ICAEW
REPRESENTATION 30/23

FRED 82 DRAFT AMENDMENTS TO FRS 102 THE FINANCIAL REPORTING STANDARD APPLICABLE IN THE UK AND REPUBLIC OF IRELAND AND OTHER FRSS

Issued 27 April 2023

ICAEW welcomes the opportunity to comment on the FRED 82 Draft amendments to FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland and other FRSs published by the Financial Reporting Council (FRC) on 15 December 2022, a copy of which is available from this link.

For questions on this representation please contact our Corporate Reporting team at crf@icaew.com quoting REP 30/23.

ICAEW broadly supports the amendments proposed in FRED 82 and agrees that the proposals largely achieve the aim of consistency with IFRS Accounting Standards while seeking to ensure that requirements are proportionate to the size and complexity of the entities applying the standards. We have made some specific comments and suggestions in response to the consultation questions below.

This response of 27 April 2023 has been prepared by the ICAEW Corporate Reporting Faculty. Recognised internationally as a leading authority on corporate reporting, the faculty, through its Financial Reporting Committee, is responsible for formulating ICAEW policy on financial and non-financial reporting issues and makes submissions to standard setters and other external bodies on behalf of ICAEW. The faculty provides an extensive range of services to its members including providing practical assistance with common corporate reporting problems.

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KEY POINTS

ICAEW BROADLY SUPPORTS THE PROPOSALS IN FRED 82

1. We welcome the opportunity to comment on the proposed amendments to FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* and other FRSs set out in FRED 82. We would like to congratulate the FRC for the excellent work done as part of this periodic review to update and improve the suite of UK GAAP standards. We believe that the proposals broadly achieve the aim of consistency with IFRS Accounting Standards while seeking to ensure that requirements are proportionate to the size and complexity of the entities applying the standards.

FURTHER SIMPLIFICATIONS FOR LEASE ACCOUNTING

2. The concept that a lease commitment fulfils the definition of a liability and should be on the balance sheet is now widely accepted and should, in our view, be brought into FRS 102. We therefore agree with the proposal to revise Section 20 of FRS 102 to reflect an on-balance sheet lease accounting model.
3. We are supportive of many of the simplifications from IFRS 16 *Leases* that have been proposed in this exposure draft, particularly the additional discount rate options offered. However, we do have concerns that the way in which the FRC has proposed to align FRS 102 with IFRS 16 has resulted in a section which is very long, detailed and therefore inconsistent with the rest of the standard. We have made some suggestions in response to Question 6 below, for ways in which the FRC might approach further simplifications to Section 20.

PROPOSED IFRS 15 ALIGNMENT IS EFFECTIVE

4. We strongly support the FRC's proposed alignment of Section 23 *Revenue* with IFRS 15 *Revenue from Contracts with Customers*, and its 5-step revenue recognition model. We commend the efforts made to ensure that the proposals retain the principles of IFRS 15, whilst at the same time leaving out guidance that is less relevant to many entities reporting under FRS 102. We are very supportive of the approach taken and agree with many of the simplifications proposed. We do, however, have a number of detailed comments and suggested improvements which are set out in our response to Question 7 below.
5. We remain unconvinced by proposals to reflect the IFRS 15 revenue recognition model in FRS 105 *The Financial Reporting Standard applicable to the Micro-entities Regime*, as we believe this is disproportionate for micro-entities. We do not believe that consistency and comparability across financial reporting frameworks is a high priority for micro entity accounts. We also see this approach as being inconsistent with the decision not to introduce on-balance sheet lease accounting to FRS 105.

RECONSIDER PROPOSED CHANGES TO FRS 103

6. We do not support the proposed changes to FRS 103 *Insurance Contracts*, which have been made as consequential amendments arising from draft revised Sections 2 and 23 of FRS 102. For example, the proposed definition of a contract has been aligned to revised Section 23 but does not refer to the impact of laws and regulations when identifying a contract, despite being an area which is integral to insurance contracts. For this reason, we do not think the proposed definition is suitable for FRS 103 and it would be best to leave this unchanged at this stage. If any changes are made, then we would suggest that the definition of a contract is aligned to the definition in IFRS 17 *Insurance Contracts*. Further discussion of this matter is included in our response to Question 9 below.

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EFFECTIVE DATE CONSIDERATIONS

7. We acknowledge that, no matter what is decided regarding the effective date of the amendments, most FRS 102 reporters will not consider the impact of the changes on their accounting and reporting processes until they start to prepare their first financial statements under the revised standard. That being said, the proposed changes in this exposure draft are significant and entities facing more complex transitions would benefit from additional time to prepare adequately. Factors the FRC may wish to consider when finalising the effective date are set out in our answer to Question 8 below.

ANSWERS TO SPECIFIC QUESTIONS

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 they seek? If not, why not?

