Need to know
May 2024

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Amendments to FRS 102 - Periodic review 2024

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This *Need to know* outlines the amendments to FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland,* and to other UK financial reporting standards, published by the Financial Reporting Council (FRC) in March 2024 as part of its periodic review of the UK financial reporting framework.

- The most significant changes to FRS 102 are to Section 20 *Leases* and Section 23 *Revenue from Contracts with Customers* (formerly Section 23 *Revenue*), with the following principal amendments:
  - the lease accounting requirements for lessees are based on the on-balance sheet model from IFRS 16 *Leases*, with appropriate simplifications. This is expected to result in an impact on the financial statements of most entities that are lessees under one or more operating leases
  - the accounting requirements for revenue are based on the five-step model for revenue recognition from IFRS 15 *Revenue from Contracts with Customers*, with appropriate simplifications. The extent to which this will change an entity's revenue recognition in practice will depend on the form of its contracts with customers.
- Several other amendments have been made which affect numerous areas of FRS 102, including a revised section on concepts and pervasive principles, changes to fair value measurement and to the requirements for uncertain tax positions.
- For FRS 105 *The Financial Reporting Standard applicable to the Micro-entities Regime*, the same principal amendments have been made for revenue as for FRS 102, with additional simplifications. However, FRS 105 has not been amended in respect of lease accounting for lessees.
- The effective date for most amendments is periods beginning on or after 1 January 2026, with early adoption permitted provided that all amendments are applied at the same time. A number of new transitional provisions are available.

Background

When it first issued FRSs 100-105, the FRC committed to regular reviews of the UK financial reporting framework to ensure it continues to function as intended and to meet its overriding objective of high-quality, understandable financial reporting that is proportionate to the size and complexity of the entity and users' information needs through the application of an IFRS-based solution unless there is a clearly better alternative.

In line with this objective, in December 2022 the FRC issued ***FRED 82*** *Draft amendments to FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland and other FRSs – Periodic Review*, an exposure draft proposing changes to FRS 102 with related amendments to the other FRSs. The FRC also issued ***FRED 84*** *Draft amendments to FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland - Supplier finance arrangements*, an exposure draft proposing disclosure requirements in respect of supplier finance arrangements, in September 2023.

After completion of its second periodic review, the FRC published ***Amendments to FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland and other FRSs – Periodic Review 2024*** in March 2024 ("the 2024 periodic review"). In developing these amendments, the FRC considered major and minor changes to IFRS Accounting Standards, the International Accounting Standards Board's (IASB's) proposed changes in developing the third edition of the IFRS for SMEs Accounting Standard, stakeholder feedback in response to FREDs 82 and 84, and other developments in corporate reporting.

The principal amendments are discussed below. The 2024 periodic review brings many more substantial changes than the 2017 review of FRS 102, predominantly to keep pace with significant new IFRS Accounting Standards that have since come into effect – notably IFRS 15 *Revenue from Contracts with Customers*, which took effect for IFRS preparers in 2018, and IFRS 16 *Leases*, which took effect for IFRS preparers in 2019.

The effective date for most amendments is for periods commencing on or after 1 January 2026, with early adoption permitted provided all amendments are adopted at the same time. The effective dates are earlier for the amendments to Section 7 *Statement of Cash Flows* of FRS 102 related to supplier finance arrangements and Section 6 *Transition to this FRS* of FRS 103 *Insurance Contracts*. A number of transitional provisions are introduced to assist companies with adoption of the amendments. Several of the transitional provisions refer to the date of initial application which is the beginning of the reporting period in which an entity first applies the 2024 periodic review amendments (for an entity with a 31 December year end, this would be 1 January 2026).

New or significantly revised requirements

Leases

Section 20 of FRS 102 was previously based on IAS 17 *Leases*. The IASB replaced IAS 17 with IFRS 16 effective for periods commencing on or after 1 January 2019. The amendments to Section 20 are based on the principles of IFRS 16 with the consequence that, for lessees, the distinction between an operating lease and a finance lease is removed and leases are instead recognised 'on balance sheet' as a right-of-use asset with a corresponding lease liability.

