but the approach proposed by FRED 82 appears logical and clear.

- We fully support the simplification of the discount rate to allow the use of the 'obtainable borrowing rate' and in rare circumstances a gilt rate. Further, the option conferred by PBE 20.53 to allow public benefit entities to use the rate of interest obtainable on deposits with financial institutions is welcomed and acknowledges most charities do not have borrowings and could otherwise spend time and money obtaining obtainable borrowing rates from lenders.

- We welcome the proposed disclosure in paragraph 20.85(a) of potential future cash outflows which are not reflected in the measurement of lease liabilities as this will provide useful information to the users of financial statements. However, given the different options that are possible in the initial measurement of the lease liability we would recommend that the type of rate being used is disclosed.

**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?

The size and complexity of entities applying FRS 102, and particularly FRS 105, are likely to be much smaller than those adopting IFRS. Further, many of the smallest businesses applying FRS 102 or FRS 105 generally have less sophisticated finance systems and less experienced finance personnel which will make adoption of the five-step model more challenging. The cost of involving external advisers to support with transition may also be significant to such organisations.

In our view, the new section would have little effect on the amount and timing of revenue recognised because many SMEs enter into relatively simple revenue contracts as opposed to those that would require long term contract accounting and therefore the more complex requirements proposed would not result in a significant change from existing practice however this would still necessitate many entities undertaking additional technical analysis to make this determination.

As we expect the outcome in many cases to result in the same amount of revenue recognised for SMEs it could be argued that the cost outweighs the benefit of this exercise. We therefore challenge the benefit of aligning the requirements of FRS 105 with IFRS 15. The FRED does not propose to extend the revised lease accounting requirements to FRS 105, a decision based upon the cost implication for these entities and we expect there to be the same significant cost of adopting IFRS 15 with little benefit for the smallest entities.



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We acknowledge that some SMEs do enter into long term and complex revenue contracts and that for these entities, the enhanced requirements proposed in the FRED would improve consistency between entities and remove GAAP differences within groups where different regimes are adopted.

To accompany the revised sections in both standards (if adopted), it would be particularly helpful to have application guidance to illustrate common examples or areas where recognition of revenue may change (or not) under the revised standards. This could be particularly useful for entities applying FRS 105 whose internal financial expertise is more likely to be limited in nature. We note that IFRS 15 includes detailed and helpful application guidance in appendix B and would suggest that similar guidance is required within FRS 102 section 23.

Overall, we support most of the simplifications and believe that the principles of IFRS 15 are appropriate as a basis for Section 23's, however we believe certain key aspects of IFRS 15 should be left unchanged to ensure consistency of application. In particular, the wording from IFRS 15:35 (criteria for recognising revenue over time) and IFRS 15:56 (variable consideration constraint) should not be amended. FRED 82 also proposes to use "promise" as the key term in section 23 of FRS 102 as opposed to IFRS which uses the term "performance obligation." For users familiar with both standards, the different terminology may lead to or cause confusion where in practice there appears to be no difference between the definitions of these two terms. In fact, IFRS defines a performance obligation as "a promise in a contract with a customer to transfer…" and FRS 102 defines a promise as "an obligation to transfer…" if the definitions are essentially interchangeable, it would seem appropriate to use the same terminology in both standards for consistency and to avoid confusion.

We also have concerns about the differences between FRED 82 and IFRS 15 in relation to the principal versus agent considerations. Whilst the approach of having three criteria which, if any are met, require treatment as principal is concise and clear, it does not allow for a principle-based consideration where the terms of an arrangement are more complex. The proposed approach is inflexible and we are concerned as to whether this will be capable of being applied effectively. We prefer the approach of IFRS 15 which is a principle-based approach (having control prior to transfer) with indicators of control. Also we are aware of circumstances where the consideration of establishing the price is critical to the assessment yet this has been excluded from the proposals.



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**Question 8: Effective date and transitional provisions**

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

FRED 82 proposes transitional provisions (see paragraphs 1.35 to 1.60 of FRS 102 and paragraph 1.11 of FRS 105).

In respect of leases, FRED 82 proposes to permit an entity to use, as its opening balances, carrying amounts previously determined in accordance with IFRS 16. This is expected to provide a simplification for entities that have previously reported amounts in accordance with IFRS 16 for consolidation purposes, promoting efficiency within groups. Do you agree with this proposal? If not, why not?

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

In respect of revenue, FRED 82 proposes to permit an entity to apply the revised Section 23 of FRS 102 on a modified retrospective basis with the cumulative effect of initially applying the revised section recognised in the year of initial application. This is expected to ease the burden of applying the new revenue recognition requirements retrospectively by removing the need to restate comparative period information. Unlike IASB/ED/2022/1, to ensure comparability between current and future reporting periods, FRED 82 does not propose to permit the revised Section 23 of FRS 102 to be applied on a prospective basis.

However, FRED 82 proposes to require micro-entities to apply the revised Section 18 of FRS 105 on a prospective basis. Do you agree with these proposals? If not, why not?

Do you have any other comments on the transitional provisions proposed in FRED 82?

Have you identified any additional transitional provisions that you consider would be necessary or beneficial? Please provide details and the reasons why.

The proposed effective date of accounting periods commencing on or after 1 January 2025 seems reasonable only if it is assumed that most entities will adopt a 'simplified' model to transition. By the time the standard is finalised (assuming this is in 2023) it will not give companies adopting a fully retrospective approach a sufficient lead time to adopt as it cannot be assumed that all entities will adopt the simplified model. It will also be important to allow SORP-making bodies the time to consult and update their own guidance which may not be achievable in time for 1 January 2025.

Some UK companies may choose to early adopt when they are already making adjustments for consolidation purposes between FRS 102 and IFRS, which we support providing that all amendments are adopted at once to minimise the impact on users and preparers of financial statements.

We consider that allowing entities to use carrying amounts previously determined in accordance with IFRS 16 a helpful simplification that is likely to be used for subsidiaries of group companies provided that there is appropriate disclosure for entities taking this option.

As above, we do not agree with the proposal to mandate the 'simplified' method of transition for leases and believe entities should be allowed the option of full retrospective adoption to:

1. improve comparability of disclosures; and



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2. help them to explain the impact of adoption better.

In the first year of adoption certain entities may want to present comparable information for various stakeholder groups especially when covenants including debt and gross margin ratios are impacted at a time when the profession wants to enhance transparency.

**Question 9: Other comments**

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

No

**Question 10: Consultation stage impact assessment**

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

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

See above

If you have any queries, or would like to discuss our comments in more detail, please do not hesitate to contact myself,

Yours sincerely

For and on behalf of Saffery Champness LLP