Overall support

8. Subject to our specific suggestions made throughout this response about disclosure requirements that might be added, removed or tweaked, we have no major comments on the proposed disclosure requirements in the main body of the standard. Overall, we believe the proposed level of disclosure required by FRS 102 is appropriate and sufficient to provide users of a diverse range of entities applying the standard with the information they need about the position, performance and cash flows of the business.
9. We have some specific suggestions about disclosure requirements in Section 23 *Revenue* that we believe could be removed, please see paragraph 70 below.

Section 1A disclosures

10. We are supportive of the FRC using the opportunity of the UK's exit from the European Union to increase the level of disclosure required of entities applying Section 1A of FRS 102. We agree that the FRC has a role in emphasizing that the minimum statutory requirements in law are not necessarily sufficient to provide a true and fair view. However, there are a few instances where we believe the proposed additional disclosures are inappropriate, as set out below.
11. Regardless of the required disclosures in this section of the standard, entities must still produce financial statements that provide a true and fair view and so even if a certain disclosure requirement is not mandated, it could still be disclosed if an entity were to judge it to be necessary for a true and fair view.
12. We believe the following proposed additions to Section 1A should either be removed or a full explanation provided to justify their inclusion:
    a) **Paragraph 1AC.26A – disclosures relating to deferred tax:** these disclosures are less useful than current tax disclosures of which there are currently no requirements to disclose – we would favour increased current tax rather than deferred tax disclosure requirements.
    b) **Paragraph 1AC.31C – disclosures about share-based payment transactions**: we agree that requiring disclosure of the charge, the liability, and the year-end share options is appropriate. However, paragraph 26.18(b), which essentially requires a roll

forward disclosure of the number and weighted average exercise prices of share options, seems superfluous for small entities.

13. We think clarity is needed around the proposed amendment to paragraph 1AC.35 for related party disclosures. It is not clear to us if small entities are to provide disclosures required by paragraphs 33.9-33.14 for the types of related parties listed, or fuller related party disclosures with a wider scope of related parties.

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?

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?

Further streamlining required

14. We agree with the proposal to align FRS 102 and FRS 105 with the IASB's 2018 Conceptual Framework as this is considered to be best practice and we think it is appropriate that UK GAAP is based on principles consistent with those applying to international standards. However, the amendments as drafted mean that Section 2 approximately doubles from 52 paragraphs to 112 paragraphs. In this context, we would like to see the FRC make this section far more succinct and streamlined.

15. We appreciate the difficulty in identifying paragraphs or sub-sections within Section 2 that could easily be removed or cut down. We suggest that the FRC apply a filter which considers which of the paragraphs are likely to be more useful for standard setters rather than for preparers or advisors. One example of a whole sub-section that could be filtered out on this basis would be paragraphs 2.25-2.27 on the cost constraint which is unlikely to be used by preparers at all.

16. Finally, the accruals basis for accounting is an important concept in the IASB's Conceptual Framework which we believe needs to be properly brought into Section 2 of FRS 102, since it is not specifically covered elsewhere in the standard. Paragraph 2.7 alludes to the accruals basis for accounting, however it is not adequately described or identified as such. While overall we would like to see this section reduced in length, in this specific circumstance, the wording in paragraph 1.17 of the IASB's Conceptual Framework could be a good basis for an additional paragraph in Section 2.

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?

Proposed alignment

17. Overall, we agree with the proposal to align the definition of fair value and the guidance on fair value measurement in Section 2A with that in IFRS 13. We believe this is an area where consistency is important, particularly for those in the valuation profession, but also for other users of financial statements.
18. We commend the FRC's efforts to significantly reduce the length and complexity of this section from what is contained within full IFRS – we believe this is entirely appropriate for the types of entity using FRS 102 and is also in keeping with the spirit of the standard.
19. As highlighted in our response to Question 8 below, we believe there needs to be additional transitional provisions for the changes to fair value accounting as there are none in the current proposals. IFRS 13 states that the standard is to be applied prospectively as of the beginning of the accounting period in which it is applied – we think that this is a sensible approach for FRS 102 as well.

Own credit risk issue

20. We would like to highlight one particular issue that we believe needs careful consideration before finalising the standard. This relates to changes in fair value of financial liabilities due to movements in own credit risk. As currently drafted, volatility due to changes in own credit risk will be required to be presented in profit or loss. Unless the financial liability is held for trading, the entity will not realise the effects on the fair value of the liability of such changes in credit risk as these will not be reflected in the settlement amount.
21. Such concerns were previously expressed to the IASB leading to an amendment to IFRS 9 *Financial Instruments* in October 2010 to require the effects of changes in credit risk to be separately presented in other comprehensive income. Therefore, as currently drafted, a GAAP difference will exist between IFRS and FRS 102, with FRS 102 following an approach that was previously challenged on grounds of relevance by stakeholders and changed by the IASB at paragraph 5.7.7 of IFRS 9. We recognise that situations in which this matter is likely to arise may be less common for FRS 102 reporters.
22. In our view, there are three options available to the FRC:
    a) proceed with the proposal to change the definition of fair value for liabilities and accept that this would introduce a presentational GAAP difference;
    b) retain the extant definition of fair value for liabilities, creating a further GAAP difference and asymmetry between fair value of assets and liabilities; or
    c) follow the IASB's solution and require entities to calculate and present these movements separately in other comprehensive income. A true and fair override of the law was required to allow FRS 101 preparers to apply the measurement and presentation requirements of IFRS 9 unamended in this regard.
23. Whilst the GAAP difference created by option (a) is not an ideal outcome, we consider it preferable to the more extensive differences implied by option (b). We also recognise that, due to the level of complexity that could be involved in separately identifying the effect of