In profit or loss, to the extent that lease payments are fixed or are variable lease payments that depend on an index or a rate, operating lease expenses are replaced with depreciation of the right-of-use asset and interest on the lease liability, leading to front-loaded expense profiles and higher Earnings Before Interest, Taxes, Depreciation, and Amortisation (EBITDA) throughout the lease. Variable lease payments that do not depend on an index or rate are expensed when the event or condition that triggers those payments occurs. Cash flow statements will also be impacted, with fixed lease payments previously shown as operating cash flows for operating leases now being split between an interest portion (classified as operating or financing depending on the entity's accounting policy) and repayment of the principal outstanding on the lease liability classified as a financing cash flow.

There are limited exemptions available to the 'on-balance sheet' treatment for short-term leases, being those with a term of 12 months or less, and for leases of low-value items. The amendments do not provide a numerical threshold for the latter, but instead give examples of assets that would not be considered low value including but not limited to cars, vans, trucks and lorries, land and buildings and production line equipment.

Observation

Although there is no numerical threshold, Section 20 requires the assessment of whether or not an asset is of low value to be done in absolute terms, rather than in relation to what is material to the lessee, in the same way as IFRS 16. The Basis for Conclusions accompanying the amendments also refers to the examples under IFRS 16 of low-value assets (i.e. tablet and personal computers, small items of office furniture and telephones), and states that the application of the recognition exemption to, at least, leases of such assets under Section 20 would be acceptable.

The amendments simplify the IFRS 16 requirements related to discounting of lease liabilities by permitting the use of the lessee's 'obtainable borrowing rate' as an alternative to the lessee's 'incremental borrowing rate' where the rate implicit in the lease cannot readily be determined. Other simplifications include reducing the number of situations in which a lease modification requires the determination of a revised discount rate and providing the option of a simpler approach to recognising gains and losses on sale and leaseback transactions. To promote efficiency within groups, which are producing consolidated accounts under IFRS Accounting Standards, the FRC has made the simplifications optional, where possible. The FRC has also introduced some further requirements and simplifications for leases of heritage assets and lessees that are public benefit entities.

Lessor accounting remains relatively unaffected. There continue to be some differences in FRS 102 as compared to IFRS 16 such as the recognition of income from operating lease payments that are structured to increase in line with expected general inflation not being on a straight-line basis.

Transition provisions require existing FRS 102 reporters that are lessees under an operating lease to recognise a right-of-use asset equal to the lease liability (adjusted for previously recognised prepayments and accruals) at the date of initial application. Comparatives should not be restated; instead, any cumulative effect of applying the amendments is recorded as an adjustment to the opening balance of retained earnings. As a practical expedient, the FRC also permits the use of the carrying amounts of right-of-use assets and lease liabilities previously calculated under IFRS 16 for group reporting purposes (for existing FRS 102 reporters) or in the entity's own accounts (for first-time adopters of FRS 102) as opening balances at the date of initial application or the date of transition, respectively. There are several other transitional provisions and practical expedients, many of which are optional.

Observation

IFRS 16 permitted a lessee to make an accounting policy choice between full retrospective application or modified retrospective application (with two measurement options). However, the amendments to FRS 102 require a lessee to apply the modified retrospective approach and entities are therefore required to recognise any cumulative effect of initial application as an adjustment to opening equity at the date of initial application.

Revenue

Section 23 of FRS 102 was previously based on IAS 18 *Revenue*. The IASB replaced IAS 18 with IFRS 15 effective for periods commencing on or after 1 January 2018. The amendments to Section 23 are based on the principles of IFRS 15 and introduce a single five-step model for revenue recognition and measurement for all contracts with customers. Based on feedback from stakeholders, the FRC has made some simplifications compared to IFRS 15, largely consistent with the IASB's proposals for SMEs. The FRC expects the amendments to improve comparability, reduce GAAP differences and make it easier for entities to account for revenue transactions correctly and consistently while providing more reliable and useful information.

The amendments provide a clear framework for revenue recognition, which results in more comprehensive and detailed requirements in FRS 102, including the following:

- identification of the contract with a customer, including contract combinations and modifications
- identification of distinct performance obligations (i.e. those goods and services to be accounted for separately) within a contract and the allocation of the transaction price to those performance obligations
- determination of whether an entity is acting as a principal or an agent in a contract
- accounting for variable consideration and significant financing components
- accounting for contract costs and contract balances
- recognition of revenue arising from licences
- additional presentation and disclosure requirements, with some disclosure exemptions for qualifying entities.