changes in credit risk, option (c) may not be proportionate to the size and scale of the entities applying FRS 102.

24. We encourage the FRC to consider this matter carefully and explore any other alternatives that might result in a more preferable outcome. In doing so we believe it would be useful to consider the sources of valuations commonly attained by FRS 102 preparers when measuring liabilities at fair value through profit or loss (FVTPL) and whether these valuations reflect the entity's own credit risk. A common example of a financial liability to be measured at FVTPL by smaller businesses is an over-the-counter interest rate swap which will commonly be provided by the bank (ie, the counterparty). If the counterparty does not reflect the entity's own credit risk, then the entity will need to engage a third party to provide a valuation that meets the proposed revised definition of fair value. This raises a question around the cost/benefit implications of introducing such a requirement.

Fair value for share-based payments

25. We agree with the proposed consequential amendment to Section 26 to retain the extant definition of fair value for the purposes of accounting for share-based payment which is consistent with IFRS 2 *Share-based Payment* that uses its own definition rather than that in IFRS 13.

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?

In IASB/ED/2022/1 the IASB proposes to retain the incurred loss model for trade receivables and contract assets, and introduce an expected credit 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, but 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?

Decision to defer

26. We agree with the FRC's decision to defer its conclusion as to whether to align FRS 102 with the expected credit loss (ECL) model to a future date. We understand that transitioning to an ECL model was a complex change even for certain IFRS reporters and therefore, given the other significant proposed amendments within FRED 82, this would be a step too far at this stage.

27. The post-implementation review of IFRS 9 is due to be published this year which may result in changes to the ECL requirements in this standard. Therefore, it would make sense to wait and see what the outcomes are from this review before making any decisions for FRS 102 in this regard.

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Potential approach

28. The question above refers to the IASB's proposal in the recent *IFRS for SMEs* exposure draft. We are not supportive of the proposed changes to the *IFRS for SMEs* standard that essentially results in a hybrid approach to impairment of financial assets, as we believe that having two separate models in one set of accounts would create unnecessary complexity and potential for confusion.
29. The FRC's preliminary view set out above seems to be a sensible approach that we would support. We also agree that the FRC should not use the existing definition of a financial institution for the purpose of defining the subset of entities that should apply an ECL model. In our view, the ECL model is most appropriate for entities that are specifically involved with lending or providing finance as a core business activity. Credit risk is a significant component of pricing decisions for this select group of entities and therefore it would be appropriate for them to approach the impairment of their financial assets through an expected loss, rather than an incurred loss, lens.
30. If the approach described above is the one which the FRC chooses to follow, we suggest that it might be possible to defer alignment with the ECL model in IFRS 9 indefinitely. This could be done by requiring that these specific types of entity identified to apply the ECL model in IFRS 9, to all financial assets measured at amortised cost. Having said this, we think the FRC ought to work closely with the FCA before deciding on the direction of travel as it might be, that as the regulator of financial services firms and markets, they are the more appropriate body to influence such an approach.

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?

Removal of IAS 39 option

31. We agree with the FRC's proposal to prevent an entity from newly adopting an accounting policy to follow the recognition and measurement requirements of IAS 39.

Temporary amendments

32. We are reading the proposal above to say that the FRC intends to delay its consideration of whether the temporary amendments made in relation to IBOR reform should be removed until it looks at the ECL provision again in the future, and that it is not considering them as part of this periodic review. We agree that it is too early to consider removing the amendments at this stage, not least because US IBOR reform has been subject to delays and therefore the amendments are still currently relevant. We do not believe there is any urgency to delete the temporary amendments at all, as they cause no harm even if they

remain after their purpose has been served. We would recommend the FRC does not consider this change until the next periodic review of UK GAAP.

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?

Leases should be on-balance sheet

33. The concept that a lease commitment fulfils the definition of a liability and should be on the balance sheet is now widely accepted and should, in our view, be brought into FRS 102. We therefore agree with the proposals to revise Section 20 of FRS 102 to reflect an on-balance sheet lease accounting model.
34. Having said this, we do not believe that importing the precise language of IFRS 16 is the only way in which to do it. In fact, importing IFRS 16 drafting with added options/simplifications results in a section that is disproportionately long, convoluted and out of balance with other sections of the standard overall.

Making Section 20 more succinct

35. We note the FRC's efforts in removing certain requirements from IFRS 16 when drafting the new Section 20, for example by not including all of the IFRS 16 Appendix B - Application Guidance. Nonetheless we believe there are grounds for further streamlining.
36. In order to express the proposal in Section 20 more concisely, consideration is needed about how important it is that the requirements in FRS 102 will always result in the same outcomes as they would when accounting under IFRS 16. If it is decided that different outcomes cannot be tolerated, then we think there are very few options available to cut the proposed wording. However, this is not in line with the original drafting of FRS 102, which purposely contained less guidance than full IFRS in order to distil the requirements of IFRS into fewer words than the full standards. In our view, allowing the possibility for some interpretation differences between full IFRS and FRS 102 would be an acceptable route and one which FRS 102 has historically followed.
37. FRS 102 already has accounting requirements for finance leases which consists of six paragraphs (20.9-20.14) and is a well understood way of accounting for lease commitments on-balance sheet. This compares with more than 100 paragraphs proposed in FRED 82. We have considered the idea that the FRC could use existing finance lease requirements as a foundation for developing more proportionate on-balance sheet lease accounting requirements. However, we appreciate that this is unlikely to be an attractive option when compared with starting from an IFRS 16-based solution. IFRS 16 has been subject to the IASB's long and thorough due process consisting of careful deliberations and debates over all the potential related issues. It does, therefore, feel somewhat inefficient to essentially start that process from scratch.
38. Our suggestion to simplify Section 20 while also ensuring that it does not mandate a way of accounting for leases that is inconsistent with IFRS 16 is for FRS 102 to be silent on certain

topics. This would have the effect that reporters are able to follow the more granular guidance set out in IFRS 16 if they choose to, but otherwise have the freedom to do something different that could theoretically result in inconsistent outcomes. Some areas that we have identified for the FRC to explore further in this respect, are set out below:

a) **Identifying the lease term:** paragraphs 20.40-20.43 and 20.45 give granular guidance on extension and termination options that could be removed or covered in implementation guidance.

b) **Reassessment of the lease liability:** paragraphs 20.72-20.75 provide extra detail and guidance regarding the discount rate to be applied when the lease liability is reassessed and could also be removed or covered separately.

c) **Lease modifications:** paragraphs 20.78 and potentially 20.80 could be removed to leave FRS 102 silent on situations in which the discount rate doesn't require updating.

39. The ideas above represent our rudimentary thinking about ways in which to make section 20 more succinct, but clearly further outreach and research is required to avoid any unintended consequences and to ensure that the anticipated consequences are acceptable. If the FRC would value some support in this exercise, we would be happy to help.

Discount rates

40. Under IFRS 16, the incremental borrowing rate must be used to discount a lease liability if the rate implicit in the lease cannot be readily determined. This is a known difficulty for IFRS preparers as determination of the incremental borrowing rate can be a subjective and complex task. We note that the FRC has introduced two types of interest rate that are not available to IFRS reporters: the lessee's obtainable borrowing rate and in exceptional cases, the gilt rate.

41. We are supportive of the options proposed and firmly believe that by introducing easy to apply additional discount rate options, the worst complexity that FRS 102 reporters may have faced if asked to apply an IFRS 16-based model is removed.

42. We are particularly supportive of the proposal to allow entities to use an obtainable borrowing rate to discount their lease liabilities, as we believe it will be a rate that is far easier for entities to determine compared to the incremental borrowing rate, despite representing a broadly similar notion.

43. We do not think that discounting lease liabilities using a gilt rate is likely to result in particularly comparable information. However, only allowing entities to use this rate in exceptional cases strikes the right balance between the need for comparability and the need to support entities in the practical application of this section of the standard. We agree that there needs to be provision of a rate option for those that cannot readily determine an incremental or obtainable borrowing rate although the basis for conclusions does not explain why a gilt rate was selected above any other type of publicly-available rate.

44. Gilt rates are typically lower than incremental or obtainable borrowing rates and therefore are likely to result in greater lease liabilities and subsequently higher value right-of-use (ROU) assets. One potential issue is that because the ROU asset is initially measured at this higher value (higher than it would be under the other discount rate options), there is a greater inherent risk that the asset may become impaired at some stage.

45. We would support the addition of a specific disclosure requirement that asks entities to disclose which of the discount rate options they have used when measuring the lease liability.

46. Finally, the PBE paragraph 20.53 states that 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. As this is a rate that has no bearing on the entity's ability to borrow, we are not clear on the appropriateness of this option. We were unable to find an explanation to support this paragraph in the Basis for Conclusions and therefore, as a minimum we believe this ought to be explained here if it is to be retained.