The amendments include simplifications compared to IFRS 15 such as an accounting policy choice on accounting for costs of obtaining a contract, providing a choice on whether to adjust revenue for the time value of money when consideration is received in advance, and allowing more judgement over allocating discounts or variable consideration to performance obligations. The simplifications are generally optional to reduce the number of differences arising for FRS 102 reporters that also produce IFRS figures for group reporting purposes. In addition, the FRC has simplified the drafting for some topics from IFRS 15, while still seeking to capture largely the same underlying principles.

Transition requirements allow existing FRS 102 reporters to apply the changes either fully retrospectively or retrospectively but with the cumulative effect of initial application presented as an adjustment to equity at the date of initial application (consistent with the options that were available to IFRS reporters on transition to IFRS 15). Several optional practical expedients are available, both for existing FRS 102 reporters and for first-time adopters of FRS 102.

Observation

Unlike the transition requirements for lease accounting (see above), the transition provisions for revenue accounting do not allow use of amounts derived under IFRS 15 where these already exist, either for the purpose of group reporting or for first-time adopters of FRS 102 who have previously reported under IFRS. Companies whose contracts with customers have a longer duration may therefore find that the numbers calculated for those contracts under the revised Section 23 differ from those calculated under IFRS 15 for consolidation purposes.

The revised revenue recognition requirements are also introduced under FRS 105 for micro-entities, with several further simplifications. A micro-entity is required to apply the changes prospectively to contracts that begin after the date it first applies the amendments, and therefore should not change its accounting policy for any contracts in progress at that date.

Concepts and pervasive principles

The amendments to FRS 102 introduce a revised Section 2 *Concepts and Pervasive Principles* to align with the IASB's *Conceptual Framework for Financial Reporting*, which was issued in 2018.

The amended definitions of assets and liabilities shift focus onto rights or obligations rather than the flow of expected economic benefit. The amended definition of an asset also introduces a greater focus on control and includes guidance on how to determine whether control exists. However, the FRC has retained the pre-existing definitions of assets and liabilities for the purpose of applying some sections of FRS 102.

Supplier finance arrangements

The amendments to FRS 102 introduce disclosure requirements regarding supplier finance arrangements in Section 7 *Statement of Cash Flows*.

The amendments describe the characteristics of supplier financing arrangements and set out the qualitative and quantitative information that an entity would need to disclose for these arrangements.

The amendments are effective for annual reporting periods beginning on or after 1 January 2025, with early application permitted. When an entity first applies the disclosure requirements related to supplier finance arrangements, it is not required to disclose the related comparative information for the preceding reporting period.

Section 1 of FRS 102 has also been amended to exempt a qualifying entity from these requirements provided that equivalent disclosures are included in the consolidated financial statements in which the entity is included.

Our ***Need to know - FRC amends FRS 102 to address supplier finance arrangements*** contains more details on this amendment.

Fair value measurement
The FRC has updated the requirements for fair value measurement to reflect the principles of IFRS 13 *Fair Value Measurement* and to improve reporting consistency and quality in respect of the measurement of fair value. The FRC has also moved the requirements for fair value measurement from an Appendix to Section 2 into a new Section 2A. One of the most significant changes is to update the definition of fair value to align it to that in IFRS 13. Under the updated definition, liabilities are measured on the basis of the value at which they could be transferred rather than settled, and adjustments for own credit risk are likely to become more common and more significant. However, the disclosure requirements in FRS 102 in relation to fair value have not been changed.

Transition provisions require existing FRS 102 reporters to apply Section 2A *Fair Value Measurement* prospectively from the date of initial application. There are no transitional provisions for first-time adopters of FRS 102.

Other changes to FRS 102

Financial instruments
The FRC decided not to introduce the expected credit loss model for financial asset impairment measurement from IFRS 9 *Financial Instruments* as part of the current periodic review. However, other amendments to Section 11 *Basic Financial Instruments* and Section 12 *Other Financial Instruments Issues* were made including introducing additional disclosure requirements about amounts arising from expected credit losses for those entities that have made an accounting policy choice to apply the recognition and measurement provisions of IFRS 9. Further, the ability to newly-adopt the accounting policy choice to apply the recognition and measurement provisions of IAS 39 has been restricted to those entities where this is necessary to achieve consistency with group financial statements. Additionally, due to the changes made to Section 23, the requirements for the recognition of dividend income from investments in non-derivative financial instruments that are equity of the issuer have been amended slightly and moved from that section to Sections 11 and 12.