Other points

47. Paragraph 20.84 states that a lessee shall not recognise any provision in respect of a lease identified as onerous. We believe that the FRC should consider removing this paragraph completely. There are many situations where there are onerous elements of a lease (such as service costs) that are not necessarily captured by the lease liability and we believe reporters should be permitted to recognise these as appropriate.
48. Paragraph 20.74 of the proposed standard allows entities to elect on a lease-by-lease basis to remeasure the lease liability if there is a change in future lease payments from a change in an index or rate, for example following a market rent review. However, paragraph 20.67(c) states that a lessee shall measure the lease liability by reflecting revised in-substance fixed lease payments. In our experience, changes to rent payments following a market rent review are considered 'in-substance fixed' under IFRS and therefore these two paragraphs appear to be contradictory as currently drafted. If changes to lease payments following a market rent review are not to be interpreted as in-substance fixed under FRS 102, this needs to be explicitly stated.

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?

Strong support for IFRS 15 alignment in FRS 102

49. We agree with the proposals to align Section 23 of FRS 102 with IFRS 15 and its five-step revenue recognition model. In our view, the existing guidance in the standard is out of date and is not adequate for accounting for anything other than the simplest of revenue arrangements.
50. We commend the efforts made to ensure that the proposals retain the principles of IFRS 15 while at the same time leaving out guidance that is less relevant to entities reporting under FRS 102. We are very supportive of the approach taken and agree with many of the simplifications proposed. We do, however, have a number of detailed comments and suggested improvements to the proposals which are set out in paragraphs 54-75 below.
51. Given the simplifications made, we would encourage the FRC to provide supporting guidance (outside of the standard) to include examples in order that FRS 102 preparers are not forced to look at IFRS when they are faced with scenarios that are not explicitly covered in the standard itself.

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Reconsider for FRS 105 and FRS 103

52. We do not agree with proposals to reflect the IFRS 15 revenue recognition model in FRS 105 as we believe this is disproportionate for micro-entities. We understand from the Basis for Conclusions that introducing the IFRS 15 revenue recognition model into FRS 105 was done to help improve and maintain consistency and comparability across all financial reporting frameworks in the UK and Republic of Ireland. We are not convinced that consistency and comparability should be prioritised over proportionality for micro entity accounts. We also see this approach as being inconsistent with the decision not to introduce on-balance sheet lease accounting to FRS 105.
53. We also do not support the proposed changes to FRS 103 *Insurance Contracts*, which have been made as consequential amendments arising from draft revised Sections 2 and 23 of FRS 102. Our concerns regarding FRS 103 are set out in response to Question 9 below.

Principal vs agent

54. IFRS 15's guidance on whether an entity is acting as a principal or an agent can be challenging to apply in practice. Many companies and their advisors find it difficult to understand these requirements and, in our experience, they lead to more application questions than any other part of the standard. We therefore agree that something needs to be done when incorporating these requirements into UK GAAP in order to make it simpler for entities to determine whether they are acting as a principal or an agent.
55. While we are supportive of what the FRC has sought to achieve in the exposure draft, we do not believe that the proposed drafting of paragraph 23.38 is quite right. We think that it is important that the FRS 102 guidance is based on – and is seen to be based on – the same core principles as IFRS 15. However, because the drafting is significantly different, there may be concerns over whether the approach taken in the exposure draft is in fact based on the same principles. This is likely to cause confusion – particularly among those familiar with IFRS 15 – and may result in different outcomes occurring.
56. IFRS 15.B35 provides an overarching principle that an entity is a principal if it 'controls the specified good or service before that good or service is transferred to a customer'. This is then supported by IFRS 15.B37 which provides a list of three example indicators that an entity controls the specified good or service before it is transferred to the customer and is therefore the principal.
57. The proposals in paragraph 23.38 take a somewhat different approach, listing three criteria and indicating that an entity would be a principal if any one of them is met. The third of these criteria is the overarching principle from IFRS 15.B35, while the others are two of the three indicators provided in IFRS 15.B37. Moreover, the third indicator from IFRS 15.B37 – which talks about having discretion in establishing the price for the specified good or service and which in some cases can be pivotal – has not been included. This is somewhat muddled and, as noted above, there may be concerns about whether what is being proposed is actually consistent with IFRS 15's core principles.
58. We suggest that paragraph 23.38 is rewritten to include a simplified version of the approach currently included in IFRS 15. We believe that having control of a specified good or service before that good or service is transferred to a customer is critical in determining whether an entity is a principal and that this should be clearly stated upfront. We therefore suggest that the FRC redrafts the requirements in FRS 102 so that they begin by outlining the overarching principle from IFRS 15.B35, before going on to separately list all of the indicators from IFRS 15.B37. This approach would result in a solution that is not only consistent with that in IFRS 15 but that is also relatively short and succinct.

59. In addition, we think that the guidance would be much easier to digest if it distinguished between scenarios in which:
    - an entity obtains control of a specified good or service (or a right to control them) and subsequently transfers control of that good or service to the customer; and
    - an entity obtains control of a promise made by another party to provide a specified good or service and subsequently transfers control of that promise to the customer.
60. These latter scenarios cause confusion, because the entity is a principal in respect of the sale of that promise, but not in respect of the goods and services embodied in that promise. In our experience, these latter scenarios tend to be the hardest to assess in practice.

Promises rather than performance obligations

61. We note that in common with the recent proposed changes to the *IFRS for SMEs* standard, FRED 82 proposes to use the term 'promises' instead of 'performance obligations' when accounting for revenue. We appreciate why this change has been proposed but are concerned that it may cause greater confusion as it introduces a subtle difference between how the term 'promise' is used in this standard compared with IFRS 15. Additionally, there is currently no explanation within the Basis for Conclusions as to why this change has been made – if the change is to be retained, an explanation will be required, so that users of the standard understand the intention behind the change.
62. When applying IFRS 15, entities initially identify the goods or services promised in the contract. If promised goods or services are not distinct, they are then bundled together with other promised goods or services until they become distinct together. Such a bundle is then treated as a single performance obligation.
63. We note that the proposed amendment to Appendix 1 *Glossary*, defines a 'promise' as being 'an obligation to transfer a good or service (or bundle of goods or services) that is distinct'. This contrasts with IFRS 15 where promised goods and services can and often will relate to items that are not distinct (and may need to be aggregated with other promised goods and services). This subtle difference may easily be missed, particularly by those familiar with applying IFRS 15 who may assume the terminology is the same.
64. On balance, in order to avoid confusion, we believe that it would be better for UK GAAP to be consistent with IFRS 15 and for it to refer to 'performance obligations' rather than 'promises'.

Preference for consistency with IFRS 15 wording

65. **Promises satisfied over time**: paragraph 23.78 is based on IFRS 15.35 but a number of changes to the existing wording have been made. Although we understand the motivation behind these changes, we think it is essential that the principles underpinning this part of the standard can be seen to be completely consistent with IFRS 15. In order to avoid unintended consequences, we strongly suggest that the wording of IFRS 15.35 is repeated verbatim in section 23.
66. **Variable consideration constraint**: paragraph 23.46 says that 'an entity shall include in the transaction price an amount of variable consideration… only to the extent that it is highly probable that this amount will become due'. This contrasts with the equivalent wording in IFRS 15.56 which says that 'an entity shall include in the transaction price some or all of an amount of variable consideration… only to the extent that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur when the uncertainty with the variable consideration is subsequently resolved'. We believe that changing the words in this way may be confusing and could result in unintended consequences, as it may be possible to read the amended words as excluding the whole of a

variable consideration amount unless the entire amount is highly probable to become due. We therefore recommend that the wording in paragraph 23.46 is aligned with that in IFRS 15.56.

67. **Repurchase agreements**: paragraph 23.87E focuses on the probability that the customer will exercise their right. This contrasts with IFRS 15 paragraph B70 which focuses on whether the customer has a significant economic incentive to exercise that right. We believe this will introduce a difference in practice in scenarios where customers are likely to exercise their right even though there is no economic incentive to do so. For example, a situation whereby a customer is likely to return a mobile handset to the provider because it is more convenient that selling it through other second-hand routes despite it being less economically favourable. In this scenario, the GAAP difference would lead the revenue to be recognised at a point in time under IFRS but over time under UK GAAP. We feel this is an undesirable difference that the FRC could resolve by using the IFRS wording instead.

Changes we do not support

68. We do not support mandating the alternative approach to material rights as set out in paragraph 23.36. We believe this approach is preferable but should not be mandated and would therefore urge the FRC to change the word ‘shall’ to ‘may’ in this instance.

69. We are concerned about the requirement in paragraph 23.59 that asks entities to adjust for the time value of money if the period between when the entity transfers the good or service promised to a customer and when the customer pays for that good or service is more than six months. The preceding paragraph cites ‘if payment is deferred beyond normal business terms…’, but we are not clear how an entity would necessarily know this is going to happen at the point of recording the revenue. We understand from the Basis for Conclusions that six months has been chosen because this is considered to be useful for users and covers most customary trade terms. However, we believe this requirement is too harsh, more onerous than full IFRS requirements and is not proportionate for most FRS 102 or FRS 105 reporters. We would urge the FRC to consider extending this to 12 months which would align with IFRS 15 and with the *IFRS for SMEs* draft proposals.