Small entities
In response to changes to the UK legal environment following the UK's withdrawal from the European Union (EU), the FRC has now been able to specify further disclosures which it believes should be required by small companies in the UK for their accounts to provide a true and fair view. The amendments update Section 1A *Small Entities* to mandate some FRS 102 disclosures that were previously only encouraged for small UK companies. However, this does not change the position for Irish entities applying FRS 102 as these continue to be within the EU.

Business combinations and goodwill
The FRC has introduced some amendments to Section 19 *Business Combinations and Goodwill* to bring limited parts of IFRS 3 *Business Combinations* into FRS 102. This includes providing additional guidance on identifying the acquirer in a business combination and on determining whether payments to former owners or employees are contingent consideration or remuneration for future services. The amendments also add limited new disclosure requirements in order to provide relevant information to users in respect of business combinations. Guidance has also been introduced on the treatment of liabilities and contingent liabilities that would be within the scope of Section 21 *Provisions and Contingencies* if incurred separately rather than assumed in a business combination.

In line with the transition provisions, an entity should not reassess the accounting for any business combination which took place prior to the date of initial application unless the initial accounting for the business combination is incomplete at that date.

Share-based payments

The amendments clarify that instruments issued in a business combination in exchange for control of the acquiree are not within the scope of Section 26 *Share-based Payment*, and that equity instruments granted to employees of the acquiree in their capacity as employees are in scope of Section 26. It also clarifies that cancellations, replacements and modifications of share-based payment arrangements as a result of a business combination are accounted for following the requirements of Section 26.

Requirements for measuring the fair value of liabilities arising from a cash-settled share-based payment transaction have been added as well as requirements for the settlement of an equity-settled share-based payment transaction by the entity transferring cash or other assets. The definition of fair value for the purpose of Section 26 has not been amended by the revised definition of fair value in Section 2A; this is consistent with the approach taken in IFRS Accounting Standards.

Income tax

The amendments made to Section 29 *Income Tax* primarily explain how to account for uncertainty in accounting for income taxes, based on the requirements in IFRIC 23 *Uncertainty over Income Tax Treatments*. Transition provisions allow an entity to apply the new requirements either fully retrospectively or, if that is not possible without the use of hindsight, retrospectively with the cumulative effect of doing so recognised in equity at the date of initial application.

Specialised activities

The FRC has made various amendments to Section 34 *Specialised Activities*, including a clearer description of when resources from non-exchange transactions should be recognised and how they should be measured, more guidance on how to determine whether an asset meets the definition of a heritage asset, additional guidance on what amounts should be included in the cost of a biological asset for agricultural activities, and additional guidance and clarifications on the accounting of service concession arrangements.

Transition to FRS 102

Section 35 of FRS 102 has been updated to remove transition provisions that have become redundant and add new provisions for the changes to revenue, leases and other amendments.

Changes to other UK Financial Reporting Standards

FRS 105 *The Financial Reporting Standard applicable to the Micro-entities Regime* – The major change is to incorporate the revised revenue recognition requirements from FRS 102 Section 23 into FRS 105, with further simplifications. No changes to lease accounting have been made for FRS 105 reporters.

FRS 103 *Insurance Contracts* – Minimal changes have been made to the body of FRS 103 and the FRC intends to wait for several years of application of IFRS 17 *Insurance Contracts* before considering alignment with that standard. However, one key amendment introduces a transition provision into FRS 103 requiring that when transitioning from IFRS Accounting Standards or a framework that used an equivalent approach and methodology for accounting for insurance contracts, an entity must disregard its existing accounting policies for insurance contracts and apply FRS 103 as if it were setting accounting policies in relation to insurance contracts for the first time. This change is effective for periods beginning on or after 1 January 2024.

Other FRSs – The changes to FRS 102 and the other FRSs have resulted in consequential minor amendments to FRS 100 *Application of Financial Reporting Requirements,* FRS 101 *Reduced Disclosure Framework,* and FRS 104 *Interim Financial Reporting*.

Further information

If you have any questions about the amendments to FRS 102, please speak to your usual Deloitte contact.

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