Disclosure requirements

70. We believe the disclosure requirements included in Section 23 are somewhat inconsistent and disproportionate to the rest of FRS 102 and therefore recommend cutting some of these out. We suggest the FRC considers removing the following:
    a) Paragraph 23.121 which asks entities to disclose disaggregated revenues into suggested categories. This does not feel particularly valuable especially given the following paragraph allows entities to choose an alternative approach anyway.
    b) Paragraph 23.123(a) which asks entities to disclose a roll forward of receivables, contract assets and contract liabilities from contracts with customers. We believe this is not an especially valuable disclosure for users of accounts prepared under FRS 102.

Further simplifications

71. Paragraph 23.17 retains IFRS 15’s rather strict guidance relating to the transfer of a series of distinct goods and services. We suggest that simplifications are made to allow more freedom when applying this guidance, particularly in relation to multi-year contracts. For example, it may be helpful to introduce a practical expedient that allows entities to treat each month, quarter or year as being distinct. We note that, in practice, a similar approach may already be possible in some scenarios in which a contract includes variable consideration. However, it appears not to be possible when all the consideration in a contract is fixed.

Include examples

72. We believe it would be useful if the FRC were to include, or refer to a separate document containing, some specific examples of how revenue would be expected to be recognised in more complex situations. Two such scenarios that we think would be helpful to include are recognising revenue for software as a service and sale of properties when there is a separate exchange and completion date.

Minor drafting suggestions

73. We believe the first sentence in paragraph 23.87A regarding repurchase agreements needs to also allow for customer put options as they are discussed in paragraphs 23.87E-23.87H but there is no mention of them here.
74. It is unclear why paragraph 23.121 includes the words ‘at a minimum’ when paragraph 23.121A allows disaggregation on an alternative basis anyway. We also feel that replacing the word ‘performance’ with ‘activities’ in paragraph 23.121A would be more appropriate.
75. We believe that paragraph 23.127A should say ‘and’ rather than ‘or’ when requiring disclosure of costs incurred to fulfil a contract, to make it clear that disclosure is required of both.

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.

Effective date considerations

76. We acknowledge that, no matter what is decided regarding the effective date of the amendments, most FRS 102 reporters will not consider the impact of the changes on their

accounting and reporting processes until they start to prepare their first financial statements under the revised standard. For an effective date of 1 January 2025, this may not be until some point in 2026.

77. That being said, the proposed changes in this exposure draft are significant and entities are likely to want an appropriate period of time to prepare adequately. There are a number of factors that we would ask the FRC to consider when finalising the effective date for the FRED 82 amendments:

    a) **Parallel running**: some entities are likely to benefit from parallel running their accounting, particularly those with complex revenue and leasing arrangements. In order to parallel run two accounting processes, entities would need to capture the right information throughout the whole comparative period. Given the timeline set out in the FRED, entities are unlikely to have enough time between the date the amendments are finalised and the start of the comparative period to prepare for this.

    b) **Learning from the IASB**: IFRS reporters were given significantly longer to prepare for changes resulting from both IFRS 15 and IFRS 16. We appreciate that IFRS reporters are generally more complex entities, however, they typically have more in-house resource to deal with such changes compared with entities reporting under UK GAAP.

    c) **Other stakeholders**: SORP-making bodies (particularly charities and housing) and training providers are likely to need to update and consult on subsequent changes to their guidance for changes to FRS 102 for which they should be allowed sufficient time. The current proposed timeline is not very forgiving for these stakeholders.

    d) **Obtaining documentation:** The process of obtaining the necessary documentation to apply the changes to lease accounting may be time consuming as this will often rely on third parties who are likely to be dealing with a high volume of similar requests for information.

    e) **Why not?**: it is not clear to us what the disadvantages are, of allowing say, an additional 12 months ahead of the effective date. We understand the need for the FRSs to be up-to-date and reflect the latest developments in corporate reporting, however it is not clear what the cost would be of allowing more time.

Leases

78. Paragraph 1.37(a) asks entities to disclose for the current period the amount of the adjustment to profit or loss for the effect of applying the revised Section 20. We believe this is a disclosure requirement that many will find challenging and would not be especially useful. We suggest instead that the FRC considers asking entities to disclose a reconciliation between the previously reported operating lease commitments and the lease liability opening balance. We believe this would be a more useful and straightforward disclosure to produce.

79. Paragraph 1.40 states that a lessee shall not restate comparative information for leases. We appreciate that not allowing the option to restate comparatives should simplify the transition process to the new accounting model for most and therefore agree with taking this option away for FRS 102 reporters.

80. Paragraph 1.41 introduces a practical expedient in which entities may recognise, at the date of initial application, the carrying amounts of lease liabilities and right-of use assets calculated under IFRS 16 for the purposes of including in consolidated financial statements. However, this practical expedient does not seem to apply to sale and leaseback transactions (paragraphs 1.51-1.53). Logically, we believe the practical expedient should include such transactions and therefore suggest the wording is amended to include them.

Other transitional provisions

81. As noted in our response to Question 3 above, we believe there needs to be additional transitional provisions for the changes to fair value accounting as there are none in the current proposals. IFRS 13 states that the standard is to be applied prospectively as of the beginning of the accounting period in which it is applied – we think that this is a sensible approach for FRS 102 as well.

Question 9: Other comments

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

Government Grants

82. We are concerned that the effect of the amendment made to paragraph 24.5A in Section 24 has not been fully considered. The paragraph states that when a grant becomes repayable it shall be recognised as a liability. The amendment then adds “the recognition of a new or increased liability for this purpose shall be recognised immediately in income”. This is inconsistent with paragraph 32 of IAS 20 *Accounting for Government Grants,* which focuses on what exactly the grant is related to. We believe this may lead to an incorrect accounting outcome, particularly for grants related to assets.
83. Additionally, we do not understand the proposed changes to paragraph 24.5E which change the wording to the degree that we believe would result in a change in practice for some and introduce diversity that would be altogether unhelpful. Paragraph B24.6 of the Basis for Conclusions states that the approach is aligned with the IAS 20 accruals model, however we do not believe this to be correct. As such, we would recommend changing the proposed wording in paragraph 24.5E with the existing wording in paragraph 20 of IAS 20.

Proposed changes to FRS 103

84. As noted above, we do not agree with the proposed changes to FRS 103, including the Implementation Guidance, which have been made as consequential amendments arising from draft revisions to Sections 2 and 23 of FRS 102. Instead, the FRC should wait until it has completed its consideration of how to align FRS 103 with IFRS 17 (as discussed in A20 of the Basis for Conclusions). The FRC will then be able to review the standard in a complete and cohesive way rather than making piecemeal changes which, as noted below, can have unhelpful unintended consequences.
85. One unintended consequence relates to the inclusion of the definition of a contract which is aligned to revised Section 23 of FRS 102 (and therefore IFRS 15). The proposed definition does not refer to the impact of laws and regulations when identifying a contract, yet this is an area which is integral for insurance contracts. In our view, the proposed definition is not suitable for insurance contracts and may, as a result, lead to insurers having to change existing accounting practice without a clear rationale. It would, therefore, be better for FRS 103 to remain unchanged for now and allow existing insurance accounting to continue until FRC has conducted its broader review. If any changes are made, then we would suggest that the definition of a contract is aligned to the definition in IFRS 17.
86. We also note that a number of drafting changes are proposed to the FRS 103 Implementation Guidance. We expect most of these to be inconsequential in nature, other than the proposed revisions to IG2.4. For context, general insurers currently include an estimate for pipeline premiums (eg, on binder business in the London Markets) in gross written premiums (GWP). The proposed revisions to IG2.4 suggest that only actual amounts reported to the insurer prior to issuance should be reflected in GWP. We think such a change

to the guidance is unnecessary and unhelpful. The consequential amendments in the Implementation Guidance are targeted at GWP, which is not a concept that is synonymous with revenue in Section 23. Rather than GWP, the 'gross earned premiums' or 'net earned premiums' might be more reflective of what one might consider to be revenue as per Section 23. Therefore, proposing changes to GWP - a concept that no longer exists under IFRS 17 having been replaced by 'Insurance revenue' - to align with Section 23 does not really help comparability between insurer and revenue generating businesses.

Impact on charities

87. We are aware of concerns from some in the charity sector regarding FRS 102, some of which are longstanding. Nevertheless, this periodic review provides a good opportunity to address them. Such concerns include those related to:

    a) clutter caused by mandatory comparatives for specialist charity disclosures;

    b) accounting requirements for non-government grants;

    c) lack of clarity regarding the recognition of legacy payments (PBE paragraph 34.70A); and

    d) uncertainty regarding the valuation and recognition of donated goods and services (PBE paragraphs 34.73A and 34.73B).

    We strongly encourage the FRC to engage closely with the charity sector and the charity SORP-making body to fully understand these concerns and consider whether there are any suitable solutions.

88. Even with the available simplifications, introducing IFRS 16 into FRS 102 is likely to be a significant challenge for smaller charities that do not have the benefit of being able to make use of FRS 105. While we do not believe this should overly influence the decisions made regarding the revised Section 20, we do believe it may contribute to further discussion about the reporting requirements for smaller charities more generally on the grounds of proportionality. We appreciate that the FRC may be limited in its ability to direct change in this regard.

Statutory formats

89. We would consider it helpful if the FRC were to comment or provide a steer on the presentation of ROU assets in the balance sheet in the context of statutory formats so that preparers have an idea of any expectation – particularly if it will be allowable in practice to create a separate category on the balance sheet for these assets.

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).

90. As a professional body, we are not in a position to provide any detailed comments in response to this question. However, one matter that has been brought to our attention is the

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potential scenario for small companies applying Section 1A to breach the company size threshold once their right-of-use assets are included on the balance sheet. It might be appropriate to include this scenario when calculating the cost impact of the proposed changes to lease accounting.

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